Sharekhan
by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Indian Oil Corporation Ltd

Q2 beats hopes; valuation attractive

Oil & Gas		Sharekhan code: IOC		
Reco/View: Buy	↔	CMP: **Rs. 95**	Price Target: **Rs. 105**	↔

↑ 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 41.92
Updated Aug 08, 2023

Severe Risk

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

Source: Morningstar

Company details

Market cap:	Rs. 1,34,335 cr
52-week high/low:	Rs. 101/68
NSE volume: (No of shares)	136 lakh
BSE code:	530965
NSE code:	IOC
Free float: (No of shares)	684.9 cr

Shareholding (%)

Promoters	51.5
FII	7.8
DII	10.7
Others	30.0

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	5.7	1.8	15.1	38.4
Relative to Sensex	7.9	3.5	10.4	33.0

Sharekhan Research, Bloomberg

Summary

- Standalone PAT of Rs. 12,967 crore was above our estimate led by better-than-expected marketing margin.
- GRM remained strong at $8.3/bbl (in-line) but refinery throughput and marketing sales volume disappointed. Petchem EBIT recovered slightly to Rs. 163 crore (up 85% q-o-q).
- After super-strong H1 earnings, earnings environment would be tough for OMCs in H2FY24 as Brent crude oil is on the boil and slump in GRMs. Normalisation of geopolitical risk premium in oil prices is key to improve sentiments.
- We maintain a Buy with an unchanged PT of Rs. 105 on inexpensive valuation of 5.5x/0.9x FY25E EPS/BV and high dividend yield of ~9%.

Standalone operating profit of Rs. 22,313 crore (down just 3.8% q-o-q despite high base of Q1FY24) was 7% above our estimate of Rs. 19,882 crore. We believe the beat was primarily driven by better-than-expected marketing earnings and some recovery in petchem EBIT to Rs. 163 crore (up 85% q-o-q). GRM was strong at $18.2/bbl (versus $8.3/bbl in Q1FY24) and was in line with our expectations. However, refinery throughput/marketing sales volume of 17.8 mt/20.9 mt, down 5.2%/6.7% q-o-q was 4%/3% below our estimate while petchem sales volume/pipeline throughput of 0.8 mt/23.9 mt, up 12%/down 4% q-o-q was 17%/2% above our estimate. Standalone PAT of Rs. 12,967 crore (down 6% q-o-q) was 2.6% above our estimate due to better-than-expected marketing performance partially offset by lower other income (down 55% y-o-y).

Key positives

- Robust GRM of $18.2/bbl in Q2FY24 versus $8.3/bbl in Q1FY24.
- Gross debt fell 2% q-o-q.

Key negatives

- Miss of 4%/3% in refinery throughput/marketing sales volume.

Revision in estimates – We have raised our FY24 earnings estimate to factor higher GRM assumption partially offset by lower auto fuel marketing margins. We have fine-tuned our FY25 earnings estimate and also introduced FY26 earnings estimates.

Our Call

Valuation – Maintain Buy on IOCL with an unchanged PT of Rs. 105: IOCL's valuation of 0.9x its FY2024E P/BV and 5.5x its FY2025E EPS is attractive, and it offers a high dividend yield of ~9%. Potential monetisation of non-core assets (hydrogen plant) could unlock value. Hence, we maintain a Buy on IOCL but with an unchanged PT of Rs. 105. Sustained high crude oil prices is a key risk to earnings recovery, especially given OMCs' inability to hike petrol/diesel price given general elections expected in May 2024.

Key Risks

Lower-than-expected auto fuel marketing margin in case of spike in crude oil price amid continued inability to raise petrol/diesel prices and lower-than-expected refining and petchem margins remain a key risk to earnings and valuation.

Valuation (Standalone) Rs cr

Particulars	FY22	FY23	FY24E	FY25E	FY26E
Revenue	5,98,164	8,39,472	7,80,558	8,16,153	8,50,497
OPM (%)	7.2%	2.7%	7.4%	6.1%	6.0%
Adjusted PAT	24,184	8,242	31,696	24,257	24,213
(%) YoY Growth	38.8	-65.9	284.6	-23.5	-0.2
Adjusted EPS (Rs.)	17.1	5.8	22.4	17.2	17.1
P/E (x)	5.6	16.3	4.2	5.5	5.5
P/B (x)	1.0	1.0	0.9	0.9	0.8
EV/EBITDA (x)	5.6	12.0	4.8	5.8	5.8
RoNW (%)	20.0	6.2	22.5	16.0	15.0
ROCE (%)	15.1	6.0	16.7	13.0	12.6

