

Current Reco	:	HOLD
Previous Reco	:	BUY
CMP	:	INR272
Target Price	:	INR267
Potential Return	:	-2%

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Market data

Sector	:	Oil & Gas
Market Cap (INRbn)	:	659
Market Cap (USDbn)	:	13
O/S Shares	:	2,428
Free Float (m)	:	241
52-wk HI/LO (INR)	:	360/247
Avg Daily Vol ('000)	:	355
Bloomberg	:	IOCL IN

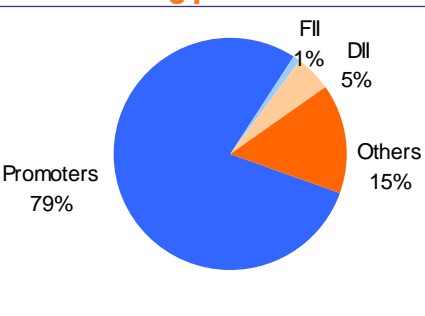
Source: Bloomberg

Returns (%)

	1m	3m	6m	12m
Absolute	7	(8)	(13)	(16)
Relative	(4)	(7)	(8)	(13)

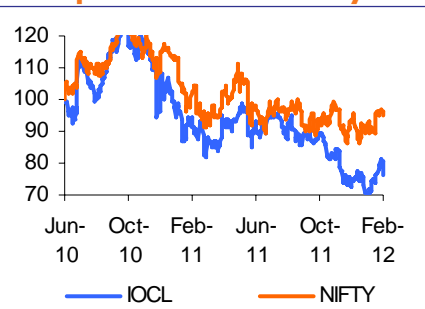
Source: Bloomberg

Shareholding pattern



Source: BSE

Price performance vs Nifty



Source: Bloomberg

COMPANY UPDATE

Indian Oil Corporation Limited

The entry tax jolt

Key highlights

- IOCL lost UP entry tax case in Allahabad High court, liability of INR84bn:** Allahabad High Court has dismissed IOCL's petition and upheld the UP Entry Tax Act 2007, whereby UP govt is entitled to levy an entry tax/octroi on crude oil at 5% (USD5.5/bbl at current oil prices) for its Mathura refinery. IOCL will have net liability of INR84bn (refer table on page 2) including last ten-year demand with interest. Hon'ble Supreme Court while accepting the review petition has asked IOCL to deposit 50% of the accrued tax liability (INR42bn) and furnish bank guarantee for the balance within next few months. Hon'ble Supreme Court has also asked IOCL to pay the tax at the prevailing rates for the future period till the review petition is decided.
- Entry tax - an irrecoverable item for refiners, to make Mathura refinery unviable:** Entry tax has been an irrecoverable item for refiners and not included as part of the refinery transfer price (RTP) as it is based on import parity price and does not include local taxes. Entry tax burden of USD5.5/bbl is huge with respect to average USD6.1/bbl GRMs made by Mathura refinery (8mmtpa) during FY09-11 and an average net margin of USD3.9/bbl.
- Full price hike in marketing looks difficult, we expect 2.5% under-realisation:** IOCL will require MoP&NG approval (largely political clearance) for raising prices on regulated products in UP to cover this additional tax. On non-regulated products, IOCL will face the problem of substitution, as products imported from nearby states will attract entry tax in UP, which can be fully set-off against VAT. We believe that when Central Govt. itself is looking to raise prices of regulated products, it would be very difficult for IOCL to separately raise price in UP to pass through the entire entry tax leading to irrecoverable expense of ~2.5%.
- Impact on earnings:** IOCL has to provide for this entire liability of INR84bn in one go, wiping off FY12e earnings. Also payment of INR42bn in next few months will increase interest liability by INR3.4bn in FY13e. Assuming 2.5% less pass through, IOCL recurring EBITDA would be impacted by INR7.4bn annually (INR2.1/sh post tax) on IOCL's recurring earnings.

