



3R MATRIX

	+	=	-
Right Sector (RS)	✓	✗	✗
Right Quality (RQ)	✓	✗	✗
Right Valuation (RV)	✓	✗	✗

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS	✗	↔	✓
RQ	✗	↔	✓
RV	✗	↔	✓

Reco/View

Change

Reco: Buy	↔
CMP: Rs. 96	
Price Target: Rs. 115	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

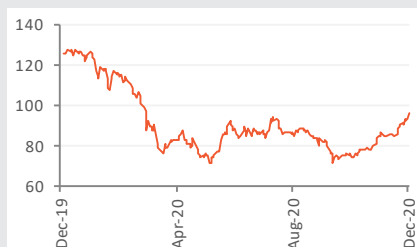
Company details

Market cap:	Rs. 90,658 cr
52-week high/low:	Rs. 130/71
NSE volume: (No of shares)	218 lakh
BSE code:	530965
NSE code:	IOC
Free float: (No of shares)	456.6 cr

Shareholding (%)

Promoters	51.5
FII	6.1
DII	13.4
Others	29.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	11	17	12	-24
Relative to Sensex	5	-3	-27	-37

Sharekhan Research, Bloomberg

Indian Oil Corporation Limited

Pipeline asset monetisation key near-term catalyst

Oil & Gas

Sharekhan code: IOC

Company Update

Summary

- IOCL's earnings momentum is expected to sustain in Q3FY2021 as it would be the first quarter of normalised volumes since the outbreak of COVID-19 (refinery utilisation and marketing sales volume back to pre-COVID level) and likely inventory gain (expected at Rs. 5,748 crore in case oil price sustains at \$50/bbl).
- Potential monetisation of non-core pipeline assets would help in value unlocking and privatisation of BPCL is expected to re-rate the refining and marketing business. Likely cut in excise duty on auto fuels would be crucial for marketing performance.
- IOCL is most attractively valued among OMCs with valuation of 0.8x its FY2023E P/BV and 5.3x its FY2023E EPS and has the most balanced earnings profile, which makes its earnings less volatile to fluctuation in marketing and refining margins.
- We expect IOCL's steep valuation discount of 57% to that of BPCL on FY2023E EPS to narrow down given strong earnings visibility, RoE of 15.5%, and high dividend yield of ~8-9%. Hence, we maintain our Buy rating with an unchanged PT of Rs. 115.

Indian Oil Corporation Limited (IOCL) is expected to benefit from sharp volume recovery as refinery utilisation rate is close to 100% in November (versus 80% in Q2FY2021), while marketing sales volume recovery has been robust with overall petroleum consumption at close to pre-COVID-19 level. The improvement is volume bodes well for absorption of fixed cost as operating leverage would kick in from Q3FY2021. However, likely cut in excise duty on petrol (Rs. 33/litre) and diesel (Rs. 31.8/litre) would be crucial for sustained strong performance of the marketing business in the rising oil price scenario. Brent oil prices have recovered sharply to \$50/bbl (although still below \$61/bbl level seen in FY2020), given anticipation of recovery in global oil demand, as positive news related to COVID-19 vaccine is expected to boost global economic recovery. High spot oil price of \$50/bbl versus IOCL's crude cost of ~\$43.8/bbl as of September could result in sizable refinery inventory gain (offsetting some weakness in auto fuel marketing margin) in Q3FY2021. Thus, we expect earnings momentum to sustain in Q3FY2021. Additionally, better crude demand could aid in improvements in GRM in CY202021 as product cracks would improve as product inventory level reduces globally. IOCL has a balanced earnings profile with steady contribution from pipeline and petchem apart from refining and marketing. We expect IOCL to post a 20% PAT CAGR over FY2020-FY2023E with RoE of ~15.5%. Moreover, IOCL's valuation is attractive at 5.3x its FY2023E EPS (at a steep discount of 46% to its historical average one-year forward PE multiple of 9.9x and 57% lower than that of BPCL on FY2023E PE). We expect IOCL's steep valuation gap with peers to narrow down given a potential sharp recovery in earnings, healthy RoE, and high dividend yield of ~8-9%. Potential monetisation of non-core assets and privatisation of BPCL would be key catalyst for IOCL. Hence, we maintain our Buy rating on IOCL with an unchanged PT of Rs. 115.

