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Indian Oil Corporation Ltd (IOC), founded in 1964, is the country's flagship national oil company with business interests straddling the entire hydrocarbon value chain – from refining, pipeline transportation and marketing of petroleum products to exploration & production of crude oil & gas, marketing of natural gas and petrochemicals. IOC has established its position as the market leader in the downstream petroleum sector of the country. The company's pan India sales network continues to be its major strength. The company and its subsidiary (CPCL) account for over 49% petroleum products market share, 31% national refining capacity and 71% downstream sector pipelines capacity in India. Having set up subsidiaries in Sri Lanka, Mauritius and the United Arab Emirates (UAE), IOC is simultaneously scouting for new business opportunities in the energy markets of Asia and Africa.

## Investor's Rationale

**Net Profit is expected to grow by ~13.1% in FY15E** - During FY14, IOC witnessed 5.8% growth in net sales reaching ₹4,883.4 billion as against ₹4,617.8 billion in FY13. On account of budgetary support of ₹371.8 billion in FY14 and a discount of ₹346.7 billion, the net profit of the company surged 59% YoY to ₹70.9 billion. The improvement in refining margins could create value for shareholders, going forward. Thus, we believe that with an enhanced & intense focus on efficiency improvement and cost optimization, coupled with a country wide reach of its refining and marketing network, IOC is expected to post 13.1% and 20.3% growth in bottom-line in FY15E and FY16E, respectively.

**Deregulation of diesel price to provide higher valuation** - With continued diesel price hikes, appreciating rupee and soft crude oil prices, there is a high probability that diesel under recoveries might be wiped out before the end of the current fiscal. This would substantially improve predictability of earnings for the entire OMC pack. Better cash flow from government will add to interest cost savings. ROEs should improve considerably over the next few years.

**New refinery to improve earning visibility in the coming year** - IOC's new refinery in Paradip, with a refining capacity of 15 million tonnes per annum, is expected to be commissioned by H2FY15E, which in turn would lead to higher earnings performance. We also expect IOC's total borrowings to decline over the next 12 months as the level of fuel subsidies falls. The company funded the cost of subsidising fuel prices with short-term borrowings until the government reimburses them. We expect the newly elected government to continue, if not speed up, efforts to deregulate fuel prices in India.

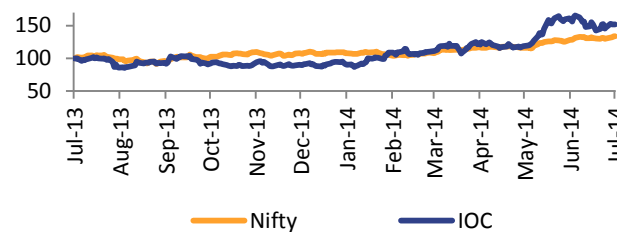
## Market Data

<b>Rating</b>	<b>BUY</b>
<b>CMP (₹)</b>	335.4
<b>Target (₹)</b>	<b>405</b>
<b>Potential Upside</b>	~20.8%
<b>Duration</b>	Long Term
Face Value (₹)	10.0
52 week H/L (₹)	385.1/186.0
Adj. all time High (₹)	435.0
Decline from 52WH (%)	12.9
Rise from 52WL (%)	80.3
Beta	1.8
Mkt. Cap (₹bn)	814.3
Enterprise Value (₹bn)	1,147.6

## Fiscal Year Ended

Y/E	FY13A	FY14A	FY15E	FY16E
Revenue (₹bn)	4,617.8	4,883.4	5,323.0	5,961.7
EBITDA (₹bn)	138.0	170.6	212.9	268.3
Net Profit (₹bn)	44.5	70.9	98.7	139.4
EPS (₹)	18.3	29.2	40.7	57.4
P/E (x)	18.3	11.5	8.2	5.8
P/BV (x)	1.3	1.2	1.1	1.0
EV/EBITDA (x)	7.7	6.7	5.3	4.1
ROCE (%)	10.8	11.3	13.1	16.0
ROE (%)	7.1	10.4	13.4	17.2

## One year Price Chart



Shareholding Pattern	Jun'14	Mar'14	Diff.
Promoters	68.6	68.6	-
FII	2.4	2.1	0.3
DII	4.6	4.8	(0.2)
Others	24.4	24.5	(0.1)

At IOC, operations are strategically structured along business verticals - Refineries, Pipelines, Marketing, R&D Centre and Business Development – E&P, Petrochemicals and Natural Gas.