Valuation and outlook

- Downgrade to HOLD:** Considering Hon'ble SC doesn't reverse High Court order, we have reduced our earnings for FY12-14e. We have revised our valuation methodology and now value IOCL at an average of: i) FY12e 0.8x BV at INR174/share; and ii) FY13e 10x EPS at INR200/share (FY13e revised EPS of INR20). We value listed investments at INR80/share. We downgrade the stock to HOLD in light of the above changes with a revised target price of INR267/share (earlier INR314/share).

Can IOCL recover UP entry tax by price hikes? We believe they can't

The committee notes that "As this is an incidence on the raw material, it cannot be recovered from product prices and leads to erosion of the refinery gross margin."

- **Historically Entry Taxes/Octroi has been an irrecoverable item for refiners:** The Committee on Pricing and Taxation of Petroleum Products in 2006 has noted that "Many state governments in India are levying irrecoverable taxes on crude oil and petroleum products. In Mumbai, the two refineries of HPCL and BPCL pay an octroi @ 3% on crude oil entering the municipal limits of Mumbai. Similarly, the state governments of Karnataka, Bihar and Assam levy 2% entry tax and Haryana levy 4% entry tax on crude oil. Out of a total of 17 PSU refineries in the country, 10 refineries are impacted by this levy". The committee notes that "As this is an incidence on the raw material, it cannot be recovered from product prices and leads to erosion of the refinery gross margin."
- Our interaction with OMCs indicate that refinery transfer price is based on import parity price and doesn't account for any local levies. Historically, none of the refiner is able to recover the entry/octroi taxes levied on them and they consider it as irrecoverable items.
- Case in point is HPCL and BPCL Mumbai refineries where these Companies have been paying 3% Octroi, and RTP built up of Mumbai Refineries doesn't reflect octroi. Similarly, MRPL is not able to recover 2% entry tax levied in Karnataka.
- For increasing regulated product prices like Diesel, Kerosene and LPG in UP to pass through 5% UP entry tax, they need a MoP&NG approval and needless to say political clearances from Delhi. Also, increasing prices due to irrecoverable items has no precedence for the ministry. Hence, we believe that complete pass through of UP entry tax of 5% on regulated products would be very difficult.
- On non-regulated products, IOCL will face the problem of substitution as products imported from nearby states though attract entry tax in UP, would be fully "set-off" against VAT paid by OMCs on sale of products. In this scenario, it would be very difficult for IOCL to pass through the entire entry tax to bulk consumers particularly aviation and industries near to UP border.
- We hence believe that on a blended basis IOCL would only be able to pass through 2.5% of entry tax and rest 2.5% will become irrecoverable expense for company, impacting its recurring EBITDA by INR7.4bn annually, which is INR2.1/share post tax impact on IOCL recurring EPS of INR30-35/share.

We assume IOCL will not be able to recover 2.5% of entry tax

IOCL's payment of INR42bn in next few months will increase its interest burden in FY13e

IOCL's entry tax liability till March '12

Particulars	Amount (INRbn)
Total Entry Tax (incl interest) till Nov'11	89.2
Un paid amount for Feb'07	0.7
Estimated Interest liability till Mar'12	14.8
Estimated liability (Dec'11-Mar'12)	5.0
Gross Tax liability	109.7
Less: Tax already paid up to 26.1.04 and charged to P&L	7.7
Less: Provision made for tax deposited in SPL A/c with Govt.	15.9
Less: Addl provision made for 2003-04	1.9
Net estimated Tax liability to be provided till Mar'12	84.1

Source: Industry

Mathura refinery's current 3-year average net margin is USD3.9/bbl, making it unviable post entry tax of 5% (USD5.5/bbl)

BPCL/HPCL already paying 3% entry tax on their Mumbai refinery

Historical entry tax imposed in UP

Upto 10th Oct'02	3%
From 11th Oct'02 to 30th Nov'06	4%
From 1st Dec'06 onwards	5%

Source: Industry

Entry taxes levied in other States

State	Entry tax
Mumbai	3%
Haryana	4%
Karnataka	2%
Bihar	2%
Assam	2%

Source: Industry

Huge contingent liabilities on various tax disputes unaccounted by OMCs

We would also like to highlight huge contingent liabilities on various ongoing tax disputes unaccounted/not provided by OMCs as per the auditor's report in FY11 Annual Report. Majority of ongoing tax disputes pertain to sales tax issues apart from IOCL's entry tax issue. The total contingent liabilities towards various disputed taxes are as below:

