

Indian Oil Corporation

1 February 2018

Reuters: IOC.BO; Bloomberg: IOCL IN

Earnings Outperformance On Account Of Inventory Gains

Indian Oil Corporation (IOCL) reported earnings of Rs79bn for 3QFY18, up 22.2% QoQ and 18.8% YoY, primarily because of: 1) Higher gross refining margin or GRM of US\$12.32/bbl versus US\$7.8/bbl in 2QFY18 and US\$7.7 in 3QFY17, mainly on account of inventory gains (Rs63bn). 2) Increase in refinery throughput to 18.2mmt in 3QFY18 versus 16.2mmt in 2QFY18. 3) Product sales growth from 21.3mmt in 3QFY17 to 22.81mmt in 3QFY18. 4) Increased capacity utilisation of pipeline leading to increase in throughput from 20.2mmt in 3QFY17 to 22.4mmt in 3QFY18. 5) Higher other income. We believe the company's capex and interest costs will increase, negatively impacting its bottom line. We have rolled forward our SOTP based valuation to FY20E with a target price of Rs414 (from Rs357 earlier) and changed our rating on it to Accumulate (from Sell earlier).

Revenues increase on account of higher throughput, rise in GRM: IOCL's net sales at Rs1,107bn in 3QFY18 increased 22.2% QoQ. Revenues increased because of: 1) Sharp rise in GRM. 2) Higher refinery throughput at 18.2mmt in 3QFY18 versus 16.1mmt in 2QFY18. The QoQ increase in refining throughput was primarily because of refinery shutdown on account of repair and maintenance in 2QFY18. When compared with 16.4mmt refinery throughput in 3QFY17, the increase was led by better capacity utilisation of Paradip refinery. Capacity utilisation of Paradip refinery increased from 64% in 3QFY17 to 93% in 3QFY18. 3) Increase in product sales from 21.3mmt in 3QFY17 to 22.81mmt in 3QFY18. 4) Higher pipeline throughput at 22.4mmt in 3QFY18 from 20.2mmt in 3QFY17 because of the increase in pipeline utilisation from 90% in 3QFY17 to 94.8% in 3QFY18.

Inventory gains lead to higher GRM: GRM in 3QFY18 was US\$12.32/bbl versus US\$7.8/bbl in 2QFY18 and US\$7.7/bbl in 3QFY17. IOCL reported inventory gain to the tune of US\$4.9/bbl in 3QFY18. In value terms, inventory gain accounted for Rs63bn, split into Rs53bn for refining and Rs10bn in marketing segment. Inventory gain accounted for approximately 61% of refining EBITDA and 37% of marketing EBITDA. IOCL reported PBT of Rs122bn which was 40% above our estimate of Rs87bn. Removing the impact of Inventory gain, PBT stood at Rs59bn, 32% below our estimate.

EBIT impacted by higher depreciation: Depreciation in 3QFY18 stood at Rs17bn versus Rs15.5bn in 3QFY17, up 10% YoY.

Earnings boosted by higher other income and lower finance costs: IOCL reported other income of Rs13bn in 3QFY18 versus Rs5.8bn in 2QFY18, up 130% QoQ and Rs7.9bn in 3QFY17, up 71% YoY. Finance costs at Rs6.5bn in 3QFY18 declined 15.2% QoQ and 34.3% YoY. Finance costs reduced on account of decline in debt from Rs378bn in 3QFY17 to Rs319bn in 3QFY18.

Roll forward our SOTP based valuation to FY20E; upgrade to Accumulate: Weak GRM environment, planned capex leading to higher debt and expected rise in interest costs will exert pressure on cash flow. We maintain our concerns on the expected decline in cash flow and RoE/RoCE with the rise in planned capex. Our increase in target price is because of rollover of our SOTP based valuation to FY20E. We have increased our target price on IOCL to Rs414 (Rs357 earlier) and upgraded the rating on it to Accumulate (from Sell earlier). We will be revising our FY18E estimates shortly.