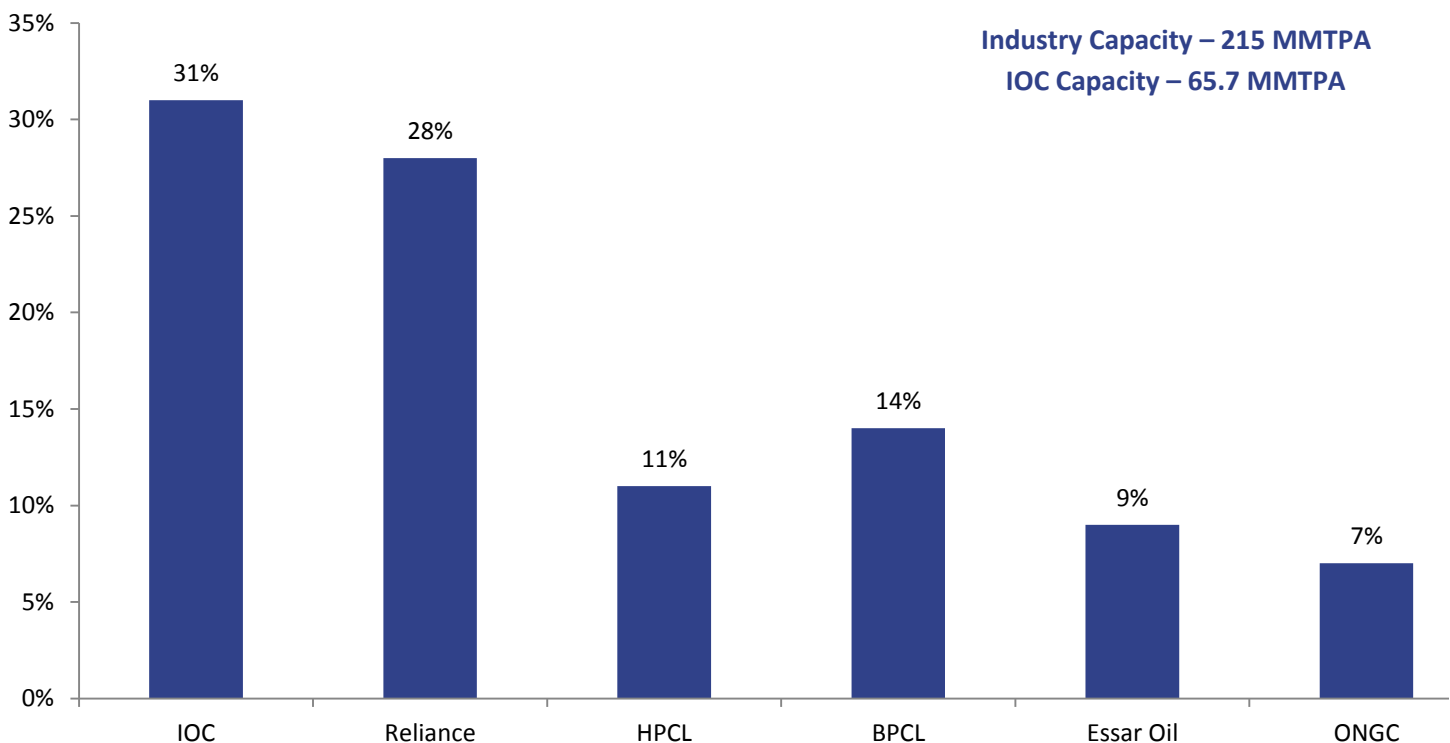
IOC is the leader in refining with a capacity of 65.7 MMTPA, as on March, 2014.

