

Indian Oil Corporation

31 October 2017

Reuters: IOC.BO; Bloomberg: IOCL IN

Dismal Earnings Performance

Indian Oil Corporation or IOCL's reported earnings at Rs37bn for 2QFY18 were down 18.7% QoQ and up 18.4% YoY, 32.2% below expectations, primarily because of: 1) Goods and Services Tax or GST impact of Rs3bn. 2) Finance costs at Rs7.7bn showing 7.6% QoQ increase. 3) Other income declining 52.1% QoQ to Rs5.8bn. 4) Foreign exchange loss of Rs2bn. However, gross refining margin or GRM increased in 2QFY18 because of Hurricane Harvey in the US recently. Hurricane Harvey caused the Singapore GRM to increase from US\$6.65/bbl at the beginning of July 2017 to US\$11.01/bbl during its peak in the first week of September 2017, which is reflected in IOCL's GRM of US\$7.98/bbl in 2QFY18. We believe the company's capex and interest costs will increase in the coming quarters, negatively impacting its bottom line. We have retained Sell rating on IOCL with a target price of Rs357.

Earnings below expectation on account of decline in sales and higher finance costs: IOCL reported 14% QoQ decline in net sales to Rs906bn in 2QFY18. Refinery throughput was 16.1 mmt in 2QFY18 versus 17.5mmt in 1QFY18 and pipeline throughput was 19.3mmt in 2QFY18 versus 21.3mmt in 1QFY18. However, EBITDA margin expanded to 8.1% in 2QFY18 from 7.6% in 1QFY18 because of higher GRM. EBITDA was below expectation because of: 1) Lower sales following the seasonal shutdown. 2) One-time provisioning made for Kandla port of Rs3bn. 3) GST impact of Rs3bn. Further, the drop in other income by 52.1% QoQ and rise in finance costs by 7.6% QoQ resulted in net profit of Rs37bn in 2QFY18, down 18.7% on QoQ basis.

GRM benefit from Hurricane Harvey; inventory gain: GRM in 2QFY18 was US\$7.98/bbl versus US\$4.32/bbl in 1QFY18 and US\$4.32/bbl in 2QFY17. Hurricane Harvey caused refinery shutdowns and refineries to operate at lower capacity, thereby driving Singapore GRM to US\$11.01/bbl during its peak. For 2QFY18, the company reported inventory gains of around US\$1.03/bbl compared to inventory loss in 1QFY18 of US\$-3.39/bbl. However, refining EBITDA was lower than expected because of: 1) GST impact of Rs1.6bn. 2) Foreign exchange loss of Rs2bn. Going forward, IOCL expects GRM of Paradip refinery to improve by around US\$2/bbl from US\$7.85/bbl (normalised GRM) with the addition of heavy crude oil.

Earnings worsen with the rise in finance costs: Finance costs at Rs7.7bn in 2QFY18 increased 7.6% QoQ and 25.7% YoY. The rise in borrowing was driven by payment of value-added tax or VAT to Odisha government after settlement of a dispute.

EBIT impacted by higher depreciation in 1HFY18: Depreciation in 1HFY18 stood at Rs34bn versus Rs29bn in 1HFY17, up 17% YoY.

Retain Sell rating: Weak GRM environment, planned capex and interest costs set to increase in the coming quarters will exert pressure on cash flow and lead to increased debt. Sustained concerns over cash flow and RoE/RoCE with the rise in planned capex led us to retain Sell rating on IOCL with a target price of Rs357.