ACCUMULATE

Sector: Oil & Gas

CMP: Rs418

Target Price: Rs414

Downside: 1%

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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)	3QFY18	2QFY18	QoQ (%)	3QFY17	YoY (%)	3QFY18E	Var. (%)
Net sales	1,106,669	905,668	22.2	931,167	18.8	957,328	15.6
Cost of goods	(873,541)	(732,980)	19.2	(738,725)	18.2	(748,264)	16.7
Employee benefits expenses	(23,595)	(23,640)	(0.2)	(18,126)	30.2	(24,113)	(2.1)
Other expenses	(76,846)	(75,315)	2.0	(94,831)	(19.0)	(77,574)	(0.9)
EBITDA	132,687	73,733	80.0	79,485	66.9	107,377	23.6
EBITDAM (%)	12	8.1	-	8.5	-	11.2	-
Depreciation and amortisation	(17,151)	(16,970)	1.1	(15,541)	10.4	(17,649)	(2.8)
EBIT	115,537	56,763	103.5	63,944	80.7	89,728	28.8
EBITM (%)	10	6	-	7	-	9	-
Other income	13,534	5,878	130.3	7,929	70.7	5,878	130.3
Interest expenses	(6,549)	(7,726)	(15.2)	(9,967)	(34.3)	(7,881)	(16.9)
Profit before tax	122,522	54,915	123.1	61,906	97.9	87,725	39.7
Tax expense	(43,690)	(17,951)	-	(21,958)	-	(28,676)	-
Effective tax rate (%)	36	33	-	35	-	33	-
PAT	78,832	36,964	113.3	39,948	97.3	59,049	33.5
NPM (%)	7.1	4.1	-	4.3	-	6.2	-

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 1: Key financials

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Revenues	3,460,447	3,553,101	4,480,501	4,985,437	5,329,306
YoY (%)	(22.1)	2.7	26.1	11.3	6.9
EBITDA	234,429	340,132	320,926	344,134	352,377
YoY (%)	136.5	45.1	(5.6)	7.2	2.4
PAT	120,225	198,495	179,763	191,164	195,047
YoY (%)	144.8	65.1	(9.4)	6.3	2.0
EPS (Rs)	29.8	42.0	37.0	39.4	40.2
RoE (%)	13.8	20.0	21.0	21.1	20.2
EV/EBITDA (x)	11.6	8.4	8.4	8.2	8.3
P/E (x)	14.0	10.0	11.3	10.6	10.4

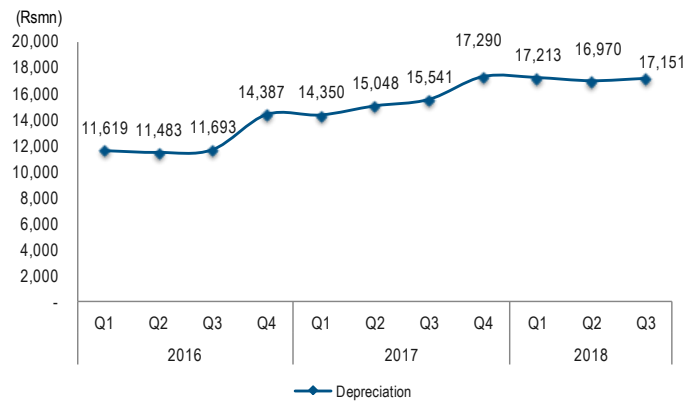
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Gross refining margin