Our Call

Valuation – Maintain Buy on IOCL with and unchanged PT of Rs. 115: IOCL is the most attractively valued stock among oil marketing companies (OMCs) with valuation of 0.8x its FY2023E P/BV and 5.3x its FY2023E EPS despite strong earnings visibility (expect 20% PAT CAGR over FY2020-FY2023E) and healthy RoE of 15.5%. Hence, we expect IOCL's steep valuation discount of 57% to that of BPCL on FY2023E EPS to narrow down given strong growth outlook and high dividend yield of 8-9%. Potential monetisation of non-core assets (IOCL has pipeline network of 14,600 kms with capacity of 94.4mtpa for crude and 21.7mmcmd for gas) would help in value unlocking and privatisation of BPCL is expected to re-rate the refining and marketing business of entire OMC pack. Hence, we maintain our Buy rating on IOCL with an unchanged PT of Rs. 115.

Key risk

Prolonged weakness in refining margin and lower-than-expected marketing sales volume amid COVID-19 economic slowdown could impact earnings outlook and valuation.

Valuation (Standalone)

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenue	5,27,701	4,86,256	4,54,381	5,28,162	5,62,223
OPM (%)	6.4%	3.9%	6.8%	5.8%	6.1%
Adjusted PAT	17,280	9,987	14,531	14,721	17,167
(%) YoY Growth	-13.5	-42.2	45.5	1.3	16.6
Adjusted EPS (Rs.)	18.4	10.6	15.4	15.6	18.2
P/E (x)	5.2	9.1	6.2	6.2	5.3
P/B (x)	0.8	1.0	0.9	0.8	0.8
EV/EBITDA (x)	5.1	10.8	5.9	5.7	5.3
RoNW (%)	15.8	9.9	14.9	14.1	15.5
ROCE (%)	15.0	6.3	11.2	10.5	11.4

