

July 23, 2020 ^{Revised}

Hindustan Petroleum Corporation Limited: Rating assigned to fresh NCD programme; reaffirmed for other facilities

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible Debenture Programme	0.0	10,000.0	[ICRA]AAA (Stable); Assigned
Non-convertible Debenture Programme	7,500.0	7,500.0	[ICRA]AAA (Stable); reaffirmed
Commercial Paper	15,000.0	15,000.0	[ICRA]A1+; reaffirmed
Issuer Rating	-	-	[ICRA]AAA (Stable); reaffirmed
Cash Credit Limits	4,000.0	4,000.0	[ICRA]AAA (Stable); reaffirmed
Fund-based Limits	18,254.0	18,254.0	[ICRA]AAA (Stable); reaffirmed
Non-fund Based Limits	22,746.0	22,746.0	[ICRA]A1+; reaffirmed
Total	67,500.0	77,500.0	

*Instrument details are provided in Annexure-1

Rationale

The ratings take into account HPCL's strategic importance in the domestic energy sector; its strong parentage (Oil and Natural Gas Corporation Limited/ONGC ([ICRA]A1+) owns 51.1% equity stake); its established brand name and its leading position in the domestic oil marketing business. The ratings favourably consider the coastal location of the company's refineries, which provides logistical advantage for import of crude oil and export of petroleum products. The ratings also factor in its strong operational efficiencies—both its refineries (Mumbai and Vishakhapatnam) have been operating at consistently high utilisation levels with healthy energy consumption levels. HPCL is undertaking modernisation and capacity expansion at both its refineries to improve the profitability of the refining operations.

The company has witnessed steady growth in its marketing volumes (CAGR of 4.4% over the last five-year period and 2.4% YoY in FY2020), driven by its growing network of retail outlets, favourable demand environment for motor spirit (MS) and high speed diesel (HSD), and its established presence in MS and HSD segment. The gross refining margins (GRMs) of domestic refiners, including HPCL, witnessed a sharp decline in FY2020 because of weak crack spreads and large inventory losses caused by sharp fall in crude prices in March 2020. While in the current fiscal, the overall marketing volumes are likely to drop due to weak demand following the Covid-19 pandemic and the consequent lockdown, the GRMs are expected to improve after some recovery in crude prices. However, since average crude oil prices in the current fiscal are expected to remain lower than the preceding fiscal, the fuel and loss component for refineries will also be lower, thereby supporting the refining margins. HPCL's liquidity profile remains strong, backed by an expected robust cash flow from operations, a sizeable portfolio of liquid investments and an adequate availability of working capital bank limits.

HPCL's operations are subject to regulatory risk pertaining to the pricing of sensitive petroleum products. Nonetheless, over the last few years, the Government of India (GoI) has been ensuring that the net under recoveries borne by the Public Sector Undertaking (PSU) oil marketing companies (OMCs) are either nil or within manageable levels by absorbing most of the gross under-recoveries (GURs) and sharing the remaining with upstream companies. Any adverse change in the GoI's

policy in this regard that weakens the key credit metrics of HPCL will be a key rating sensitivity. The gross under-recoveries (GURs) of public sector oil marketing companies (OMCs) was lower in FY2020 on YoY basis at Rs 245 billion as against Rs 374 billion in FY2019, due to fall in crude oil prices. As per ICRA's estimates, the subsidy requirement for FY2021 will be Rs. 90 billion, assuming the Indian basket of crude price of \$35/bbl and INR/USD of 76. Accordingly, the subsidy provided for FY2021 at Rs. 388 billion in the Union Budget of 2020-21 would be adequate to clear the backlog.

HPCL is exposed to project implementation risks as it is in the midst of implementing large-scale projects spanning the entire downstream value chain as well as through subsidiaries and joint ventures (JVs). Depending on the scale of HPCL's expansion plans, the debt coverage metrics might be moderated over the next three-four years; however, ICRA expects the same to remain comfortable. Nonetheless, any material time or cost overruns that could lead to larger-than-estimated funding requirements would be a key rating sensitivity. ICRA also notes that the company has moderately rationalised its capex plans for next three years considering the impact of Covid-19 pandemic.

