Indian Oil Corporation Limited

Instrument	Amount (In Rs Billion)	Rating Action
Long-term Bonds Programme	45.28	[ICRA]AAA (Stable) reaffirmed
Commercial Paper Programme	400.00	[ICRA]A1+ reaffirmed

ICRA has reaffirmed the [ICRA]AAA (pronounced ICRA triple A) rating assigned to the Rs. 45.28[*] billion[†] bond programme of Indian Oil Corporation Limited (IOC)[‡]. 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.

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 part 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 declining trend in the levels of short term borrowings. Nonetheless, any steep rise in crude oil prices due to geopolitical or other reasons and/or steep depreciation of the INR against USD leading to higher under recovery burden will be key rating sensitivities.

The gross under recoveries of the OMCs have been declining owing to the fall in international crude oil prices. The under recovery sharing on upstream companies remained at US$ 56/bbl till H1 FY15, however following decline of crude oil prices from July 2014 onwards the under recovery sharing was moved to an ad-hoc mechanism. Post the decline in crude oil prices, the GoI has announced that it would share under-recovery upto Rs. 12/litre on SKO (PDS) while the balance under-recovery on kerosene will be borne by the PSU upstream companies. With regards to LPG (domestic), the GoI has approved a fixed subsidy capped upto Rs. 18/kg under the Direct Benefit Transfer for Domestic LPG (DBTL), which translates to Rs. 255.6 per cylinder.

Additionally the GoI now transfers the subsidy through an escrow account mechanism. For LPG the government transfers funds to the OMCs in an escrow account at the rate of Rs 18/kg and for PDS Kerosene at the rate of Rs 12/litre. The OMCs withdraw the compensation from this account and the balance is left in the bank account. In the case of LPG due to the low prices of crude oil, the OMCs' actual under-recoveries has been lower than Rs 18/kg since April 2015. Due to subsidy being lower than Rs 18/kg the balance in the pool account has swelled and the OMCs plan to tap into these funds when under-recoveries start rising due to a possible crude oil price spike. Accordingly short term borrowings have been on a declining trend following the reduction in crude oil prices leading to lower gross under recoveries and faster remittance of subsidy from the GoI.

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* Long Term Bond Programme of Rs 45.28 billion (Rs 4528.20 crore)
† 100 lakh = 1 crore = 10 million
‡ For complete rating scale and definitions, please refer to ICRA's Website, www.icra.in, or any of the ICRA Rating Publications

The gross under-recoveries of public sector OMCs almost halved with 48.3% (yoy) decline to Rs. 723 billion in FY15 from Rs. 1399 billion in FY14 primarily driven by 82.6% fall in under-recoveries on diesel to Rs. 109 billion in FY15 from Rs. 628 billion in FY14 following diesel price deregulation in October 2014. ICRA projects gross under-recoveries (GURs) of OMCs to decrease by ~58% from Rs. 723 billion for FY15 to Rs. ~300 billion for FY16 (estimated at average Indian basket crude oil price of US$ 51/bbl and INR/US$ of 65 for FY16). Soft level of crude oil prices are expected to lead to materially lower under-recoveries on LPG and Kerosene, while deregulated diesel and petrol prices would ensure no subsidy burden on auto fuels (viz. diesel and petrol).

IOC has plans to incur a large capital expenditure of Rs 1.75 trillion over the next seven years on upgradation of its existing refineries, new refinery, completion of 15 MMTPA new integrated refinery at Paradip (Orissa), various pipeline projects, petrochemical projects, marketing infrastructures and exploration & production (E&P) activities among other initiatives. The company began dispatching products from the Paradip refinery in November 2015 end even as some of the secondary processing units at the refinery are being commissioned in stages. 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 52 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.

The petrochemical complex of the company at Panipat operated at optimal capacity utilization levels in 2014-15, with improvement in profitability. Accordingly the project has imparted greater diversity to IOC's business portfolio and partly reduced its 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 65.7 million metric tonnes per annum (MMTPA), which is 31% of the total refining capacity in India (as on March 31, 2015). 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 49%. 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).

With the reduction in gross under recoveries, the short term/working capital borrowings of the company have reduced both in absolute terms and as a proportion of the total debt. As a proportion of total debt, the short term/working capital borrowings reduced from 56% as on March 31, 2014 to 33% as on March 31, 2015. 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.

Going forward, although the gross under recoveries will remain sizeable the same are expected to decline from the levels of 2014-15 on account of decline in crude oil prices and deregulation of diesel. 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.

Company Profile

IOC is currently the largest corporate entity in India by sales. Government of India has 58.57% equity stake in the company. IOC and its subsidiaries have a total refining capacity of 65.7 MMTPA, which is 31% (as on March 31, 2015) of the total domestic refining capacity. The company accounted for 49% of the total petroleum products sold within the country in 2014-15. 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.

Recent Results

As per unaudited and provisional results, the company posted a net profit of Rs 61.1 billion on an operating income of Rs 1866.9 billion in H1 FY16 as against a net profit of Rs 16.2 billion on an operating income of Rs 2366.2 billion in H1 FY15.

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