Disputed cases at FY11 end

(INRm)	IOCL	BPCL	HPCL
Central Excise	22,604	14,272	4,923
Customs Duty	1,536	787	667
Sales Tax	76,638	39,476	76,141
Income Tax	618	146	5
Service Tax	823	31	1,273
Entry Tax	66,665		
Others	344		
Total	169,228	54,713	83,009
Cases with Supreme Court	22,960	5,621	1,589
% of cases with Supreme Court	14%	10%	2%
Contingent Liability	78,209	47,240	45,688

Source: Auditor's report of FY11 Annual reports of OMCs

Details of the UP entry tax case

- Allahabad High Court in judgement dated 23 Dec'11 has dismissed IOCL's petition and upheld the Entry Tax Act of 2007. HC has held that under new Act defects have been rectified, fund has been created by the Govt, and now entry tax is compensatory in nature, dismissing IOCL's writ petition.
- IOCL filed Special Leave Petition (SLP) before Supreme Court on Jan 04, 2012 wherein interim order has been pronounced on Jan 17, 2012. The operation of the judgement of Allahabad HC is stayed subject to IOCL deposit 50% of the accrued tax liability/arrears and furnish bank guarantee for the balance amount by Feb 14, 2012.
- IOC shall continue to pay the tax at the prevailing rates for the future period as applicable.

- In case UP loses the matter at the time of final hearing, it shall refund the amount deposited with interest. However, in case IOCL loses the matter, the department is at liberty to encash the bank guarantee offered by IOCL and also issue demand notice demanding interest, and penalty on the amount outstanding as arrears of tax.

IOCL's Entry tax dispute - Chronology of events

Date	Event
Act of 2000	Entry tax on various items, including crude oil and gas, was issued by UP Govt as per UP Tax on Entry of Goods Ordinance 1999
27-Jan-04	Act challenged by IOCL before Allahabad High Court. Allahabad HC declared Ordinance/Act as invalid
2-Feb-04	SC granted stay order and asked IOCL to deposit all the taxes that may be realised by UP Govt. after 27th Jan'04 in a separate account. Consequent to this, INR15.9bn was deposited under protest by IOCL with the State Govt, during Jan'04 - Feb'07. In addition INR7.7bn was paid by way of tax during Nov'99-Jan'04
14-Jul-06	SC remanded the appeals filed by UP State Govt, to Allahabad HC to re-examine the issue
8-Jan-07	Allahabad HC held that it cannot be proved that levy and collection of entry tax is compensatory in nature. Consequently IOCL stopped depositing the amounts in the Special Account from March'07 and also stopped making any provision for the Entry Tax. The judgment was challenged by UP state
24-Sep-07	UP Act of 2000 was repealed and new Ordinance was passed by UP State to levy entry tax with retrospective effect from 1st Nov'99 maintaining the same rate of tax
10-Oct-07	IOCL filed writ petition before Allahabad HC which passed stay order in favor of IOCL
23-Dec-11	Allahabad HC dismissed IOCL's petition and upheld the Entry Tax Act of 2007. HC has held that under new Act defects has been rectified, fund has been created by the Govt, and now entry tax is compensatory in nature
4-Jan-12	IOCL filed Special Leave Petition (SLP) before Supreme Court
17-Jan-12	Interim order passed by SC and Entry tax will be applicable to IOCL

Source: Industry, Antique

Entry Tax demands received from UP Govt, for period up to Nov'11

Year	Entry tax paid by IOCL on crude	Entry tax on R-LNG	Add. demand on crude (Ex. Int.)	Demand for interest	Total
FY00	717	-	109	-	826
FY11	1,895	-	197	-	2,092
FY02	1,866	-	318	-	2,184
FY03	2,698	-	294	-	2,992
FY04	1,076	-	2,273	-	3,349
FY05	3,085	-	380	-	3,465
FY06	5,558	-	-	-	5,558
FY07	6,725	-	613	467	7,805
FY08	-	-	9,203	5,729	14,931
FY09	-	48	11,717	-	11,764
FY10	-	15	10,141	-	10,186
FY11	-	178	13,339	-	13,517
FY12 till Nov'11	-	210	10,306	-	10,516
Total	23,619	481	58,890	6,196	89,186

