MOTILAL OSWAL

Indian Oil Corporation

STOCK INFO.	BLOOMBERG
BSE Sensex: 10,752	IOC IN
	REUTERS CODE
S&P CNX: 3,148	IOC.BO

Equity Shares (m)	1,168.0
52-Week Range (Rs)	622/310
1,6,12 Rel. Perf. (%)	-5/-33/-46
M.Cap. (Rs b)	451.8
M.Cap. (US$ b)	6.5

1 August 2006

Buy

Previous Recommendation:Buy

Rs387

YEAR END	NET SALES (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
03/06A	1,613,166	49,324	42.2	-9.8	9.2	1.3	15.5	17.6	0.3	6.2
03/07E	2,275,337	27,588	23.6	-44.1	16.4	1.2	7.7	11.0	0.2	7.5
03/08E	1,582,251	41,701	35.7	51.2	10.8	1.1	10.6	13.1	0.3	6.0

- IOC reported a net loss of Rs14.4b (before extra-ordinary income) for 1QFY06 as against loss of Rs542m last year, on account of large under-recoveries, and non-issuance of oil bonds before the quarterly results. Stronger than expected refining margin softened the blow. Net profit including extraordinary gains (on account of sale of ONGC stake) was Rs17.8b.
- Fuel marketing under-recoveries (net of upstream sharing and refinery discounts) of Rs49b was up 53.4% YoY, thanks to historic high crude prices and sticky domestic retail prices. Upstream players sharing of Rs29.9b (up 78.4% YoY) and discounts from refineries set off part of the losses. However, non-issuance of estimated Rs34.6b (our estimate) of oil bonds pulled down performance.
- Strong refining margin of US6.7/bbl (as against US$6.16/bbl last year) cushioned losses caused by under-recoveries. EBITDA contribution from pipeline was largely flat at Rs5.8b. Inventory gains at Rs2.1b was up 52% YoY. On the operations front, refinery thruput at 10m tons was up 9.3% YoY, while market sales volume was up 2.5% at 13.1m tons. Pipeline thruput was up 5.1% YoY at 11.7m tons.
- While oil bond issue over the next couple of months would wipe off the losses, we believe, lack of clarity on policy to tackle incremental losses (given the higher crude prices) would continue to impact stock performance. However, at a P/E of 10.8x FY08E and an EV/EBITDA of 6.0x FY08E, valuations are attractive. We believe stronger than expected refining margins could provide a positive earnings surprise. Maintain **Buy**.

QUARTERLY PERFORMANCE (STANDALONE) (Rs Million)

Y/E MARCH	FY06				FY07E				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Net Sales	**386,235**	**400,452**	**442,936**	**507,844**	**486,884**	**532,398**	**474,025**	**469,649**	**1,737,467**	**1,962,956**
Change (%)	*7.3*	*12.9*	*11.1*	*24.1*	*26.1*	*32.9*	*7.0*	*-7.5*	*14.1*	*13.0*
Raw Material Consumed	138,141	159,771	182,479	198,831	200,298	220,000	210,000	207,476	679,221	837,774
Staff Cost	4,355	4,335	4,368	5,380	4,893	4,500	4,500	5,611	18,438	19,504
Fininshed Goods Purchase	221,652	222,421	219,312	237,558	262,155	245,000	230,976	225,000	900,943	963,131
Other Exp (incl Stock Adj)	17,427	-919	35,169	13,770	27,983	21,000	21,750	22,588	65,448	93,321
EBITDA	**4,661**	**14,844**	**1,608**	**52,305**	**-8,445**	**41,898**	**6,799**	**8,974**	**73,418**	**49,226**
% of Net Sales	*1.2*	*3.7*	*0.4*	*10.3*	*-1.7*	*7.9*	*1.4*	*1.9*	*4.2*	*2.5*
% Change	*-82.5*	*-20.3*	*-86.6*	*257.9*	*-281.2*	*182.3*	*322.7*	*-82.8*	*2.1*	*-33.0*
Depreciation	5,439	5,215	5,549	5,802	5,750	6,000	6,500	6,859	22,005	25,109
Interest	1,684	2,497	3,225	2,817	3,344	2,000	2,000	1,085	10,222	8,429
Other Income	2,115	6,021	5,796	11,986	3,153	3,975	1,850	1,939	25,918	10,917
PBT	**-347**	**13,153**	**-1,369**	**55,672**	**-14,387**	**37,873**	**149**	**2,969**	**67,109**	**26,604**
Tax	196	3,657	-1,310	15,367	56	5,484	35	700	17,909	6,276
Rate (%)	*-56.5*	*27.8*	*95.7*	*27.6*	*-0.4*	*14.5*	*23.6*	*23.6*	*26.7*	*23.6*
PAT	**-542**	**9,496**	**-58**	**40,306**	**-14,443**	**32,388**	**113**	**2,269**	**49,201**	**20,328**
Change (%)	*-103.7*	*-23.4*	*-100.5*	*351.4*	*nm*	*241.1*	*nm*	*-94.4*	*0.6*	*-58.7*
PAT incl extra-ordinaries					**17,805**					**52,576**

