

BUY

TP: Rs 170 | ▲ 117%

INDIAN OIL CORP

Oil & Gas

02 November 2020

Valuations at a disconnect to earnings resilience

IOCL's Q2FY21 EBITDA of Rs 94bn (2.6x YoY) was above estimates. Q2 highlights: (a) refining business outperformed with GRMs at US\$ 8.6/bbl (driven by US\$ 9.6/bbl inventory gains), (b) marketing earnings underperformed with EBITDA at Rs 36bn (-5% YoY), and (c) petchem EBITDA was above estimates at Rs 12bn. Management indicated that volume have improved from Oct'20, shaping up for an exciting H2FY21. Our Sep'21 SOTP-based target price changes to Rs 170 (from Rs 195), on higher capex assumption.

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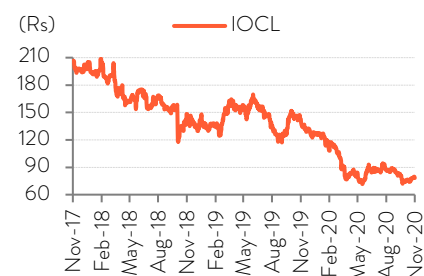
GRMs surge on inventory gains: IOCL's GRMs at US\$ 8.6/bbl carry massive inventory gains of US\$ 9.6/bbl, outperforming our estimates. With benchmark Singapore GRMs recovering in Oct'20, Q3FY21 could look even better. Management sees core GRMs normalising by Q4 as oil demand recovers. Refinery utilisation rates have improved to ~95% levels in October. Petrochemical EBITDA margins expanded to US\$ 226/mt (+8% YoY, +13% QoQ), along with a sharp recovery in volumes (0.72mmt, +37% YoY).

Ticker/Price	IOCL IN/Rs 78
Market cap	US\$ 10.0bn
Shares o/s	9,479mn
3M ADV	US\$ 21.6mn
52wk high/low	Rs 144/Rs 71
Promoter/FPI/DII	52%/6%/42%

Source: NSE

Marketing earnings normalise: Marketing margins in Q2 normalised from an exceptional Q1, averaging at ~Rs 1,900/mt (+7% YoY). This along with pipeline business margins of ~Rs 745/mt still adds up to an above-average Rs 2,600/mt. Q3 is expected to be better for marketing margins given a decline in oil prices. IOCL intends to maintain these margins at above-average levels to support expansion in retail outlets (~2,500 p.a.) over 2-3 years.

STOCK PERFORMANCE



Source: NSE

Valuations discounting the worst: Valuations at 4x FY22E EBITDA are at a significant discount to BPCL, offering a staggering >15% dividend yield potential. Like other PSUs, the stock has been under pressure owing to concerns over cash utilisation. Management sees growth in volumes reviving from Q3FY21, implying a strong H2FY21 performance.

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	5,281,575	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)	173,767	80,622	200,494	222,138	222,499
Adj. EPS (Rs)	18.9	8.8	21.8	24.2	24.2
Adj. EPS growth (%)	(19.2)	(53.6)	148.7	10.8	0.2
Adj. ROAE (%)	15.4	7.8	19.4	19.5	18.6
Adj. P/E (x)	4.1	8.9	3.6	3.2	3.2
EV/EBITDA (x)	3.9	9.2	4.5	4.0	3.6

Source: Company, BOBCAPS Research

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Important disclosures, including any required research certifications, are provided at the end of this report.



FIG 1 – IOCL: Q2FY21 SALES VOLUME GROWTH VS. INDUSTRY

Petroleum products (mmt)	IOCL QoQ growth (%)	Industry QoQ growth (%)	IOCL YoY growth (%)	Industry YoY growth (%)	IOCL H1FY21 YoY growth (%)	Industry H1FY21 YoY growth (%)
LPG	4.5	5.1	1.2	0.2	7.2	5.8
MS	38.5	41.1	(6.1)	(5.0)	(21.6)	(20.8)
HSD	3.4	5.3	(19.3)	(15.6)	(28.0)	(25.2)
SKO	(3.0)	(3.0)	(22.7)	(24.2)	(31.1)	(33.0)
ATF	104.0	107.3	(58.5)	(60.3)	(68.6)	(70.5)
FO/LSHS	18.5	17.4	(0.1)	(3.9)	(7.4)	(8.5)
Others	19.3	6.6	(17.2)	(3.2)	(26.0)	(7.2)
Total	12.6	11.3	(15.4)	(10.1)	(23.3)	(17.6)

