ICRA

January 13, 2017

Indian Oil Corporation Limited (Revised)

Instrument	Amount (Rs Billion)	Rating Action
Long-term Bonds Programme	27.02 (reduced from Rs 27.33 billion)	[ICRA]AAA (Stable) reaffirmed
Long-term Bonds Programme	17.95	[ICRA]AAA (Stable) withdrawn
Commercial Paper Programme	400.00	[ICRA]A1+ reaffirmed

Rating Action: ICRA has reaffirmed the [ICRA]AAA (pronounced ICRA triple A) rating assigned to the Rs. 27.02[1] billion[2] (reduced from Rs 27.33 billion) bond programme of Indian Oil Corporation Limited (IOC)[3]. ICRA has also reaffirmed the [ICRA]A1+ (pronounced ICRA A one plus) rating assigned to the Rs 400.00 billion commercial paper programme of IOC. The outlook on the long term rating is Stable.

ICRA has also withdrawn the [ICRA]AAA rating assigned to the Rs. 17.95 billion bond programme (Bond Series VII B and XII) of IOC as the company has fully redeemed these instruments and there is no amount outstanding against these rated instruments.

Detailed Rationale

The ratings reaffirmation reflects IOC's high financial flexibility arising from its large sovereign ownership, large portfolio of liquid investments and ability to raise funds from the domestic/foreign banking system and capital markets at competitive rates. Besides, the ratings of IOC continue to reflect its dominant and strategically important position in the Indian energy sector, its integrated business model and its role in fulfilling the socio political objectives of GoI. Although OMCs will continue to be subjected to regulatory risk on the pricing of sensitive petroleum products in line with prevailing crude oil prices, GoI has been ensuring that the net under recoveries borne by PSU OMCs are within manageable levels by absorbing most of the GURs itself with the rest shared by upstream companies. IOC is also exposed to project implementation risks as it is in the midst of implementing large projects spanning the entire downstream value chain though this risk is largely mitigated by the company's proven track record of successfully implementing several large projects.

In the past the high levels of gross under recoveries and delays in cash compensation by the government had led to elevated levels of short term borrowings for the OMCs. As the interest costs on short term borrowings are not factored while estimating industry under recoveries, it impacts the OMCs net profits. With the decline in crude oil prices the levels of gross under recoveries have reduced besides which the setting up of escrow account mechanism has substantially reduced the delays in cash compensation by the GoI thereby leading to a decline in the levels of short term borrowings. Nonetheless, any reversal of the current under recovery sharing policy on LPG (domestic) /SKO (PDS) and deregulation of HSD/MS prices, in a scenario of sharp rise in crude prices will be a key rating sensitivity.

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1 Long Term Bond Programme of Rs 27.02 billion (Rs 2701.60 crore)

2 100 lakh = 1 crore = 10 million

3 For complete rating scale and definitions, please refer to ICRA's Website, www.icra.in, or any of the ICRA Rating Publications

Key Rating Drivers

Credit strengths

- Dominant position in the domestic refining and marketing business
- Favourable location of the refineries and stable pipeline margins
- Vertical integration projects have led to an improvement in business risk profile
- Demonstrated support of GoI to ensure the profitability of OMCs in the past despite high under-recoveries; materially lower under-recoveries in the last 2 years have led to improvement in liquidity due to fall in debt levels and interest burden
- Considerable liquidity and financial flexibility derived from its investment portfolio and significant sovereign ownership

Credit weakness

- Vulnerability of the company's profitability to the global refining margin cycle, import duty protection, and INR-USD parity levels
- Moderate regulatory risk due to regulated pricing of LPG (domestic) and SKO; regular price rise of these products and other measures taken by the GoI to reduce under-recovery levels may further reduce the risk
- New project implementation risks, partly mitigated by the long demonstrated history of IOC in implementing projects across refining, marketing and pipelines segments
- With the company increasing its Upstream portfolio it is exposed to geological, technology and execution risks that are inherent in E&P activities

Key Rating Sensitivities

- Any reversal of the current under recovery sharing policy on LPG (domestic) /SKO (PDS) and deregulation of HSD/MS prices, in a scenario of sharp rise in crude prices, resulting in higher net under recoveries and strain in key credit metrics

Description of key rating drivers highlighted above:

The gross under recoveries of the OMCs have declined owing to the fall in international crude oil prices. Post the decline in crude oil prices, the GoI shares the under-recovery upto Rs. 12/litre on SKO (PDS) and upto Rs. 18/kg under the Direct Benefit Transfer for Domestic LPG (DBTL). Additionally the GoI now transfers the subsidy through an escrow account mechanism. Accordingly short term borrowings have declined.

