Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Indian Oil Corporation Ltd

Robust Q1 on strong margin performance; Attractive valuation

Oil & Gas	Sharekhan code: IOC	Result Update

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. 103**	
Price Target: **Rs. 125**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

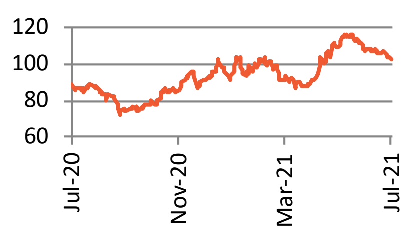
Company details

Market cap:	Rs. 97,154 cr
52-week high/low:	Rs. 118/71
NSE volume: (No of shares)	225 lakh
BSE code:	530965
NSE code:	IOC
Free float: (No of shares)	456.6 cr

Shareholding (%)

Promoters	51.5
FII	6.7
DII	12.4
Others	29.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-4	13	8	17
Relative to Sensex	-5	5	-1	-23

Sharekhan Research, Bloomberg

Summary

- Q1FY2022 PAT at Rs. 5,941 crore (down 32% q-o-q) was higher than our and street estimates, led by robust margins – reported GRM of $6.6/bbl (vs. our estimate of $5.3/bbl), higher marketing EBITDA margin of Rs2,883/mt (up 74% q-o-q) and sustained strong petchem EBITDA margin at $412/mt (up 1.3% q-o-q).
- Lower-than-anticipated impact of lockdown with marketing sales volume of 18.8mmt (down 9.6% q-o-q) and strong refinery utilisation of 96%. Petrol/diesel volume fell 14.9%/12.8% q-o-q but was above estimate; core GRM of $2.2/bbl was in-line.
- Strong earnings performance to sustain led by volume recovery (petrol/diesel at >100%/~85-90% of pre-COVID level), likely structural improvement in auto fuel margin, cyclical recovery in GRM, sustained high petchem margin, and inventory gain. Maintenance shutdown at Paradip refinery to have a slight impact on Q2 refinery throughput.
- Retain Buy on IOCL with an unchanged PT of Rs. 125 given attractive valuation (FY23E PE of 4.8x), earnings visibility, RoE of 17-18%, and dividend yield of ~10%. Pipeline asset monetisatin and BPCL privatisation are key re-rating catalyst.

Indian Oil Corporation Limited (IOCL) reported standalone Q1FY2022 operating profit of Rs. 11,126 crore (down 17.6% q-o-q), 3.4%/6.5% higher than our/consensus estimates of Rs. 10,763 crore/Rs. 10,445 crore. Strong performance was led by 1) higher-than-expected reported GRM of $6.6/bbl (includes inventory gain of $4.3/bbl) versus our estimate of $5.3/bbl, 2) higher-than-expected marketing margin (including inventory gain) at Rs. 2,883/mt (strong recovery with 74% q-o-q improvement) supported by resumption of daily auto fuel price hikes and higher margins on industrial fuels, and 3) 20% beat in petchem EBITDA at Rs. 1,738 crore (up 2.7x y-o-y; down 11.5% q-o-q) with blended EBITDA margin remaining resilient at $412/mt (up 2.1x y-o-y; up 1.3% q-o-q). Core GRM was at $2.2/bbl, in-line with our estimates. Volume performance was also good with refinery throughput of 16.7mmt (down only 5% q-o-q; utilisation rate of 96%) and marketing sales volume of 18.8 mmt (down 9.6% q-o-q) was higher than our estimate of 17.9 mmt. PAT came in at Rs. 5,941 crore (down 32.3% q-o-q), 2%/11% above our/street estimate of Rs. 5,809 crore/Rs. 5,359 crore, given strong margin performance and marginally lower-than-expected effective income tax rate. IOCL's strong earnings momentum is expected to sustain in the coming quarters, supported by multiple drivers such as volume recovery (lower-than-expected impact of second wave of COVID-19 with petrol/diesel at >100%/~85-90% of pre-COVID level currently), auto fuel price hike to improve marketing margin, cyclical recovery in refining margin over CY2021E-CY2022E as petroleum product cracks would improve with decline in the global petroleum inventories amid pick-up in global demand, and likely inventory gain in Q2FY2022 as spot crude oil price of $75/bbl (versus $68.6/bbl in Q1FY2022). Moreover, IOCL's valuation is attractive at 4.8x its FY2023E EPS, 0.7x FY2023E P/BV, and 4.6x FY2023E EV/EBITDA and at a steep discount of 63%/51%/48% to that of BPCL. We expect IOCL's steep valuation gap with peers to narrow down, given a potential sharp recovery in core earnings, healthy RoE of 17-18%, and a high dividend yield of ~10%. Potential monetisation of non-core assets (pipeline and hydrogen-producing facilities) and privatisation of BPCL would be key catalysts for IOCL. Hence, we maintain our Buy rating on IOCL with an unchanged price target (PT) of Rs. 125.

