

Reforms stalled; cut PO by 11% to reflect de-rating

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9M EPS just Rs15 as government compensated 45% subsidy

Indian Oil Corporation (IOC) has reported a profit of Rs16.3bn (EPS: Rs6.7) in 3Q FY11. Its 9M EPS is Rs14.6, which is just 42% of our FY11E EPS of Rs34.9. Weak 9M EPS is due to the government compensating just 45% of 9M subsidy against our assumption that 58.5% of FY11E subsidy would be compensated. Government being generous in 4Q and FY11E EPS being in line with our estimate is not ruled out. We retain Buy on IOC.

9M EPS Rs19-31 if government compensated 50-67% subsidy

The petroleum secretary had indicated in July 2010 that the government would compensate 50-67% of FY11E subsidy of R&M companies like IOC. However, it has compensated only 44.6% of 9M subsidy while another 33% was reimbursed by the upstream companies. IOC's 9M EPS would have been Rs18.6-31.1 if government had compensated 50-67% of 9M subsidy. Our FY11E EPS estimate of Rs34.9 assumes government compensates 58.5% of subsidy. IOC's 9M EPS would have been Rs24.9 if 58.5% of 9M subsidy was compensated.

FY11E EPS in line with estimate not ruled out

In 9M FY10, the government had compensated just 41% of subsidy. However, it was generous in 4Q and compensated 56.5% of FY10 subsidy. Thus the government being generous in 4Q FY11 cannot be ruled out. We have therefore kept our FY11E EPS of Rs34.9 unchanged despite 9M EPS being just Rs14.6.

Cut PO by 11% to reflect de-rating on stalling of reforms

Reforms have stalled due to the surge in oil price. To reflect the consequent de-rating our PO is now based on P/E of 9x (10x earlier). Market value of IOC's investments in ONGC, Petronet LNG, GAIL and Oil India are lowered by Rs14/share. The total impact is a cut in its PO by 11% to Rs413.

Stock Data

Price	Rs311.55
Price Objective	Rs413.00
Date Established	10-Feb-2011
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs273.05-Rs458.90
Mrkt Val / Shares Out (mn)	US\$16,632 / 2,428.0
Average Daily Volume	1,094,958
BofAML Ticker / Exchange	IOCOF / BSE
Bloomberg / Reuters	IOCL IN / IOC.BO
ROE (2011E)	15.4%
Net Dbt to Eqty (Mar-2009A)	88.2%
Est. 5-Yr EPS / DPS Growth	10.0% / 10.0%
Free Float	28.0%

Key Changes

(Rs)	Previous	Current
Price Obj.	463.00	413.00

Estimates (Mar)

(Rs)	2009A	2010A	2011E	2012E	2013E
Net Income (Adjusted - mn)	25,994	118,505	84,667	92,121	111,081
EPS	10.71	48.81	34.87	37.94	45.75
EPS Change (YoY)	-67.7%	355.9%	-28.6%	8.8%	20.6%
Dividend / Share	3.84	13.00	12.00	13.00	16.00
Free Cash Flow / Share	13.04	(29.53)	43.09	59.32	35.59

Valuation (Mar)

	2009A	2010A	2011E	2012E	2013E
P/E	29.10x	6.38x	8.93x	8.21x	6.81x
Dividend Yield	1.23%	4.17%	3.85%	4.17%	5.14%
EV / EBITDA*	13.59x	5.62x	6.55x	5.84x	4.89x
Free Cash Flow Yield*	4.18%	-9.48%	13.83%	19.04%	11.42%

* For full definitions of *iQmethod*SM measures, see page 5.

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Refer to important disclosures on page 6 to 8. Analyst Certification on Page 4. Price Objective Basis/Risk on page 4. Link to Definitions on page 4. 11019296

iQprofileSM Indian Oil Corp.