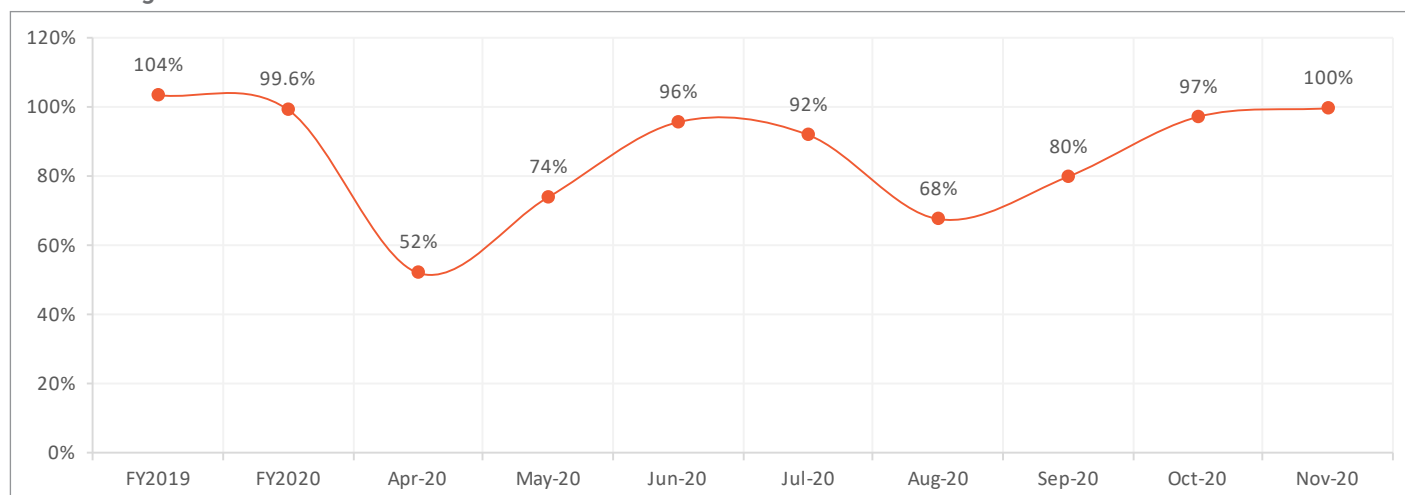
Source: Company; Sharekhan estimates

Sharp improvement in IOCL refinery utilisation rate to 100% in November

IOCL's refinery utilisation rate has witnessed continuous improvement since August (impacted due to monsoons as petroleum demand is lower) and has now recovered back to 100% in November as compared to only 52%-74% April-May 2020. This sharp improvement in refinery utilisation rate reflects faster-than-anticipated recovery in India's petroleum consumption (which even witnessed 3% y-o-y growth in October 2020).

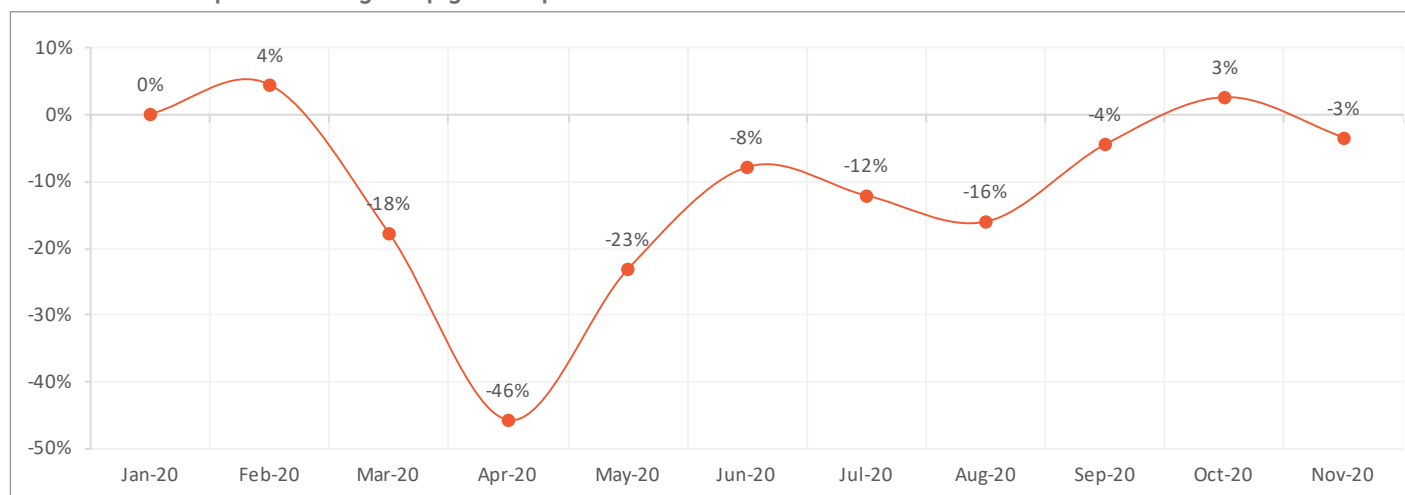
India's overall petroleum consumption has increased sharply over May-June and is currently at 97% of pre-COVID-19 level as compared to only 50%-55% in April 2020. Overall petroleum consumption has recovered sharply by 80% to 17.8 million tonne in November 2020 from low of 9.9 million tonne in April 2020. India has witnessed strong y-o-y growth across petroleum products in November (except for diesel, ATF kerosene, and petroleum coke), with petrol consumption at 2.7 million tonne (up 5% y-o-y) and LPG at 2.4 million tonne (up 4% y-o-y). Although diesel consumption declined by 7% y-o-y to 7 million tonne, it remained largely stable on m-o-m basis. ATF demand continued to remain weak with 48% y-o-y decline to 0.4mmt. Industrial fuel such as naphtha, fuel oil, and bitumen also witnessed sharp improvement, with volume increasing by 7% y-o-y, 9% y-o-y, and 18% y-o-y, respectively in November. Recovery in petroleum consumption is well above street expectations and bodes well for earnings growth of OMCs.