The Stable outlook on the [ICRA]AAA rating reflects ICRA's opinion that HPCL will continue to benefit from its position in the domestic energy sector, its strategic importance to the GoI and its strong parentage.

Key rating drivers

Credit strengths

Demonstrated support of GoI to ensure profitability of OMCs despite high under-recoveries - The GoI has provided dedicated support to cushion the OMCs from high under-recoveries in the past by institutionalising a subsidy sharing framework, wherein a large part of the under recoveries are borne by it through budgetary allocation. In FY2020, the gross under-recoveries for HPCL declined to Rs. 281 crore from Rs. 957 crore in FY2019, following the decline in crude prices during the period. Despite the change in ownership to ONGC, ICRA believes HPCL will continue to be of strategic importance to the GoI as it will continue to play a key role in fulfilling the socio-economic policies of the GoI. Any adverse change in the GoI's policy in this regard will be a key rating sensitivity.

Coastal refinery provides logistical advantages in terms of sourcing of crude and exports - HPCL owns and operates two refineries, one in Mumbai and the other in Visakhapatnam. Since both the refineries are located in coastal regions, the company enjoys logistical benefits in terms of lower costs and the time taken to transport the imported crude to the refineries and to export refined products. This lowers its inventory requirement to a significant extent when compared to other OMCs with inland refineries.

Established brand name and position in domestic marketing business - The company is one of the three leading public OMCs, with a ~24% market share (including private players) as of end of FY2020. HPCL has the second-largest marketing network spanning across the country and actively undertakes multiple branding and customer loyalty initiatives. Moreover, its marketing margins on transportation fuels, industrial fuels and other products have been healthy.

Healthy refining operations - HPCL has reported refinery utilisation levels above 100% for the past few years. The company's GRMs had remained stable in recent years driven by operational efficiencies and effective crude procurement strategies. However, in FY2020, its GRMs declined to US\$ 1.03/bbl from US\$ 5.01/bbl in FY2019 as crude prices plummeted due to the failure of OPEC+ to agree to production cuts and the Covid-19 pandemic, resulting in huge inventory losses for oil refining and marketing entities in India. Further, the GRMs declined because of weak crack spreads in light and middle distillates. In early Q1 FY2021, the marketing margin witnessed strong growth because of lower crude prices even as retail prices were not reduced; however, after duty hikes in May 2020, the marketing margin has moderated to a more normalised level. Nonetheless, the GRMs are expected to witness improvement in FY2021 due to some recovery in crude prices and lower fuel and loss expected, although there may be some moderation in the marketing volume. Going forward,

with the completion of expansion projects, the scale and cash flows are expected to witness improvement in the medium term.

Healthy financial flexibility - The company enjoys high financial flexibility that allows it to raise debt and access capital markets at competitive rates to fund its capex and working capital requirements. The flexibility is supported by HPCL's strong parentage arising from ONGC's 51.1% stake.

Credit challenges

Vulnerability of refining segment's profitability to global refining margin cycle, crude price volatility, import duty protection, and INR-US\$ parity levels - Given the nature of the business, the company would remain exposed to the movement in the commodity price cycles and the volatility in the crude prices. Any adverse changes in the import duty on its products would also have an impact on the company's profitability on domestic sales. HPCL's profitability is also exposed to the forex rates (INR-US\$), given the business is primarily dollarised on sales, crude procurement and forex loans.

Moderate financial profile - Although HPCL has demonstrated healthy credit metrics in FY2019, its key credit metrics, such as Total Debt/OPBDITA, interest coverage and RoCE¹, over a longer period have been moderate. Moreover, with large capital outlay on the ongoing projects, its metrics would not see any meaningful improvement till the investments start yielding returns.

