

BUY

TP: Rs 195 | ▲ 124%

INDIAN OIL CORP

Oil & Gas

04 August 2020

Improved outlook on marketing margins

IOCL's Q1FY21 EBITDA at Rs 55bn (-34% YoY) was above estimates. Key Q1 highlights: (a) Marketing earnings surged with EBITDA at Rs 62bn (ex-inventory, +48% YoY), (b) refining business underperformed with GRMs at US\$ 4.4/bbl (ex-inventory), (c) pipeline/petrochemicals EBITDA beat estimates at Rs 11.5bn/Rs 7.3bn. We adjust FY21/FY22 earnings estimates by -3%/+8% and roll forward to a revised Sep'21 SOTP-based TP of Rs 195 (from Rs 175). Diversification renders IOCL a better bet among OMC peers.

GRMs below estimates with surprise inventory loss: IOCL's GRMs underperformed at US\$ 4.4/bbl (ex-inventory loss of US\$ 6.4/bbl). We were surprised at the inventory loss which contrasts with gains reported by peers. Management clarified that expected inventory gains from Q1 would rather be realised in Q2FY21, considering the higher inventory days (~45 days). Adj. GRMs indicate that IOCL continued to gain from high discounts on Middle East crude.

Marketing earnings surge: Marketing business EBITDA at Rs 62bn (ex-inventory gain) was well above estimates on the back of better margins (Rs 3,763/mt). Management has more than delivered on its guidance of improving marketing margins, which bolsters the earnings outlook over FY21-FY23. Pipeline business EBITDA declined to Rs 11.5bn (-29% YoY) due to lower capacity utilisation of ~63.5% during the quarter. Petchem margins at US\$ 200/mt (+6.5% YoY, +105% QoQ) offset the drop in volumes and led to petchem EBITDA outperformance.

Remains our top pick: Valuations at 3.3x FY22E EBITDA are at a significant discount to BPCL, offering a staggering >12% dividend yield potential. Like other PSUs, the stock has been under pressure owing to concerns over cash utilisation. We believe valuations price in most of these concerns. Retain BUY.

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Ticker/Price	IOCL IN/Rs 87
Market cap	US\$ 11.0bn
Shares o/s	9,479mn
3M ADV	US\$ 26.5mn
52wk high/low	Rs 156/Rs 71
Promoter/FPI/DII	52%/6%/42%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	5,281,489	4,843,623	3,471,995	4,361,902	5,033,901
EBITDA (Rs mn)	352,227	164,049	405,082	462,542	469,986
Adj. net profit (Rs mn)	173,837	104,114	206,635	238,608	243,193
Adj. EPS (Rs)	18.9	11.3	22.5	26.0	26.5
Adj. EPS growth (%)	(19.1)	(40.1)	98.5	15.5	1.9
Adj. ROAE (%)	15.4	10.2	21.7	23.5	22.2
Adj. P/E (x)	4.6	7.7	3.9	3.3	3.3
EV/EBITDA (x)	4.1	9.7	4.6	4.0	3.8

Source: Company, BOBCAPS Research

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FIG 1 – IOCL Q1FY21 SALES VOLUME GROWTH VS. INDUSTRY

Petroleum products (mmt)	IOCL QoQ growth (%)	Industry QoQ growth (%)	IOCL YoY growth (%)	Industry YoY growth (%)
LPG	(4.0)	(5.0)	14.2	13.3
MS	(28.3)	(29.5)	(36.2)	(35.9)
HSD	(25.5)	(23.8)	(35.2)	(33.3)
SKO	(2.9)	(5.8)	(37.6)	(39.7)
ATF	(78.1)	(79.7)	(79.0)	(80.7)
FO/LSHS	(15.6)	(13.1)	(14.8)	(13.5)
Others	(34.1)	(19.6)	(34.4)	(11.5)
Total	(25.6)	(22.5)	(30.6)	(24.5)

Source: Company, Industry, BOBCAPS Research

FIG 2 – QUARTERLY PERFORMANCE

Y/E March (Rs mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
Net sales	623,966	1,315,125	(52.6)	1,184,391	(47.3)
EBITDA	55,123	83,500	(34.0)	2,122	2,497.9
EBITDA margin (%)	8.83	6.35	39.1	0.18	-
Depreciation and Amortisation	23,545	20,929	12.5	23,895	(1.5)
Interest	11,713	15,091	(22.4)	18,504	(36.7)
Other income	6,422	6,314	1.7	17,223	(62.7)
PBT	26,286	53,794	(51.1)	(23,055)	(214.0)
Provision for tax	7,177	17,833	(59.8)	(84,248)	(108.5)
Effective Tax Rate (%)	27.31	33.15	-	365.42	-
PAT Adjusted	19,108	35,961	(46.9)	(14,548)	(231.3)
EPS Adjusted (Rs)	2.0	3.8	(46.9)	(1.5)	(231.3)