IOCL refinery utilisation rate back to 100% in November



Source: PPAC India, Media reports, Sharekhan Research

Petroleum consumption recovery sharply above pre-COVID-19 level in October



Source: PPAC India; Sharekhan Research

IOCL refinery utilisation improved sharply as petroleum consumption is at pre-COVID-19 level

Particulars	FY2019	FY2020	Apr-20	May-20	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20
Barauni refinery	6661	6516	247	337	512	437	318	376	435
Koyali refinery	13505	13075	578	769	1041	1092	834	899	1049
Haldia refinery	7965	6463	305	319	533	580	562	440	585
Mathura refinery	9737	8948	506	730	769	754	641	615	709
Panipat refinery	15281	15038	457	919	1173	1115	977	1025	1237
Guwahati refinery	863	892	0	24	64	87	89	75	84
Digboi refinery	676	664	54	56	61	51	56	46	61
Bongaigaon refinery	2513	2045	174	196	193	222	206	189	222
Paradip refinery	14616	15778	725	959	1227	1025	266	992	1279
Total refinery throughput	71817	69419	3046	4311	5573	5363	3950	4657	5662
Refinery utilisation rate	FY2019	FY2020	Apr-20	May-20	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20
Barauni refinery	111%	109%	49%	67%	102%	87%	64%	75%	87%
Koyali refinery	99%	95%	51%	67%	91%	96%	73%	79%	92%
Haldia refinery	106%	81%	46%	48%	80%	87%	84%	66%	88%
Mathura refinery	122%	112%	76%	110%	115%	113%	96%	92%	106%
Panipat refinery	102%	100%	37%	74%	94%	89%	78%	82%	99%
Guwahati refinery	86%	89%	0%	28%	77%	104%	107%	90%	101%
Digboi refinery	104%	102%	99%	104%	113%	95%	103%	85%	113%
Bongaigaon refinery	107%	87%	89%	100%	98%	114%	105%	96%	113%
Paradip refinery	97%	105%	58%	77%	98%	82%	21%	79%	102%
Overall utilisation rate	104%	100%	52%	74%	96%	92%	68%	80%	97%

Source: PPAC India; Sharekhan Research

Recent surge in oil prices would mean high inventory gains in Q3FY2021

Most of IOCL's refineries are land locked (except for 15mmt Paradip refinery) and, thus, inventory levels are high as it takes time for movement of inventory. Crude inventory stood at 9mmt and product inventory stood at 8.4mmt as of September 2020. At spot oil prices, we expect crude inventory gain of Rs. 3,020 crore (\$3.2/ bbl) in Q3FY2021 and product inventory gain of Rs. 2,728 crore.

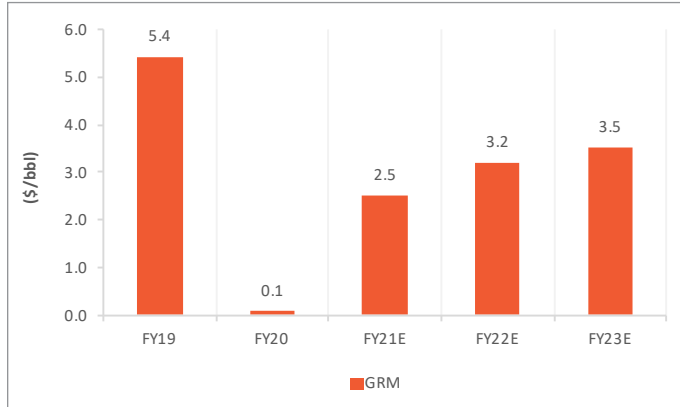
Spot oil price would mean inventory gain of Rs. 5,747 crore for IOCL in Q3FY2021

Particulars	Value
IOCL crude cost (\$/bbl)	43.8
Spot oil price (\$/bbl)	50
Crude inventory as on September 2020	9
Product inventory as on September 2020	8.4
Crude inventory gain expected in Q3FY2021 (Rs. crore)	3,020
Product inventory gain expected in Q3FY2021 (Rs. crore)	2,728
Total inventory gain expected in Q3FY2021 (Rs. crore)	5,748

