FitchRatings

25 Nov 2019 | Affirmation

Fitch Affirms Bharat Petroleum at 'BBB-'; Outlook Stable

Fitch Ratings-Singapore/Mumbai-25 November 2019: Fitch Ratings has affirmed India-based Bharat Petroleum Corporation Limited's (BPCL) Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'BBB-'. The Outlook is Stable. The agency has also affirmed BPCL's senior unsecured rating and the ratings on its outstanding senior unsecured debt at 'BBB-'. Fitch has also affirmed the rating on subsidiary BPRL International Singapore Pte. Ltd.'s US dollar guaranteed notes at 'BBB-'.

Fitch equalises BPCL's rating with that of its largest shareholder, the state of India (BBB-/Stable), based on Fitch's Government-Related Entities (GRE) Rating Criteria, due to a strong likelihood of government support.

We assess BPCL's Standalone Credit Profile (SCP) at 'bb+' to reflect its dominant market position as India's second-largest oil marketing company by sales and number of retail outlets, the average-but-improving complexity of its refining assets, its limited vertical integration and its moderate financial profile.

The government announced in-principle approval for selling its entire stake in BPCL on 20 November 2019. We have not factored this in given the early stage of the process and lack of information on potential bidders and the probable ownership structure. The state intends to complete the stake sale quickly and may appoint advisors soon, but we believe it could take time due to the diligence process, managing stakeholder expectations and valuation discussions. We may factor the sale in if and when interest from serious bidders is established, as previous instances of fuel-price controls and clarity on future prices could affect bidder interest and valuations. Fitch will monitor developments and consider appropriate rating action if the sale progresses. Consequently, we are treating the potential sale as an event risk. Fitch may no longer assess BPCL under the GRE criteria should the sale go through. The privatisation would also trigger the change of control clause in BPCL's bonds, giving bondholders a right to redeem; see Fitch Ratings: To Reassess Bharat Petroleum's Ratings if Govt Stake Sale Proceeds, published 9 October 2019.

The government has also indicated that BPCL's 61.7% owned subsidiary, Numaligarh Refinery Limited (NRL), would be carved-out and sold to another state-owned enterprise as part of this divestment process. NRL has a refining capacity of 3 million tonnes a year and ran at 97% utilisation in the financial year ended March 2019 (FY19), with 65% of volume coming from diesel, around 20% from petrol and the remainder from other products. The refinery has a high Nelson Complexity Index of 9.6 and generated a robust gross refining margin (GRM) of USD11.8/barrel (bbl) in FY19 and USD9.7/bbl in 1HFY20. It also contributes to around 20% of consolidated EBITDA.

KEY RATING DRIVERS

Strength of State Linkage: Fitch assesses BPCL's status, ownership and control by the sovereign as 'Strong'. The state directly owns 53.3% of the company and appoints BPCL's board. We assess the support record and expectations as 'Strong', as BPCL has received tangible state support via subsidies to meet under-recoveries on products sold below market prices. The subsidies were approved by parliament. It has also received indirect government support for its upstream acquisitions outside the country.

State's Incentive to Support: Fitch assesses the socio-political implications of a default by BPCL as 'Very Strong'. A default would significantly affect the country's energy security given BPCL's position as India's second-largest oil marketing company. BPCL, along with two other state-owned oil marketing companies, imports a large share of the country's crude oil - a default would jeopardise their ability to do so and disrupt the economy. Fitch sees the financial implications of default as 'Strong', as BPCL is a key state-owned borrower and its financial default could limit the availability and raise the cost of financing options for the state and other GREs.

Significant Downstream Company: Fitch expects BPCL to maintain its strong market position in refining and marketing over the medium-term based on its investment plans. BPCL's marketing domestic sales volume reached 43.1 million tonnes (mt) in FY19 with a 23% domestic market share. It is also India's third-largest refiner, with a refining capacity of 38.3mt a year, including 7.8mt at its Bharat Oman Refineries Limited (BORL) joint venture.

Large Capex: We expect capex of around INR477 billion over FY20-FY23 for the upgrade of refineries to meet new emission standards, to expand its petrochemical operation at its Kochi plant and augment marketing and pipeline infrastructure. The company also plans to set up a petrochemical plant at Rasayani near Mumbai; however we understand that the final decision may only occur after the government's stake sale. We have factored in investment for BPCL's share of holdings in its Mozambique block; the final investment decision was announced in June 2019.

Moderate Financial Profile: Fitch expects BPCL's net leverage - measured by net adjusted debt/ operating EBITDAR, including BORL on a proportionately consolidated basis - to rise to 3.1x in FY20, from 2.7x in FY19, due to its large capex plans and modest GRM in the near term. We expect leverage to marginally improve to 2.8x in FY21 and 2.6x in FY22, supported by benefits accruing from greater complexity of BPCL's expanded Kochi refinery, its petrochemical expansion and the implementation of new International Maritime Organisation fuel regulations from January 2020.