Source: Company, BOBCAPS Research

FIG 3 – SEGMENT PERFORMANCE

Segment	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
Refining					
Refining throughput (mmt)	12.93	17.30	(25.3)	17.10	(24.4)
GRMs (US\$/bbl)	(1.98)	4.69	(142.2)	(9.64)	(79.5)
Normalised GRM (US\$/bbl)	4.41	3.60	22.7	8.94	(50.6)
Refining EBITDA (Rs mn)	(35,230)	16,590	-	(124,510)	-
Refining EBITDA (US\$/bbl)	(4.9)	1.9	-	(13.4)	-
Inventory gains/(loss) (Rs mn)	(45,880)	9,770	-	(161,840)	-
Inventory gains/(loss) (US\$/bbl)	(6.4)	1.1	-	(17.4)	-
Exchange fluctuation gain/(loss) (Rs mn)	(170)	(120)	-	(10,530)	-
Adj. EBITDA	10,820	6,940	55.9	47,860	(77.4)
Adj. EBITDA (US\$/bbl)	1.5	0.8	91.0	5.2	(70.9)
Operating costs (US\$/bbl)	2.9	2.8	3.2	2.6	9.1
Marketing					
Total Marketing sales (mmt)	16.50	21.60	(23.6)	22.21	(25.7)
Domestic	15.25	20.52	(25.7)	19.15	(20.4)
Exports	1.26	1.08	16.0	1.50	(16.3)
Marketing EBITDA (Rs mn)	77,010	45,650	68.7	23,320	230.2
Marketing EBITDA (Rs/mt)	4,666	2,113	120.8	1,050	344.3
Inventory gains/(loss) (Rs mn)	13,920	2,560	443.8	(22,910)	(160.8)
Inventory gains/(loss) (Rs/mt)	843	118	611.8	(1,032)	(181.8)
Exchange fluctuation gain/(loss) (Rs mn)	980	1,040	5.8	(16,670)	105.9
Adj. EBITDA	62,110	42,050	47.7	62,900	(1.3)
Adj. EBITDA (Rs/mt)	3,763	1,946	93.3	2,833	32.9
Pipeline					
Pipeline throughput (mmt)	15.02	21.90	(31.4)	20.79	(27.8)
Pipeline EBITDA (Rs mn)	11,500	16,230	(29.1)	15,400	(25.3)
Pipeline EBITDA (Rs/mt)	766	741	3.3	741	3.4
Petrochemicals					
Volumes (mmt)	0.48	0.53	(8.7)	0.66	(27.3)
Petrochemicals EBITDA (Rs mn)	7,280	6,860	6.1	4,750	53.3
Petrochemicals EBITDA (US\$/mt)	200	187	6.5	97	105.2
Others (Rs mn)	990	4,490	(78.0)	(12,660)	107.8
Total Adjusted EBITDA (Rs mn)	92,700	76,570	21.1	118,250	(21.6)

Source: Company, BOBCAPS Research

Earnings call highlights

- IOCL reported refining inventory losses in Q1 as its refineries are located inland, as opposed to coastal plants which clock faster inventory gains. The same gain comes with a 2-3-month lag for inland refineries.
- Another reason for the loss is the accounting practice of booking inventory at the lower of net reported value (NRV) or cost. Thus, even though crude prices went up during the quarter (which should lead to inventory gains), the company can report inventory losses if the stock held is of a lower cost than NRV. And as IOCL has high inventory days (45-46 days – also skewed a bit higher due to the lockdown), it takes a quarter for the company to realise gains on crude, implying it may report inventory gains in Q2FY21.
- In the marketing segment, inventory is usually held for ~15 days – this figure was also skewed a little higher during the quarter.
- Crude was valued at US\$ 32-33/bbl as of 30th June and at US\$ 36-37/bbl during the previous quarter
- In FY21, planned capex totals Rs 260bn, of which Rs 40bn is for refining, Rs 40bn for pipelines, Rs 22bn for R&D and the remaining for marketing, petrochemical and other projects. The capex plan is being closely monitored and may be altered in line with the situation emerging post-lockdown.
- Management views its capex plans in gas, pipelines and petrochemicals as futuristic projects. Even though petrochemical products are in oversupply globally, IOCL will go ahead with its petchem capex as it anticipates the imposition of anti-dumping duty which will cause PX-PTA demand to rise.
- Capex in the refining segment thus far was mainly for Paradip and then for BSVI upgrades last year. Now, only Barauni refinery expansion remains. This plan will be closely monitored in relation to the post-lockdown situation.
- The company would like to strengthen its marketing arm given that it delivers steady returns. At present, IOCL has 29,000 retail outlets and plans to continue adding 1,000 outlets every year.