E: MOSt Estimates

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IOC reported a net loss of Rs14.4b (before extra-ordinary income) for 1QFY06 as against loss of Rs542m last year, on account of large under-recoveries, and non-issuance of oil bonds before the quarterly results. Stronger than expected refining margin softened the blow. Net profit including extraordinary gains (on account of sale of ONGC stake) was Rs17.8b.

Fuel marketing losses continue to hurt

Fuel marketing under-recoveries (net of upstream sharing and refinery discounts) of Rs49b was up 53.4% YoY, thanks to historic high crude prices and sticky domestic retail prices. Upstream players sharing of Rs29.9b (up 78.4% YoY) and discounts from refineries set off part of the losses.

However, non-issuance of estimated Rs34.6b (our estimate) of oil bonds pulled down performance. We expect oil bonds to be issued in 2QFY07, wiping off 1QFY07 losses.

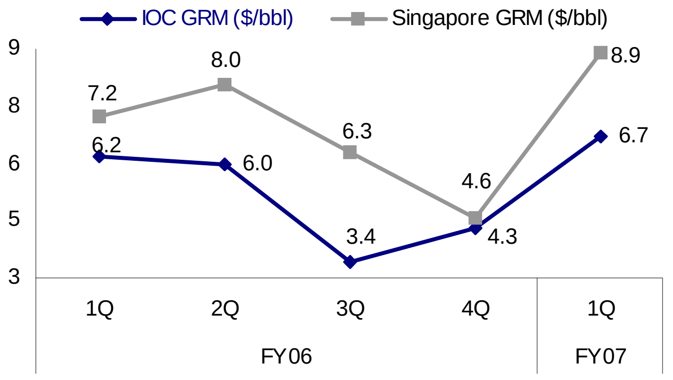
Inventory gains at Rs2.1b was up 52% YoY. However, the quantum of swing in inventory has been moderated after inventory valuation methodology was changed to weighted average from FIFO by IOC last year.

Refining margin buoyancy continues

Strong refining margin of US6.7/bbl (as against US$6.16/bbl last year) cushioned losses caused by under-recoveries. Adjusting for (industry) average refinery discounts of US$1.7/bbl, GRM of about US$8.4/bbl, is comparable to Singapore GRM of US$8.9/bbl and other PSU refineries. Continued strong refining margins in 2QFY07 could drive earnings upgrade.

Global refining margins are on an extended upswing, which is likely to continue for the next 48 months, given the limited new capacity in the pipeline and robust demand growth. We believe Singapore complex margins of US$7.5/bbl (as against 1QFY07 GRM of US$8.9/bbl) is sustainable.

QUARTERLY REFINERY-WISE MARGIN TREND (US$/BBL)



Source: Company/Motilal Oswal Securities

Pipeline earnings remain stable

EBITDA contribution from pipeline was largely flat at Rs5.8b, though pipeline thruput was up marginally by 5.1% YoY at 11.7m tons.

Operating parameters improve

On the operations front, refinery thruput at 10m tons was up 9.3% YoY, partly on account of commissioning of 6m tons of new capacity at Panipat. We expect thruput to further rise in the coming quarters as the full impact of the expansion flows through.

Market sales volume was up 2.5% at 13.1m tons. We believe demand growth, impact of higher crude thruput and Reliance winding down its retail thruput in June 2006 could have driven market sales growth.

Adjusting FY07 estimates

We have adjusted our FY07 (consolidated) estimates to reflect profit from sale of ONGC stake as extra-ordinary income and adjustment to tax outgo.