Source: Sharekhan Research

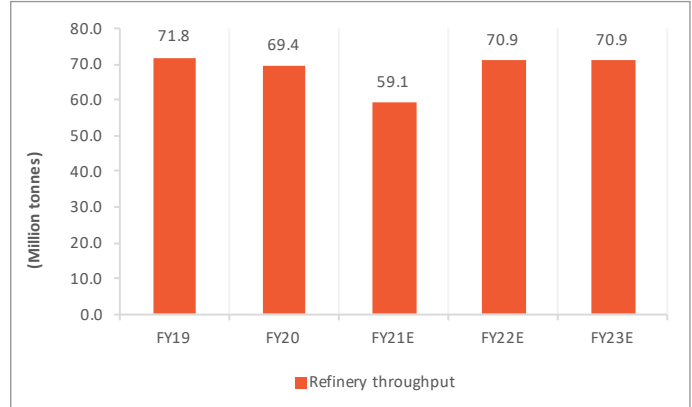
Financials in charts

Refining margin to gradually improve



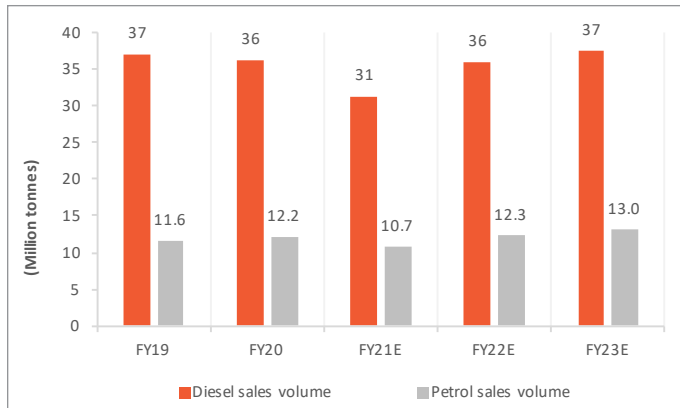
Source: Company, Sharekhan Research

Refining throughput to normalise over FY21E-FY22E



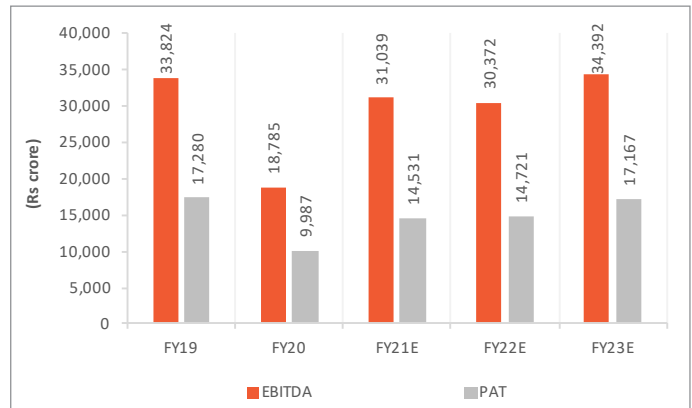
Source: Company, Sharekhan Research

Volume recovery to be strong



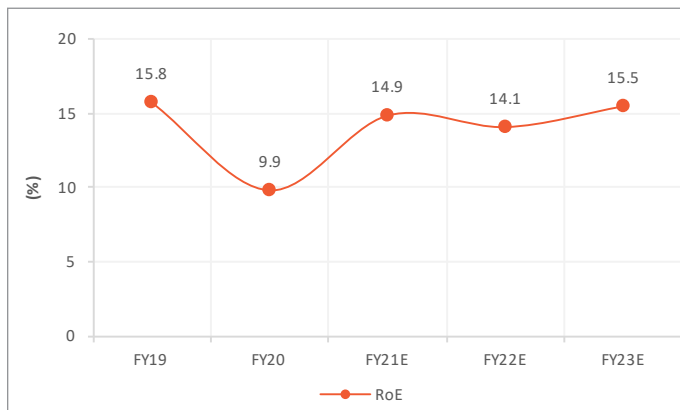
Source: Company, Sharekhan Research

Strong earnings visibility



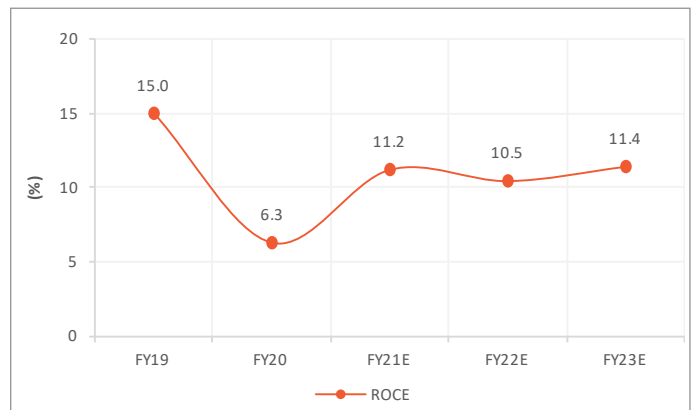
Source: Company, Sharekhan Research

RoE trend



Source: Company, Sharekhan Research

RoCE trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Volume recovery and steady auto fuel marketing margins bode well for OMCs

India's petrol and diesel consumption is expected to grow at 8% and 3% annually, respectively, in the medium term as penetration for two-wheelers and passenger