Source: Company; Sharekhan estimates

Stock Update
Result Update

Decent Q2; GRM stays strong at $18/bbl

Standalone operating profit of Rs. 22,313 crore (down just 3.8% q-o-q despite high base of Q1FY24) was 7% above our estimate of Rs. 19,882 crore. We believe the beat was primarily driven by better-than-expected marketing earnings and some recovery in petchem EBIT to Rs. 163 crore (up 85% q-o-q). GRM was strong at $18.2/bbl (versus $8.3/bbl in Q1FY24) and was in line with our expectations. However, refinery throughput/marketing sales volume of 17.8 mt/20.9 mt, down 5.2%/6.7% q-o-q was 4%/3% below our estimate while petchem sales volume/pipeline throughput of 0.8 mt/23.9 mt, up 12%/down 4% q-o-q was 17%/2% above our estimate. Standalone PAT of Rs. 12,967 crore (down 6% q-o-q) was 2.6% above our estimate due to better-than-expected marketing performance partially offset by lower other income (down 55% y-o-y).

Results (Standalone) Rs cr

Particulars	Q2FY24	Q2FY23	YoY (%)	Q1FY24	QoQ (%)
Revenue	**1,79,740**	**2,07,485**	**-13.4**	**1,97,527**	**-9.0**
Total Expenditure	1,58,427	2,05,525	-22.9	1,75,363	-9.7
Reported operating profit	21,313	1,960	987.4	22,164	-3.8
Adjusted operating profit	**21,313**	**-8,841**	**NA**	**22,164**	**-3.8**
Other Income	982	2198	-55.3	688	42.7
Interest	1,846	1,441	28.1	1,626	13.5
Depreciation	3,280	2,962	10.7	3,152	4.0
Reported PBT	17,170	-244	NA	18,074	-5.0
Adjusted PBT	**17,170**	**-11,045**	**NA**	**18,074**	**-5.0**
Tax	4,203	28	NA	4,323	-2.8
Reported PAT	12,967	-272	NA	13,750	-5.7
Adjusted PAT	**12,967**	**-11,073**	**NA**	**13,750**	**-5.7**
Equity Cap (cr)	941	941		941	
Reported EPS (Rs.)	13.8	-0.3	NA	14.6	-5.7
Adjusted EPS (Rs.)	13.8	-11.8	NA	14.6	-5.7
Margins (%)			**BPS**		**BPS**
Adjusted OPM	11.9	-4.3	NA	11.2	63.7
Adjusted NPM	7.2	-5.3	NA	7.0	25.3
Tax rate	24.5	-0.3	NA	23.9	55.6

Source: Company; Sharekhan Research

Key operating performance

Operating performance	Q2FY24	Q2FY23	YoY (%)	Q1FY24	QoQ (%)
Reported GRM ($/bbl)	18.2	18.5	-1.8	8.3	117.7
Refining throughput (mmt)	17.8	16.1	10.4	18.8	-5.2
Petroleum products market sales including exports (mmt)	20.9	20.8	0.8	22.4	-6.7
Petchem sales (mmt)	0.8	0.54	53.0	0.7	12.0
Pipeline throughput (mmt)	23.9	23.6	1.0	25.0	-4.3

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector Outlook – Inability to hike petrol and diesel prices a concern for OMCs

OMCs' earnings remained stressed in 9MFY23 on two counts – first, sustained high crude oil prices and an inability to hike retail petrol/diesel prices that would mean large marketing losses on auto fuels and second, refining margins have declined sharply due to lower transportation fuel crack spreads. Moreover, a weakening Indian Rupee would add to trouble given a rise in forex losses. OMCs' inability to hike petrol and diesel prices also remains a concern.

