Indian Oil Corporation Limited

February 27, 2019

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-Convertible Bonds - Series-VIIIB	1,070.00	0.00	[ICRA]AAA (Stable); withdrawn
Commercial Paper	40,000.00	40,000.00	[ICRA]A1+; Reaffirmed
Total	**41,070.00**	**40,000.00**	

**Instrument details are provided in Annexure-1*

Rationale

The reaffirmation of the rating reflects IOC's high financial flexibility arising from its large sovereign ownership (53.88% stakes owned by the GoI), significant portfolio of liquid investments (~ Rs. 26,676 crore including GoI bonds and investments in GAIL (India) limited (GAIL, rated [ICRA]AAA(stable)/[ICRA]A1+), Oil & Natural Gas corporation (ONGC, rated [ICRA]A1+)ONGC and Oil India limited (OIL)), and ability to raise funds from the domestic/foreign banking system and capital markets at competitive rates. Besides, the ratings of the company 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-economic objectives of the GoI.

IOCL will continue to be subjected to regulatory risk as seen in the recent intervention by the Government of India (GoI) in October 2018 to reduce selling prices of Motor Spirit (MS) and High-Speed Diesel (HSD). Additionally, regulatory risks for IOC related to pricing of sensitive petroleum products remain in an elevated crude oil price environment, however the past track record of the GoI to ensure low under-recovery levels for PSU OMCs provides comfort from the credit perspective. Any adverse change in the GoI's policy in this regard, resulting in a weakening of key credit metrics of IOCL will be a key rating sensitivity. Petroleum subsidy Revised Estimate (RE) of ~Rs. 207 billion (excluding new LPG connections) for FY2019 is lower than the expected burden of Rs. 379 billion in the current year. This will impact the oil marketing companies. The working capital debt of oil marketing companies will increase to meet the subsidy shortfall, leading to higher interest costs. In line with the backlog from FY2019, the petroleum subsidy allocation of Rs. 336 billion for FY2020 would fall short by Rs. 183-250 billion. As per ICRA estimates, the Government of India (GoI) subsidies are projected to be ~Rs. 345-415 billion (at the Indian basket crude oil price of USD 65-70/bbl and INR/USD of 72). The significant under-allocation for FY2020 may lead to moderately higher debt and interest levels for oil marketing companies (OMCs).

The ratings take into account the diversified location base of the company's refineries (11 refineries on a consolidated basis). The ratings also reflect integration of IOC in marketing, pipelines, and petrochemicals segments (contributing 19%, 15% and 14% respectively in total EBITDA[1] for FY2018) reducing cyclicality associated with the refining segment (contributing 48% of EBITDA in FY2018). The ratings also factor in the vulnerability of the company's profitability to the global refining margin cycle, import duty protection, and INR-USD parity levels. 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 the risk is largely mitigated by the company's proven track record of successfully implementing several large projects.

[1] *EBITDA: Earnings before Interest, Taxes, Depreciation, and Amortisation*

Key rating drivers

Credit strengths

Strategic importance for the GoI in the domestic energy sector - IOC, being the largest oil refining and marketing company in India, commands considerable economic importance. The company holds significant strategic importance for GoI as it helps in meeting the socio-economic objectives of the government through control on prices of sensitive products like subsidised liquefied petroleum gas (LPG) and superior kerosene oil (SKO). The company is also the largest contributor to the government exchequer. Thus, the sovereign support is expected to continue going forward as well.

Dominant position in the domestic refining and marketing business - The company dominates the domestic refining sector with a share of 32.6%. The company is also the leading public oil marketing company with a ~44% market share (including private players) as of end of FY2018. The company has the largest marketing network spanning across the country and actively undertakes multiple branding and customer loyalty initiatives.

Diversified location base of the refineries - The company owns and operates nine refineries spread across the country besides having a majority stake in Chennai Petroleum Corporation Limited (CPCL), which provides it control over an additional two refineries, taking the aggregate to eleven. Six out of its nine refineries are located in inland areas. The most recently set up refinery at Paradip, being situated at the coast, has improved IOC's diversification from the perspective of land-locked vis-à-vis coastal presence.

