Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Indian Oil Corporation Ltd

Subdued Q3; valuation attractive

Oil & Gas	Sharekhan code: IOC
Reco/View: Buy ↔	CMP: Rs. 80 / Price Target: Rs. 92 ↑

↑ 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	35.50
Updated Dec 08, 2022	
High Risk	

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

Source: Morningstar

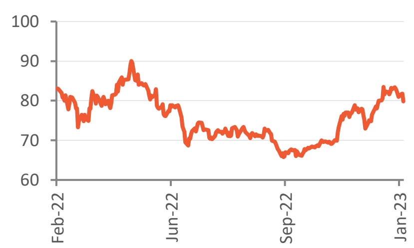
Company details

Market cap:	Rs. 1,12,687 cr
52-week high/low:	Rs. 91 / 65
NSE volume: (No of shares)	146 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	2.3	16.3	10.9	-3.8
Relative to Sensex	4.7	18.3	8.2	-4.1

Sharekhan Research, Bloomberg

Summary

- Q3FY23 PAT of Rs. 448 crore was significantly below our estimate due to continues high loss (posted Rs. 616 crore EBIT loss) in the petchem segment, a forex loss of Rs. 1,700 crore and probably inventory loss (IOCL did not provide details) as crude oil prices declined sharply q-o-q.
- Refining performance remains strong with reported GRM of $12.9/bbl (in-line), and a 13% q-o-q rise in refining throughput to 18.2 mmt. Marketing sales volume also rose by 8% q-o-q 24.3 mmt; however, petchem sales volume declined sharply by 48%/30% y-o-y/q-o-q to 0.37 mmt in Q3FY23.
- We believe that earnings downgrade cycle is largely over for OMCs and expect earnings to normalize over FY24-25 led by strength in GRM with likely normalised auto fuel marketing margins. Any spike in crude oil prices is a key risk to earnings recovery especially given OMCs inability to hike petrol/diesel price in inflationary environment.
- We maintain a Buy on IOCL with a revised PT of Rs. 92 on inexpensive valuation of 4.6x/0.8x FY24E EPS/BV and FY24E dividend yield of 11%.

Indian Oil Corporation Limited's (IOCL's) Q3FY23 standalone operating profit of Rs. 3,593 crore (versus loss of Rs. 8,841 crore in Q2FY23) was 38% below our estimate of Rs. 5,836 crore. The large miss was due to high EBIT loss of Rs. 616 crore from petchem (versus expectation of positive earnings and EBIT loss of Rs. 129 crore in Q2FY23), higher-than-expected forex loss of Rs. 1,700 crore and probability higher marketing inventory loss (IOCL do not provide details of inventory loss). GRM remained resilient and in line with expectations at $12.9/bbl. Volume performance was strong with 13%/8% q-o-q rise in refining throughput/marketing sales volume at 18.2 mmt/24.3 mmt. However, petchem sales volume declined sharply by 48%/30% y-o-y/q-o-q to 0.37 mmt in Q3FY23. PAT of Rs. 448 crore (versus adjusted net loss of Rs. 11,073 crore) was also 74%/86% below our/street estimate due to margin pressure in petchem segment and high forex/inventory loss.

Key positives

- Continued strength in GRM at $12.9/bbl.
- Better-than-expected refining throughput at 18.2mmt, up 13% q-o-q.

Key negatives

- Higher petchem EBIT loss of Rs. 616 crore versus Rs. 129 crore in Q2FY23.

Revision in estimates – We have cut our FY23 earnings estimates to factor in net loss in 9MFY23. We have fine-tuned our FY24-25 earnings estimates.

Our Call

Valuation – Maintain Buy on IOCL with a revised PT of Rs. 92: We believe that earnings downgrade cycle is largely over for OMCs and continued strength in GRMs (supported by high middle distillate cracks) with likely normalised auto fuel marketing margins would lead to normalised earnings over FY24-25. IOCL is the most attractively valued stock among oil marketing companies (OMCs) with a valuation of 0.8x its FY2024E P/BV and 4.6x its FY2024E EPS and stock offers high dividend yield (~11% on FY24E DPS). Potential monetisation of non-core assets (hydrogen plant) could unlock value. Hence, we maintain a Buy on IOCL with a revised PT of Rs. 92.

Key Risks

Sustained weak auto fuel marketing margin in case of continued inability to raise petrol/diesel prices and lower-than-expected refining margins remain a key risk to earnings and valuation.

