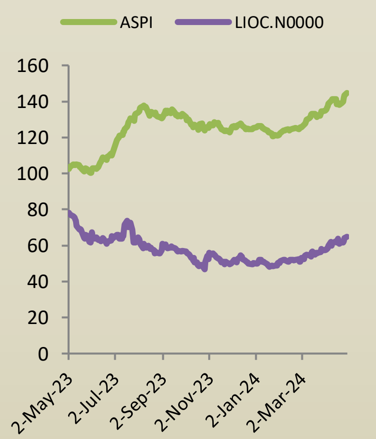
Member of the Colombo Stock Exchange

May 2024

Trading Snapshot

Sector	Energy
CSE Code	LIOC.N0000
Bloomberg Ticker	LIOC SL
Shares in Issue (Mn)	532
52 Week High (LKR)	159
52 Week Low (LKR)	95.2
Market Cap (LKR Mn)	70,152
Market Cap (USD Mn)	236.84
LKR:USD	296.20
Market Price (LKR)	131.75

Relative Stock Performance



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Lanka IOC PLC (LIOC)

Initiation Report: BUY

Market Price LKR 131.75| Target Price LKR 155 | Upside +17%

Case for Investment

Opening of Additional Fuel Stations To Enhance Revenue: LIOC expects to have around 270+ fuel stations in operation by end June 2024 and further grow to 300+ sheds in the near term. The addition of the new filling stations is expected to greatly enhance LIOC's presence in the auto fuels segment, increasing market share and revenue.

Entry of New Players: The entry of new players, namely, "Sinopec", "United Petroleum" and "RM Parks" into the fuel market has enhanced competition. The new players are expected to have 200 fuel stations each. However, the greater number of LIOC fuel stations (strategically located throughout the country) is expected to sustain its revenue generation potential. Moreover, significant price competition is unlikely given the homogeneity of the fuel product.

Bunkering Segment Expected To Show Growth: The expansion of bunkering operations at Hambantota Port and growing vessel movements is expected to further enhance revenue from Bunkering operations. Bunkering's contribution to total revenue was 20% in FY2024, with further growth expected.

Valuation: Presently, the stock trades on a Forward PER of 5x at a significant discount to the Broad Market PER of 11x. We arrive at blended 12M **Target Price of LKR 155 per Share**, by assigning an equal weight to values derived from 3 methods (Forward PBV, Forward PER and DCF valuation). LIOC currently has upside potential of ~17% from the current market price. **We recommend BUY.**

Investor Guide

YE 31st March	2023	2024	2025E	2026E	2027E
Revenue (LKR Mn)	281,488	263,569	283,405	325,067	359,682
+/- Growth	*212.93%*	*-6.37%*	*7.53%*	*14.70%*	*10.65%*
Net Profit (LKR Mn)	37,696	13,945	13,597	14,645	16,337
+/- Growth	*682.32%*	*-63.01%*	*-2.50%*	*7.71%*	*11.55%*
EPS (LKR)	70.79	26.19	25.54	27.50	30.68
PE (x)	2.42	4.46	5.16	4.79	4.29
NAV (LKR)	115.00	137.98	159.02	181.52	207.20
PBV (x)	1.49	0.85	0.83	0.73	0.64
Dividend/Share (LKR)	2.25	4.00	4.50	5.00	5.00
Dividend Yield (%)	1.31%	3.42%	3.42%	3.80%	3.80%
ROE (%)	88.16%	20.70%	17.20%	16.15%	15.79%
ROA (%)	51.19%	15.16%	12.76%	12.46%	12.36%
Market Cap (LKR Mn)	91,318	62,192	70,152	70,152	70,152
Share Price - (LKR)	171.50	116.80	131.75	131.75	131.75

Source: LIOC Financials, SC Securities Research. Market Price as of 29th April 2024