Key positives

- Improvement in blended marketing EBITDA margin by 74% q-o-q to Rs. 2,883/mt.
- Better-than-expected reported GRM of $6.6/bbl (versus estimate of $5.3/bbl) led by refinery inventory gain.
- Higher-than-expected petchem EBITDA margin of $412/mt (up 1.3% q-o-q).

Key negatives

- Market share loss of 55 bps y-o-y in MS to 40.3% in Q1FY2022.
- Lower-than-expected petchem sales volume at 0.66mmt (down 12.6% q-o-q).

Our Call

Valuation – Maintain Buy on IOCL with an unchanged PT of Rs. 125: We have increased our FY2022-FY2023 earnings estimates to factor in higher petchem and marketing margins, partially offset by slightly lower refinery utilisation rate (given Paradip maintenance shutdown in Q2FY2022). We have also introduced our FY2024 earnings estimate in this report. IOCL is the most attractively valued stock among oil marketing companies (OMCs) with a valuation of 0.8x its FY2023E P/BV and 4.8x its FY2023E EPS and has a balanced earnings profile with steady contribution from pipeline and petchem segments, apart from refining and marketing. We expect IOCL's steep valuation discount of 63% to that of BPCL on FY2023E EPS to narrow down, given recovery in core earnings, strong RoE of 17-18%, and high dividend yield of ~10%. Potential monetisation of non-core assets and likely privatisation of BPCL are expected to aid re-rating of the entire OMC pack. Hence, we maintain our Buy rating on IOCL with an unchanged PT of Rs. 125.

Key Risks

Prolonged weakness in refining margin and lower-than-expected marketing margin (due to the recent rise in oil price) and sales volume amid COVID-19 economic slowdown could impact earnings outlook and valuation.

Valuation (Standalone) Rs cr

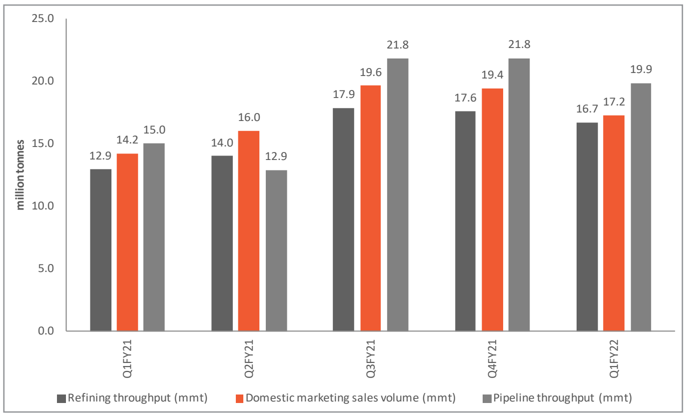
Particulars	FY20	FY21	FY22E	FY23E	FY24E
Revenue	4,86,256	3,78,058	5,50,816	5,96,983	6,34,558
OPM (%)	3.9%	10.1%	7.6%	6.5%	6.9%
Adjusted PAT	9,987	17,426	23,492	20,434	23,350
(%) YoY Growth	-42.2	74.5	34.8	-13.0	14.3
Adjusted EPS (Rs.)	10.6	18.5	25.0	21.7	24.8
P/E (x)	9.7	5.6	4.1	4.8	4.2
P/B (x)	1.0	0.9	0.8	0.8	0.7
EV/EBITDA (x)	11.1	5.0	4.3	5.0	4.6
RoNW (%)	9.9	17.1	20.4	16.5	17.6
ROCE (%)	6.3	14.7	15.6	13.3	14.2