Significant capex planned over next three-year period - The company is in the midst of aggressive capex plans of ~ Rs. 39,000 crore (including equity investments of ~Rs. 7,200 crore in JVs) outlined for the period between FY2021 and FY2023. Due to the impact of the Covid-19 pandemic, the company has moderately rationalised its capex plan for the period. HPCL's capex plans include the implementation of major projects such as the capacity expansion at both its refineries, expansion of its pipeline network and setting up of new pipelines. The company would also have significant equity contribution towards key JV projects, including the refinery-cum-petrochemical complex in Rajasthan (74% stake) and the setting up of its LNG terminal in Gujarat (50% stake). Any material time or cost overruns in the group projects could increase the company's borrowing levels and weaken the credit metrics.

Lack of freedom in pricing of sensitive petroleum products - While MS and HSD are deregulated, at times the PSU OMCs face pressure in revising the prices in line with the global prices. Moreover, prices of LPG (domestic) is controlled, on which the GoI pays subsidy to cover the under recoveries. Though the GoI has been ensuring that net under-recoveries of OMCs are either nil or within manageable levels, any increase in the same in a scenario of high crude oil prices would impact the key credit metrics of the company. In March 2020, the GOI instructed state-run oil companies to price PDS² SKO³ at market rates, following the moderation in crude prices, thereby eliminating the subsidy. However, any change in the GoI's policy, with hardening of crude prices, remains a sensitivity factor. As per ICRA's estimates, subsidy requirement for FY2021 will be Rs. 90 billion, assuming Indian basket of crude price of \$35/bbl and INR/USD of 76. Accordingly, the subsidy provided for FY2021 at Rs 388 billion in the Union Budget of 2020-21 would be adequate to clear the subsidy backlog.

¹ Return on capital employed

² Public distribution system

³ Superior kerosene oil

Liquidity position: Strong

HPCL's liquidity profile is expected to remain **strong**, aided by healthy cash flow generation and sizeable cash and cash equivalents (Rs. 5,439 crore on standalone books as on March 31, 2020). Further, the company has adequate fund-based and non-fund based working capital limits, a sizeable part of which is unutilised. It also enjoys high financial flexibility owing to its strong parentage.

Rating sensitivities

Positive triggers – Not Applicable

Negative triggers – Downward pressure on HPCL's ratings could arise if a) a significant increase in net under-recoveries, due to changes in Government policies on pricing/subsidy sharing on sensitive petroleum products, erodes the company's profits and cash flows or b) larger-than-expected debt-funded capex deteriorates the company's credit profile.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Downstream Oil Companies
Parent/Group Support	Parent: Oil and Natural Gas Corporation Limited The assigned rating factors in the systemic importance that HPCL holds, which we expect should induce the Government/ONGC to extend timely policy/financial support to the rated entity, should there be a need
Consolidation / Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of HPCL. ICRA has factored in the rated entity's support to fund the equity component of the investment in its JV projects, any cost overruns, and debt servicing support in the initial stage of operations. The subsidiaries and JVs of HPCL that have been considered are enlisted in Annexure 2.

About the company:

HPCL is a public-sector enterprise that owns and operates two refineries, one in Mumbai with 7.5 million metric tonnes per annum (MMTPA) capacity and one in Visakhapatnam with an 8.3 MMTPA capacity. The company was incorporated in 1952 as Standard Vacuum Refining Company of India Limited. HPCL has a 49% stake in a JV with Mittal Energy Investments Pte Limited for operating an 11.3 MMTPA refinery in Bhatinda, Punjab. HPCL has a 16.95% equity stake in Mangalore Refinery and Petrochemicals Ltd. (MRPL), which operates a 15 MMTPA refinery in Mangalore. Majority shareholding of HPCL (51.1%) is held by ONGC, which was acquired from the Gol in January 2018. In October 2019, the company was granted 'Maharatna' status, which implies higher operational and financial autonomy.

