Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Indian Oil Corporation Ltd

Weak Q1; maintain Buy on inexpensive valuation

Oil & Gas	Sharekhan code: IOC
Reco/View: Buy ↔	CMP: Rs. 71
	Price Target: Rs. 82 ↓

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 35.5

Updated July 08, 2022

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 1,00,473 cr
52-week high/low:	Rs. 95/68
NSE volume: (No of shares)	137 lakh
BSE code:	530965
NSE code:	IOC
Free float: (No of shares)	684.9 cr

Shareholding (%)

Promoters	51.5
FII	8.2
DII	11.5
Others	28.8

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-4.4	-15.7	-14.2	1.2
Relative to Sensex	-13.5	-17.7	-11.8	-8.6

Sharekhan Research, Bloomberg

Summary

- Q1FY23 net loss of Rs. 1993 crore was much higher than ours/street's estimates on a larger-than-expected marketing loss and weak performance of petchem segment (EBIT fell 53% q-o-q) offsetting best-ever refining performance.
- Large negative auto fuel marketing margin continued to dent marketing performance and offset benefit of all-time high reported GRM of $32/ bbl. Volume performance was mixed as refinery throughput/marketing volumes rose 4%/6% q-o-q, while petchem volumes plunged by 17% q-o-q.
- We believe that H2FY23 would factor in the worst for OMCs and gradual petrol/diesel prices hikes hike coupled with likely normalisation of refining margins would drive an earnings recovery in H2FY23-FY24.
- We maintain a Buy on IOCL with a revised PT of Rs. 82 (lowered PT to reflects a cut in PE multiple given a sharp fall in refining margins) on inexpensive valuation of 4.2x/0.7x FY24E EPS/BV and FY24E dividend yield of 12%.

Indian Oil Corporation Limited's (IOCL's) Q1FY23 standalone operating profit of Rs. 1,359 crore (down 87.8% y-o-y and 88.3% q-o-q) steeply missed ours/street's estimate led by a higher-than-expected loss (large negative marketing margin on petrol/diesel on non-revision of retail prices) in the marketing business and sharper-than-anticipated decline in profitability (EBIT down by 53% q-o-q to Rs. 269 crore) at petchem business. Even all-time reported GRM of $31.8/bbl could not provide any much relief from massive loss in the marketing business. Excluding inventory gains of $6.5/bbl, the crore GRM improved by 86% q-o-q to $25.3/bbl reflecting strong transportation fuel (diesel, petrol and ATF) crack spreads. Volume performance was mixed with a 4%/6/8% q-o-q increase in refinery throughput/marketing volumes/pipeline throughput to 19 mmt/23 mmt/24 mmt, but petchem volumes declined by 17% q-o-q to 0.6 mmt. The company reported a net loss of Rs. 1,993 crore (versus expectations of a net loss of Rs. 525 crore and PAT of Rs. 6,022 crore in Q4FY22) primarily on losses in marketing business and weak performance of petchem segment.

Key positives

- All-time high reported GRM of $31.8/bbl.

Key negatives

- Large negative marketing margin on auto fuels due to non-revision of petrol/diesel prices.
- Sharper-than-expected decline of 53% q-o-q in petchem EBIT.

Revision in estimates – We have sharply cut our FY23 earnings estimates to factor in marketing losses in H1FY23 and weakening GRM. We have fine-tuned our FY24 earnings estimates.

Our Call

Valuation – Maintain Buy on IOCL with a revised PT of Rs. 82: IOCL is the most attractively valued stock among oil marketing companies (OMCs) with a valuation of 0.7x its FY2024E P/BV and 4.2x its FY2024E EPS and has a balanced earnings profile with steady contribution from the pipeline and petrochemical segments, besides refining & marketing. Potential monetisation of non-core assets (hydrogen plant) could unlock value. Moreover, we believe that H2FY22 would factor in the worst for OMCs and a gradual normalisation of refining & marketing margins would lead to overall earnings recovery and sustained good dividend yield (~12% on FY24E DPS). Hence, we maintain a Buy on IOCL but with a lower PT of 82 (reflects lower PE multiple given sharp fall in refining margins).

Key Risks

Sustained weak auto fuel marketing margin and a steep fall in refining margins remains key risk to earnings and valuation.