Valuation methodology

We adjust FY21/FY22 earnings estimates by -3.4%/+8.3% as we lower GRM estimates while raising marketing margins. Rolling valuations forward, we move to a revised Sep'21 SOTP-based target price of Rs 195 (from Rs 175). Business diversification renders IOCL a better bet among OMC peers. Valuations at 3.3x FY22E EBITDA are at a significant discount to BPCL, offering a staggering >12% dividend yield potential. Like other PSUs, the stock has been under pressure owing to concerns over cash utilisation. We believe valuations price in most of these concerns. Retain BUY.

FIG 4 – REVISED ESTIMATES

(Rs mn)	FY21E			FY22E			FY23E
	Old	New	Var (%)	Old	New	Var (%)	New
Revenue	3,819,405	3,471,995	(9.1)	4,750,389	4,361,902	(8.2)	5,033,901
EBITDA	425,094	405,082	(4.7)	440,281	462,542	5.1	469,986
EBITDA margin (%)	11.1	11.7	-	9.3	10.6	-	9.3
PAT	214,120	206,635	(3.5)	220,755	238,608	8.1	243,193
EPS (Rs)	23.3	22.5	(3.4)	24.0	26.0	8.3	26.5

Source: BOBCAPS Research

Our SOTP valuation is based on the following (unchanged) multiples:

- refining business valued at 6x Sep'22E EBITDA (Rs 30/sh from Rs 45 earlier), as we lower our GRM estimates to US\$ 2/US\$ 4/bbl for FY21/FY22 (from US\$ 4.5),
- marketing business valued at 6x Sep'22E EBITDA (Rs 146/sh from Rs 110 earlier), as we raise our marketing EBITDA estimates to Rs 2,500-3,000/mt over FY21-FY22 (from Rs 1,900/mt earlier),
- petrochemicals business valued at 5x Sep'22E EBITDA
- pipeline business valued at 5x Sep'22E EBITDA.

FIG 5 – SOTP VALUATION SUMMARY

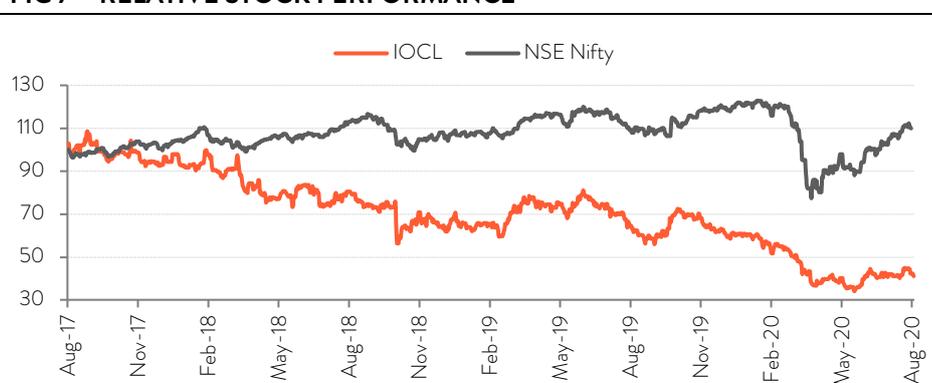
	EV (Rs bn)	Value (Rs/sh)	Comments
Refining	278	30	6x Sep'22E EBITDA
Marketing	1,342	146	6x Sep'22E EBITDA
Petrochemicals	294	32	5x Sep'22E EBITDA
Pipeline	447	49	5x Sep'22E EBITDA
Total core business EV	2,367	235	
Less: Net Debt	669	73	
Equity value of operational segments	1,698	185	
Add: Total investments	85	12	Listed holdings at 20% discount to CMP and others at investment value
IOCL Equity value	1,782	195	7.5x FY22E EPS

