



## 3R MATRIX

	+	=	-
Right Sector (RS)	Green	Grey	Red
Right Quality (RQ)	Green	Grey	Red
Right Valuation (RV)	Green	Grey	Red

+ Positive = Neutral - Negative

## What has changed in 3R MATRIX

	Old		New
RS	Grey	↔	Grey
RQ	Green	↔	Green
RV	Green	↔	Green

## ESG Disclosure Score NEW

ESG RISK RATING  
Updated Oct 08, 2022

35.5

## High Risk

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

Source: Morningstar

## Company details

Market cap:	Rs. 96,377 cr
52-week high/low:	Rs. 95/65
NSE volume: (No of shares)	142.0 lakh
BSE code:	530965
NSE code:	IOC
Free float: (No of shares)	684.9 cr

## Shareholding (%)

Promoters	51.5
FII	7.2
DII	11.2
Others	30.0

## Price chart



## Price performance

(%)	1m	3m	6m	12m
Absolute	1.9	-4.1	-18.8	-22.1
Relative to Sensex	-3.9	-8.6	-25.2	-23.1

Sharekhan Research, Bloomberg

## Indian Oil Corporation Ltd

Marketing continues to drag earnings; GRM surprised positively

Oil & Gas	Sharekhan code: IOC		
Reco/View: Buy	↔	CMP: Rs. 68	Price Target: Rs. 82 ↔
↑ Upgrade	↔ Maintain	↓ Downgrade	

## Summary

- Q2FY23 reported net loss of Rs. 272 crore was much lower than our estimate on account of one-off LPG subsidy of Rs. 10,801 crore and surprisingly high GRM of \$18.5/bbl despite expectation of inventory loss on sharp q-o-q decline in Brent crude oil price. Adjusting for LPG subsidies, the net loss was high at Rs. 11,073 crore (versus our estimate of net loss of Rs. 9,520 crore).
- Weak performance reflects large losses in the marketing business due to negative diesel margin and weak petchem performance (EBIT loss of Rs. 129 crore versus positive EBIT of Rs. 1,609 crore in Q2FY22). Refining throughput/marketing volume/petchem volume at 16.1 mmt/20.8 mmt/0.54 mmt, down 15%/9.6%/16.5% q-o-q.
- We believe that H2FY23 factors 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 an unchanged PT of Rs. 82 on inexpensive valuation of 4/0.7x FY24E EPS/BV and FY24E dividend yield of 12%.

Indian Oil Corporation Limited's (IOCL's) Q2FY23 standalone operating profit came in at Rs. 1,960 crore (down 81.6% y-o-y; up 44.2% q-o-q) versus our estimate of operating loss Rs. 9,822 crore. The positive surprise on operating profit front was driven by sharply higher-than-expected GRMs of \$18.5/bbl and compensation of Rs. 10,801 crore from government related to LPG under-recoveries for FY22 and H1FY23. Adjusting for LPG subsidy, operating loss stood at Rs. 8,841 crore which we believe was on the account of continued large losses in the marketing business due to negative diesel margins and weak petchem performance (EBIT loss of Rs. 129 crore versus positive EBIT of Rs. 1,609 crore in Q2FY22). Volume performance also disappointed and missed estimate with refining throughput/marketing volume/petchem volume at 16.1 mmt/20.8 mmt/0.54 mmt, down 15%/9.6%/16.5% q-o-q. Reported net loss stood at Rs. 272 crore (loss of Rs. 1,993 crore in Q1FY23). However, adjusting for LPG subsidy, net loss was higher at Rs. 11,045 crore (versus our estimate of a net loss of Rs. 9,520) due to margin pressure in marketing/petchem segment.

## Key positives

- Sharply higher-than-expected GRM of \$18.5/bbl.

## Key negatives

- Large negative marketing margin on auto fuels due to non-revision of petrol/diesel prices.
- Negative petchem EBIT of Rs. 129 crore versus positive EBIT of Rs. 1,609 crore in Q2FY22.

**Revision in estimates** – We have cut our FY23 earnings estimates to factor in marketing losses in H1FY23. We have fine-tuned our FY24 earnings estimates and introduced FY25 earnings estimate in this report.

