India starts to fill up tank with IOC divestment

By Jackie Horne | 25 August 2015

Indian government defies its stock market's worst trading day in more than six years to raise $1.4 billion from the sale of a 10% stake in Indian Oil Corporation.

Its advertising says that "with Indian Oil anything is possible" and on Monday the Indian government proved that motto correct after successfully divesting a 10% stake in the company on one of the worst trading days in recent history.

Fears about global growth, particularly in China, pushed investors into panic mode and stock markets into freefall, with the BSE Sensex dropping 5.94% to suffer its biggest one-day drop in six-and-a-half years.

Some fund managers believe India was the victim of indiscriminate selling. "The country is the biggest single beneficiary of low oil prices, which will positively impact earnings," Jon Thorn, founder of India Capital Fund, told *FinanceAsia*.

“Markets are moving on fear rather than fundamentals,” he argued. "India is one of the assets that should be bought rather than sold and will be again once people stop panicking."

Indian Oil Corporation (IOC) itself fell 4.11% to close at Rs378.25, which meant investors who bid for the stock during the government’s one-day sale ended up buying shares at a 2.27% premium to secondary market trading levels.

Unsurprisingly, retail accounts, mutual funds and foreign institutional investors (FII's) all stayed well clear of the deal, which saw the government raise Rs93.79 billion ($1.4 billion) from the sale of 242.79 million shares at a floor price of Rs387. Instead, bankers reported that state-owned entities led by Life Insurance Corporation of India picked up all the stock.

The institutional book, covering 80% of the deal, closed 1.43 times oversubscribed, while the retail portion for the remaining 20% closed only 18% subscribed even though individual investors were offered shares at a 5% discount to the floor price. All the excess retail shares have been placed with institutions.

Bankers said that some of the domestic SOEs purchased the stock so they could establish a long-term position. For while IOC is India's largest company by revenues, its stock only averages about $8.7 million volume a day because the freefloat is only 12.1%.

The deal consequently represented a fairly hefty 161 days trading volume.

According to S&P Capital IQ figures, the government owned 68.57% pre-divestment, with various other strategic corporate investors including Oil & National Gas Corp (ONGC) and Oil India holding a further 18.7%. FII's, meanwhile, held about 2.4% and mutual funds 1.2%.

The new deal will almost double the freefloat, although bankers said liquidity is only likely to pick up slowly.

"Some of the investors who purchased this deal are not natural long-term holders of the stock," one banker commented. "However, they're under no pressure to sell either so I think we'll see a steady improvement of the freefloat over time as the stock price rises back above Rs387 again."

"In some ways low retail participation is a plus point," the banker added. "Settlement is T+2 so retail investors didn't want to take the risk of further falls on Tuesday. But their absence means there will be less flipping."

The government is likely to be fairly happy with the outcome of the deal. IOC has fallen 17.9% since its year-to-date high or Rs458 on July 24 but is still up 13.1% since the beginning of the year.

India revs up divestment programme

So far, the government has raised about 18% of its targeted Rs695 billion ($10.37 billion) in privatisation proceeds for the fiscal year 2015/16, which began in April.

At the end of April it raised Rs16.1 billion ($240 million) from a divestment in the Rural Electrification Corp of India, followed by Rs16 billion ($239 million) from Power Finance Corp at the end of July and, most recently, $530 million ($7.9 million) from a sale in Dredging Corp.

The government's divestment department has cabinet approval for a string of share sales, the largest of which will be for Coal India. Last week, the government said it had sent banks a request for proposals to lead a 10% divestment, which would raise Rs221.2 billion ($3.29 billion) based on Monday's Rs338 closing price.

The government currently holds a 78.65% stake in the world’s biggest coal producer. Following January’s most recent Rs226 billion ($3.4 billion) secondary share sale, the stock has a 19.2% freefloat.

How the government times any new transaction could prove key to the success of its overall privatisation programme this year. And the stock has not performed well recently, dropping 23.9% since August 4 and 11.7% year-to-date.

As such it has underperformed the BSE Sensex, which is also now 6.4% under water.

Other state-owned companies on the block include: ONGC, which could raise $1.56 billion from a 5% sale based on Monday’s close; NTPC, which would raise $1.69 billion from an 11.36% sale; Bharat Heavy Electricals - $450 million from a 5% sale; National Aluminium Corp - $120 million from a 10% sale; Hindustan Copper - $110 million from a 15% stake and Engineers India - $90 million from a 10% sale.

IOC: buy or sell?

Analysts remain split on whether IOC has much further upside. At 1.49 times price to book, the stock is trading at its highest level since 2009, although it did briefly hit the same valuation in 2011.

Its recent first-quarter results showed that revenues slid 19% year-on-year but overall profitability was bolstered by higher sales volume, improving refining margins and inventory gains. Net income of Rs61 billion came in ahead of consensus expectations.

Kotak said it finds the stock "relatively inexpensive" compared to BPCP and HPCL and cited improving gross refining margins of $10.7 per barrel compared to $9 in the fourth quarter.

Morgan Stanley said it expects "better gross refining margins driven by higher fuel oil margins and lower fuel costs due to lower oil prices coupled with completion of refinery projects."

However, UBS believes analysts should not get carried away with improving margins. It recently argued that last October's diesel price de-regulation has been priced in.

It also concluded that Indian refiners are unlikely to be able to boost their non-fuel margins to the same level as global peers, which have far stronger convenience store operations at their petrol stations.

IOC has 10 refineries with capacity of 65.7 million tons per annum, which gives it a 31% domestic market share. It also has 11,000km of pipeline and a 46.7% share of the petrol market.

Lead managers for IOC's government divestment were Citi, Deutsche Bank, JM Financial, Kotak and Nomura.