### IOC - India's flagship national oil company

IOC is the largest refining and marketing company in India, with business interests spanning the entire hydrocarbon value chain. It operates 8 refineries (incl BRPL) with a capacity of 65.7 million metric tonne per annum (MMTPA) and has a 52% stake in Chennai Petroleum Corporation Ltd. (CPCL) having refining capacity of 11.5 MMTPA. The company has a pipeline network of >11,214 km (77.3 MMTPA capacity). In addition, the company has 23,993 petrol/diesel outlets and has interests in petrochemicals and upstream oil and gas. IOC is a Public Sector Company with 78.9% Government stake. At IOC, operations are strategically structured along business verticals - Refineries, Pipelines, Marketing, R&D Centre and Business Development – E&P, Petrochemicals and Natural Gas. To achieve the next level of growth, IOC is currently forging ahead on a well laid-out road map through vertical integration— upstream into oil exploration & production (E&P) and downstream into petrochemicals – and diversification into natural gas marketing and alternative energy, besides globalization of its downstream operations. Having set up subsidiaries in Sri Lanka, Mauritius and the United Arab Emirates (UAE), IOC is simultaneously scouting for new business opportunities in the energy markets of Asia and Africa.

With an over 34,000 strong workforce, IOC has been helping to meet India's energy demands for over half a century. IOC is the leader in refining with a capacity of 65.7 MMTPA, as on March, 2014. With a capacity utilization of 98%, IOC achieved a crude throughput of 53.13 MMTPA during FY14 from its refineries segment. The combined distillate yield of all refineries of the company during the year remained at 78.1%. For the first time in FY14, the company has processed nine new crudes (including high TAN crudes). 26 new crudes were included in the Trial crude basket after evaluation for suitability to all Refineries.

#### The largest refiner in India

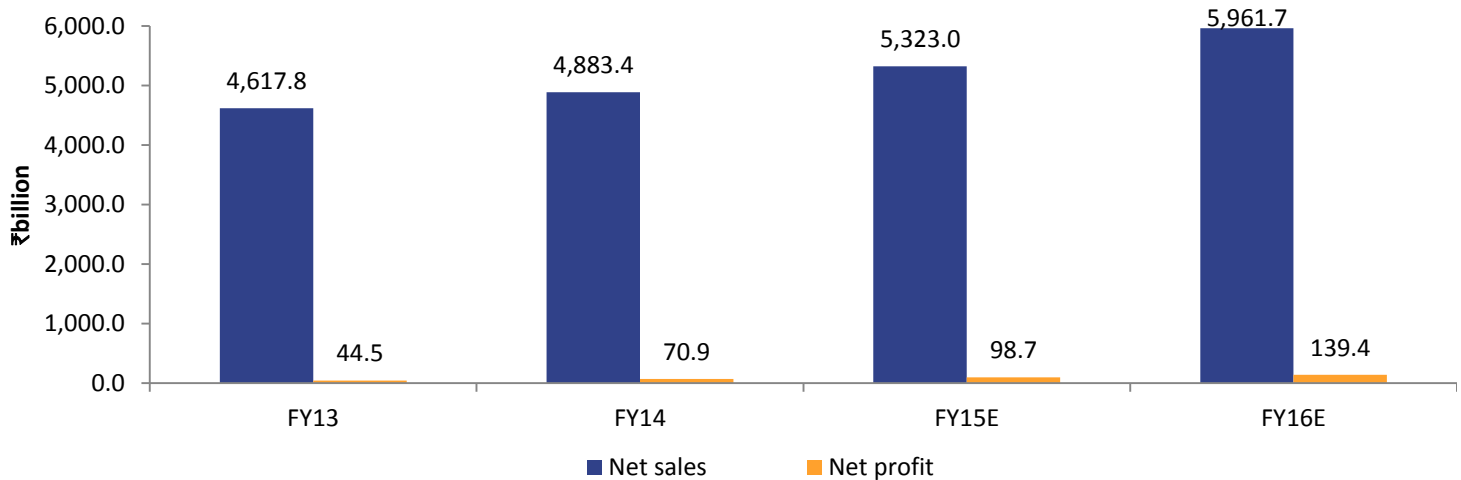


The company saw a robust growth in its net profit by 59% YoY at ₹70.9 billion, primarily on account of budgetary support by the government and the upstream sharing of subsidy burden.