cars improves and GDP growth recovers to normal levels. Although oil prices have recovered to \$50/bbl, but they still remain well below \$61/bbl level seen in FY2020. Thus, reasonable oil price would benefit OMCs in terms of lower working capital requirement. Although core refining margins could remain weak in the near term, gradual reduction of global petroleum product inventories (given improvement in oil demand) would improve refining margin in CY2021. Overall, marketing margin should remain steady as OMCs would pass on the increase in the price increases to end customers but likely reduction in excise duty on auto fuels would be crucial for performance marketing business especially in case of sharp increase in the oil prices.

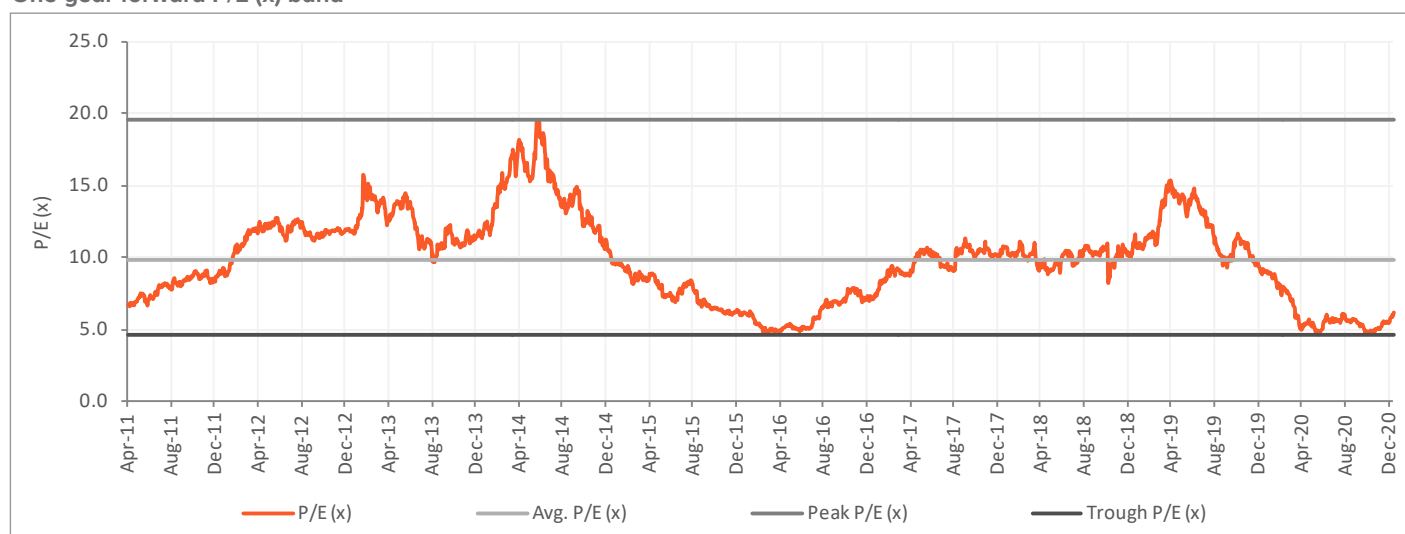
■ Company Outlook – Strong earnings momentum to continue in H2FY2021 led by volume recovery and inventory gain

