

Stock Update

Hindustan Oil Exploration Co. Ltd.

July 28, 2022





Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Exploration & Production	Rs. 167	Existing investors can hold and new investors can buy the stock and add on the dips to Rs 152-156	Rs. 194	Rs. 214	2 quarters

HDFC Scrip Code	HINOIL
BSE Code	500186
NSE Code	HINDOILEXP
Bloomberg	HOE IN
CMP July 28, 2022	167
Equity Capital (Rs Cr)	130.5
Face Value (Rs)	10.0
Equity Share O/S (Cr)	13.1
Market Cap (Rs Cr)	2179.2
Book Value (Rs)	57.7
Avg. 52 Wk Volumes	1158485
52 Week High	245.2
52 Week Low	115.7

Share holding Pattern % (June, 2022)	
Promoters	0.0
Institutions	3.9
Non Institutions	96.1
Total	100.0



HDFCsec Retail research
stock rating meter

for details about the ratings, refer at the end of the report

* Refer at the end for explanation on Risk Ratings

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Our Take:

We had issued initiating coverage report on Jan 28, 2022 and recommended Buy between Rs. 208-212 & add more on dips to Rs 174-178 for the base case fair value of Rs 238 and for the bull case fair value of Rs 274 over the next two quarters ([Link](#)). The time frame for the report ends on July 28, 2022.

There has been an improvement in the business fundamentals and the company updated key operational development regarding the B-80 project over the period. Due to some technical hurdle at D-1 well in B-80 block, the stock has underperformed. However, HOEC portfolio comprises 10 Oil & Gas blocks of Discovered Resources and 1 exploratory block, all of which have resources with some upside potential. Over the next two years, the company expects significant ramp up in volumes which would ensure growth visibility going ahead on account of rising production in B-80 and premium in the North-east gas of \$1 to \$6.1 per mmbtu.

HOEC is focused on for resolving the technical issue at D-1 well in B-80 project as soon as possible. We expect that the company will come out with efficient production and better capacity utilization in the next 2-3 quarters. Besides, the company will not see any major impact on its performance due to recently levied windfall tax, as company is not majorly engaged in extraction of crude oil. We have reduced our estimates due to delay in B-80 project (D1).

Going ahead, we think existing investors can hold and new investors can buy the stock and add on the dips to Rs 152-156 for the base case fair value of Rs. 194 and bull case fair value of Rs. 214 over the next two quarters. However, risk averse investors can exit the stock as the time frame has expired. We give here below the key updates post our initiation of the report and have revised earnings estimates. While the earnings have got postponed the growth in FY24E onwards could be faster and the DCF value will be maintained as the delay in production will get offset by higher price realisation and higher volumes.

Q4FY22, Result Update

HOEC reported 46% YoY growth in consolidated revenue to Rs 42 crore led by increase in sales price of gas in Assam and higher realization due to increase in oil prices. EBITDA increased by 79% YoY to Rs 20.9 crore in Q4FY22 and was down by 8.1% QoQ. EBITDA margin ramped up to 49.5% in Q4FY22 and 40.5% in Q4FY21. It was 51.7% in Q3FY22.

HOEC reported net loss of Rs 27 crore, impacted by exceptional items, the company had reported net profit at Rs 21 crore in Q4FY21 and Rs 19 crore in Q3FY22. Adjusted net profit was almost flat at Rs 7 crore in Q4FY22. The company had paid Rs 27.9 crore related to settlement with the Government of India on royalty issue to secure 10 years extension of the block PY-1. HOEC and GOI had a dispute on computation of royalty payable under the PSC, since commencement of production from 2009 onwards.



Financial Summary (Consolidated)

Particulars (Rs cr)	Q4FY22	Q4FY21	YoY-%	Q3FY22	QoQ-%	FY20	FY21	FY22	FY23E	FY24E
Total Operating Income	42	29	46.4	30	38.5	202	114	156	528	718
EBITDA	21	12	79.1	16	30.9	125	54	79	253	349
Depreciation	11	6	94.1	5	123.5	29	23	26	44	50
Other Income	1	1	65.7	2	-18.4	22	11	11	13	15
Interest Cost	4	1	194.8	2	176.9	6	6	9	16	13
Tax	0	-1	-164.3	0	90.5	0	-2	0	31	46
RPAT	-27	21	-228.3	12	-336.2	111	39	54	177	259
APAT	7	7	-0.8	19	-62.6	138	53	20	179	261
Diluted EPS (Rs)	0.5	0.6	-0.8	1.5	-62.6	8.5	3.0	4.2	13.5	19.8
RoE-%						22.6	7.6	2.7	21.3	24.7
P/E (x)						19.6	55.3	40.1	12.3	8.4
EV/EBITDA						16.3	42.8	31.3	9.5	6.5