### Posted healthy numbers in FY14

During FY14, IOC has reported 5.8% YoY revenue growth to ₹4,883.4 billion from ₹4,617.8 billion in FY13, mainly due to higher realization. Realizations were higher on the back of diesel price hikes implemented over the past 12 months. For FY14, volumes declined 1.9% YoY to 71.1 MMTPA owing to 4.7% YoY decline in diesel sales and steep fall in FO/LSHS sales to 2.7 million tons. An 8% YoY increase in gasoline volumes and 5.5% YoY rise in LPG sales helped offset the impact. IOC posted 59% YoY increase in its FY14 net profit at ₹70.9 billion on account of higher budgetary support from the government. Government's compensation for the full year is decided only at the end of the year. In FY14, budgetary support from government fell 30% to ₹371.8 billion and discounts from upstream companies rose 8% to ₹347.6 billion compared to FY13. Another reason for the growth in net profit was a 17% decrease in interest expenses. Interest cost declined as the company issued a foreign currency bond at a low cost of debt and utilization of cash compensation from the government used as a repayment of working capital loan.

### Revenue and net profit growth trend



IOC's EBITDA grew by 23.6% YoY to ₹170.6 billion. EBITDA margin improved ~50bps YoY to 3.5% on account of higher realizations.

At present, IOC's 13 pipeline projects are under implementation at an approved cost of about ₹70 billion.

In terms of operational performance, EBITDA grew by 23.6% YoY to ₹170.6 billion. EBITDA margin improved ~50bps YoY to 3.5% on account of higher realizations. The company sold 75.531 MMTPA of petroleum products during FY14, including exports of 4.384 MMTPA, down by 1% YoY. Refining throughput of the company declined by 3% YoY at 53.13 MMTPA and the throughput of the company's countrywide pipeline network was down 3% at 73.609 MMTPA as compared to the corresponding quarter of the previous year. The gross refining margins during the year 2013-14 were USD 4.24/barrel (bbl) as compared to USD 3.16/bbl in 2012-13.

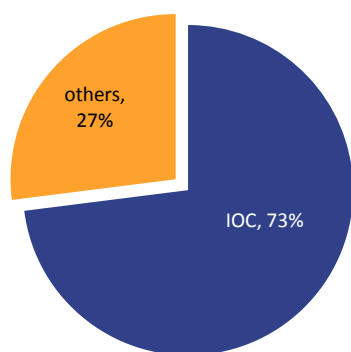
### Well positioned to take advantage of largest pipeline network

IOC has the largest crude and product pipeline in the country, with a market share of 57%. With a pipeline network of >11,214 km, the company's pipeline network is a major source of strength as it facilitates cost-effective and environment friendly transportation. The pipeline division of the company has done a commendable job by transporting 73.08 MMTPA of crude oil and finished products in FY14. At present, IOC's 13 pipeline projects are under implementation at an approved cost of about ₹70 billion. Upon completion, these projects would result in additional length of over 3,200 km and added capacity of about 15.5 MMTPA. With a focus on transporting heavier crudes, IOC has augmented its Salaya-Mathura pipeline

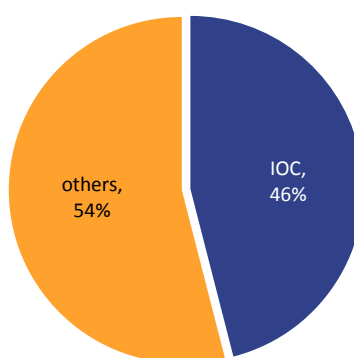
At present, the gas pipeline's capacity of the company stands at 9.5 million metric standard cubic meter per day (mmscmd) in FY14, with a pipeline length of 134 km.

