Oil & Gas/Chemicals | India

Indian Oil Corporation IOCL IN

NEUTRAL

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NOMURA FINANCIAL ADVISORY AND SECURITIES (INDIA) PRIVATE LIMITED, INDIA

RESULTS FIRST LOOK

Like other oil marketing companies, IOCL reported a poor set of numbers (net loss of INR74.9bn), due to no govt. support and large forex losses. While gross under-recoveries declined a sharp 51% q-q, IOCL's bottom-line did not benefit. Net under-recoveries actually increased 2% q-q, as the government did not give cash support. Subsidy sharing mechanism remains ad-hoc and non transparent. GRMs at US$(0.03)/bbl also disappointed. We continue to believe that for OMCs to emerge as long-term investment ideas, clarity is needed on the subsidy sharing mechanism. Maintain Neutral.

Price target: 365.0 INR **Price (08 Nov 2011): 299.3 INR**

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Disappointing 2QFY12 results due to no government support and large forex losses

- **Earnings vs. our Forecast:** **BELOW**

Likely Impact:

- **Earnings Estimates:** **NO CHANGE**
- **Dividend Estimates:** **NO CHANGE**
- **Price Target:** **NO CHANGE**
- **Long-term View:** **CONFIRMED**

Key highlights of 2QFY12 results:

- More than operating performance, under-recoveries and the sharing mechanism continue to be the key determinant of profit (or loss) for IOCL, in our view.
- IOCL reported another disappointing quarterly result in 2Q (net losses of INR74.9bn) mainly due to no government compensation and large foreign exchange fluctuation losses of INR23.3bn. It had reported net loss of INR37.2bn in 1Q FY12.
- While gross under-recoveries declined by a sharp 51% q-q to INR117.6bn (due to price hikes and duty cuts announced in June 2011), IOCL's bottom-line did not benefit. IOCL's net under-recoveries actually increased by 2% q-q to 78.4bn (INR76.7 in 1Q) as the government did not give any cash compensation (INR82bn or 34% of gross U/Rs in 1Q). It was made to absorb higher under-recoveries (~67% vs 32% in 1QFY12 and 9% in FY11) in 2Q.
- Similar to 1QFY12, upstream support was at 1/3rd of gross under-recoveries.
- While it is likely that the govt/upstream will make good some of the losses in subsequent quarters, the entire sharing mechanism remains ad-hoc and non transparent.
- 2Q results were also impacted by large foreign exchange fluctuation losses of INR23.3bn (INR12.3 on crude liability and INR11bn on other than crude liabilities) due to sharp rupee depreciation (~10%) towards the end of the quarter.
- Reported refining margins at US$(0.03)/bbl in 2Q (down 100% y-y and q-q) was disappointing. Regional benchmark Singapore complex margins in 2Q were US$9.0/bbl.
- Refining throughput at 13MMT (down 9% q-q) was impacted by shutdown in Mathura and Koyali refineries.
- Marketing sales (incl exports) at 17.7MMT declined 8% q-q.

- Reported pipeline throughput at 17.8MMT (up 14% y-y, down 8% q-q) and pipeline EBITDA at INR9.45bn (up 23% y-y, down 7% q-q).

- IOCL's gross debt has increased to INR753bn as of Sept 2011 (up from INR527bn as of March 2011 and INR674bn as of June 2011). Interest costs have increased sharply by 192% y-y and 43% q-q to INR14.8bn.

We continue to believe that lower under-recoveries may not result in any improved bottom-lines of oil marketing companies (OMCs). Profitability of OMCs continues to remain at the mercy of the government dictated sharing mechanism. We continue to believe that for these companies to emerge as long-term investment ideas, further clarity is needed on future steps towards de-regulation, as well as sharing mechanism. We maintain NEUTRAL on IOCL.

Exhibit 1: IOCL – 2QFY12 results

INR bn	2QFY11	1QFY12	2QFY12F	2QFY12A	y-y	q-q	Comments
Net sales	697.5	925.2	985.2	891.5	28%	-4%	
Grant from GOI	72.2	82.0	61.3	0.0			No Govt. support in 2Q.
(Inc)/dec in stock	(24.5)	(23.7)	0.0	(2.8)			
Purchases	364.0	512.9	469.2	403.7	11%	-21%	
RM cons	313.6	490.6	482.1	463.4	48%	-6%	Post upstream discount of INR39.2bn
Staff cost	16.0	11.7	15.0	11.8	-26%	1%	
Other expenses	35.3	40.0	49.3	68.9	95%	72%	Include forex loss of INR23.3bn
Total expenses	(704.5)	(1,031.5)	(1,015.5)	(945.1)	34%	-8%	
EBITDA	**65.2**	**(24.2)**	**31.0**	**(53.6)**			Pipeline EBITDA of INR9.45bn
Depreciation	(11.2)	(12.2)	(12.5)	(12.6)	13%	3%	
EBIT	54.0	(36.5)	18.5	(66.3)			
Interest	(5.1)	(10.4)	(11.0)	(14.8)	192%	43%	Debt drawdown of INR78bn in 2Q.
Other income	12.3	9.6	10.0	6.2	-49%	-35%	
Profit before tax	61.3	(37.2)	17.5	(74.9)			
Provision for tax	(8.3)	0.0	0.0	0.0			
PAT	**52.9**	**(37.2)**	**17.5**	**(74.9)**			1HFY12 losses of INR112bn (vs PAT of INR19bn in 1HFY11 / 74bn in FY11)
EPS (INR/sh)	21.8	(15.3)	7.2	(31)			