Diversification Efforts; Improving Integration: BPCL plans to increase its presence in gas distribution to diversify from regular petroleum products. The company expects gas distribution and an increased focus on petrochemicals to mitigate long-term risks related to auto fuels and liquefied petroleum gas. BPCL, through its wholly owned Bharat Gas Resources Limited, secured 13 licences in city-gas distribution bidding in FY19.

We also expect BPCL's vertical integration to improve in the medium term, supported by upstream and petrochemical investments. However, contribution to BPCL's overall cash flow is likely to remain limited in the medium-term due to the small size of these businesses. Integration may improve in the longer term when more upstream assets become operational. BPCL's upstream subsidiary, Bharat PetroResources Ltd., received dividends of around USD82 million in FY19 from its investment in Russian-based OJSC OC Rosneft.

DERIVATION SUMMARY

BPCL's closest peers under Fitch's GRE Rating Criteria are Indian Oil Corporation Ltd (IOC, BBB-/Stable, SCP: bb+) and Indonesia's PT Pertamina (Persero) (BBB/Stable, SCP: bbb-). Fitch's assessment of all the GRE factors for IOC is the same as for BPCL. Fitch assesses the socio-political implications of a default by both BPCL and IOC as 'Very Strong', since these state-controlled oil-marketing companies import a large share of India's crude oil and a default would jeopardise their ability to do so, disrupting the economy. The status, ownership and control; support record and expectations; and financial implications of default factors are assessed as 'Strong' for both.

Pertamina's status, ownership and control by the sovereign is considered 'Very Strong', as the state fully owns the national oil company, appoints its board and senior management and directs and approves investments. We also see the support record as 'Very Strong', as Pertamina consistently receives subsidies for selling certain petroleum products below market price. Fitch regards the socio-political and financial implications of a default as 'Very Strong' due to Pertamina's monopoly position in downstream operations in Indonesia and as a proxy borrower for the Indonesian government.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- Oil price (Brent) of USD65/bbl in 2019, USD62.5/bbl in 2020 and USD60.0/bbl in 2021
- Marketing volume growth of around 1.5% in FY20, gradually improving to 5.0% over the medium term

- Standalone GRM of USD3.90/bbl in FY20, USD5.25/bbl in FY21 and USD6.00/bbl in FY22 (FY18: USD6.85/bbl, FY19: USD4.60/bbl). NRL's GRM at USD10.2/bbl in FY20 and USD11.5/bbl in FY21 and BORL's GRM at USD7.2/bbl in FY20 and USD8.4/bbl in FY21
- Capex of around INR80 billion in FY20, INR125 billion in FY21 and INR148 billion in FY22. This includes around USD530 million for the Mozambique block over FY20-FY22
- Dividends of USD75 million a year from its upstream assets from FY20
- Dividend payout ratio of 50%

RATING SENSITIVITIES

Developments that May, Individually or Collectively, Lead to Positive Rating Action
- An upgrade of the sovereign rating, provided the likelihood of support from the state remains strong

Developments that May, Individually or Collectively, Lead to Negative Rating Action
- A downgrade of the sovereign rating
- A significantly lower probability of state support

For India's sovereign rating, the following sensitivities were outlined by Fitch in its rating action commentary of 4 April 2019:

The main factors that, individually or collectively, could trigger positive rating action are:
- Greater confidence in a sustained reduction in general government debt over the medium term.
- Higher sustained investment and growth rates without the creation of macroeconomic imbalances, such as from successful structural reform implementation.

The main factors that could trigger negative rating action are:
- A rise in the government debt burden, for instance due to the absence of fiscal consolidation or higher off-budget spending.
- Loose macroeconomic policy settings that cause a return of persistently high inflation and widening current-account deficits, which would increase the risk of external funding stress.

LIQUIDITY

Strong Liquidity: BPCL's liquidity remains strong, with cash and cash equivalents of INR64 billion at FYE19 (FYE18: INR68 billion). BPCL had INR80 billion of funded sanctioned undrawn credit lines as of 30 September 2019, INR80 billion of revolving credit limits and INR25 billion of unutilised term loan limits. The company has adequate access to domestic and international capital markets and secure banking relationships. Its INR5 billion of investments in other state-owned enterprises at FYE19 provide an additional liquidity cushion.

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ESG CONSIDERATIONS
Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3 - ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity.

For more information on our ESG Relevance Scores, visit www.fitchratings.com/esg

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Applicable Criteria

Corporate Rating Criteria (pub. 19 Feb 2019)
Corporates Notching and Recovery Ratings Criteria (pub. 14 Oct 2019)
Country-Specific Treatment of Recovery Ratings Criteria (pub. 18 Jan 2019)
Government-Related Entities Rating Criteria (pub. 13 Nov 2019)

Parent and Subsidiary Rating Linkage (pub. 27 Sep 2019)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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