and Paradip-Haldia-Barauni pipeline to 25 MMTPA and 15.2 MMTPA from 21 MMTPA and 11 MMTPA, respectively. In the marketing and distribution operations, cost optimization is directly linked to the efficiency of infrastructure. LPG transportation is an area, where substantial expansion in the pipeline network is required to bring cost efficiency. Presently, IOC's Paradip-Haldia-Durgapur and Ennore-Trichy-Madurai LPG pipeline projects are under implementation. Natural gas pipelines are increasingly emerging as a new opportunity for the company. At present, the gas pipeline's capacity of the company stands at 9.5 million metric standard cubic meter per day (mmscmd) in FY14, with a pipeline length of 134 km. Having built its stronghold in the petroleum pipelines, IOC is aiming to establish a significant position in the national natural gas grid. IOC in association with GSPL, BPCL and HPCL, is setting up three gas pipelines from West and East to North.

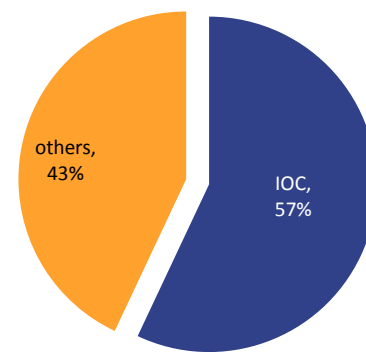
### Largest pipeline market share



Crude oil pipeline



Product pipeline



Total pipeline

Till March 2014, the company had invested ₹260.4 billion. Further, the company plans to invest ₹120 billion in FY15E.

### Robust investment plans

IOC's investment programme during the XII Plan period captures opportunities and envisages to under-take projects worth over ₹562 billion across the energy value chain. Till March 2014, the company had invested ₹260.4 billion. Further, the company plans to invest ₹120 billion in FY15E. The currently under implementation 15 MMTPA refinery at Paradip has reached an advanced stage of completion. In addition, a number of other major projects such as Paradip-Raipur-Ranchi product pipeline, augmentation of Paradip-Haldia-Barauni pipeline, Paradip-Haldia-Durgapur pipeline, new marketing terminal at Paradip, LPG facilities at Paradip, debottlenecking of Salaya-Mathura Pipeline and FCC revamp at Mathura are at various stages of implementation. Thus, we believe that on the back of robust investment plan IOC is expected to boost volume growth in future.

### Petrochemical and E&P business to boost operational efficiency

In the integrated businesses, viz. petrochemicals, the company has recorded highest ever petrochemicals sales of 2.114 MMTPA in FY14 against 2.072 MMTPA during FY13. IOC strengthened its market presence in the segment and emerged as the second largest petrochemicals player in the country. During FY14, the company increased its product basket to 36 polymers and obtained 9 original equipment manufacturer (OEM) approvals for polymer products. In Exploration & Production (E&P), IOC has participating interest in 13 domestic and 11 overseas

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*In Exploration & Production (E&P), IOC has participating interest in 13 domestic and 11 overseas blocks, IOC is operator with 100% participating interest (PI) in 2 onshore exploration blocks in Cambay basin.*

*The 15 MMTPA Paradip refinery is expected to get commissioned in H2FY15, the complete benefit from which will get reflected in FY16E numbers*

blocks, IOC is operator with 100% participating interest (PI) in 2 onshore exploration blocks in Cambay basin. In 2013, the company acquired 10% interest in Pacific North West LNG, Canada. In the remaining 11 domestic blocks, IOC holds a non-operating participating interest ranging between 20% to 30%.

IOC's integrated business operations are likely to increase competitive advantage in the complete deregulated scenario. Therefore, we believe that the company's investments in Petrochemicals and E&P business likely to enhance operational efficiency.