Key Income Statement Data (Mar)	2009A	2010A	2011E	2012E	2013E
(Rs Millions)					
Sales	2,875,353	2,539,641	3,335,559	3,613,179	4,070,277
Gross Profit	NA	NA	NA	NA	NA
Sell General & Admin Expense	(2,799,000)	(2,355,068)	(3,177,249)	(3,435,615)	(3,858,031)
Operating Profit	44,458	149,022	118,998	129,171	158,832
Net Interest & Other Income	(7,967)	18,697	9,007	11,176	10,465
Associates	NA	NA	NA	NA	NA
Pretax Income	36,491	167,718	128,005	140,347	169,298
Tax (expense) / Benefit	(12,533)	(40,499)	(40,055)	(44,541)	(54,012)
Net Income (Adjusted)	25,994	118,505	84,667	92,121	111,081
Average Fully Diluted Shares Outstanding	2,428	2,428	2,428	2,428	2,428

Key Cash Flow Statement Data

Net Income	25,994	124,364	84,667	92,121	111,081
Depreciation & Amortization	31,894	35,552	39,313	48,392	53,413
Change in Working Capital	NA	NA	NA	NA	NA
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	111,707	(93,055)	76,571	137,818	10,630
Cash Flow from Operations	169,596	66,861	200,550	278,331	175,125
Capital Expenditure	(137,942)	(138,553)	(95,928)	(134,305)	(88,718)
(Acquisition) / Disposal of Investments	(105,337)	99,243	65,500	(5,000)	260
Other Cash Inflow / (Outflow)	0	0	0	0	1
Cash Flow from Investing	(243,279)	(39,311)	(30,427)	(139,305)	(88,457)
Shares Issue / (Repurchase)	216	9,495	1,781	0	0
Cost of Dividends Paid	(10,918)	(35,588)	(32,850)	(35,588)	(43,800)
Cash Flow from Financing	74,557	(4,836)	(114,416)	(125,588)	(44,400)
Free Cash Flow	31,654	(71,693)	104,622	144,026	86,407
Net Debt	463,417	478,741	339,688	236,250	193,384
Change in Net Debt	84,385	(1,457)	(139,053)	(103,438)	(42,868)

Key Balance Sheet Data

Property, Plant & Equipment	576,156	682,452	739,067	824,980	860,285
Other Non-Current Assets	314,065	214,523	149,023	154,023	153,763
Trade Receivables	59,379	57,993	65,844	70,129	79,937
Cash & Equivalents	10,052	15,984	71,691	85,128	127,395
Other Current Assets	402,596	575,982	553,970	447,239	493,470
Total Assets	1,362,248	1,546,934	1,579,594	1,581,500	1,714,850
Long-Term Debt	192,514	213,885	181,166	141,166	141,166
Other Non-Current Liabilities	59,691	54,170	54,170	54,170	54,170
Short-Term Debt	280,955	280,841	230,212	180,212	179,612
Other Current Liabilities	358,654	455,270	514,397	546,084	608,549
Total Liabilities	891,814	1,004,166	979,946	921,633	983,497
Total Equity	470,434	542,768	599,648	659,867	731,352
Total Equity & Liabilities	1,362,248	1,546,934	1,579,594	1,581,500	1,714,850

iQmethodSM - Bus Performance*

Return On Capital Employed	4.6%	12.2%	8.6%	9.3%	11.0%
Return On Equity	5.8%	24.2%	15.4%	15.2%	16.6%
Operating Margin	1.5%	5.9%	3.6%	3.6%	3.9%
EBITDA Margin	2.7%	7.3%	4.7%	4.9%	5.2%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	6.5x	0.6x	2.4x	3.0x	1.6x
Asset Replacement Ratio	4.3x	3.9x	2.4x	2.8x	1.7x
Tax Rate (Reported)	34.3%	24.1%	31.3%	31.7%	31.9%
Net Debt-to-Equity Ratio	98.5%	88.2%	56.6%	35.8%	26.4%
Interest Cover	1.1x	8.6x	4.9x	7.5x	9.5x

Key Metrics

* For full definitions of iQmethodSM measures, see page 5.

Company Description

State-owned IOC is India's largest refining & marketing (R&M) company. As of end-FY10 it had 33% of India's refining capacity at 1.23m b/d. IOC had 47% market share in petroleum product in India in FY10. It is the market leader in lubricants in India. It is also emerging as a large petrochemical player and already has 2.3m tpa capacity. It also has a large net work of crude pipelines to transport crude to its inland refineries and product pipelines to evacuate products from these refineries.