(Source: Company, HDFC sec)

Change in Estimates

Rs in Cr	FY23E		FY24E	
	Old	New	Old	New
Revenue	722	528	975	718
EBITDA	346	253	474	349
APAT	260	179	370	261
EPS	20.0	13.5	28.4	19.8

Key updates

Development on B-80 block Gas E-Auction

HOEC's production commenced from Gas well-D2 of B-80 block in Mumbai offshore, and this well was being developed under the Revenue Sharing Contract Model. D2 Gas well opened and gas process systems commissioned successfully and committed sales gas volume to GSPC is 10 mmscfd of gas. First Gas from B-80 being packed into WO-16 to BPB (14"-56 km) pipeline of ONGC since May 31, 2022. HOEC is addressing the technical challenges of subsea umbilical system issues in D1 oil well, as it observed the loss of hydraulic fluid once again.

HOEC enjoys oil and gas marketing freedom. To discover the market price for the gas, as required by the Government policy, HOEC had invited proposals for participation in the e-auction for sale of 0.3 mmscmd natural gas to be produced from B-80. In response, bidders from both private and public sector had submitted their bids and pursuant to the techno-commercial evaluation, e-auction to discover the gas price was held on March 08, 2022 and M/s Gujarat State Petroleum Corporation (GSPC) has emerged as the successful bidder. The contract for offtake



of gas on an immediate sale basis shall be entered with GSPC for a duration of 2 years and the monthly sales gas price in US\$/mmbtu will be calculated at 22.2% of the previous month average Brent Crude Oil price in US\$/barrel. A floor price of US\$ 6/mmbtu is applicable, i.e., if in any month the calculated sales gas price is less than US\$ 6/mmbtu then a price of US\$ 6/mmbtu shall apply. At this stage, production is expected at 10 million cubic feet, however the company is committed to produce in the band of 12-15 mcf.

Production & Phase-II development of Dirok block

HOEC reported 27.7mmscfd of gas production in Q4FY22 from Dirok block. Oil India, Indian Oil Corporation and HOEC have formed JV to run this block. HOEC has 27% of participating interest in the Dirok block. In addition to Oil India, gas is supplied to four other buyers at premium price. Premium sales in Q4FY22 stood at ~40% of total Dirok sales.

For upcoming Phase II, HOEC got the approval of Field Development Planning (FDP), and obtained Environmental Clearance. For laying of 18-inch pipeline, the company has received Stage 1 Forest Clearance. For Dirok, the company is laying of 35km pipeline to connect directly to Duliajan hub and drilling of 3 development wells to increase production from 35 mmscfd to 55 mmscfd.

Production and Offtake Arrangements for PY-1 block

PY-1 block is only offshore platform in Cauvery Basin with 8 slots and four wells drilled and the company has 100% participating interest in the PY-1 block. GAIL is the sole buyer for the gas produced in this field. HOECL reported 55mmscfd processing capacity in Q4FY22, and realised US\$ 3.67 mmbtu.

HOEC got the approval of PY-1 Adhoc extension. Field development for next phase, G&G studies completed and new well locations identified for the full field development and the company completed EIA study for obtaining Environmental Clearance for drilling additional wells. The company is looking to finalise the Settlement Agreement for grant of 10-year extension.

Production of Kharsang and its Phase-I development plan

HOEC reported 476boepd oil production from Kharsang in Q4FY22, the company has 30% + direct participating interest. Kharsang oil field is located in the state of Arunachal Pradesh and 60 kms away from Dirok. The company is planning to drill 18 new wells in near future. Post drilling of 18 wells, production expected to increase to 1800 boepd. The company got approval of Revised Field Development (RFDP) & Mining lease granted till 15 June 2030.