SELL

Sector: Oil & Gas

CMP: Rs414

Target Price: Rs357

Downside: 14%

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Key Data

Current Shares O/S (mn)	4,855.9
Mkt Cap (Rsbn/US\$bn)	2,021.3/31.2
52 Wk H / L (Rs)	463/282
Daily Vol. (3M NSE Avg.)	5,769,953

Price Performance (%)

	1 M	6 M	1 Yr
IOCL	3.9	(5.4)	28.6
Nifty Index	5.9	11.4	20.1

Source: Bloomberg

Y/E March (Rsmn)	2QFY17	1QFY18	2QFY18	QoQ (%)	YoY (%)	1QFY18E	Var. (%)
Net sales	803,701	1,054,343	905,667	(14.10)	12.69	1,037,735	(12.7)
Cost of goods	(663,296)	(878,245)	(732,980)	(16.54)	10.51	(842,484)	(13.0)
Employee benefits expenses	(18,717)	(24,140)	(23,640)	(2.07)	26.30	(24,623)	(4.0)
Other expenses	(63,965)	(71,960)	(75,315)	4.66	17.74	(75,558)	(0.3)
EBITDA	57,723	79,998	73,733	(7.83)	27.74	95,070	(22.4)
EBITDAM (%)	7.2	7.6	8.1	-	-	9.2	-
Depreciation and amortisation	(15,048)	(17,213)	(16,970)	(1.41)	12.77	(18,074)	(6.1)
EBIT	42,675	62,785	56,763	(9.59)	33.01	76,996	(26.3)
EBITM (%)	5.3	6.0	6.3	-	-	7.4	-
Other income	8,541	12,276	5,878	(52.12)	(31.18)	12,276	(52.1)
Interest expenses	(6,147)	(7,180)	(7,726)	7.60	25.69	(7,898)	(2.2)
Extraordinary/exceptional items	-	-	-	-	-	-	-
Profit before tax	45,069	67,881	54,914	(19.10)	21.84	81,374	(32.5)
Tax expense	(13,850)	(22,393)	(17,951)	(19.84)	29.61	(26,853)	(33.2)
Effective tax rate (%)	31	33	33	-	-	33	-
PAT	31,219	45,488	36,963	(18.74)	18.40	54,521	(32.2)
NPM (%)	3.9	4.3	4.1	-	-	5.3	-
EPS	6.6	9.6	7.8	-	-	11.2	-

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 1: Key financials

Y/E March (Rsmn)	FY16	FY17E	FY18E	FY19E	FY20E
Revenues	34,87,520	40,13,524	44,80,501	49,85,437	53,29,306
YoY (%)	(21.5)	15.1	11.6	11.3	6.9
EBITDA	2,61,244	3,48,205	3,20,926	3,44,134	3,52,377
YoY (%)	163.5	33.3	(7.8)	7.2	2.4
PAT	1,44,847	1,96,241	1,79,763	1,91,164	1,95,047
YoY (%)	194.9	35.5	(8.4)	6.3	2.0
EPS (Rs)	29.8	40.4	37.0	39.4	40.2
RoE (%)	19.6	24.6	21.1	21.1	20.2
EV/EBITDA (x)	9.3	7.2	8.0	7.9	8.0
P/E (x)	13.8	10.2	11.2	10.5	10.3

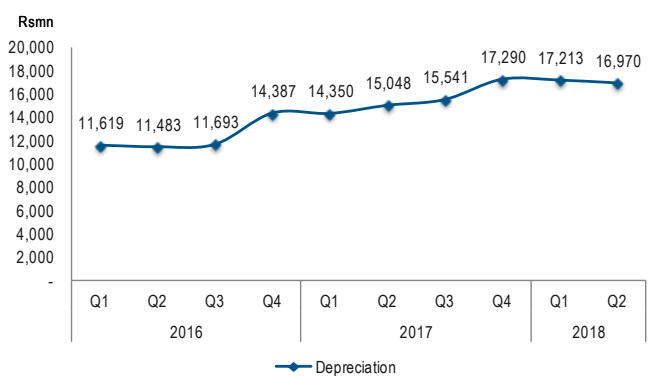
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Gross refining margin