Source: BOBCAPS Research

FIG 6 – KEY ASSUMPTIONS

	FY21E	FY22E	FY22E
Oil (US\$/bbl)	35.0	40.0	45.0
GRMs (US\$/bbl)	2.0	4.0	4.0
Singapore GRMs (US\$/bbl)	2.0	4.0	4.0
Refinery throughput (mmt)	75	80	80
Pipeline throughput (mmt)	100.0	108.0	116.0
Market sales (mmt) – including exports	85	88.3	90.6
USDINR	76	78	80
Petrochemicals EBITDA (US\$/mt)	238	186	184
Marketing EBITDA (Rs/mt)	3,000	2,500	2,500

Source: BOBCAPS Research

FIG 7 – RELATIVE STOCK PERFORMANCE

Source: NSE

Key risks

- IOCL's earnings are sensitive to GRMs and marketing margins on product sales. These tend to be more volatile for the company considering its high inventory days.
- Further market share losses on fuel product sales could result in below-expected volumes and affect marketing business earnings.
- Adverse pipeline tariff orders or regulations by PNGRB mandating third-party use of IOCL's pipelines could hurt pipeline business earnings.
- Below-expected petrochemical spreads would hit profitability of the business

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	5,281,489	4,843,623	3,471,995	4,361,902	5,033,901
EBITDA	352,227	164,049	405,082	462,542	469,986
Depreciation	(85,065)	(98,549)	(99,442)	(105,919)	(111,307)
EBIT	267,162	65,500	305,639	356,623	358,679
Net interest income/(expenses)	(48,880)	(65,787)	(82,082)	(90,590)	(92,172)
Other income/(expenses)	27,143	27,903	36,306	36,410	40,355
Exceptional items	0	113,046	0	0	0
EBT	245,425	27,615	259,863	302,443	306,861
Income taxes	(86,531)	(53,007)	(65,481)	(76,212)	(77,329)
Min. int./Inc. from associates	14,942	(23,492)	12,254	12,377	13,660
Reported net profit	173,837	(8,932)	206,635	238,608	243,193
Adjusted net profit	173,837	104,114	206,635	238,608	243,193

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	411,941	298,382	275,071	344,704	371,951
Other current liabilities	573,909	581,994	338,971	437,003	537,667
Provisions	123,860	110,206	188,931	220,300	225,033
Debt funds	933,278	1,157,035	985,906	1,025,451	1,046,780
Other liabilities	165,097	114,131	114,131	114,131	114,131
Equity capital	91,810	91,810	91,810	91,810	91,810
Reserves & surplus	1,032,882	830,329	887,389	962,301	1,042,701
Shareholders' fund	1,124,692	922,139	979,200	1,054,111	1,134,512
Total liabilities and equities	3,351,551	3,237,012	2,914,047	3,230,232	3,464,605
Cash and cash eq.	10,647	26,184	43,777	49,356	24,782
Accounts receivables	157,977	138,955	108,226	135,045	151,707
Inventories	771,265	672,918	445,327	571,400	674,161
Other current assets	364,641	314,861	219,816	279,920	339,989
Investments	439,277	391,448	471,448	471,448	471,386
Net fixed assets	1,373,725	1,393,077	1,361,590	1,423,144	1,468,761
CWIP	234,010	299,559	263,851	299,908	333,809
Intangible assets	10	10	10	10	10
Total assets	3,351,551	3,237,012	2,914,047	3,230,233	3,464,605

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	258,901	89,617	306,078	344,528	354,499
Changes in working capital	(158,351)	48,021	165,755	(13,962)	(46,846)
Other operating cash flows	14,276	(78,869)	(36,306)	(36,410)	(40,355)
Cash flow from operations	114,826	58,769	435,527	294,156	267,298
Capital expenditures	(175,911)	(84,902)	67,195	(97,611)	(79,518)
Change in investments	8,784	47,829	(80,000)	0	62
Other investing cash flows	27,143	27,903	36,306	36,410	40,355
Cash flow from investing	(139,985)	(9,170)	23,500	(61,201)	(39,101)
Equities issued/Others	(2,977)	0	0	0	0
Debt raised/repaid	306,528	223,758	(171,130)	39,546	21,329
Dividends paid	(127,679)	(45,653)	(157,146)	(181,462)	(184,948)
Other financing cash flows	(145,030)	(212,167)	(113,158)	(85,460)	(89,151)
Cash flow from financing	30,842	(34,062)	(441,434)	(227,376)	(252,770)
Changes in cash and cash eq.	5,683	15,537	17,593	5,578	(24,574)
Closing cash and cash eq.	10,647	26,184	43,777	49,356	24,782