### **15 MMTPA Paradip refinery to commission by H2FY15E**

IOC's Paradip refinery is at advanced stage of implementation. The company had earlier set March 2014 as its deadline for commissioning of the project. However, due to various hurdles including slump in the oil market, land and labor problems, delay in commissioning of the captive power plant and protests over laying of water pipelines from Mahanadi to the plant site, the refinery work has been delayed. Also, due to currency fluctuations, the project cost has escalated to ₹327.1 billion from ₹290 billion estimated originally. The refinery project is much awaited since its commissioning holds the key to development of the PCPIR (petroleum, chemicals & petrochemicals investment region) hub planned across 284 sq. km in Kendrapara and Jagatsinghpur districts. As on March 2014, 96.1% overall Physical Progress and 94.0% overall construction progress has been achieved.

The construction of oil refinery at Paradip by IOC is expected to get completed by H2FY15E, the complete benefit from Paradip refinery is expected to get reflected in FY16E numbers.

#### **Paradip refinery is on the verge of completion**

The 15 MMTPA Paradip refinery, is one of the most modern refineries in the world

Ability to process toughest crudes, with crude oil mix of 100%HS & 40% heavy crude oil

Ability to produce distillate yield of 81%

Refinery has superior secondary processing, with complexity factor of 12.2

Ability to consume energy of 50 MBN, the best in the industry

*To keep pace with the high growth in the retail business, the company has commissioned over 1,700 retail outlets in FY14.*

### **Focused on strengthening the position in retail segment**

With domestic sales of 70.0 MMTPA petroleum products, the company continued to maintain its position as the market leader in FY14. To keep pace with the high growth in the retail business, the company has commissioned over 1,700 retail outlets (including over 750 KSKs) during the year, increasing their total number to over 23,993. Due to high growth potential, the company continued to strengthen its rural positioning as compared to its peers

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*We expect that de-regulation of petroleum product prices will improve profitability of the company on the back of better realizations and lower interest costs on the back of lower under-recovery.*

in the form of the Kisan Seva Kendras (KSK). The total number of KSKs surpassed the 6000 mark. We believe that the company's new initiatives, such as portability of LPG connection within and across companies and sale of 5-kg free-trade LPG cylinders through select ROs and Kirana stores will continue to increase its market share in LPG segment.

### **Rising crude oil prices & rupee depreciation remains a major concern for the company**

Due to geopolitical tension in the Middle East and the recent unrest in Iraq caused by the seizure of major cities in the country by the militant group Islamic State of Iraq and Syria (ISIS), there has been a significant increase in International Oil prices during the past three weeks.

The price of the Indian crude oil basket (sour grade crude oil and sweet grade crude oil) was USD 113.63/bbl on 3<sup>rd</sup> July, 2014 – up from \$106.88/barrel at the beginning of June, 2014. India imports close to 2 million bbl/day of crude oil – so a rise in prices will lead to a higher import bill. India's state-owned oil marketing companies sustain huge losses on the sale of retail fuels such as diesel, petrol, LPG and kerosene because the selling price is less than the cost. The government provides subsidies to make up for their losses. A higher oil price will mean increased losses and a bigger subsidy bill for the government. We expect that de-regulation of petroleum product prices will improve profitability of the company on the back of better realizations and lower interest costs on the back of lower under-recovery.

#### **Burden of under-recovery sharing**

<b>(₹bn)</b>	<b>FY12</b>	<b>FY13</b>	<b>FY14</b>
<i>Gross under realization</i>	754.7	857.9	729.4
<i>Upstream discount</i>	299.6	319.7	346.7
<i>Cash compensation</i>	454.7	532.8	371.8
<i>Net under realization</i>	0.2	5.5	10.8