Source: Company; Sharekhan estimates

Q1 PAT above our and street estimate given beat in reported GRM, marketing margin and petchem EBITDA

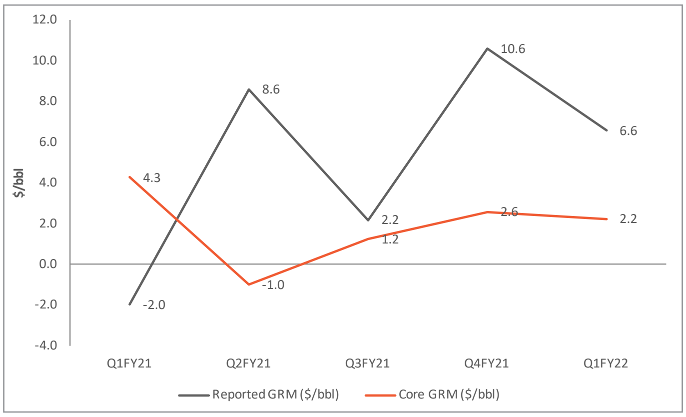
Standalone Q1FY2022 operating profit of Rs. 11,126 crore (down 17.6% q-o-q), 3.4%/6.5% higher than our/consensus estimates of Rs. 10,763 crore/Rs. 10,445 crore. Strong performance was led by 1) higher-than-expected reported GRM of $6.6/bbl (includes inventory gain of $4.3/bbl) versus our estimate of $5.3/bbl, 2) higher-than-expected marketing margin (including inventory gain) at Rs. 2,883/mt (strong recovery with 74% q-o-q improvement) supported by resumption of daily auto fuel price hikes and higher margins on industrial fuels, and 3) 20% beat in petchem EBITDA at Rs. 1,738 crore (up 2.7x y-o-y; down 11.5% q-o-q) with blended EBITDA margin remaining resilient at $412/mt (up 2.1x y-o-y; up 1.3% q-o-q). Core GRM was at $2.2/bbl, in-line with our estimates. Volume performance was also good with refinery throughput of 16.7mmt (down only 5% q-o-q; utilisation rate of 96%) and marketing sales volume of 18.8 mmt (down 9.6% q-o-q) was higher than our estimate of 17.9 mmt. PAT came in at Rs. 5,941 crore (down 32.3% q-o-q), 2%/11% above our/street estimate of Rs. 5,809 crore/Rs. 5,359 crore, given strong margin performance and marginally lower-than-expected effective income tax rate.