The GoI has directed OMCs to increase the consumer price of subsidised LPG (domestic) by ~Rs. 1.95 per cylinder/month since the beginning of July 2016. The move to increase price follows various steps taken by the GoI to reduce subsidy like DBTL, cancellation of fake connections, pursuing the "GiveItUp" campaign etc. The GoI has also directed OMCs to increase the retail prices of subsidised Kerosene by Rs. 0.25/litre every fortnight up to April 2017. Following the increase in prices till March 2017, the GoI may continue to bear threshold LPG subsidy upto crude oil prices of ~US$64-65 /bbl and SKO subsidy upto US$55-60/bbl.

Organization of the Petroleum Exporting Countries (OPEC), on November 30, 2016, has agreed to cut total crude oil production of its member countries by 1.2 million barrels per day (mbpd) from January 2017. The decision by the OPEC has led to spike in global crude oil prices by ~15-20% with Benchmark Brent Crude prices touching US$57/bbl. With crude oil prices of US$50-60 for the balance months in FY2017, ICRA projects GoI's Oil Subsidy Burden to be around Rs. 170-190 billion for FY2017, which would be well within budget allocation of ~Rs. 270 billion for the current fiscal.

During H1 FY2017, the gross under-recovery of IOCL declined by 41.9% (YoY) to Rs. 28 billion from Rs. 48 billion in H1 FY2016 following lower crude oil prices. Nonetheless, the recent spike in crude oil prices, if sustained, could lead to higher working capital requirements of the company, leading to increased debt and interest levels.

IOC has plans to incur a large capital expenditure of Rs 1.8 trillion over the next six-seven years on up gradation of its existing refineries, ramp up refinery capacities, various pipeline projects, petrochemical projects, marketing infrastructures and exploration & production (E&P) activities among other initiatives. The Paradip refinery is steadily ramping up its capacity utilisation and is expected to achieve an average capacity utilization of 65-70% during FY2017. Timely completion of these projects without significant cost overruns would remain important to the business risk profile of IOC, given the large outlay on the projects in relation to the company's current balance sheet size.

IOC is building a 5 MMTPA LNG terminal at Ennore in the state of Tamil Nadu. The project is proposed to be set up via a JV in which IOC would have 50% shareholding. The balance 50% would be held by strategic investors. The capex for the Ennore LNG terminal is estimated at Rs 43 billion and the terminal is expected to be commissioned by 2018. For the gas tie ups the company is looking to source part of the gas from Pacific North West LNG project in Canada in which it has 10% stake. Additionally IOC has signed an agreement with Mitsubishi Corp of Japan for 0.7 million tonnes a year of LNG for 20 years from Cameron LNG project in USA and the delivery is expected to start from the first quarter of 2018.

Over the last few years, profits from the petrochemical business of IOC has significantly improved (petrochemicals accounted for 20% of PBIT in H1 FY2017 from a negative contribution to PBIT in FY2012) both on account of stabilisation of new projects and improvement in industry level upturn. Going ahead, the company has lined up more petrochemical projects, which will impart greater diversity to IOC's business portfolio and partly reduce the company's exposure to the risks associated with its Refining and Marketing (R&M) business.

IOC is the largest refining company in India, with refineries across the country. Its refining capacity is 80.7 million metric tonnes per annum (MMTPA), which is 35% of the total refining capacity in India (as on March 31, 2016). IOC's refineries are located across the country, with two—the Panipat (Haryana) and Mathura (Uttar Pradesh) refineries—being in the North, from which it services the petroleum product-deficit northern and central regions of the country. Ramp up in the production from the Paradip refinery will enable IOC to process more heavy and sour crude. The increasing proportion of sour crude should help the company take advantage of the spread between sweet and sour crude.

IOC has a dominant market position in both retail and industrial fuels, with an overall market share of 45.9%. With the commissioning of a number of new refinery projects and augmentation of pipeline capacities the availability of products is likely to increase in the country. IOC is expected to maintain its leadership position in the downstream petroleum business, given its well-established marketing infrastructure, consisting of, among other things, terminals, depots, retail outlets, liquefied petroleum gas (LPG) bottling plants, and dealers of LPG and superior kerosene oil (SKO).

Low prices of crude oil and petroleum products led to higher demand for liquid fuels, which, along with limited supply addition, led to an improved supply–demand balance for the global refining industry, which got reflected in higher crack spreads for almost the entire product slate of the refineries. The high demand growth of polymers/petrochemicals at relatively lower prices led to an increase in demand for naphtha, which also boosted global GRMs. GRMs of Indian refining companies remained high in FY2016 and H1 FY2017, meanwhile, following healthy global crack spreads for most products. The medium term outlook for GRMs is healthy, in line with healthy demand levels and expectation of demand growth matching supply addition globally. In India, the demand growth would be healthy, in line with improving economic activity. Besides GRMs, the earnings of IOC are exposed to foreign exchange (forex) risk as pricing of most of its products and crude oil is in US Dollars as per industry practice and import duty protection.