Valuation (Standalone) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenue	3,78,058	5,98,164	5,62,961	5,90,132
OPM (%)	10.1%	7.2%	5.2%	7.5%
Adjusted PAT	17,426	24,184	12,494	24,201
(%) YoY Growth	*74.5*	*38.8*	*-48.3*	*93.7*
Adjusted EPS (Rs)	12.3	17.1	8.8	17.1
P/E (x)	5.8	4.2	8.0	4.2
P/B (x)	0.9	0.8	0.7	0.7
EV/EBITDA (x)	5.1	4.9	7.5	5.2
RoNW (%)	17.1	20.0	9.3	17.2
ROCE (%)	14.7	15.8	9.2	14.4

Source: Company; Sharekhan estimates

Weak results; reported net loss on large marketing loss

Q1FY23 standalone operating profit of Rs. 1,359 crore (down 87.8% y-o-y and 88.3% q-o-q) steeply missed ours/street's estimate led by a higher-than-expected loss (large negative marketing margin on petrol/diesel on non-revision of retail prices) in the marketing business and sharper-than-anticipated decline in profitability (EBIT down by 53% q-o-q to Rs. 269 crore) at petchem business. Even all-time reported GRM of $31.8/bbl could not provide any much relief from massive loss in the marketing business. Excluding inventory gains of $6.5/bbl, the crore GRM improved by 86% q-o-q to $25.3/bbl reflecting strong transportation fuel (diesel, petrol and ATF) crack spreads. Volume performance was mixed with a 4%/6/8% q-o-q increase in refinery throughput/marketing volumes/pipeline throughput to 19 mmt/23 mmt/24 mmt, but petchem volumes declined by 17% q-o-q to 0.6 mmt. The company reported a net loss of Rs. 1,993 crore (versus expectations of a net loss of Rs. 525 crore and PAT of Rs. 6,022 crore in Q4FY22) primarily on losses in marketing business and weak performance of petchem segment.

Results (Standalone) Rs cr

Particulars	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)
Revenue	**2,24,253**	**1,18,671**	**89.0**	**1,77,287**	**26.5**
Total Expenditure	2,22,894	1,07,544	107.3	1,65,660	34.5
Reported operating profit	**1,359**	**11,126**	**-87.8**	**11,628**	**-88.3**
Other Income	684	564	21.3	952	-28.2
Interest	1,725	1,257	37.2	1,607	7.3
Depreciation	2,847	2,634	8.1	2,887	-1.4
Reported PBT	-2,529	7,798	NA	8,085	NA
Tax	-537	1,857	NA	2,063	NA
Reported PAT	**-1,993**	**5,941**	**NA**	**6,022**	**NA**
Equity Cap (cr)	941	941		941	
Reported EPS (Rs.)	-2.1	6.3	NA	6.4	NA
Margins (%)			**BPS**		**BPS**
OPM	0.6	9.4	-877.0	6.6	-595.3
NPM	-0.9	5.0	NA	3.4	NA
Tax rate	21.2	23.8	-259.4	25.5	-429.5

Source: Company; Sharekhan Research

Key operating performance

Operating performance	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)
Reported GRM ($/bbl)	31.8	6.6	383.4	18.5	71.6
Refining inventory gain/(loss) ($/bbl)	6.5	4.3	49.1	4.9	31.0
Core GRM ($/bbl)	25.3	2.2	1031.3	13.6	86.3
Refining throughput (mmt)	18.9	16.7	13.3	18.3	3.7
Petroleum products market sales including exports (mmt)	23.0	18.8	22.0	21.7	6.1
Petchem sales (mmt)	0.6	0.7	-2.1	0.8	-17.5
Pipeline throughput (mmt)	24.5	20.5	19.4	22.6	8.5

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Near term muted outlook on weakening GRM and elevated crude

OMCs' earnings in H1FY23 is expected to remain challenging on two counts – Firstly, sustained high crude oil prices and inability to hike retail petrol/diesel would mean large marketing loss on auto fuels and secondly, refining margin has declined sharply due to lower transportation fuel crack spreads. Moreover, the weakening Indian Rupee would add to the trouble given a rise in forex losses. However, we believe that both refining and marketing margins would gradually normalise and thus expect a recovery in earnings of OMCs in H2FY23.