Valuation (Standalone) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	5,98,164	7,36,100	7,84,473	8,17,109
OPM (%)	7.2%	3.3%	6.2%	6.5%
Adjusted PAT	24,184	7,196	24,728	27,035
(%) YoY Growth	*38.8*	*-70.2*	*243.7*	*9.3*
Adjusted EPS (Rs)	17.1	5.1	17.5	19.1
P/E (x)	4.7	15.7	4.6	4.2
P/B (x)	0.9	0.8	0.8	0.7
EV/EBITDA (x)	5.1	9.6	5.0	4.8
RoNW (%)	20.0	5.4	17.8	18.1
ROCE (%)	15.8	6.8	15.7	16.1

Source: Company; Sharekhan estimates

Another weak quarter: earnings miss on petchem loss and FX/ inventory loss

Q3FY23 standalone operating profit of Rs. 3,593 crore (versus loss of Rs. 8,841 crore in Q2FY23) was 38% below our estimate of Rs. 5,836 crore. The large miss was due to high EBIT loss of Rs. 616 crore from petchem (versus expectation of positive earnings and EBIT loss of Rs. 129 crore in Q2FY23), higher-than-expected forex loss of Rs. 1,700 crore and probability higher marketing inventory loss (IOCL do not provide details of inventory loss). GRM remained resilient and in line with expectations at $12.9/bbl. Volume performance was strong with 13%/8% q-o-q rise in refining throughput/marketing sales volume at 18.2 mmt/24.3 mmt. However, petchem sales volume declined sharply by 48%/30% y-o-y/q-o-q to 0.37 mmt in Q3FY23. PAT of Rs. 448 crore (versus adjusted net loss of Rs. 11,073 crore) was also 74%/86% below our/street estimate due to margin pressure in petchem segment and high forex/inventory loss.

Results (Standalone) Rs cr

Particulars	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Revenue	2,04,740	1,66,788	22.8	2,07,485	-1.3
Total Expenditure	2,01,147	1,56,926	28.2	2,05,525	-2.1
Reported operating profit	3,593	9,862	-63.6	1,960	83.3
Adjusted operating profit	**3,593**	**9,862**	**-63.6**	**-8,841**	**NA**
Other Income	1715	1375	24.7	2198	-22.0
Interest	1,953	979	99.4	1,441	35.5
Depreciation	3,099	2,779	11.5	2,962	4.6
Reported PBT	257	7,480	-96.6	-244	NA
Adjusted PBT	257	7,480	-96.6	-11,045	NA
Tax	-191	1,619	-111.8	28	NA
Reported PAT	448	5,861	-92.4	-272	NA
Adjusted PAT	**448**	**5,861**	**-92.4**	**-11,073**	**NA**
Equity Cap (cr)	941	941		941	
Reported EPS (Rs.)	0.5	6.2	-92.4	-0.3	NA
Adjusted EPS (Rs.)	0.5	6.2	-92.4	-11.8	NA
Margins (%)			**BPS**		**BPS**
Adjusted OPM	1.8	5.9	-415.8	-4.3	NA
Adjusted NPM	0.2	3.5	-329.5	-5.3	NA
Tax rate	-74.6	21.6	-9620.3	-0.3	NA

Source: Company, Sharekhan Research

Key operating performance

Operating performance	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Reported GRM ($/bbl)	12.9	12.0	7.5	18.5	-30.1
Refining throughput (mmt)	18.2	17.4	4.6	16.1	13.1
Petroleum products market sales including exports (mmt)	22.8	20.8	9.6	20.8	9.6
Petchem sales (mmt)	0.37	0.7	-47.5	0.54	-30.2
Pipeline throughput (mmt)	23.8	21.8	9.3	23.6	0.7

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Improving outlook but inability to hike petrol and diesel prices a concern for OMCs

OMCs' earnings remained stressed in H1FY23 on two counts – first, sustained high crude oil prices and the inability to hike retail petrol/diesel prices would mean large marketing losses on auto fuels and second, refining margins have declined sharply due to lower transportation fuel crack spreads. Moreover, the weakening Indian Rupee would add to trouble given a rise in forex losses. OMCs inability to hike petrol and diesel prices also a remains a concern. However, we believe that the recent decline in the Brent crude oil prices, likely resilient refining margins and normalisation of marketing margins would gradually normalise and thus expect a recovery in earnings of OMCs over FY24-FY25.