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Depreciation



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Interest costs



Source: Company, Nirmal Bang Institutional Equities Research

Consolidated financials

Exhibit 5: Income statement

Y/E March (Rsmn)	FY16	FY17E	FY18E	FY19E	FY20E
Net sales	34,87,520	40,13,524	44,80,501	49,85,437	53,29,306
Growth YoY (%)	(21.5)	15.1	11.6	11.3	6.9
Operating costs	30,71,618	35,07,385	39,85,930	44,50,824	47,68,302
Staff expenses	82,276	72,561	78,443	84,802	91,679
Other expenses	72,383	85,372	95,202	1,05,676	1,16,948
EBITDA	2,61,244	3,48,205	3,20,926	3,44,134	3,52,377
EBITDA growth (%)	163.5	33.3	(7.8)	7.2	2.4
EBITDA margin (%)	7.5	8.7	7.2	6.9	6.6
Depreciation	63,695	60,941	67,605	67,755	67,905
EBIT	1,97,549	2,87,264	2,53,321	2,76,379	2,84,472
EBIT (%)	5.7	7.2	5.7	5.5	5.3
Net interest expense	36,300	25,392	25,405	32,574	35,774
Other income	52,874	36,116	42,616	42,616	42,616
Other adjustments	8,884	-	-	-	-
Earnings before tax	2,05,240	2,97,988	2,70,533	2,86,421	2,91,314
Tax- total	56,528	97,882	86,905	91,392	92,402
Rate of tax (%)	27.5	32.8	32.1	31.9	31.7
Net profit	1,48,712	2,00,106	1,83,628	1,95,029	1,98,912
Minority and other interest	(3,865)	(3,865)	(3,865)	(3,865)	(3,865)
Net profit for group	1,44,847	1,96,241	1,79,763	1,91,164	1,95,047

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Balance sheet

Y/E March (Rsmn)	FY16	FY17E	FY18E	FY19E	FY20E
Share capital	24,280	48,559	48,559	48,559	48,559
Reserves and surplus	7,35,660	7,65,592	8,20,370	8,75,186	9,33,886
Net worth	7,59,940	8,14,151	8,68,929	9,23,745	9,82,445
Loans	6,13,281	5,96,057	6,86,057	8,16,057	9,46,057
Minority interest	14,143	18,008	21,873	25,738	29,603
Deferred tax liability	96,158	96,858	97,558	98,258	98,958
Total capital employed	14,83,522	15,25,075	16,74,418	18,63,799	20,57,064
Net fixed assets	12,92,810	13,89,949	15,17,344	17,04,589	18,91,685
Goodwill	791	791	791	791	791
Investments	1,22,972	1,86,610	1,86,610	1,86,610	1,86,610
Current assets loans	10,03,093	10,13,596	11,24,451	12,00,201	12,59,694
Inventories	4,20,947	5,03,435	5,64,509	6,22,285	6,47,537
Debtors	86,604	97,145	1,08,253	1,18,717	1,26,512
Cash and bank	1,92,993	87,850	1,16,520	1,14,028	1,30,472
Loans and advances	2,94,334	3,00,984	3,10,984	3,20,984	3,30,984
Current investments	8,216	24,182	24,184	24,186	24,189
Less: Current liab. & prov.	9,36,144	10,65,871	11,54,778	12,28,392	12,81,716
Current liabilities	6,15,051	7,00,036	7,97,413	8,65,381	9,18,704
Provisions	3,21,094	3,65,835	3,57,365	3,63,011	3,63,011
Net current assets	66,949	(52,275)	(30,328)	(28,191)	(22,022)
Miscellaneous	-	-	-	-	-
Total capital employed	14,83,522	15,25,075	16,74,418	18,63,799	20,57,064