Source: Company, BOBCAPS Research

FIG 2 – QUARTERLY PERFORMANCE

Y/E March (Rs mn)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	H1FY21	H1FY20	YoY (%)
Net sales	856,105	1,116,897	(23.3)	623,966	37.2	1,480,071	2,432,021	(39.1)
EBITDA	94,272	35,722	163.9	55,123	71.0	149,394	119,222	25.3
EBITDA margin (%)	11.01	3.20	-	8.83	-	10.09	4.90	-
Depreciation and Amortisation	24,036	20,975	14.6	23,545	2.1	47,582	41,904	13.5
Interest	2,211	13,083	(83.1)	11,713	(81.1)	13,924	28,173	(50.6)
Other income	15,374	6,481	137.2	6,422	139.4	21,796	12,794	70.4
PBT	83,398	8,145	923.9	26,286	217.3	109,684	61,939	77.1
Provision for tax	21,125	2,511	741.4	7,177	194.3	28,302	20,344	39.1
Effective Tax Rate (%)	25.33	30.82	-	27.31	-	25.80	32.84	-
PAT Adjusted	62,273	5,634	1,005.3	19,108	225.9	81,381	41,595	95.7
EPS Adjusted (Rs)	6.6	0.6	1,005.3	2.0	225.9	8.6	4.4	97.0

Source: Company, BOBCAPS Research

FIG 3 – SEGMENT PERFORMANCE

Segment	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	H1FY21	H1FY20	YoY (%)
Refining								
Refining throughput (mmt)	13.97	17.54	(20.3)	12.93	8.0	26.90	34.84	(22.8)
GRMs (US\$/bbl)	8.62	1.28	573.4	(1.98)	-	3.46	2.96	16.9
Normalised GRM (US\$/bbl)	(1.33)	3.55	(137.5)	4.41	(130.1)	1.45	3.57	(59.3)
Refining EBITDA (Rs mn)	40,770	(20,270)	(301.1)	(35,230)	(215.7)	5,540	(3,680)	(250.5)
Refining EBITDA (US\$/bbl)	5.4	(2.2)	(338.9)	(4.9)	(209.4)	0.4	(0.2)	(281.5)
Inventory gains/(loss) (Rs mn)	73,240	(15,340)	(577.4)	(45,880)	(259.6)	27,360	(5,570)	591.2
Inventory gains/(loss) (US\$/bbl)	9.6	(1.7)	(667.2)	(6.4)	(250.9)	1.8	(0.3)	692.2
Exchange fluctuation gain/(loss) (Rs mn)	2,560	(5,200)	149.2	(170)	1,605.9	2,390	(5,320)	(144.9)
Adj. EBITDA	(35,030)	270	(13,074.1)	10,820	(423.8)	(24,210)	7,210	(435.8)
Adj. EBITDA (US\$/bbl)	(4.6)	0.0	(15,512.3)	1.5	(406.1)	(1.6)	0.4	(504.8)
Operating costs (US\$/bbl)	3.6	2.9	22.4	2.9	24.8	3.2	2.9	13.2
Marketing								
Total Marketing sales (mmt)	18.90	21.42	(11.8)	16.50	14.5	35.40	43.03	(17.7)
Domestic	17.70	18.95	(6.6)	14.24	24.3	30.28	39.47	(23.3)
Exports	1.20	1.23	(2.0)	1.25	(3.8)	2.43	2.31	5.1
Marketing EBITDA (Rs mn)	36,060	38,130	(5.4)	77,010	(53.2)	113,070	83,780	35.0