IOCL's earnings momentum is expected to remain good as overall operational performance is expected to improve considerably in H2FY2021, with refineries operating at 100% level and petroleum demand consumption back to pre-COVID-19 level. IOCL is expected to benefit from the recent rise in oil price as Q3FY2021 could see inventory gain if current rally in oil price of \$50/bbl sustains. Overall, volume recovery, inventory gains, better downstream margin (refining and petchem margin) in CY2021, and lower interest cost would result in strong earnings growth (expect a 20% PAT CAGR over FY2020-FY2023E).

■ Valuation – Maintain Buy on IOCL with an unchanged PT of Rs. 115

IOCL is the most attractively valued stock among oil marketing companies (OMCs) with valuation of 0.8x its FY2023E P/BV and 5.3x its FY2023E EPS despite strong earnings visibility (expect 20% PAT CAGR over FY2020-FY2023E) and healthy RoE of 15.5%. Hence, we expect IOCL's steep valuation discount of 57% to that of BPCL on FY2023E EPS to narrow down given strong growth outlook and high dividend yield of 8-9%. Potential monetisation of non-core assets (IOCL has pipeline network of 14,600 kms with capacity of 94.4mtpa for crude and 21.7mmscmd for gas) would help in value unlocking and privatisation of BPCL is expected to re-rate the refining and marketing business of entire OMC pack. Hence, we maintain our Buy rating on IOCL with an unchanged PT of Rs. 115.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

IOCL is a leader in the domestic downstream oil sector with non-replicable infrastructure – total refining capacity of 81mmt (33% market share; owns 11 of 22 refineries in India), retail outlets of 30,000 (~42% market share), and pipeline capacity of 80.6mmt. The company is also a market leader in domestic petroleum sales with volume of 83.9mmt, besides owning a petrochemicals plant at Panipat (with naphtha cracker capacity of 1.46mmt, LAB capacity of 0.12mmt, and PX/PTA capacity of 0.5mmt).

Investment theme

The recent sharp volume recovery with refineries operating at 100% utilization and marketing sales volume back to pre-COVID-19 level bodes well for the earnings for OMCs. Moreover, IOCL have diversified earnings with exposure to pipeline and petrochemicals, which insulated it from volatility in refining and marketing margins. Privatisation of BPCL would re-rate the refining and marketing business of OMCs while monetisation of pipeline assets could unlock value for IOCL. Moreover, IOCL's valuation is attractive with a steep discount to that of BPCL.

Key Risks

- ♦ Lower-than-expected refining and marketing margins could affect earnings outlook.
- ♦ Lower-than-expected volume in case of prolonged economic slowdown amid COVID-19.
- ♦ Volatility in quarterly earnings in case of fluctuations in oil prices and INR-USD rate.

Additional Data

Key management personnel

Shrikant Madhav Vaidya	Chairman
Sandeep Kumar Gupta	Director - Finance
Gurmeet Singh	Director – Marketing
Akshay Kumar Singh	Director - Pipelines

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Oil & Natural Gas Corp Ltd	14.2
2	Life Insurance Corp of India	6.5
3	Oil India Ltd	5.2
4	IOC SHARES TRUST	2.5
5	ICICI Prudential Asset Management	2.3
6	SBI Funds Management Pvt Ltd	1.5
7	Franklin Resources Inc	0.9
8	Vanguard Group Inc/The	0.8
9	BlackRock Inc	0.6
10	Prudential PLC	0.5

Source: Bloomberg

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Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and deteriorating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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