In October 2016, IOCL, Oil India Limited (OIL) and Bharat PetroResources Limited (BPRL) completed the acquisition of 23.9% participating interest in the CJSC Vankorneft from Rosneft Oil Company for US$ 2.02 billion. CJSC Vankorneft is the owner of Vankor Field and North Vankor license. Vankor is Russia's second largest field by production and accounts for 4% of Russian production and currently producing oil at a peak level of approximately 440,000 bopd. The initial recoverable reserves of the Vankor field as on January 1, 2015 are estimated at 476 million tonnes of oil and condensate and 173 billion cubic meters of gas. Additionally in October 2016, IOCL, OIL and BPRL completed the acquisition of 29.9% of the charter capital of LLC TYNGD, from Rosneft Oil Company for US$ 1242 million. TYNGD is operator of one of the largest oil and gas fields in East Siberia, Russia which are estimated to hold recoverable reserves of 137 million tonnes. TYNGD is currently producing 1.1 million tonnes of oil and is expected to ramp up production to 5 million tonnes by 2021.

IOCL, OIL and BPRL have jointly taken a $2 billion short term loan for the aforementioned acquisitions which is expected to be replaced by forex bonds. With IOCL, increasing its upstream portfolio it is exposed to geological, technology and execution risks that are inherent in E&P activities.

As a proportion of total debt, the short term/working capital borrowings were 33% as on March 31, 2016. Additionally IOC continues to enjoy high financial flexibility, that has enabled it to borrow from the domestic and overseas banking system and capital markets at finer rates, to fund its large working capital requirements and for project finance. Besides the company has outstanding equity shares in ONGC, GAIL, Oil India, receivables from Trust created due to mergers with IBP and BRPL, unsold stock of GoI Special Oil bonds (around Rs 114 billion as on March 31, 2016), which provide comfort in case there is any increase in debt levels.

Going forward, the gross under recoveries will remain moderate but lower than past levels owing to moderate crude oil prices and various measures taken by GoI. However in case of a sharp rise in the crude oil price, ICRA believes GoI will continue to ensure an adequate under recovery sharing mechanism so that the net under recovery burden on the PSU OMCs is low. Nevertheless, ICRA expects the debt servicing ability of IOC to remain strong, given its high financial flexibility and its strategic role in the Indian R&M sector.

Analytical Approach

Not Applicable

Links to applicable criteria

Rating Methodology for Downstream Oil Companies
Corporate Credit Rating - A Note on methodology

Company Profile
IOC is currently the largest corporate entity in India by sales. Government of India has 58.28% equity stake in the company. IOC and its subsidiaries have a total refining capacity of 80.7 MMTPA, which is 35% (as on March 31, 2016) of the total domestic refining capacity. The company accounted for 45.9% of the total petroleum products sold within the country in FY2016. IOC also enjoys a dominant presence in the domestic crude and product transportation business, controlling significant share in the country's total downstream pipeline capacity.

Status of Non-Cooperation: Not Applicable

Any other information: Not Applicable

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Rating history of Last 3 years

S.No	Name of Instrument	Current Rating (2017)			Chronology of Rating History for the past 3 years		
		Type	Amount outstanding (Rs. Billion)	Date & Rating	Date & Rating in FY2016	Date & Rating in FY2015	Date & Rating in FY2014
				January 2017	December 2015	July 2014	September 2013
1	Long term Bond Programme	Long Term	27.02* (reduced from Rs 27.33 billion)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Negative)
2	Long term Bond Programme	Long Term	17.95	[ICRA]AAA (Stable) withdrawn	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Negative)
3	Commercial Paper	Short Term	400.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

*outstanding as on March 31, 2016

Complexity level of the rated instrument: ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in.

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Annexure-1
Details of Instrument

Name of the instrument	Date of issuance	Coupon rate	Maturity Date	Size of the issue (Rs. Billion)	Current Rating and Outlook
Non-Convertible Redeemable Bonds Series-IX	11th December 2008	10.70%	11th December 2016	16.00*	[ICRA]AAA (Stable)
Non-Convertible Redeemable Bonds Series-VIII-B	10th September 2008	11.00%	10th September 2018	10.70*	[ICRA]AAA (Stable)
Non-Convertible Redeemable Bonds Series-V	18th July 2001	10.25%	13 equal annual instalments starting July 2004	0.32*	[ICRA]AAA (Stable)
Commercial Paper	-	-	-	400.00	[ICRA]A1+

*outstanding as on March 31, 2016

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