Segment	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	H1FY21	H1FY20	YoY (%)
Marketing EBITDA (Rs/mt)	1,908	1,780	7.2	4,666	(59.1)	3,194	1,947	64.0
Inventory gains/(loss) (Rs mn)	760	3,560	(78.7)	13,920	(94.5)	14,680	6,120	139.9
Inventory gains/(loss) (Rs/mt)	40	166	(75.8)	843	(95.2)	415	142	(191.5)
Exchange fluctuation gain/(loss) (Rs mn)	4,160	(6,150)	167.6	980	(324.5)	5,140	(5,110.0)	(200.6)
Adj. EBITDA	31,140	40,720	(23.5)	62,110	(49.9)	93,250	82,770	12.7
Adj. EBITDA (Rs/mt)	1,648	1,901	(13.3)	3,763	(56.2)	2,634	1,924	36.9
Pipeline								
Pipeline throughput (mmt)	17.35	21.75	(20.2)	15.02	15.5	32.36	43.65	(25.9)
Pipeline EBITDA (Rs mn)	12,920	15,870	(18.6)	11,500	12.3	24,420	32,100	(23.9)
Pipeline EBITDA (Rs/mt)	745	730	2.1	766	(2.7)	755	735	2.6
Petrochemicals								
Volumes (mmt)	0.72	0.53	36.9	0.48	50.0	1.20	1.05	14.1
Petrochemicals EBITDA (Rs mn)	12,110	7,740	56.5	7,280	66.3	19,390	14,600	32.8
Petrochemicals EBITDA (US\$/mt)	226	209	8.2	200	13.3	215	198	8.4
Others (Rs mn)	7,790	730	967.1	990	(686.9)	8,780	5,220	68.2
Total Adjusted EBITDA (Rs mn)	28,930	65,330	(55.7)	92,700	(68.8)	121,630	141,900	(14.3)

Source: Company, BOBCAPS Research

Earnings call highlights

- IOCL's refineries had operated at 67% utilisation in Aug'20 due to Paradip refinery shutdown and intermittent Covid-led lockdowns. In September and October, capacity utilisation has risen to 81% and 95% respectively.
- Gasoline demand has recovered to pre-Covid levels, though gas oil has witnessed a more volatile recovery than gasoline.
- Petchem plants operated at below 50% capacity due to lower product uplift.
- Capex until H1FY21 stood at Rs 105bn and the planned spend for FY21 is Rs 210bn standalone with an additional Rs 50bn for group companies. The outlay is likely to remain at the same level for FY22.
- Capex breakdown – Rs 210bn (standalone) of which Rs 40bn will be for the refinery segment (towards BSVI and brownfield expansion), >Rs 45bn for the pipeline segment (IOCL has a pipeline coming up in the southern part of India and an LPG pipeline in the east), and >Rs 45bn for the marketing segment (Rs 15bn into cylinders and regulators and Rs 15bn-20bn into retail outlets).
- Bongaigaon refinery expansion from 2.3mmt to 2.7mmt should be completed within a month and Barauni expansion from 6mmt to 9mmt should take 3-4 years. Barauni has chemical plants coming up along with a refinery. The Panipat refinery expansion plan (>10mmtpa) may not be taken up in the near term.
- IOCL plans to add 2,200-2,500 retail outlets every year.
- The company currently has Rs 73bn outstanding from the Indian government.
- Management says it is evaluating buyback proposals based on investor feedback, but has no plans for one as of now.

Valuation methodology

Valuations at 4x FY22E EBITDA are at a significant discount to BPCL, offering a staggering >15% dividend yield potential. Like other PSUs, the stock has been under pressure owing to concerns over cash utilisation. Management sees growth in volumes reviving from Q3FY21, implying a strong H2FY21 performance. We maintain BUY, with a revised Sep'21 SOTP-based target price of Rs 170 (from Rs195), as we raise Debt assumption on higher capex guidance by management.

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

- Refining and marketing business valued at 6x Sep'22E EBITDA. Marketing business valued at a premium to peers on continuous market share gains and strong infrastructure advantage
- Petrochemicals business valued at 5x Sep'22E EBITDA, a discount to Reliance Industries on relatively lower margins and loss of market share
- Pipeline business valued at 5x Sep'22E EBITDA