Source: Company data, Nomura estimates

Exhibit 2: IOCL – Key operating matrix

	2QFY11	1QFY12	2QFY12F	2QFY12A	y-y	q-q
Refinery throughput (MMT)	12.1	14.3	13.5	13.0	8%	-9%
Pipelines throughput (MMT)	15.5	19.3	18.5	17.8	14%	-8%
Marketing Sales (MMT)	16.9	19.3	18.2	17.7	5%	-8%
Brent (US$/bbl)	76.3	117.1	112.5	112.5	47%	-4%
Exchange Rate (INR/US$)	46.5	44.7	45.8	45.8	-2%	2%
Refining Margins (US$/bbl)						
GRM	6.6	4.7	8.0	-0.03	-100%	-101%
Singapore GRM	4.3	8.6	9.0	9.0	109%	5%
Premium/(Discount) to Singapore	2.3	-3.9	-1.0	-9.0		
Subsidy sharing (INR bn)						
Gross U/R	64.1	238.1	122.6	117.6	84%	-51%
Less: Upstream	21.4	79.3	40.9	39.2	84%	-51%
Less: Govt support	72.2	82.0	61.3	0.0		
Net U/R	-29.5	76.7	20.4	78.4		2%

Source: Company data, Nomura estimates

Valuation Methodology and Investment Risks: Please see below

Note: Ratings and Price Targets are as of the date of the most recently published report (http://go.nomuranow.com/research/globalresearchportal) rather than the date of this email.

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Mentioned companies

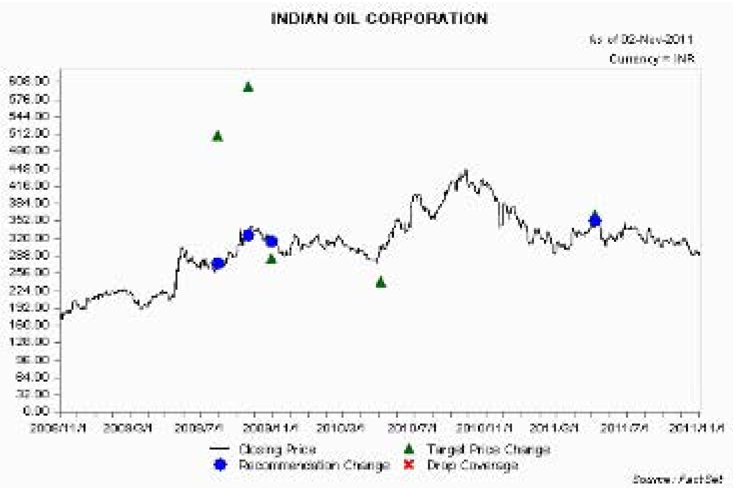
Issuer name	Ticker	Price	Price date	Stock rating	Disclosures
Indian Oil Corporation	IOCL IN	299.3 INR	08 Nov 2011	Neutral	

Previous Rating

Issuer name	Previous Rating	Date of change
Indian Oil Corporation	Reduce	12 May 2011

Indian Oil Corporation (IOCL IN) **299.3 INR (08 Nov 2011)** Neutral

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
06-May-2011		365.00	353.15
06-May-2011	Neutral		353.15
05-May-2010		240.00	299.20
30-Oct-2009		283.00	314.10
30-Oct-2009	Reduce		314.10
21-Sep-2009		600.00	326.62
21-Sep-2009	Neutral		326.62
31-Jul-2009		510.00	273.52
31-Jul-2009	Reduce		273.52

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology Our 12-month target price of INR365 is based on 1.3x P/B multiple to FY13F book value per share of INR281.

Risks that may impede the achievement of the target price Key upside risks - Significant change in government policy on fixing retail prices. Complete deregulation would be a significant positive in the long term and could lead to a re-rating. Even partial deregulation, but with a clear policy on sharing of any under-recoveries, would also be positive for IOCL. A significant and sustained decline in global oil prices would also be positive, since losses on retail fuels decline sharply at low oil prices. Refining margins that are higher than our estimates would be a positive for IOCL.Key downside risks – Higher oil prices, lower than expected refining margins, higher net under-recoveries are key downside risks.

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Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published from 30 October 2008 and in Japan from 6 January 2009

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Explanation of Nomura's equity research rating system in Japan published prior to 6 January 2009

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