December 04, 2017

Hindustan Petroleum Corporation Limited

Summary of rated instruments

Instrument*	Rated Amount (Rs. crore)	Rating Action
Issuer Rating	--	[ICRA]AAA (Stable) assigned

*Instrument details are provided in Annexure-1

Rating action

ICRA has assigned an issuer rating of [ICRA]AAA (pronounced ICRA triple A) to Hindustan Petroleum Corporation Limited (HPCL). The outlook on the rating is stable.

Rationale

The rating reflects HPCL's strategic importance in the domestic energy sector, its large sovereign ownership, its established brand name and leading position in the domestic oil marketing business. The rating further factors in the coastal location of the company's refineries which provides logistical advantages for import of crude oil and export of petroleum products. The rating also takes into account the strong operational efficiencies of the company with both its refineries operating at more than 100% utilisation levels and maintaining healthy energy consumption levels. The company has witnessed steady growth in its marketing volumes (CAGR of 3% over last 5-year period) driven by its growing network of retail outlets, strong demand indicators for motor spirit and diesel, and its established presence in this business segment. The liquidity profile of HPCL is robust backed by a sizeable portfolio of liquid investments (~Rs. 5,100 crore as of March 31, 2017) and adequate availability of working capital bank limits.

Although HPCL will continue to be subjected to regulatory risk on the pricing of sensitive petroleum products in line with prevailing crude oil prices, the Government of India (GoI) has been ensuring that the net under recoveries borne by Public Sector Undertaking (PSU) oil marketing companies (OMCs) are within manageable levels by absorbing most of the gross under-recoveries (GURs) itself with the rest shared by upstream companies. Any adverse change in GoI policy in this regard will be a key rating sensitivity.

HPCL is also exposed to project implementation risks as it is in the midst of implementing large projects spanning the entire downstream value chain on its own books as well as through subsidiaries and joint ventures (JV). HPCL has a capex outlay planned of about Rs. 60,000 crore up to FY2021, which includes equity infusion by the company of ~Rs. 10,000 crore towards JV projects over the same period. The scale of HPCL's expansion plans would lead to some moderation in its debt coverage metrics over the next 3-4 years, but ICRA expects the same to still 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 has taken note of the on-going acquisition of HPCL by Oil and Natural Gas Corporation Limited (ONGC) wherein the latter would take over GoI's 51.1% stake in HPCL. ICRA expects HPCL to continue to operate as a separate entity with a strong brand despite the change in ownership. Moreover,, its strategic importance to GoI is expected to remain intact despite change in majority ownership in favour of ONGC. ICRA has not however factored in any other M&A transactions as part of this ownership change and will continue to monitor developments in this regard and take appropriate rating action once more clarity emerges on the same.

Key rating drivers

Credit strengths

- **Demonstrated support of GoI to ensure the profitability of OMCs in the past 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 large part of the under recoveries are borne by it through budgetary allocation. Further, materially lower under-recoveries in the last two years have led to improvement in liquidity due to fall in debt levels and lower interest burden. HPCL's net under-recoveries have declined from Rs. 164 crore in FY2015 to Rs. 20 crore in FY2016, increasing only marginally to Rs. 32 crore in FY2017. Notwithstanding change in majority ownership in favour of ONGC, ICRA believes HPCL will continue to be of strategic importance to GoI as it will continue to play a key role in fulfilling socio-economic policies of GoI. Any adverse change in GoI policy in this regard will be a key rating sensitivity.
- **Locational advantages of being a coastal refinery for sourcing of crude as well as 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 time taken to transport the imported crude to the refineries and to export refined products to dealer locations. This also lowers the company's inventory requirement to a significant extent when compared to other OMCs with inland refineries.
- **Established brand name and position in the domestic refining and marketing business –** The company is one of the three leading public OMCs with a ~20% market share (including private players) as of end of FY2017. The company has the second-largest marketing network spanning across the country and actively undertakes multiple branding and customer loyalty initiatives.
- **Healthy refining operations with steady GRM levels –** HPCL has reported refinery utilisation levels above 100% for the past few years. In FY2017, the company achieved a 1 million metric tonnes per annum (MMTPA) increase in its Mumbai refinery capacity (6.5 MMTPA to 7.5 MMTPA) through debottlenecking and other technical improvements leading to higher throughput. The company's GRMs have remained healthy driven by operational efficiencies and effective crude procurement strategies. The company reported GRM of US$6.75/bbl in H1FY2018 compared to US$5.12 in H1FY2017.
- **Healthy financial flexibility supported by the strong parentage –** 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 same is supported by HPCL's strong parentage arising from the GoI's 51.1% stake, which would be acquired by ONGC in the near term.

Credit concerns

- **Vulnerability of the company's refining segment's profitability to the 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 domestic sales. The company's profitability is also exposed to the forex rates (INR-US$) given the business is largely dollarized on sales, crude procurement and forex loans.
- **Moderate financial profile -** Although HPCL has demonstrated healthy credit metrics in FY2017, its key credit metrics, such as Total Debt/OPBDITA, interest coverage and RoCE, over a longer period have been moderate. Moreover, with large capital outlay on the ongoing projects, its metrics should moderate over the next 3-4 years till the investments start yielding healthy returns.

- **Significant capex planned over next four-year period –** The company has aggressive capex plans of ~ Rs. 60,000 crore (including equity investments in JVs) outlined for the next four-year period up to FY2021. HPCL's capex plans include the implementation of major projects including 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 an LNG terminal in Gujarat (50% stake). Any material time or cost overruns in the group projects could lead to an increase in the company's borrowing levels and weakening of credit metrics.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below**.**

Links to applicable criteria:
Corporate Credit Rating Methodology
Rating Methodology for Downstream Oil Companies

About the company:
HPCL is a PSU that owns and operates two refineries, one in Mumbai with a 7.5 million metric tonnes per annum (MMTPA) capacity and one in Visakhapatnam with a 8.3 MMTPA capacity. The 'Navratna' status 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. Ltd. for operating a 11.3 MMTPA refinery in Bhatinda, Punjab. HPCL also 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 currently held by GoI and the same is to be acquired by Oil and Natural Gas Corporation Limited (ONGC) by the end of FY2018.

Key Financial Indicators (Audited)

	FY2016	FY2017	H1 FY2018 (P)
Operating Income (Rs. crore)	177,701	187,024	100,991
PAT (Rs. crore)	3,726	6,209	2,659
OPBDIT/ OI (%)	4.8%	5.7%	4.5%
RoCE (%)	16.3%	21.8%	
Total Debt/ TNW (times)	1.2	1.0	0.3
Total Debt/ OPBDIT (times)	2.5	2.0	1.7
Interest coverage (times)	13.1	19.8	15.1
NWC/ OI (%)	(1%)	(1%)	

Note: The above financials are as per Ind AS
OI: Operating Income; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net-Worth + Deferred Tax Liability - Capital Work - in Progress); NWC: Net Working Capital

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for last three years:
Table:

S. No.	Instrument	Current Rating			Chronology of Rating History for the past 3 years
		Type	**Amount Rated (Rs. crore)**	**Date & Rating**	**Date & Rating in FY2017**
				December 2017	**NA**
1	Issuer Rating	Long-term	-	[ICRA]AAA (Stable)	NA

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 www.icra.in

Annexure-1

Instrument Details

ISIN No.	Instrument	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Issuer Rating	-	-	-	-	[ICRA]AAA (Stable)

Source: HPCL

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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