FIG 4 – SOTP VALUATION SUMMARY

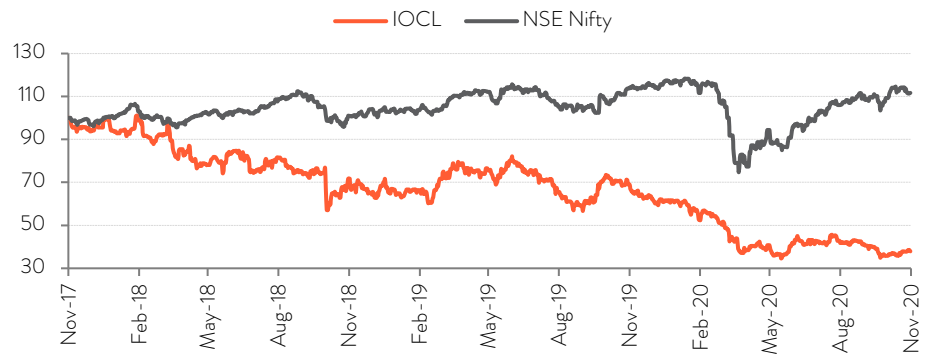
	EV (Rs bn)	Value (Rs/sh)	Comments
Refining	278	30	6x Sep'22E EBITDA
Marketing	1,342	146	6x Sep'22E EBITDA
Petrochemicals	294	32	5x Sep'22E EBITDA
Pipeline	454	49	5x Sep'22E EBITDA
Total core business EV	2,367	258	
Less: Net Debt	891	97	
Equity value of operational segments	1,476	161	
Add: Total investments	72	10	Listed holdings at 20% discount to CMP and others at investment value
IOCL Equity value	1,548	170	6.8x FY22E EPS

Source: BOBCAPS Research

FIG 5 – KEY ASSUMPTIONS

	FY21E	FY22E	FY23E
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 6 – 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	5,281,575	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)	(103,912)	(114,919)	(120,301)
EBIT	267,162	65,500	301,170	347,624	349,685
Net interest income/(expenses)	(48,880)	(65,787)	(85,682)	(97,790)	(99,372)
Other income/(expenses)	27,143	27,903	36,164	30,589	28,883
Exceptional items	0	113,046	0	0	0
EBT	245,425	27,615	251,652	280,424	279,196
Income taxes	(86,531)	53,007	(63,412)	(70,663)	(70,357)
Min. int./Inc. from associates	14,872	13,660	12,254	12,377	13,660
Reported net profit	173,767	(18,764)	200,494	222,138	222,499
Adjusted net profit	173,767	80,622	200,494	222,138	222,499

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	411,941	276,035	275,071	344,704	371,951
Other current liabilities	573,926	564,560	338,971	437,003	537,667
Provisions	123,860	112,062	182,910	204,152	204,745
Debt funds	933,278	1,267,576	1,065,906	1,105,451	1,126,780
Other liabilities	165,097	114,393	114,131	114,131	114,131
Equity capital	91,810	91,810	91,810	91,810	91,810
Reserves & surplus	1,030,608	859,793	1,021,468	1,070,703	1,138,865
Shareholders' fund	1,122,418	951,603	1,113,278	1,162,513	1,230,675
Total liabilities and equities	3,349,294	3,294,992	3,122,104	3,402,486	3,620,480
Cash and cash eq.	10,610	22,960	119,213	118,332	91,885
Accounts receivables	158,075	132,595	108,226	135,045	151,707
Inventories	771,265	670,108	445,327	571,400	674,161
Other current assets	360,477	314,951	212,177	270,164	328,009
Investments	441,123	355,709	255,844	255,844	255,782
Net fixed assets	1,373,725	1,502,371	1,634,701	1,669,019	1,700,190
CWIP	234,010	296,289	346,605	382,670	418,735
Intangible assets	10	10	10	10	10
Total assets	3,349,294	3,294,992	3,122,104	3,402,486	3,620,479

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	258,831	79,785	304,405	337,056	342,799
Changes in working capital	(154,269)	15,093	196,218	(21,971)	(48,764)
Other operating cash flows	14,276	(78,607)	(36,426)	(30,589)	(28,883)
Cash flow from operations	118,839	16,271	464,197	284,496	265,153
Capital expenditures	(175,911)	(190,925)	(286,558)	(185,302)	(187,536)
Change in investments	6,938	85,414	99,864	0	62
Other investing cash flows	27,143	27,903	36,164	30,589	28,883
Cash flow from investing	(141,830)	(77,608)	(150,530)	(154,713)	(158,591)
Equities issued/Others	(2,977)	0	0	0	0
Debt raised/repaid	306,528	334,299	(201,671)	39,546	21,329
Dividends paid	(127,679)	(45,653)	(152,476)	(168,936)	(169,210)
Other financing cash flows	(147,234)	(224,828)	136,731	(1,273)	14,873
Cash flow from financing	28,638	63,818	(217,415)	(130,663)	(133,009)
Changes in cash and cash eq.	5,647	2,481	96,252	(880)	(26,448)
Closing cash and cash eq.	10,610	13,128	119,212	118,332	91,884