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Cash flow

Y/E March (Rsmn)	FY16	FY17E	FY18E	FY19E	FY20E
Profit after tax	1,48,712	2,00,106	1,83,628	1,95,029	1,98,912
Depreciation	63,695	60,941	67,605	67,755	67,905
Other income	(43,991)	(36,116)	(42,616)	(42,616)	(42,616)
Interest	36,300	25,392	25,405	32,574	35,774
Working capital changes	51,623	14,081	6,723	(4,628)	10,275
Others	(15,388)	700	700	700	700
Operating cash flow	2,40,951	2,65,104	2,41,444	2,48,814	2,70,950
Capital expenditure	(1,64,236)	(1,58,080)	(1,95,000)	(2,55,000)	(2,55,000)
Investments	513	(63,638)	-	-	-
Other income	43,991	36,116	42,616	42,616	42,616
Cash flow from investnents	(1,19,733)	(1,85,602)	(1,52,384)	(2,12,384)	(2,12,384)
Equity	-	-	-	-	-
Debt	(35,729)	(17,224)	90,000	1,30,000	1,30,000
Interest expenses	(36,300)	(25,392)	(25,405)	(32,574)	(35,774)
Dividends	(41,243)	(1,42,029)	(1,24,986)	(1,36,348)	(1,36,348)
Cash flow from financing	(1,13,271)	(1,84,645)	(60,390)	(38,922)	(42,122)
Total cash generation	7,947	(1,05,143)	28,671	(2,492)	16,444
Opening cash balance	1,85,045	1,92,993	87,850	1,16,520	1,14,028
Closing cash & bank balance	1,92,992	87,850	1,16,520	1,14,028	1,30,472

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Key ratios

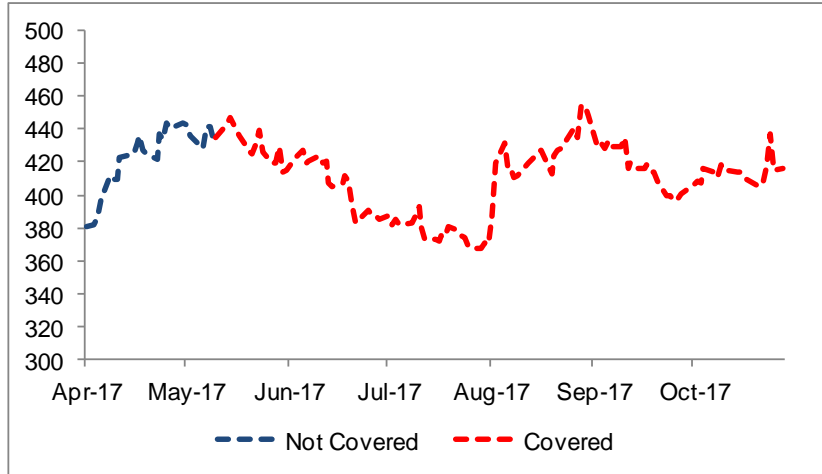
Y/E March (Rsmn)	FY16	FY17E	FY18E	FY19E	FY20E
Profitability and return ratios					
EBITDA margin (%)	7.5	8.7	7.2	6.9	6.6
EBIT margin (%)	5.7	7.2	5.7	5.5	5.3
Net profit margin (%)	4.2	4.9	4.0	3.8	3.7
RoE(%)	19.6	24.6	21.1	21.1	20.2
RoCE (%)	16.7	21.7	17.6	17.0	15.8
Working capital & liquidity ratios					
Receivables (days)	9	9	9	9	9
Inventory (days)	50	52	52	51	50
Payables (days)	73	73	73	71	70
Current ratio (x)	1.07	0.95	0.97	0.98	0.98
Valuation ratios					
EV/sales (x)	0.7	0.6	0.6	0.5	0.5
EV/EBITDA (x)	9.3	7.2	8.0	7.9	8.0
P/E (x)	13.8	10.2	11.2	10.5	10.3
P/BV (x)	2.6	2.5	2.3	2.2	2.0

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price	Target price (Rs)
12 May 2017	Sell	425	396
29 May 2017	Sell	425	396
4 August 2017	Sell	388	357
31 October 2017	Sell	414	357

Rating track graph



Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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