Source: Industry, Antique

Valuation and outlook

Considering Hon'ble SC doesn't reverse High Court order, we have reduced our earnings for FY12-14e. We have revised our valuation methodology and now value IOCL at an average of: i) FY12e 0.8x BV at INR174/share; and ii) FY13e 10x EPS at INR200/share (FY13e revised EPS of INR20). We have also revised IOCL's chemical margin for FY13e. We value listed investments at INR80/share. We downgrade the stock to HOLD with a revised target price of INR267/share (earlier INR314/share).

Schedule of investments

Investment	Shares (m)	Price (post 20% haircut)	Value
O N G C	658	210	137,901
Chennai Petroleum	77	162	12,486
GAIL	31	336	10,292
Petronet LNG	94	120	11,250
Oil India	11	1,008	10,786
Lanka IOC and IOC Mauritius		1.5x BV	7,798
Total			190,512
No. of shares (m)			2,370
Value/sh			80

Source: Company, Antique ; Note: Other investments-CMP at 20% discount

SoTP valuation

Particulars	Earnings	Multiple	Value/sh (INR)
FY12e Book Value	218	0.8x	174
Core business FY13e EPS	20.0	10x	200
Average of book value and PE			187
Investments			80
Value/sh			267

Source: Antique

Key Financials - IOCL

Year ended March	FY09	FY10	FY11	FY12e	FY13e
Net Revenue (INRbn)	3,030	2,711	3,322	4,317	4,401
EBITDA (INRbn)	64	123	117	93	124
PAT (INRbn)	97	102	74	(37)	47
EPS (INR)	39.4	43.1	31.4	(15.6)	20.0
CEPS (INR)	51.1	56.7	50.6	4.9	40.9
PE (x)	7.8	7.1	9.8	(19.7)	15.4
PB (x)	1.7	1.4	1.3	1.4	1.3
EV/EBITDA (x)	13.3	7.6	8.9	13.9	9.4
RoE (%)	22	20	13	(7)	9

Source: Company, Antique

Financials

Profit and loss account (INRm)

YE 31st Mar	2009	2010	2011	2012e	2013e
Revenues	3,030,125	2,711,320	3,322,088	4,316,636	4,401,176
Expenses	(2,966,320)	(2,588,128)	(3,204,806)	(4,224,073)	(4,277,347)
EBITDA	63,805	123,192	117,282	92,563	123,828
D & A	(28,817)	(32,271)	(45,467)	(48,649)	(49,622)
EBIT	34,988	90,920	71,815	43,914	74,206
Interest expense	(39,521)	(15,265)	(26,698)	(52,007)	(44,757)
Other income	47,820	65,405	45,842	(47,094)	41,180
Profit before tax	43,286	141,061	90,958	(55,188)	70,629
Tax	(13,790)	(38,855)	(16,504)	18,212	(23,307)
Profit after tax	29,495	102,205	74,455	(36,976)	47,321
Adjusted profit after tax	96,775	102,206	74,455	(36,976)	47,321
Recurring EPS (INR)	39.4	43.1	31.4	(15.6)	20.0

Balance sheet (INRm)