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	18.9	(2.0)	21.8	24.2	24.2
Adjusted EPS	18.9	8.8	21.8	24.2	24.2
Dividend per share	11.5	4.3	14.2	15.7	15.8
Book value per share	122.3	103.6	121.3	126.6	134.0

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	0.3	0.3	0.5	0.4	0.3
EV/EBITDA	3.9	9.2	4.5	4.0	3.6
Adjusted P/E	4.1	8.9	3.6	3.2	3.2
P/BV	0.6	0.8	0.6	0.6	0.6

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	70.8	(94.4)	79.7	79.2	79.7
Interest burden (PBT/EBIT)	91.9	(130.4)	83.6	80.7	79.8
EBIT margin (EBIT/Revenue)	5.1	1.4	8.7	8.0	6.9
Asset turnover (Revenue/Avg TA)	167.5	145.8	108.2	133.7	143.4
Leverage (Avg TA/Avg Equity)	2.8	3.2	3.1	2.9	2.9
Adjusted ROAE	15.4	7.8	19.4	19.5	18.6

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	(19.2)	(53.6)	148.7	10.8	0.2
Profitability & Return ratios (%)					
EBITDA margin	6.7	3.4	11.7	10.6	9.3
EBIT margin	5.1	1.4	8.7	8.0	6.9
Adjusted profit margin	3.3	1.7	5.8	5.1	4.4
Adjusted ROAE	15.4	7.8	19.4	19.5	18.6
ROCE	9.0	3.0	10.2	11.5	11.1
Working capital days (days)					
Receivables	9	11	13	10	10
Inventory	61	63	73	52	54
Payables	29	27	33	29	29
Ratios (x)					
Gross asset turnover	3.4	2.7	1.7	2.0	2.1
Current ratio	0.8	0.7	0.6	0.7	0.8
Net interest coverage ratio	5.5	1.0	3.5	3.6	3.5
Adjusted debt/equity	0.8	1.3	0.9	0.8	0.8

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

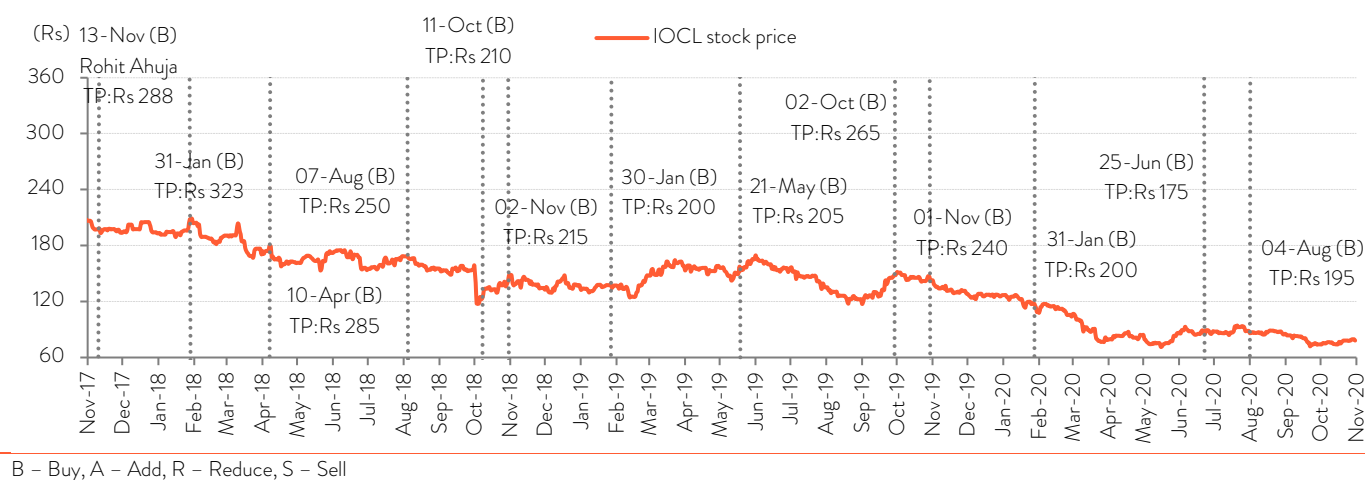
ADD – Expected return from >+5% to +15%

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)



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