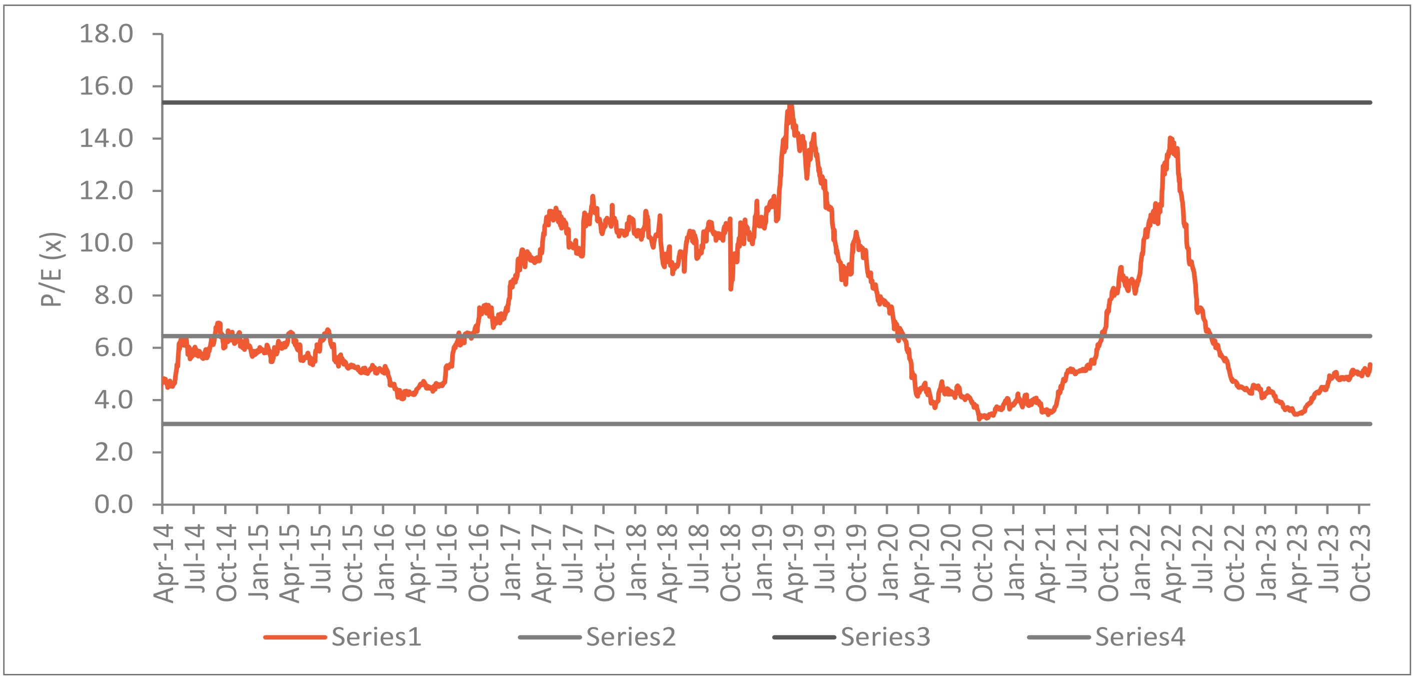
■ Company Outlook – H2 earnings environment challenging

Over Q4FY23 to Q2FY24, earnings performance has been strong, amid high GRM and better auto fuel marketing margins. Post super strong H1 earnings, we believe that earnings environment to be tough for OMC in H2FY24 given sharp rise in Brent crude oil price and steep fall in GRM. If high crude oil prices sustain, OMCs may also incur large auto fuel under-recoveries and the same result into losses in H2FY24.

■ Valuation – Maintain Buy on IOCL with an unchanged PT of Rs. 105

IOCL's valuation of 0.9x its FY2024E P/BV and 5.5x its FY2025E EPS is attractive, and it offers a high dividend yield of ~9%. Potential monetisation of non-core assets (hydrogen plant) could unlock value. Hence, we maintain a Buy on IOCL but with an unchanged PT of Rs. 105. Sustained high crude oil prices is a key risk to earnings recovery, especially given OMCs' inability to hike petrol/diesel price given general elections expected in May 2024.

One-year forward P/E (x) band



Source: Sharekhan Research

About the company

IOCL is a leader in the domestic downstream oil sector with non-replicable infrastructure – total refining capacity of 81 mmt (32% market share; owns 11 of 22 refineries in India), retail outlets of 36,445, and pipeline capacity of 93.1 mmt. The company is also a market leader in domestic petroleum sales with volume of 89 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

Earning environment to be tough for OMC in H2FY24 given sharp rise in Brent crude oil price and steep fall in GRM. Normalisation of geopolitical risk premium in oil price is key to improve sentiments for OMCs. 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 a high dividend yield.

Key Risks

- Lower-than-expected refining and marketing margins could affect earnings outlook.
- Lower-than-expected volume in case of economic slowdown.
- 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: Bloomberg

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Oil & Natural Gas Corp Ltd	14.2
2	Life Insurance Corp of India	7.5
3	Oil India Ltd	5.2
4	IOC SHARES TRUST	2.5
5	Vanguard Group Inc/The	1.2
6	SBI Funds Management Ltd	0.8
7	BlackRock Inc	0.8
8	ICICI Prudential Asset Management	0.5
9	ICICI Prudential Life Insurance Co	0.3
10	Norges Bank	0.3

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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