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	18.9	(1.0)	22.5	26.0	26.5
Adjusted EPS	18.9	11.3	22.5	26.0	26.5
Dividend per share	11.5	4.3	14.6	16.9	17.2
Book value per share	122.5	100.4	106.7	114.8	123.6

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	0.3	0.3	0.5	0.4	0.4
EV/EBITDA	4.1	9.7	4.6	4.0	3.8
Adjusted P/E	4.6	7.7	3.9	3.3	3.3
P/BV	0.7	0.9	0.8	0.8	0.7

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	70.8	(121.9)	79.5	78.9	79.3
Interest burden (PBT/EBIT)	91.9	(130.4)	85.0	84.8	85.6
EBIT margin (EBIT/Revenue)	5.1	1.4	8.8	8.2	7.1
Asset turnover (Revenue/Avg TA)	167.4	147.0	112.9	142.0	150.4
Leverage (Avg TA/Avg Equity)	2.8	3.2	3.2	3.0	3.1
Adjusted ROAE	15.4	10.2	21.7	23.5	22.2

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	25.3	(8.3)	(28.3)	25.6	15.4
EBITDA	(15.4)	(53.4)	146.9	14.2	1.6
Adjusted EPS	(19.1)	(40.1)	98.5	15.5	1.9
Profitability & Return ratios (%)					
EBITDA margin	6.7	3.4	11.7	10.6	9.3
EBIT margin	5.1	1.4	8.8	8.2	7.1
Adjusted profit margin	3.3	2.1	6.0	5.5	4.8
Adjusted ROAE	15.4	10.2	21.7	23.5	22.2
ROCE	9.0	3.1	11.1	13.0	12.4
Working capital days (days)					
Receivables	9	11	13	10	10
Inventory	61	63	73	52	54
Payables	29	28	34	29	29
Ratios (x)					
Gross asset turnover	3.4	2.7	1.8	2.1	2.3
Current ratio	0.8	0.7	0.6	0.7	0.8
Net interest coverage ratio	5.5	1.0	3.7	3.9	3.9
Adjusted debt/equity	0.8	1.2	1.0	0.9	0.9

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

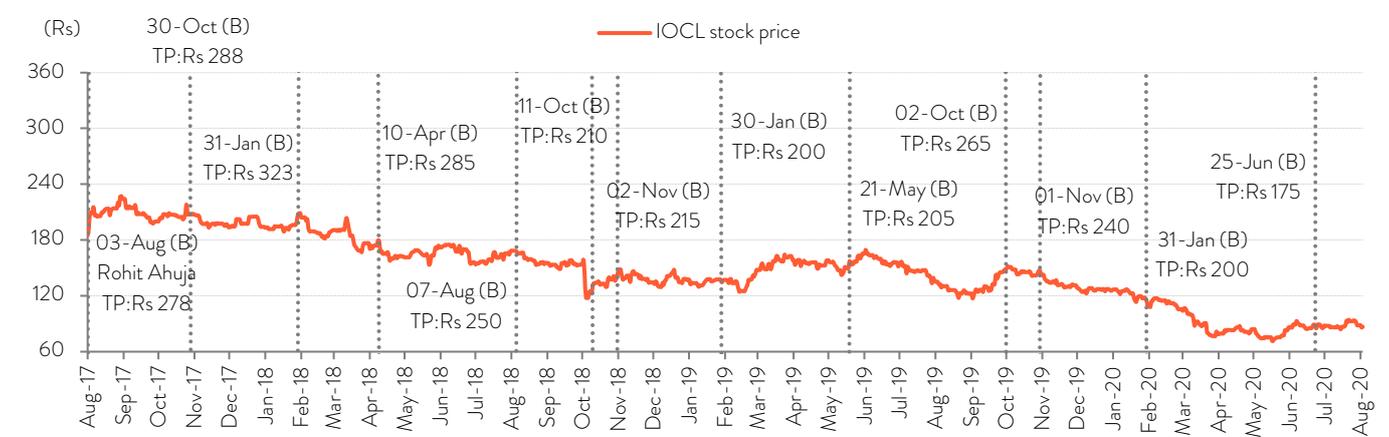
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

RATINGS AND TARGET PRICE (3-YEAR HISTORY): INDIAN OIL CORP (IOCL IN)



B – Buy, A – Add, R – Reduce, S – Sell

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