Strong volume performance despite impact of COVID-19



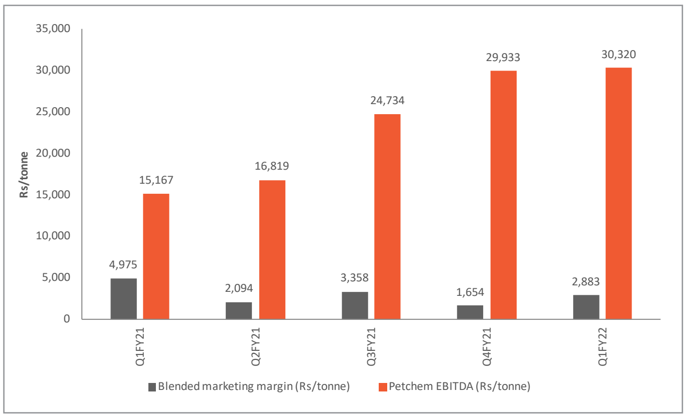
Source: Company; Sharekhan Research

Reported GRM aided by inventory gain



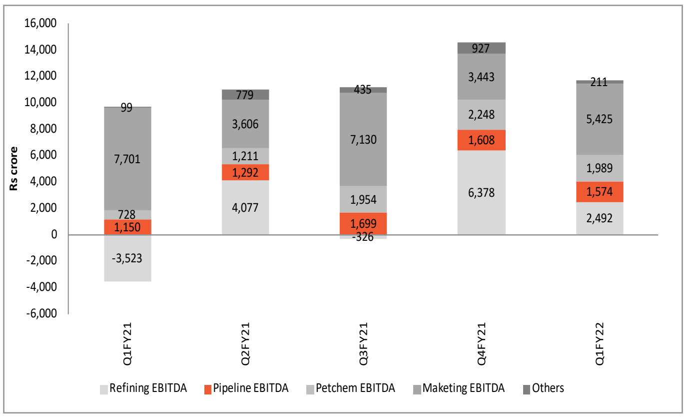
Source: Company; Sharekhan Research

Marketing and petchem margin trend



Source: Company; Sharekhan Research

Segment-wise EBITDA trend



Source: Company; Sharekhan Research

Results (Standalone) **Rs cr**

Particulars	Q1FY22	Q1FY21	YoY (%)	Q4FY21	QoQ (%)
Net Sales	**1,18,671**	**62,397**	**90.2**	**1,23,714**	**-4.1**
Total Expenditure	1,07,544	56,884	89.1	1,10,212	-2.4
Reported operating profit	11,126	5,512	101.8	13,502	-17.6
Adjusted operating profit	**11,126**	**5,512**	**101.8**	**13,502**	**-17.6**
Other Income	564	642	-12.2	1102	-48.8
EBITDA	11,690	6,154	89.9	14,603	-20.0
Interest	1,257	1,171	7.3	1,073	17.2
Depreciation	2,634	2,355	11.9	2,579	2.1
Exceptional income/(expense)	0	0	NA	0	NA
Reported PBT	7,798	2,629	196.7	10,951	-28.8
Adjusted PBT	**7,798**	**2,629**	**196.7**	**10,951**	**-28.8**
Tax	1,857	718	158.7	2,170	-14.4
Reported PAT	5,941	1,911	210.9	8,781	-32.3
Adjusted PAT	**5,941**	**1,911**	**210.9**	**8,781**	**-32.3**
Equity Cap (cr)	941	941		941	
Reported EPS (Rs.)	6.3	2.0	210.9	9.3	-32.3
Adjusted EPS (Rs.)	6.3	2.0	210.9	9.3	-32.3
Margins (%)			**BPS**		**BPS**
Adjusted OPM	9.4	8.8	54.1	10.9	-153.8
Adjusted NPM	5.0	3.1	194.4	7.1	-209.1
Tax rate	23.8	27.3	-349.1	19.8	400.0