Integration in marketing, pipelines, and petrochemicals segments reducing cyclicality associated with the refining segment – IOC's large marketing operations generate largely stable profits, although subject to risks related to regulatory developments and inventory gains/losses to some extent. Further, a large pipeline infrastructure owned by the company also results in stable cash generation for the company. The forward integration of IOC into petrochemical segment provides operational synergies, like conversion of surplus products in the country such as naphtha, into higher value petrochemicals (like HDPE, PP etc), which also lead to higher margins. Overall, significant integration across segments reduces the risks related to refining operations.

Demonstrated support of GoI to ensure the profitability of OMCs in the years of high under-recoveries - The GoI has provided dedicated support to cushion the OMCs from high under-recoveries especially in years of high crude oil prices like FY2012 and FY2013. In FY2015, the GoI institutionalised a subsidy sharing framework wherein large part of the under recoveries were borne by it through budgetary allocation. Further, materially lower under-recoveries in FY2017 and FY2018 has led to improvement in liquidity due to fall in debt levels and lower interest burden. With an increase in the crude oil prices in H1 FY2019, the gross under-recoveries have increased for the company and the OMCs in general resulting in higher working capital borrowings. GoI has been bearing the entire burden of under-recoveries since FY2016 and hence thus under recoveries for the OMCs has remained nil.

Considerable liquidity and financial flexibility derived from its investment portfolio and significant sovereign ownership: IOC continues to enjoy high financial flexibility, that has enabled it to borrow from the domestic and overseas banking system and capital markets at competitive rates, to fund its large working capital requirements and for project finance. The same is supported by IOC's strong parentage arising from the GoI's 53.88% stake. The company's investments in ONGC, GAIL, and Oil India with current aggregate market value of ~Rs. 16,493 crore as on February 20, 2019 besides unsold stock of GoI Special Oil bonds and GoI securities of ~Rs. 7865.3 crore as on March 31, 2018 provide considerable financial flexibility.

Credit challenges

Vulnerability of the company's profitability to the global refining margin cycle, import duty protection, and INR-USD parity levels - Given the nature of the business, the company would remain exposed to the movement in the commodity price cycles and the volatility in the crude prices. Any adverse changes in the import duty on its products would also have an impact on the company's domestic sales. The company's profitability is also exposed to the forex rates (INR-US$) given the business is largely dollarized on sales, crude procurement and foreign currency loans.

Increase in regulatory risk related to under-recoveries in an elevated crude oil price environment; consistent fall in consumption of kerosene to partly offset the risk – Higher crude oil prices, if sustained, lead to material increase in gross under-recoveries (GURs) as was witnessed in H1 FY2019 and consequently raise the working capital requirements and short-term debt levels of OMCs, thereby negatively impacting their profitability. ICRA expects GURs for OMCs to increase from Rs. 197 billion in FY2018 to ~Rs. 379 billion in FY2019 and to ~Rs. 345-415 billion in FY2020 (at crude price of US$65-70/bbl). Additionally, in a recent intervention by the Government of India (GoI) in October 2018 the OMCs were directed to reduce selling prices of Motor Spirit (MS) and High-Speed Diesel (HSD) owing to elevated prices of these auto fuels. Accordingly, the regulatory risks for IOC related to pricing of sensitive petroleum products and auto fuels remains in an elevated crude oil price environment, however the past track record of the GoI to ensure low under-recovery levels for PSU OMCs provides comfort from the credit perspective. Any adverse change in the GoI's policy in this regard, resulting in a weakening of key credit metrics of IOCL will be a key rating sensitivity

New project implementation risks, partly mitigated by the long-demonstrated history of IOC in implementing projects across refining, marketing, petrochemicals and pipelines segments: The company has significant capex plans spanning the entire downstream value chain with an outlay of ~Rs. 1,800 billion over next 6-7 years. The capex plans include the ongoing up-gradation of refineries for production of BS-VI compliant fuel, brownfield expansion of refineries, setting up of nearly 6,500 km of pipeline infrastructure, investments in setting up of retail infrastructure, setting up of petrochemical plants etc. Besides the company is also planning to set-up a mega refinery under a JV with other two PSU OMCs along with ADNOC and Saudi-Aramco on the west coast of India for nearly $44 billion (IOC's share of $11 billion). Any material time or cost overruns in the group projects could lead to an increase in the company's borrowing levels and moderation of credit metrics. However, the risk is largely mitigated by the company's proven track record of successfully implementing several large projects.