Year ended 31st Mar	2009	2010	2011	2012e	2013e
Share Capital	12,356	24,280	24,280	24,280	24,280
Reserves & Surplus	428,109	481,250	529,044	492,068	522,226
Networth	440,465	505,529	553,323	516,348	546,505
Debt	449,721	445,663	527,339	717,339	617,339
Capital Employed	890,185	951,192	1,080,662	1,233,686	1,163,844
Gross Fixed Assets	623,885	720,895	931,376	951,213	1,262,398
Accumulated Depreciation	(275,669)	(305,084)	(349,502)	(398,151)	(447,774)
Net Assets	348,217	415,811	581,874	553,062	814,624
Capital work in progress	181,861	212,686	126,477	220,000	13,415
Investments	322,693	223,703	195,448	161,469	186,469
Current Assets Loans & Advances					
Inventory	251,496	364,041	492,845	552,388	552,618
Debtors	59,379	57,993	88,697	105,260	104,229
Cash & Bank	7,980	13,151	12,944	(5,548)	(10,193)
Loans & advances and others	126,877	158,886	238,877	377,894	250,799
Current Liabilities & Provisions					
Current Liabilities	327,546	344,802	525,499	606,009	623,347
Provisions	26,035	102,716	67,635	89,183	93,773
Net Current Assets	92,151	146,553	240,229	334,801	180,334
Deferred tax assets/(liabilities)	(54,736)	(47,561)	(63,366)	(35,646)	(30,998)
Application of Funds	890,185	951,192	1,080,662	1,233,686	1,163,844

Per share data

Year ended 31st Mar	2009	2010	2011	2012e	2013e
No. of shares (Mn)	2,458	2,370	2,370	2,370	2,370
BVPS (INR)	179	213	234	218	231
CEPS (INR)	51	57	51	5	41
DPS (INR)	4	13	10	0	6

Margins (%)

Year ended 31st Mar	2009	2010	2011	2012e	2013e
EBITDA	2	5	4	2	3
EBIT	1	3	2	1	2
PAT	1	4	2	(1)	1

Source: Company, Antique

Cash flow statement (INRm)

Year ended 31st Mar	2009	2010	2011	2012e	2013e
PBT	(359,328)	147,495	83,471	(55,188)	70,629
Depreciation	30,377	32,397	45,669	48,649	49,622
Interest	29,299	(1,165)	13,653	15,101	3,577
Changes in working capital	75,689	(156,060)	(50,132)	(113,064)	149,822
Tax paid	(7,607)	(27,313)	(35,850)	(9,508)	(27,955)
CF from operating activities	(231,570)	(4,647)	56,812	(114,009)	245,695
Capex	(123,897)	(125,062)	(123,767)	(113,360)	(104,600)
Investments	299,388	147,353	28,464	33,978	(25,000)
Income from investments	16,288	24,471	23,123	(15,101)	(3,577)
CF from investing activities	191,779	46,761	(72,180)	(94,483)	(133,177)
Changes in share capital	-	-	-	-	-
Changes in Debt	91,407	(4,059)	81,676	190,000	(100,000)
Dividends & Interest paid	(51,881)	(32,884)	(66,515)	-	(17,163)
CF from financing activities	39,526	(36,943)	15,161	190,000	(117,163)
Net cash flow	(264)	5,171	(207)	(18,492)	(4,646)
Add: Opening balance	8,244	7,980	13,151	12,944	(5,548)
Closing balance	7,980	13,151	12,944	(5,548)	(10,193)

Growth indicators (%)

Year ended 31st Mar	2009	2010	2011	2012e	2013e
Revenue	22	-11	23	30	2
EBITDA	-35	93	(5)	(21)	34
PAT	35	6	(27)	(150)	(228)
EPS	30	10	(27)	(150)	(228)

Valuation (x)

Year ended 31st Mar	2009	2010	2011	2012e	2013e
PE (x)	7.8	7.1	9.8	(19.7)	15.4
P/BV (x)	1.7	1.4	1.3	1.4	1.3
EV/EBITDA (x)	13.3	7.6	8.9	13.9	9.4
EV/Sales (x)	0.4	0.4	0.4	0.3	0.3
Dividend Yield (%)	1.2	4.3	3.2	0.0	2.0

Financial ratios

Year ended 31st Mar	2009	2010	2011	2012e	2013e
RoE (%)	22	20	13	(7)	9
RoCE (%)	4	10	7	4	6
Debt/Equity (x)	1.0	0.9	1.0	1.4	1.1
EBIT/Interest (x)	0.9	6.0	2.7	0.8	1.7

Source: Company Antique

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