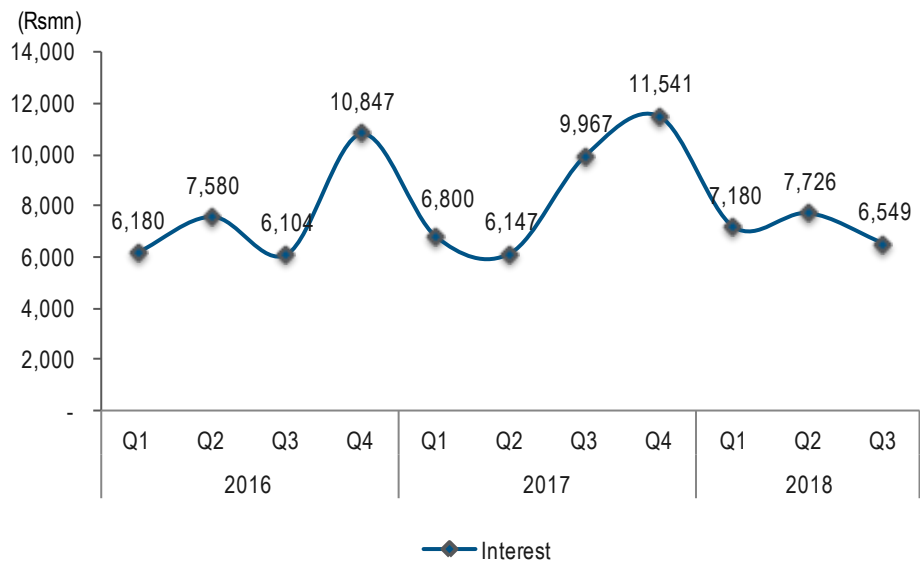
Source: Company, Nirmal Bang Institutional Equities Research

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	FY17	FY18E	FY19E	FY20E
Net sales	3,460,447	3,553,101	4,480,501	4,985,437	5,329,306
Growth YoY (%)	(22.1)	2.7	26.1	11.3	6.9
Operating costs	2,850,235	2,751,190	3,985,930	4,450,824	4,768,302
Staff expenses	75,018	102,040	78,443	84,802	91,679
Other expenses	300,765	359,738	95,202	105,676	116,948
EBITDA	234,429	340,132	320,926	344,134	352,377
EBITDA growth (%)	136.5	45.1	(5.6)	7.2	2.4
EBITDA margin (%)	6.8	9.6	7.2	6.9	6.6
Depreciation	56,984	68,486	67,605	67,755	67,905
EBIT	177,445	271,646	253,321	276,379	284,472
EBIT (%)	5.1	7.6	5.7	5.5	5.3
Net interest expenses	34,690	37,213	25,405	32,574	35,774
Other income	21,865	45,125	42,616	42,616	42,616
Other adjustments	(16,098)	-	-	-	-
Earnings before tax	180,718	279,558	270,533	286,421	291,314
Tax- total	56,584	75,704	86,905	91,392	92,402
Rate of tax (%)	31.3	27.1	32.1	31.9	31.7
Net profit	124,133	203,854	183,628	195,029	198,912

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Balance sheet

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Share capital	23,697	47,393	48,559	48,559	48,559
Reserves and surplus	876,099	973,568	827,370	875,186	933,886
Net worth	899,796	1,020,961	875,929	923,745	982,445
Loans	689,711	830,598	686,057	816,057	946,057
Minority interest	14,260	19,046	21,873	25,738	29,603
Deferred tax liability	69,708	68,887	97,558	98,258	98,958
Total capital employed	1,673,475	1,939,492	1,681,418	1,863,799	2,057,064
Net fixed assets	1,262,513	1,327,352	1,517,344	1,704,589	1,891,685
Goodwill	10	10	791	791	791
Investments	315,680	442,143	186,610	186,610	186,610
Current assets loans	737,350	966,105	1,131,451	1,200,201	1,259,694
Inventories	422,567	658,843	564,509	622,285	647,537
Debtors	76,845	88,992	108,253	118,717	126,512
Cash and bank	7,349	3,295	31,967	29,475	45,919
Loans and advances	120,506	93,254	310,984	320,984	330,984
Current investments	110,084	121,722	115,737	108,739	108,742
Less: Current liab. & prov.	642,080	796,119	1,154,778	1,228,392	1,281,716
Current liabilities	540,149	605,453	797,413	865,381	918,704
Provisions	101,931	190,665	357,365	363,011	363,011
Net current assets	95,270	169,986	(23,328)	(28,191)	(22,022)
Miscellaneous	-	-	-	-	-
Total capital employed	1,673,475	1,939,492	1,681,418	1,863,799	2,057,064