Key financial indicators (Consolidated - audited)

	FY2019	FY2020
Operating Income (Rs. crore)	275,473	269,092
PAT (Rs. crore)	6,691	2,639
OPBDIT/OI (%)	4.4%	2.1%
RoCE (%)	20.4%	4.4%
Total Debt/TNW (times)	0.9	1.3
Total Debt/OPBDIT (times)	2.3	7.0
Interest Coverage (times)	15.5	5.0

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2021)				Chronology of Rating History for the Past 3 Years					
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Rating	FY2020		FY2019	FY2018		
					23-July-20	10-Jan-20	1-Oct-19	8-Jan-19	29-Mar-18	24-Jan-18	4-Dec-17
1	NCDs	Long Term	10,000	Unplaced	[ICRA]AAA (Stable)	-	-	-	-	-	-
2	NCDs	Long Term	7,500	7,500	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	-	-
3	Commercial Paper	Short term	15,000	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-	-
4	Cash Credit	Long term	4,000	-	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	-	-
5	Fund Based Limits	Long term	18,254	-	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	-	-
6	Non-Fund Based Limits	Short term	22,746	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-	-
7	Issuer Rating	-	-	-	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website [click here](#)

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	NCDs	Yet to be placed	-	-	10,000.0	[ICRA]AAA (Stable)
INE094A08069	NCDs	March 2020	7.03%	April 2030	1,400.0	[ICRA]AAA (Stable)
INE094A08051	NCDs	January 2020	6.38%	April 2023	600.0	[ICRA]AAA (Stable)
INE094A08044	NCDs	October 2019	6.8%	December 2022	3,000.0	[ICRA]AAA (Stable)
INE094A08036	NCDs	August 2019	7.0%	August 2024	2,000.0	[ICRA]AAA (Stable)
INE094A08028	NCDs	April 2019	8.0%	April 2024	500.0	[ICRA]AAA (Stable)
NA	Commercial Paper	-	-	7-365 days	15,000.0	[ICRA]A1+
NA	Cash Credit Limits	-	-	-	4,000.0	[ICRA]AAA(Stable)
NA	Fund Based Limits	-	-	-	18,254.0	[ICRA]AAA (Stable)
NA	Non-Fund Based Limits	-	-	-	22,746.0	[ICRA]A1+
NA	Issuer Rating	-	-	-	-	[ICRA]AAA (Stable)

Source: Hindustan Petroleum Corporation Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Prize Petroleum Co. Ltd.	100.00%	Full Consolidation
HPCL Biofuels Ltd.	100.00%	Full Consolidation
HPCL Middle East FZCO	100.00%	Full Consolidation
HPCL Rajasthan Refinery Limited	74.00%	Limited Consolidation
HPCL Shapoorji Energy Private Ltd.	50.00%	Limited Consolidation
Ratnagiri Refinery and Petrochemicals Limited	25.00%	Limited Consolidation
HPCL Mittal Energy Ltd.	48.99%	Limited Consolidation
Bhagyanagar Gas Ltd.	24.99%	Limited Consolidation
Aavantika Gas Ltd.	49.99%	Limited Consolidation
Petronet India Ltd.	16.00%	Limited Consolidation
Petronet MHB Ltd.	32.72%	Limited Consolidation
Godavari Gas Pvt. Ltd.	26.00%	Limited Consolidation
Hindustan Colas Pvt. Ltd.	50.00%	Limited Consolidation
South Asia LPG Co. Pvt. Ltd.	50.00%	Limited Consolidation
Mumbai Aviation Fuel Farm Facility Pvt. Ltd.	25.00%	Limited Consolidation
HPOIL Gas Pvt. Ltd.	50.00%	Limited Consolidation

Corrigendum:

Document dated July 23, 2020 has been corrected with revisions as detailed below:

- Section related to Liquidity Position on page 4 has been revised: Cash and cash equivalents have been revised from Rs. 5,458 crore to Rs 5,439 crore.
- Section related to Rating history table on page 6 has been revised: Rating history of January 24, 2018 has been included as it was not previously mentioned.

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