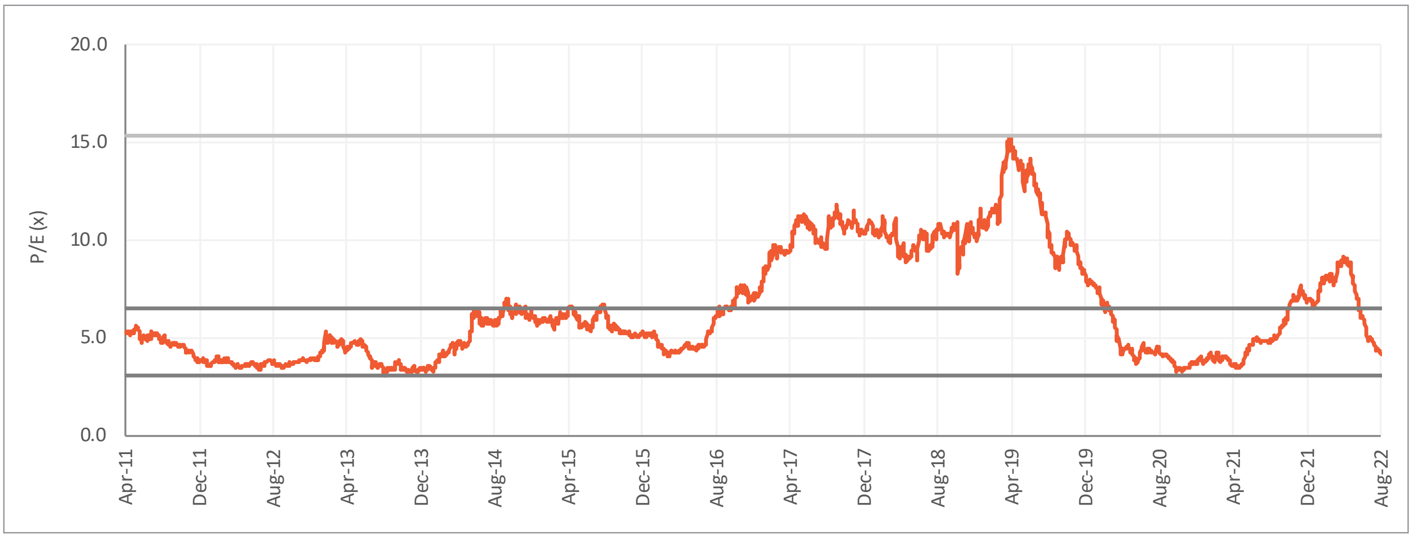
■ Company Outlook – Near-term earnings headwinds; expect a gradual recovery

We expect IOCL's earnings to remain muted in H1FY23 due to negative marketing margins on motor spirit (MS)/ high-speed diesel (HSD) given inadequate price revision amid elevated crude oil price and high products cracks. Moreover, refining margins have also weakened recently and may not provide relief against marketing losses. Overall, we expect IOCL's standalone PAT to decline sharply by 48% y-o-y in FY23 and recover strongly by 94% y-o-y in FY24 as marketing segment's profitability would normalize gradually. Likely normalization of international crude oil prices, steep MS/HSD retail price hikes or rationalisation of petrol/diesel excise duty remain key for an earnings revival of OMCs.

■ Valuation – Maintain Buy on IOCL with a revised PT of Rs. 82

IOCL is the most attractively valued stock among oil marketing companies (OMCs) with a valuation of 0.7x its FY2024E P/BV and 4.2x its FY2024E EPS and has a balanced earnings profile with steady contribution from the pipeline and petrochemical segments, besides refining & marketing. Potential monetisation of non-core assets (hydrogen plant) could unlock value. Moreover, we believe that H2FY22 would factor in the worst for OMCs and a gradual normalisation of refining & marketing margins would lead to overall earnings recovery and sustained good dividend yield (~12% on FY24E DPS). Hence, we maintain a Buy on IOCL but with a lower PT of 82 (reflects lower PE multiple given sharp fall in refining margins).

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

IOCL has diversified earnings with exposure to pipeline and petrochemicals, which insulated it from volatility in refining and marketing margins. Monetisation of hydrogen plant could unlock value for IOCL. Moreover, IOCL's valuation is attractive 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	ONGC Ltd	14.20
2	LIC	7.96
3	Oil India	5.16
4	IOC Shares Trust	2.48
5	SBI Funds Management	1.26
6	Vanguard Group Inc	0.96
7	Blackrock Inc	0.74
8	ICICI Prudential Asset Management Co Ltd	0.50
9	Kotak Mahindra Asset Management Co Ltd	0.24
10	Nippon Life India Asset Management Co Ltd	0.22

Source: Bloomberg (Old data)

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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 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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