With the company increasing its upstream portfolio it is exposed to geological, technology and execution risks that are inherent in E&P activities – The company currently has upstream portfolio of 19 blocks (domestic and overseas) and has been actively trying to expand the same. However, increasing presence in the upstream sector exposes the company to geological, technological and execution risks that are inherent in E&P activities.

Liquidity Position:

IOC's cash balances including short term investments was Rs. 10,183 crore (including the GoI oil bonds) as on September 30, 2018. The free cash flows after meeting the capex incurred and dividend payments going forward will remain negative for the company in the near term. The company has scheduled debt repayment of ~Rs. 2500 crore in FY2019 along with short term debt of Rs. 35,528 crore as on December 2018. However, given the company's strong access to capital markets and high financial flexibility owing to the sovereign ownership, the overall liquidity position is expected to remain comfortable. Besides, the company has investments in equity shares in ONGC, GAIL, Oil India with aggregate current market value of Rs. 16,493 crore as on February 20, 2019 which also provide financial flexibility and support liquidity of the company.

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Downstream Oil Companies
Parent	Government of India: The ratings factor in implicit support from GoI in terms of support of the Gross Under Recoveries for LPG and SKO being borne by the GoI thus supporting the profitability of PSU OMCs.
Consolidation	For arriving at the ratings, ICRA has considered the consolidated financials of IOCL. ICRA has factored in the rated entity's support to fund the equity component of the investment in its JV projects, any cost overruns and, and debt servicing support in the initial stage of operations. The subsidiaries and JVs of IOCL that have been considered are enlisted in Annexure 2.

About the company:

IOC is currently the largest corporate entity in India by sales. Government of India has 53.88% equity stake in the company. The company and its subsidiaries have a total refining capacity of 80.7 MMTPA, which is 32.4% (as on November 1, 2018) of the total domestic refining capacity. The company accounted for 44% of the total petroleum products sold within the country in FY2018. 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. The company has interests across the gas value chain as well, from LNG import terminals to city gas distribution networks (CGD). The company currently operates CGD networks in Agra and Lucknow through Green gas Limited (joint venture with GAIL (India) Limited); besides, the company is also implementing CGD projects in Chandigarh, Allahabad, Panipat, Daman, Ernakulam, Udhamsingh Nagar, and Dharwad through IndianOil-Adani Gas Private Limited - a JV with the Adani group.

Key financial indicators (audited)

	FY2017	FY2018
Operating Income (Rs. crore)	3,55,379	4,21,492
PAT (Rs. crore)	19,745	21,715
OPBDIT/OI (%)	9.7%	9.9%
RoCE (%)	21.1%	22.1%
Total Debt/TNW (times)	0.6	0.6
Total Debt/OPBDIT (times)	1.8	1.6
Interest coverage (times)	9.2	10.9

Source: ICRA estimates; OI: Operating Income; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net-Worth + Deferred Tax Liability - Capital Work - in Progress); NWC: Net Working Capital

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs Crore)	Current Rating (FY2019) Date & Rating Feb 2019	Chronology of Rating History for the past 3 years: Date & Rating FY2018 Jan 2018	Date & Rating in FY2017 Jan 2017	Date & Rating in FY2016 Dec 2015
1	Commercial Paper	Short Term	40,000.00	NA	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**
2	Non-Convertible Bonds - Series-VIIIB	Long Term	1,070.00	Nil	**[ICRA]AAA (Stable) withdrawn**	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**

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

Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE242A07207	Non-Convertible Bonds Series-VIIIB	-	-	-	-	[ICRA]AAA (Stable) withdrawn
NA	Commercial Paper	NA	NA	7-365 days	40,000.00	[ICRA]A1+

Source: Indian Oil Corporation Limited.

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Chennai Petroleum Corporation Limited	51.9%	Full Consolidation
Indian Catalyst Private Limited	100.0%	Full Consolidation
IndianOil (Mauritius) Limited	100.0%	Full Consolidation
Lanka IOC PLC	75.1%	Full Consolidation
IOC Middle East FZE	100.0%	Full Consolidation
IOC Sweden AB	100.0%	Full Consolidation
IOCL (USA) Inc	100.0%	Full Consolidation
IndOil Global BV	100.0%	Full Consolidation
IOCL Singapore PTE Limited	100.0%	Full Consolidation

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