Investment Thesis

A comprehensive solution to the subsidy problem plaguing IOC and peers appears unlikely in the foreseeable future. The subsidy regime makes earnings of IOC and its peers highly unpredictable. IOC's earnings tend to be more stable than peer. However IOC has far less leverage than peers to auto fuel marketing margins, which is one of the main earnings drivers for IOC and peers. IOC has more exposure than peers to petrochemicals and petrochemical outlook is likely to be poor for at least 2-3 years.

Stock Data

Price to Book Value 1.3x

IOC's 3Q and 9M FY11 results

Table 1: IOC's 3Q and 9M FY11 results

Rsmn	3Q FY11	3Q FY10A	% Change	9M FY11	9M FY10	% Change
Net sales	808,973	704,098	15%	2,301,576	1,905,591	21%
Total expenditure	776,056	676,393	15%	2,226,414	1,821,758	22%
EBITDA	32,917	27,705	19%	75,161	83,832	-10%
Interest	7,233	4,091	77%	18,024	10,908	65%
Depreciation	11,778	7,996	47%	33,302	23,400	42%
Other Income	7,886	6,783	16%	25,335	30,308	-16%
PBT	21,793	22,400	-3%	49,171	79,832	-38%
Tax	5,445	4,061	34%	13,768	21,822	-37%
Recurring PAT	16,348	18,339	-11%	35,403	58,011	-39%
Extra-ordinary items	0	(11,373)	NM	0	(11,373)	NM
Reported PAT	16,348	6,966	135%	35,403	46,638	-24%
Recurring EPS	6.7	7.6	-11%	14.6	23.9	-39%
Reported EPS	6.7	2.9	135%	14.6	19.2	-24%

Source: Company, BofA Merrill Lynch Global Research

3Q and 9M FY11 EBITDA break-up

Table 2: IOC's 3Q and 9M FY11 EBITDA break-up

Rsmn	3Q FY11	3Q FY10A	% Change	9M FY11	9M FY10	% Change
Refining	23,310	11,552	102%	55,386	50,589	9%
Inventory gains/losses	3,260	3,050	7%	8,080	26,740	-70%
Lubes	1,000	1,000	0%	3,000	3,000	0%
Petrochemicals	(1,400)	400	NM	(4,000)	4,700	NM
Pipelines	8,630	7,740	11%	25,420	24,260	5%
Marketing losses/subsidy	(1,883)	3,962	NM	(12,725)	(25,457)	NM
	32,917	27,705	19%	75,161	83,832	-10%
Earnings drivers						
Refining Margin (US\$/bbl)	6.31	3.69	71%	5.26	4.84	9%
Exchange rate (US\$=Rs)	44.85	46.63	-4%	45.67	47.91	-5%
Domestic sales volumes (mmt)	17.26	16.51	5%	50.19	48.79	3%
Crude throughput (mmt)	13.32	12.53	6%	38.73	37.41	4%

Source: Company, BofA Merrill Lynch Global Research

9M EPS Rs18.6-31.1 if compensation 50-67% subsidy

Table 3: 9M EPS Rs18.6-31.1 if government compensates 50-67% subsidy

Rsmn	Base case - 45%	50%	67%
Govt contribution	116,624	130,391	173,854
Profit	35,403	45,040	75,465
EPS	14.6	18.6	31.1

Source: Company, BofA Merrill Lynch Global Research

Price objective basis & risk

IOC (IOCOF)

Our PO of Rs413/share is based on a PE of 9.0x on IOC's FY12E consolidated EPS (excluding dividend income from ONGC, PLNG, and GAIL) of Rs35.4/share. Our PO also includes the market value of IOC's investments in ONGC, Petronet LNG, GAIL and Oil India (OIL) of Rs94/share. Downside risks: (1) IOC has to bear higher subsidy than assumed by us (2) government reverts to a cost-plus-based regulated pricing mechanism, (3) steep decline in regional and, hence, IOC's refining margins to levels below assumed by us, and (4) Lower-than-expected auto fuel marketing margins (5) Steep decline in market price of ONGC, Petronet LNG and GAIL. Upside risks: (1) IOC has to bear lower subsidy than assumed by us (2) Government eliminates subsidies on all products, (3) Refining margins are higher than forecast by us, (4) Sharp rise in market prices of ONGC and GAIL.

Link to Definitions

Energy

Click [here](#) for definitions of commonly used terms.