FY22 Performance

- HOEC's revenue as well as profitability has been volatile over the past, as company's business nature carry a potentially high level of attendant safety and environmental risks. Now, taking into the consideration of cost rationalisation strategy and company's focus in direct sale to consumers with a premium pricing, the company could report substantial and consistent growth in revenue and profitability going forward.
- HOEC has been debt free over the FY15 to FY20 with surplus cash. However, for ongoing and upcoming activities in different projects, company raised fund through debt in FY21 and FY22. Debt to Equity stood at 0.5x as on March 31, 2022. Apart from this, company has conservative approach on dividend payout to shareholders, retained funds are used only for capex.
- HOEC's financial profile looks strong supported by healthy cash accruals. Total Cash and cash equivalents stood at Rs 66 crore as on March 31, 2022 vs. Rs 117 crore as on 31 March, 2021. We expect the FCF could be positive going forward, even after factoring in annual capex. Capital spending is expected to remain moderate; this and incremental working capital needs are likely to be funded through cash accruals.
- Because of cost rationalization efforts, the company could see growth in profitability as well as better return ratios in the future.

Rise in Crude oil and Gas prices and Windfall tax impact

Oil prices have climbed on expectation of demand recovery and supply shortage due to Ukraine and Russian war, as European Union has imposed sanctions on Russian oil imports into EU. Crude Oil (WTI) climbed sharply by 36.6% YoY to US\$ 98.9/bbl. Higher crude oil prices lead to higher realization for HOEC and helped shore up its profitability. Apart from this, Natural gas has rallied sharply in the last few months and momentum could continue in the near to medium term. Natural Gas price is at US\$ 8.6 /mbtu, which is up by 112% YoY. The annual demand is expected to hit pre-pandemic levels in 2022, according to the International Energy Agency (IEA). This is spurred by the return of vehicular traffic in most of the major countries in the world as well as the improving overall economic outlook.

HOEC also benefits out of APM gas price revision. Gas prices under APM has been revised from \$ 2.9 per mmbtu in Oct 2021 per mmbtu to \$6.1 in April 2022 onwards.

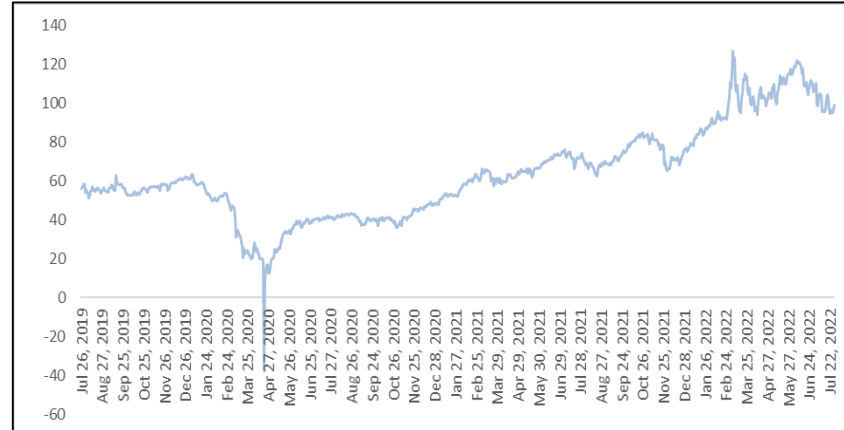
On July 20, 22, the government cut the tax on domestically produced crude by about 27% to Rs 17,000 a ton from Rs 23250 per ton, imposed on July 02, 2022. However, stability in oil prices, and currency stability will help further reduction in windfall taxes under fortnightly review.

International crude prices have slumped since mid-June on concerns about a potential global recession, slumped 11.5% in last one month. HOEC's oil revenue contributes 15% to overall sales. in case of B-80, the royalty is 10% in both oil and gas and the company is not producing oil due to some technical issue. With, 27% and 25% participating interest, Dirok and Kharsang blocks are producing crude oil and the royalty payable rate is in the range of 10-20%. Therefore, we are expecting a minimal impact of windfall tax on crude oil for HOEC.



Oil & Gas Price:

Crude Oil WTI Fut-US\$/bbl



Natural Gas Price-US\$/mbtu



(Source: Investing.com, HDFC sec)

What could go wrong?