**Balance Sheet (Consolidated)**

Y/E (₹bn)	FY13A	FY14A	FY15E	FY16E
Share Capital	24.3	24.3	24.3	24.3
Reserve and surplus	606.1	654.9	713.1	785.2
<b>Net Worth</b>	<b>630.4</b>	<b>679.1</b>	<b>737.4</b>	<b>809.5</b>
Minority Interest	12.6	11.7	11.7	11.7
Loans	247.9	358.7	330.0	303.6
Long-term provisions	4.2	4.4	4.4	4.4
Other Liability	114.5	136.9	158.3	177.2
Deferred tax Liability	63.3	64.2	66.2	68.1
Current Liability	1,344.3	1,411.4	1,538.4	1,676.9
<b>Total Equity &amp; Liabilities</b>	<b>2,417.2</b>	<b>2,666.4</b>	<b>2,846.4</b>	<b>3,051.4</b>
Goodwill	0.9	0.9	0.9	0.9
Fixed assets	939.3	1,105.3	1,140.1	1,185.7
Investments	36.9	85.7	88.2	90.9
Loans & adv	53.5	49.4	49.4	49.4
other asset	12.8	13.5	14.9	16.4
Current Assets	1,373.8	1,411.7	1,552.8	1,708.1
<b>Total assets</b>	<b>2,417.2</b>	<b>2,666.4</b>	<b>2,846.4</b>	<b>3,051.4</b>

**Key Ratios (Consolidated)**

Y/E	FY13A	FY14A	FY15E	FY16E
EBITDA Margin (%)	3.0	3.5	4.0	4.5
EBIT Margin (%)	2.5	2.9	3.2	3.7
NPM (%)	1.0	1.4	1.8	2.3
ROCE (%)	10.8	11.3	13.1	16.0
ROE (%)	7.1	10.4	13.4	17.2
EPS (₹)	18.3	29.2	40.7	57.4
P/E (x)	18.3	11.5	8.2	5.8
BVPS (₹)	259.6	279.7	303.7	333.4
P/BVPS (x)	1.3	1.2	1.1	1.0
EV/Operating Income (x)	0.2	0.2	0.2	0.2
EV/EBITDA (x)	7.7	6.7	5.3	4.1

**Profit & Loss Account (Consolidated)**

Y/E (₹bn)	FY13A	FY14A	FY15E	FY16E
<b>Net sales</b>	<b>4,617.8</b>	<b>4,883.4</b>	<b>5,323.0</b>	<b>5,961.7</b>
Expenses	4,479.8	4,712.9	5,110.0	5,693.4
<b>EBITDA</b>	<b>138.0</b>	<b>170.6</b>	<b>212.9</b>	<b>268.3</b>
Other Income	35.1	34.4	30.3	30.9
Depreciation	56.9	63.6	71.2	79.8
<b>EBIT</b>	<b>116.2</b>	<b>141.4</b>	<b>172.0</b>	<b>219.4</b>
Interest	71.2	59.1	48.4	39.7
Exceptional Item	0.0	17.5	19.2	21.1
Profit before tax	45.0	99.8	142.7	200.8
Tax	8.8	30.1	42.8	60.2
Minority Int	(8.2)	(1.2)	(1.2)	(1.2)
<b>Net Profit</b>	<b>44.5</b>	<b>70.9</b>	<b>98.7</b>	<b>139.4</b>

**Valuation and view**

IOC posted strong earnings growth in FY14, mainly on the back of lower subsidy burden. Further, full diesel deregulation will lead to lower interest costs. We see earnings growth in the next two years from the improvement in GRM due to commercialization of Paradip refinery and lower interest expense on continued diesel price hike. Going ahead, we believe that stabilization of the currency coupled with deregulation of petroleum product prices should result in an improvement of profitability for the company by way of better realizations and lower interest costs on the back of lower under-recovery. We continue to maintain our positive stance on OMCs on pricing reforms. Moreover, any solution to subsidy sharing mechanism would prove to be a big positive for the stock.

At a current CMP of ₹335.4, IOC is attractively placed at P/E of ~8.2x and ~5.8x, for FY15E and FY16E, respectively. Considering the above aspects, we rate the stock as 'BUY' with a target price of ₹405, which implies a potential upside of ~20.8% for the coming 12 months.



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