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Cash flow

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Profit after tax	124,133	203,854	183,628	195,029	198,912
Depreciation	56,984	68,486	67,605	67,755	67,905
Other income	(7,375)	69,421	(42,616)	(42,616)	(42,616)
Interest	13,963	10,768	25,405	32,574	35,774
Working capital changes	33,856	(76,220)	6,723	(4,628)	10,275
Others	34,682	5,370	700	700	700
Operating cash flow	256,242	281,680	241,444	248,814	270,950
Capital expenditure	(160,479)	(137,802)	(195,000)	(255,000)	(255,000)
Investments	2,241	(65,382)	-	-	-
Other income	22,134	26,821	42,616	42,616	42,616
Cash flow from investments	(136,104)	(176,363)	(152,384)	(212,384)	(212,384)
Equity	-	-	-	-	-
Debt	(44,699)	46,420	90,000	130,000	130,000
Interest expenses	(39,496)	(28,021)	(25,405)	(32,574)	(35,774)
Dividends	(34,703)	(127,768)	(124,986)	(136,348)	(136,348)
Cash flow from financing	(118,897)	(109,370)	(60,390)	(38,922)	(42,122)
Total cash generation	1,241	(4,053)	28,671	(2,492)	16,444
Opening cash balance	6,108	7,349	3,295	31,967	29,475
Closing cash & bank balance	7,349	3,295	31,967	29,475	45,919

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Key ratios

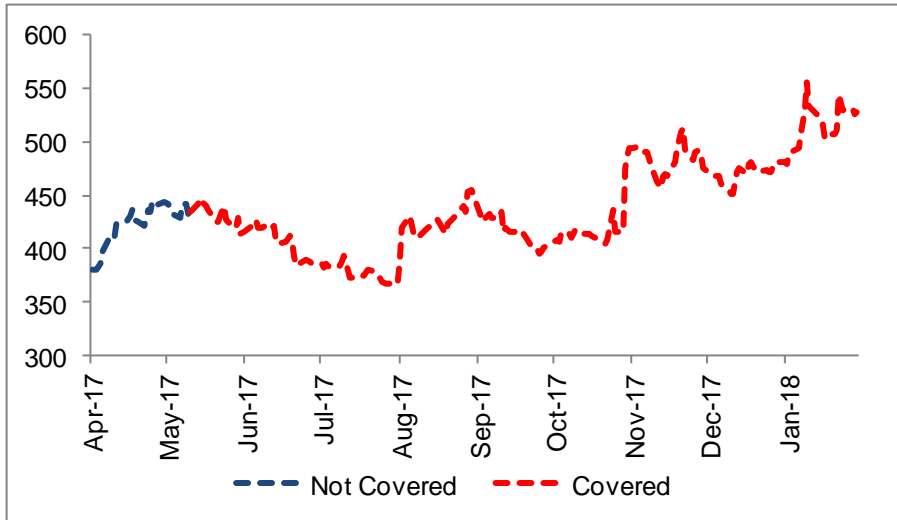
Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Profitability and return ratios					
EBITDA margin (%)	6.8	9.6	7.2	6.9	6.6
EBIT margin (%)	5.13	7.65	5.65	5.54	5.34
Net profit margin (%)	3.5	5.6	4.0	3.8	3.7
RoE(%)	13.8	20.0	21.0	21.1	20.2
RoCE (%)	11.2	14.7	16.6	16.2	15.1
Working capital & liquidity ratios					
Receivables (days)	8	9	9	9	9
Inventory (days)	54	87	52	51	50
Payables (days)	69	80	73	71	70
Current ratio (x)	1.15	1.21	0.98	0.98	0.98
Valuation ratios					
EV/sales (x)	0.8	0.8	0.6	0.6	0.5
EV/EBITDA (x)	11.6	8.4	8.4	8.2	8.3
P/E (x)	14.0	10.0	11.3	10.6	10.4
P/BV (x)	2.3	2.0	2.3	2.2	2.1

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
1 February 2018	Accumulate	418	414

Rating track graph



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BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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