- E&P business is highly capital intensive activity and has long gestation period with high uncertainty with respect to estimation of reserves. The success of E&P activities depends on quality of the available data engineering, geographies, geologies and geopolitical interpretation. Adverse outcome or failure on E&P project could bring cost burden and impact its profitability. HOEC however prefers asset light model.
- A large part of the growth in topline and bottomline of HOEC would be driven by B-80. The total investment made in B-80 including the assets for captive use through its subsidiary is Rs 955 crore. HOECL has commenced production from D2 Well and there is no clarity on D1, as it faces technical challenges. Any delay in the commencement of production, lower than expected production and/or lower realization could impact the growth rates of financial parameters and hence could impact the stock price movements.
- Given the volatility in Crude oil and petroleum product prices, inventory gains/losses in each quarter can be large affecting the estimates. Any decrease in the price of the crude oil may hamper the profitability of the company. Prices of crude oil depend on various factors including policies by major producers of crude oil, global as well as regional demand variations, geopolitical situations and market sentiment. Any increase in windfall tax could impact its margins going forward.
- The company's operation and day to day activities are subject to various rules and regulations. Change in regulations may impact its operation and financials and have short term, medium term and long term impact to the value of company.
- Delay in commercialisation of the B-80 block due to incomplete positioning of site, adverse weather condition and monsoon, could impact investor's sentiment towards the stock.

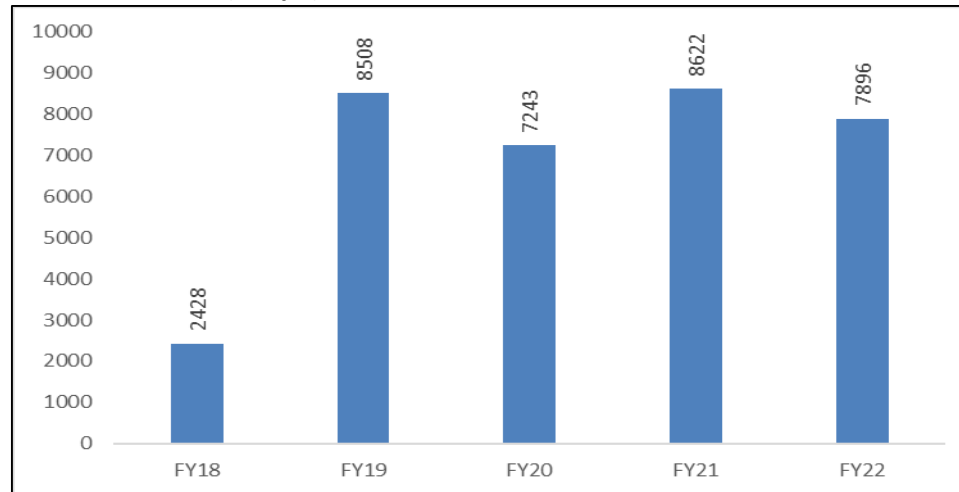


- Overall, gas dominates ~85% of the volumes, and oil 15%. Fall in domestic gas prices than Oil prices could impact its revenue as well as volumes. The impact of a falling oil price is however partly mitigated via the production sharing formula in the PSCs. However, B-80 product could help to transform its production mix to almost equal sphere.
- HOEC has poor track record of dividend payout, paid only in two different years (FY08 and FY10) over the life of its 38 years. Further, company has no plans to pay dividend to shareholder in the next two three years.

Company Profile:

Hindustan Oil Exploration Company Ltd (HOEC) was incorporated in the year 1983, is engaged in Oil exploration and production of crude oil and natural gas in onshore and offshore fields. HOEC was the first mid-sized private company in India to enter into field of oil and gas exploration and its operational activities commenced in 1991. HOEC provides geological and geophysical services relating to the exploration of oil and natural gas and other field services. The company has built a strong portfolio of onshore and offshore fields in India. The company has participating interest in 11 oil/gas fields in India (in Cambay basin, Cauvery basin, Assam Arakan basin, Mumbai Offshore basin and Rajasthan basin), it consists of 10 Oil & Gas blocks of Discovered Resources and 1 Exploratory block which are in varying stages of E&P life cycle i.e. exploration, development and production.

Gross Production (boepd)





One Year Price Chart



HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. These stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicity of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.



Hindustan Oil Exploration Co. Ltd.



Disclosure:

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