Source: Company; Sharekhan Research

Key operating performance

Particulars	Q1FY22	Q1FY21	YoY (%)	Q4FY21	QoQ (%)
Reported GRM ($/bbl)	6.6	-2.0	NA	10.6	-37.9
Refining inventory gain/(loss) ($/bbl)	4.3	-6.3	NA	8.0	-45.7
Core GRM ($/bbl)	2.24	4.3	-47.5	2.60	-13.9
Refining throughput (mmt)	16.7	12.9	29.3	17.6	-5.0
Petroleum products market sales including exports (mmt)	18.8	15.5	21.6	20.8	-9.6
Petchem sales (mmt)	0.7	0.5	36.7	0.8	-12.6
Pipeline throughput (mmt)	19.9	15.0	32.4	21.8	-9.0
Reported segmental performance (Rs. crore)					
Refining EBITDA	2,492	-3,523	NA	6,378	-60.9
Pipeline EBITDA	1,574	1,150	36.9	1,608	-2.1
Petchem EBITDA	1,989	728	173.2	2,248	-11.5
Marketing EBITDA	5,425	7,701	-29.6	3,443	57.6
Others	211	99	113.1	927	-77.2
Total reported EBITDA (including other income)	**11,691**	**6,155**	**89.9**	**14,604**	**-19.9**

Source: Company; Sharekhan Research

Outlook and Valuation

■ **Sector view – Recovery in GRM to mid-cycle level, decent volume growth, and better auto fuel marketing margins bode well for earnings of OMCs**

India's consumption of petrol and diesel is expected to grow at a decent rate annually in the medium term, as penetration for two-wheelers and passenger cars improves and GDP growth normalises. We believe OMCs' auto fuel marketing margins would soon normalise to historical levels as they have started daily auto fuel price revisions. Moreover, gradual reduction of global petroleum product inventories (given an improvement in oil demand and reduction in refinery run-rates) could improve core refining margin to mid-cycle level of $3-4/bbl over CY2021E-CY2022E. Privatisation of BPCL (is successful) could play a crucial role to align marketing margins on petrol to global standards. All the above factors bode well for sharp earnings growth for Indian OMCs.

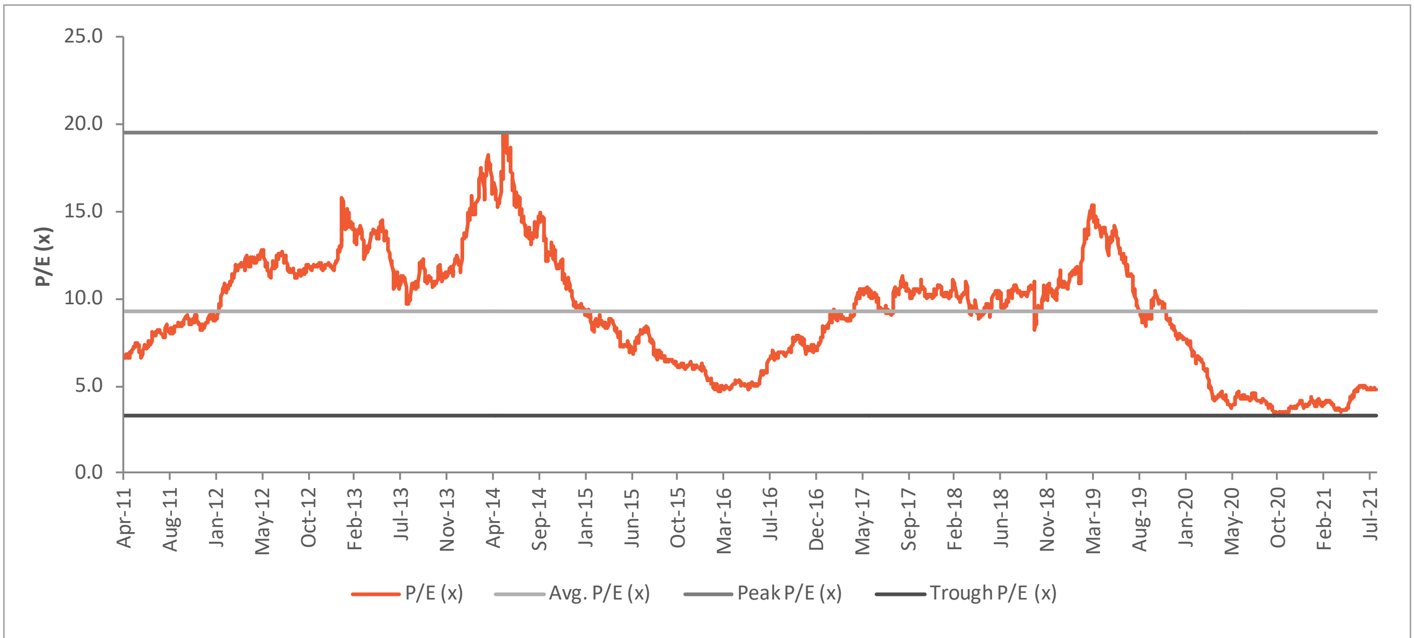
■ **Company outlook - Earnings to improve with cyclical recovery in GRM, higher polymer spreads, and marketing margin**