REVISED ESTIMATES (RS B)

	FY07			FY08		
	OLD	NEW	% CH.	OLD	NEW	% CH.
EBITDA	68.3	68,.2	-	84.1	84.1	-
Net profit (pre-ext.)	52.2	27.6	-47.2	41.7	41.7	-
EPS	44.7	23.6	-47.2	35.7	35.7	-
Net profit (post-ext.)	52.2	59.8	14.5			
EPS (post-ext.)	44.7	51.2	14.5			

Source: Motilal Oswal Securities

New refining and petrochemical capacity to drive volume growth

Commissioning of 6m tons of new refining capacity at Panipat along with PX/PTA complex (550ktpa of PTA and 350ktpa of PX) is expected to drive volume growth over the next 3 quarters. Strong margin environment on both refining and petrochemical front (GRMs are at a new high, while PX spread over naphtha is at a historic high) augurs well for IOC.

Valuation and view

While oil bond issue over the next couple of months would wipe off the losses, we believe, lack of clarity on policy to tackle incremental losses (given the higher crude prices) would continue to impact stock performance. However, at a P/E of 10.8x FY08E and an EV/EBITDA of 6.0x FY08E, valuations are attractive. We believe, most of the negatives are already in the price, while stronger than expected refining and petrochemical margins could provide a positive earnings surprise. Maintain **Buy**.

Indian Oil Corporation: an investment profile

Company description

A Fortune-500 company, IOC is the largest refining and marketing company in India, with capacity and market share of 50-54%.

Recent developments

- Government has announced that it would bear 1/3rd of fuel marketing losses along with standalone refiners.
- Standalone refiners are sharing a part of the loss burden.

Key investment arguments

- Government has announced that it would bear 1/3rd of fuel marketing losses along with standalone refiners. This loss sharing would enable oil marketing companies to turn profitable
- Policy risk more than priced in. Valuations continue to reflect highly pessimistic earnings expectation.

Key investment risks

- Continued increase in crude prices, along with non-revision of retail prices of controlled products.
- Loss of market share to private players.

Valuation and view

- At a P/E of 10.8x FY08E and an EV/EBITDA of 6.0x FY08E, valuations are not demanding.
- We maintain **Buy.**

Sector view

- Refining margins are on an upswing due to improved fundamentals, globally. We expect the upcycle to continue the next 48 months.

COMPARATIVE VALUATIONS

		IOC	BPCL	HPCL
P/E (x)	FY07E	16.4	13.8	20.0
	FY08E	10.8	9.9	13.9
P/BV (x)	FY07E	1.2	1.1	0.8
	FY08E	1.1	1.0	0.8
Div. Yield (%)	FY07E	3.1	0.0	0.0
	FY08E	3.1	0.0	0.0
EV/EBITDA (x)	FY07E	7.5	5.1	8.5
	FY08E	6.0	4.5	7.0

EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	23.6	49.0	-51.8
FY08	35.7	47.0	-24.1

SHAREHOLDING PATTERN (%)

	JUN.06	MAR.06	JUN.05
Promoters	91.3	91.3	91.3
Domestic Institutions	4.0	3.8	3.4
FIIs/FDIs	1.8	2.0	1.9
Others	3.0	3.0	3.4

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
387	-	-	Buy

INCOME STATEMENT				(Rs Million)
Y/E MARCH	2005	2006E	2007E	2008E
Net Sales	**1,334,072**	**1,613,166**	**2,275,337**	**1,582,251**
Total Income	**1,334,072**	**1,613,166**	**2,275,337**	**1,582,251**
Finished Gds Purchase	572,158	652,278	964,809	527,039
Raw Materials Cons	567,197	778,336	1,113,818	840,786
Duties, Taxes, etc	140,227	177,981	129,778	129,778
Transportation	40,188	41,798	41,798	41,798
Employee Costs	119,494	113,767	147,532	149,992
EBITDA	**94,065**	**87,403**	**68,289**	**84,062**
% of Net Sales	*7.1*	*5.4*	*3.0*	*5.3*
Depreciation	25,246	25,524	28,567	29,187
Interest	7,681	12,519	9,454	3,874
Other Income	14,219	23,572	15,634	14,483
PBT	**75,357**	**72,932**	**45,902**	**65,484**
Tax	16,348	21,773	13,144	19,520
Rate (%)	*21.7*	*29.9*	*28.6*	*29.8*
PAT	59,009	51,159	32,758	45,964
Group net profit	**59,009**	**51,159**	**32,758**	**45,964**
Minority interest	-4,317	-1,835	-5,170	-4,263
Net profit pre-extraordi	**54,692**	**49,324**	**27,588**	**41,701**
Change (%)	*-27.0*	*-9.8*	*-44.1*	*51.2*