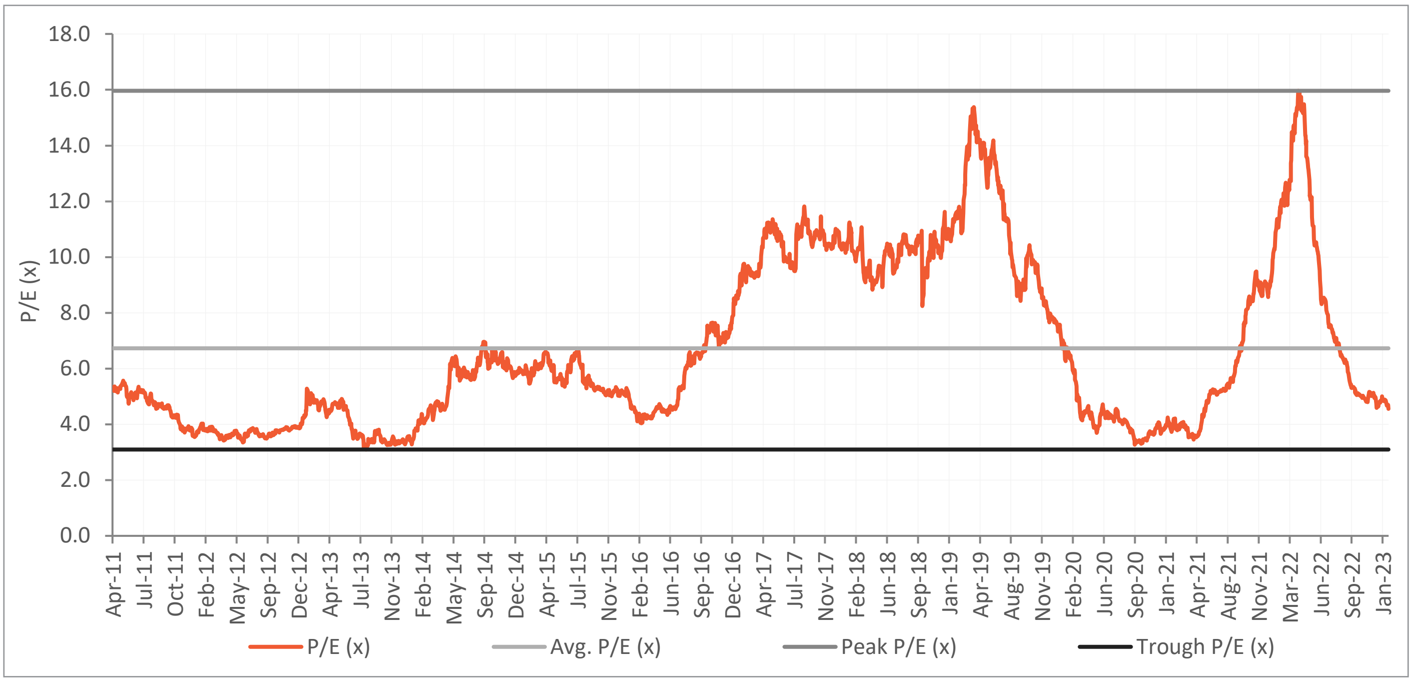
■ Company Outlook – Expect gradual earnings recovery

We believe that core earnings of IOCL to largely normalize from over FY24-25 supported by encouraging trends in refining (Singapore GRM at $10-11/bbl in January 2023)) and marketing margins (declining auto fuel under-recoveries and expectation of positive auto fuel marketing margin from Q4FY23). Likely normalisation of international crude oil prices and a stability in GRMs hold the key for an earnings revival of OMCs. Any kind of compensation from the government on loss in auto fuels could reduce FY23 losses of OMCs although probability of the same seems low given both diesel/petrol are deregulated petroleum products and government's fiscal constraints.

■ Valuation – Maintain Buy on IOCL with a revised PT of Rs. 92

We believe that earnings downgrade cycle is largely over for OMCs and continued strength in GRMs (supported by high middle distillate cracks) with likely normalised auto fuel marketing margins would lead to normalised earnings over FY24-25. IOCL is the most attractively valued stock among oil marketing companies (OMCs) with a valuation of 0.8x its FY2024E P/BV and 4.6x its FY2024E EPS and stock offers high dividend yield (~11% on FY24E DPS). Potential monetisation of non-core assets (hydrogen plant) could unlock value. Hence, we maintain a Buy on IOCL with a revised PT of Rs. 92.

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
Sanjay Kaushal	Director – Finance
V Satish Kumar	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)

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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