We expect IOCL's strong earnings momentum to sustain in the coming quarters, supported by multiple drivers such as: 1) volume recovery (lower-than-expected impact of second wave of COVID-19), 2) auto fuel price hike to improve marketing margin, 3) cyclical recovery in refining margin over CY2021E-CY2022E as petroleum product cracks would improve as global petroleum inventories would decline amid pick-up in global demand, 4) sustained high petchem margin, and 5) likely inventory gain in Q2FY2022 as spot crude oil price of $75/bbl (versus $68.6/bbl in Q1FY2022). Overall, we expect a 10% PAT CAGR over FY2021-FY2024E (despite strong growth of 75% in FY2021) and improvement in RoE to 17.6%. Also, IOCL is planning for a joint venture with a Malaysian oil & gas major for marketing of auto fuels (diesel and petrol) and natural gas retailing. The JV would help IOCL to expand market share and aid to the volume growth.

■ **Valuation - Maintain Buy on IOCL with an unchanged PT of Rs. 125:**

We have increased our FY2022-FY2023 earnings estimates to factor in higher petchem and marketing margins, partially offset by slightly lower refinery utilisation rate (given Paradip maintenance shutdown in Q2FY2022). We have also introduced our FY2024 earnings estimate in this report. IOCL is the most attractively valued stock among oil marketing companies (OMCs) with a valuation of 0.8x its FY2023E P/BV and 4.8x its FY2023E EPS and has a balanced earnings profile with steady contribution from pipeline and petchem segments, apart from refining and marketing. We expect IOCL's steep valuation discount of 63% to that of BPCL on FY2023E EPS to narrow down, given recovery in core earnings, strong RoE of 17-18%, and high dividend yield of ~10%. Potential monetisation of non-core assets and likely privatisation of BPCL are expected to aid re-rating of the entire OMC pack. Hence, we maintain our Buy rating on IOCL with an unchanged PT of Rs. 125.

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 81 mmt (33% market share; owns 11 of 22 refineries in India), retail outlets of 32,303 (~42% market share), and pipeline capacity of 80.6 mmt. The company is also a market leader in domestic petroleum sales with volume of 83.9 mmt, besides owning a petrochemicals plant at Panipat (with naphtha cracker capacity of 1.46 mmt, LAB capacity of 0.12 mmt, and PX/PTA capacity of 0.5 mmt).

Investment theme

Core earnings outlook has improved considerably with recovery in refining margin, high polymer spreads, and likely normalisation of auto fuel marketing margin, as OMCs have restarted daily petrol/diesel price revision. Moreover, IOCL has 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 and the stock offers high dividend yield.

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

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	7.7
3	Oil India Ltd	5.2
4	IOC SHARES TRUST	2.5
5	SBI Funds Management Pvt Ltd	1.7
6	SBI Long Term Equity Fund	1.7
7	Vanguard Group Inc/The	1.0
8	ICICI Prudential Asset Management	0.9
9	Franklin Resources Inc	0.7
10	BlackRock Inc	0.6

Source: Bloomberg

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 detoriating 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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