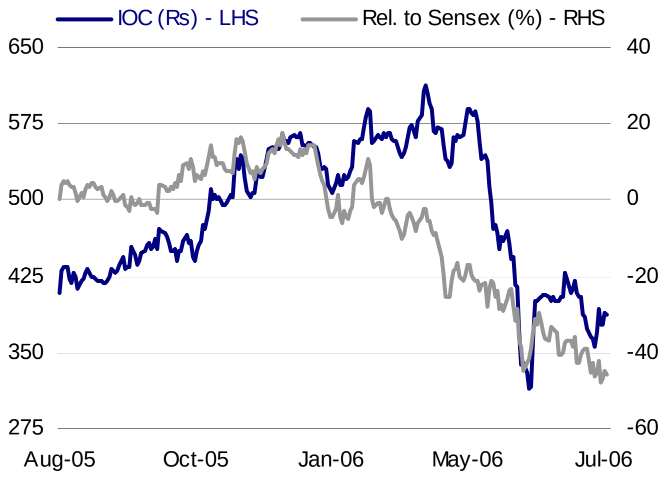
RATIOS				
Y/E MARCH	2005	2006E	2007E	2008E
Basic (Rs)				
FDEPS	**46.8**	**42.2**	**23.6**	**35.7**
Cash EPS	65.3	71.7	49.3	64.5
Book Value	251.9	294.1	317.7	353.4
Dividend	14.5	12.5	12.0	12.0
Valuation (x)				
P/E	8.3	9.2	16.4	10.8
Cash P/E	5.9	5.4	7.9	6.0
EV / EBITDA	5.9	6.2	7.5	6.0
EV / Sales	0.4	0.3	0.2	0.3
Price / Book Value	1.5	1.3	1.2	1.1
Dividend Yield (%)	3.7	3.2	3.1	3.1
Profitability Ratios (%)				
RoE	20.5	15.5	7.7	10.6
RoCE	18.4	17.6	11.0	13.1
Leverage Ratio				
Debt / Equity (x)	0.4	0.3	0.3	0.2

 # Adjusted for value of investments

BALANCE SHEET				(Rs Million)
Y/E MARCH	2005	2006E	2007E	2008E
Share Capital	11,680	11,680	11,681	11,682
Reserves	282,528	331,852	359,440	401,141
Net Worth	**294,208**	**343,532**	**371,121**	**412,823**
Minority interest	**15,935**	**16,207**	**19,835**	**22,742**
Loans	124,937	112,777	92,810	96,069
Deferred Tax	50,665	52,359	57,514	65,743
Capital Employed	**485,745**	**524,874**	**541,280**	**597,377**
Gross Fixed Assets	512,341	614,518	659,463	703,441
Less: Depreciation	188,256	212,731	240,245	268,230
Net Fixed Assets	**324,085**	**401,787**	**419,218**	**435,211**
Capital WIP	62,259	31,965	12,548	-9,511
Investments	49,653	54,472	71,046	87,602
Goodwill	13,667	13,299	13,554	13,803
Cash & Bank Balance	17,641	23,173	34,645	42,846
Inventory	134,325	133,622	132,670	134,169
Debtors	46,746	59,343	70,932	49,558
Loans & Advances	66,976	68,662	70,386	72,306
Other assets	627	30	31	32
Liabilities	208,509	242,389	265,317	210,205
Provisions	21,724	19,090	18,432	18,433
Net Current Assets	**36,081**	**23,351**	**24,915**	**70,272**
Application of Funds	**485,745**	**524,874**	**541,280**	**597,377**

E: MOSt Estimates; Consolidated before merger

STOCK PERFORMANCE (1 YEAR)



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Disclosure of Interest Statement	Indian Oil Corporation
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	Yes
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No