## Our Call

**Valuation – Maintain Buy on IOCL with an unchanged 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 4x 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 H2FY23 factors 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 an unchanged PT of 82.

## Key Risks

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

## Valuation (Standalone)

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	5,98,164	5,46,589	5,89,855	6,16,515
OPM (%)	7.2%	4.8%	7.5%	8.2%
Adjusted PAT	24,184	10,149	24,003	27,823
(%) YoY Growth	38.8	-58.0	136.5	15.9
Adjusted EPS (Rs. )	17.1	7.2	17.0	19.7
P/E (x)	4.0	9.5	4.0	3.5
P/B (x)	0.7	0.7	0.7	0.6
EV/EBITDA (x)	4.8	8.2	5.1	4.7
RoNW (%)	20.0	7.6	17.1	18.5
ROCE (%)	15.8	7.9	14.3	15.5

Source: Company; Sharekhan estimates

### Weak performance; GRM surprise positively at \$18.5/bbl; LPG subsidy led to lower net loss

Q2FY23 standalone operating profit came in at Rs. 1,960 crore (down 81.6% y-o-y; up 44.2% q-o-q) versus our estimate of operating loss Rs. 9,822 crore. The positive surprise on operating profit front was driven by sharply higher-than-expected GRMs of \$18.5/bbl and compensation of Rs. 10,801 crore from government related to LPG under-recoveries for FY22 and H1FY23. Adjusting for LPG subsidy, operating loss stood at Rs. 8,841 crore which we believe was on the account of continued large losses in the marketing business due to negative diesel margins and weak petchem performance (EBIT loss of Rs. 129 crore versus positive EBIT of Rs. 1,609 crore in Q2FY22). Volume performance also disappointed and missed estimate with refining throughput/marketing volume/petchem volume at 16.1 mmt/20.8 mmt/0.54 mmt, down 15%/9.6%/16.5% q-o-q. Reported net loss stood at Rs. 272 crore (loss of Rs. 1,993 crore in Q1FY23). However, adjusting for LPG subsidy, net loss was higher at Rs. 11,045 crore (versus our estimate of a net loss of Rs. 9,520) due to margin pressure in marketing/petchem segment.

#### Results (Standalone)

Particulars	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)
Revenue	2,07,485	1,35,418	53.2	2,24,253	-7.5
Total Expenditure	2,05,525	1,24,790	64.7	2,22,894	-7.8
Reported operating profit	1,960	10,628	-81.6	1,359	44.2
<b>Adjusted operating profit</b>	<b>-8,841</b>	<b>10,628</b>	<b>NA</b>	<b>1,359</b>	<b>NA</b>
Other Income	2198	1434	53.3	684	221.6
EBITDA	-6,643	12,062	NA	2,043	NA
Interest	1,441	986	46.2	1,725	-16.4
Depreciation	2,962	2,706	9.5	2,847	4.0
Exceptional income/(expense)	10801	0	NA	0	NA
Reported PBT	-244	8,370	NA	-2,529	NA
<b>Adjusted PBT</b>	<b>-11,045</b>	<b>8,370</b>	<b>NA</b>	<b>-2,529</b>	<b>NA</b>
Tax	28	2,010	-98.6	-537	NA
Reported PAT	-272	6,360	NA	-1,993	NA
<b>Adjusted PAT</b>	<b>-11,073</b>	<b>6,360</b>	<b>NA</b>	<b>-1,993</b>	<b>NA</b>
Equity Cap (cr)	941	941		941	
Reported EPS (Rs. )	-0.3	6.8	NA	-2.1	NA
Adjusted EPS (Rs. )	-11.8	6.8	NA	-2.1	NA
<b>Margins (%)</b>			<b>BPS</b>		<b>BPS</b>
Adjusted OPM	-4.3	7.8	NA	0.6	NA
Adjusted NPM	-5.3	4.7	NA	-0.9	NA
Tax rate	-0.3	24.0	NA	21.2	NA

Source: Company, Sharekhan Research

#### Key operating performance

Operating performance	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)
GRM (\$/bbl)	18.5	6.6	182.3	31.8	-41.9
Refining throughput (mmt)	16.1	15.3	5.3	18.9	-15.0
Petroleum products market sales including exports (mmt)	20.8	18.4	12.7	23.0	-9.6
Petchem sales (mmt)	0.54	0.77	-30.3	0.64	-16.5
Pipeline throughput (mmt)	23.6	19.5	21.0	24.5	-3.4

Source: Company, Sharekhan Research

## Outlook and Valuation

### ■ Sector view - Near term muted outlook on weakening GRM and elevated crude

OMCs' earnings in H1FY23 are 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 automobile 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.