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10 February 2011

APR - Energy Coverage Cluster

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
BUY				
	Formosa Plastics	FSAPF	1301 TT	Kenneth Whee
	GS Holdings	GSHDF	078930 KS	Kenneth Whee
	Hindustan Petro.	XHTPF	HPCL IN	Vidyadhar Ginde
	IOC	IOCOF	IOCL IN	Vidyadhar Ginde
	Kolon Industries	XKLN	120110 KS	Joon-Ho Lee
	Kunlun Energy	CNPXF	135 HK	Vitus Leung
	LG Chem	LGCLF	051910 KS	Kenneth Whee
	Nan Ya Plastics	NNYPF	1303 TT	Joon-Ho Lee
	Oil India Ltd	XLCRF	OINL IN	Vidyadhar Ginde
	ONGC	ONGCF	ONGC IN	Vidyadhar Ginde
	Reliance Inds	XRELF	RIL IN	Vidyadhar Ginde
	Reliance Inds -G	RLNIY	RIGD LI	Vidyadhar Ginde
	Sinopec	SNPMF	386 HK	Thomas Wong
	Sinopec - A	SNP	SNP US	Thomas Wong
	SK Innovation	XVERF	096770 KS	Kenneth Whee
NEUTRAL				
	BPCL	XBPCF	BPCL IN	Vidyadhar Ginde
	Citic Resources	CTJHF	1205 HK	Vitus Leung
	CNOOC	CEOHF	883 HK	Thomas Wong
	CNOOC	CEO	CEO US	Thomas Wong
	Formosa Chemicals & Fibre	XFUMF	1326 TT	Kenneth Whee
	Formosa Petrochemical	FPTCF	6505 TT	Kenneth Whee
	PetroChina	PCCYF	857 HK	Thomas Wong
	PetroChina - A	PTR	PTR US	Thomas Wong
	S-Oil	SOOCF	010950 KS	Kenneth Whee
UNDERPERFORM				
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RSTR				
	Cairn India	XCANF	CAIR IN	Vidyadhar Ginde

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill Amortization}$
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales} + \text{Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

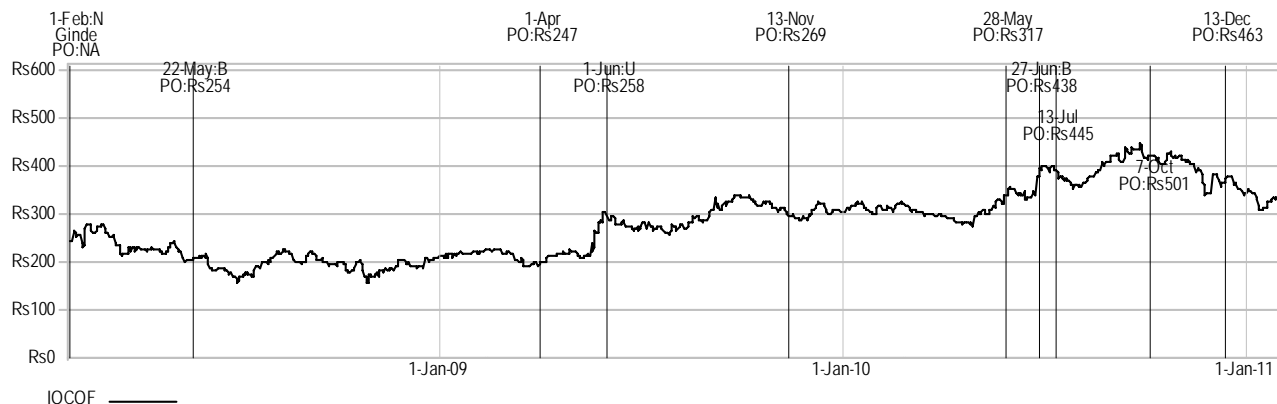
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IOCOF Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid, NR: No Rating

Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of January 31, 2011 or such later date as indicated.

Investment Rating Distribution: Energy Group (as of 01 Jan 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	162	58.70%	Buy	94	64.38%
Neutral	59	21.38%	Neutral	29	58.00%
Sell	55	19.93%	Sell	22	45.83%

Investment Rating Distribution: Global Group (as of 01 Jan 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	2011	53.86%	Buy	874	48.31%
Neutral	925	24.77%	Neutral	444	52.30%
Sell	798	21.37%	Sell	276	36.75%

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