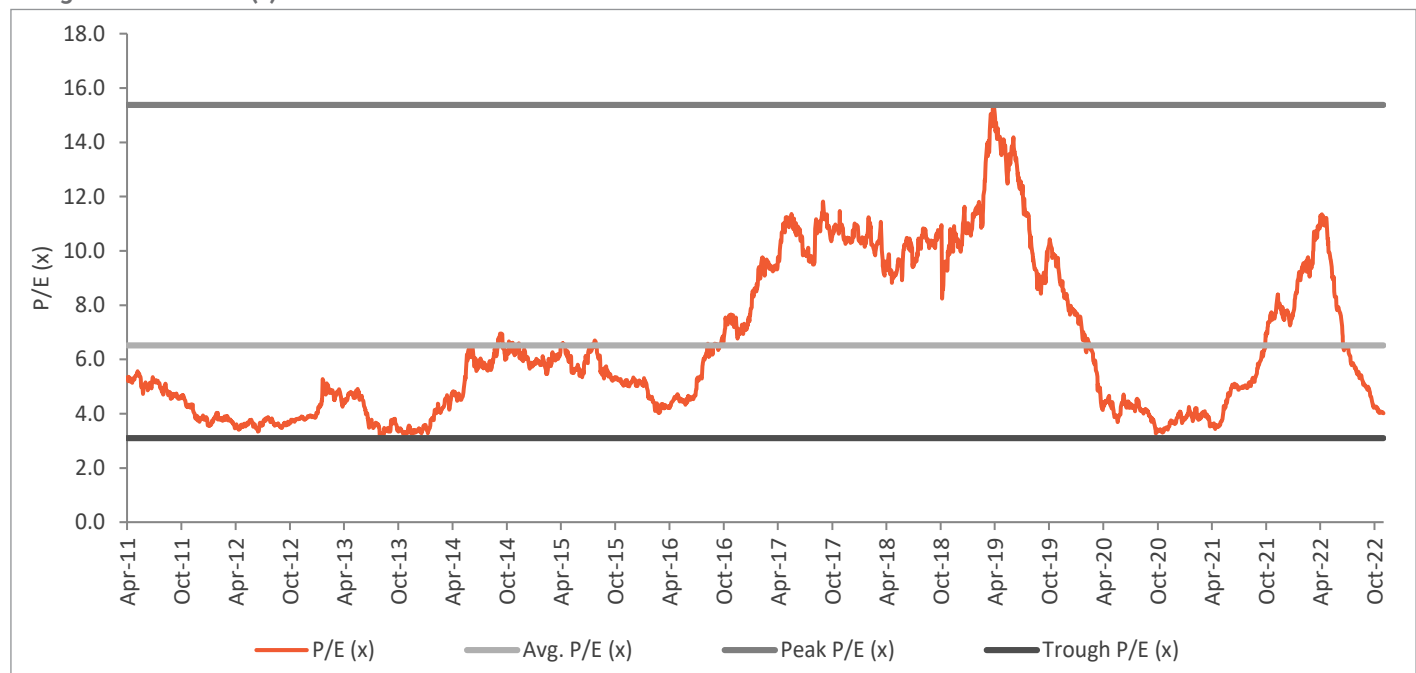
### ■ Company outlook - Near-term earnings headwinds; expect a gradual recovery

IOCL's earnings remained 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 has been also volatile and may not provide relief against marketing losses. Overall, we expect IOCL's standalone PAT to decline sharply by 58% y-o-y in FY23 and recover strongly by 137% y-o-y in FY24 as marketing segment's profitability would normalise gradually. Likely normalisation 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 an unchanged 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 4x 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 H2FY23 factors 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 an unchanged PT of 82.

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: Bloomberg

### 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 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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by BNP PARIBAS

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