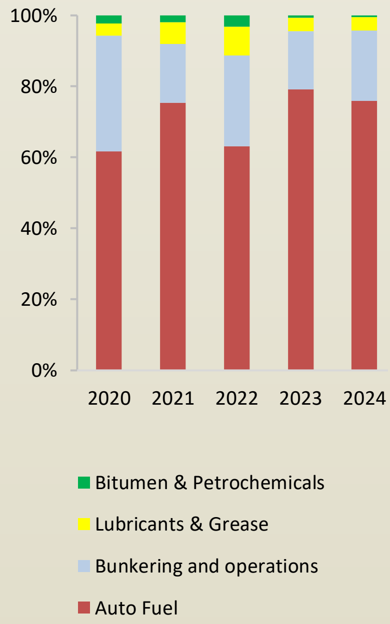
Company Overview

LIOC is a subsidiary of the Indian OIl Corporation Ltd, (IOCL), which is India's state owned energy company with presence in 8 countries. IOCL is also India's highest ranked energy PSU with a Fortune-500 listing (Rank 94 for 2023). Thus LIOC benefits strongly from the management and operational support of the parent company. LIOC was formed with the signing of an MOU between the state–owned Ceylon Petroleum Corporation (CPC) and IOCL in June 2002; subsequently, LIOC commenced operations in Sri Lanka in CY2003. The company has currently been in operation for over two decades in Sri Lanka.

The Company's workforce consists of around 160+ employees based in Colombo and Trincomalee. An additional 5,000+ indirect workers are employed at all its retail outlets spread country-wide.

LIOC operates close to 260+ fuel stations, providing both Petrol and Diesel. Currently, the Company has a market share of approximately 19 - 20% in the auto fuel retail market. Further, it is a leading player in the bunker market serving vessels in the Colombo, Galle, Trincomalee and Hambantota ports. The Company is also the second largest player in the lubricants market, with a market share of ~21%. The "Servo" brand of lubricants is solely provided by LIOC in Sri Lanka. Additionally, LIOC operates in the Bitumen and Petrochemicals markets, although revenue streams from the two business lines are not significant.

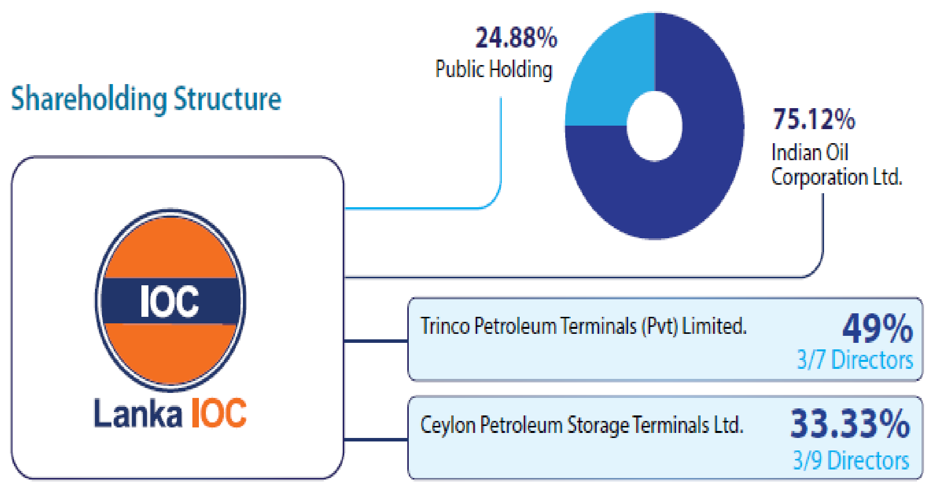
Figure 02: LIOC Revenue Contribution



Source: LIOC Annual Reports

Auto Fuel continues to be the main revenue generator for LIOC. The Company currently holds ~ 19% market share in the auto fuel market.

Figure 01: Group Structure



Source: LIOC Annual Report 2023

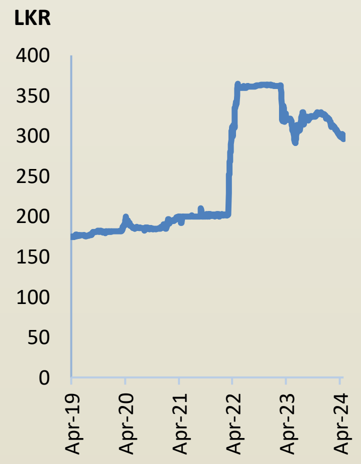
At present, IOCL has 75% ownership in LIOC with the remainder held by the public. LIOC also holds a 49% stake in **Trinco Petroleum Terminals (Pvt) Limited (TPTL)**, a joint venture entity formed with the CPC, to develop 61 oil storage tanks in the Upper Tank Farm in Trincomalee. LIOC also holds a 33.3% stake in **Ceylon Petroleum Storage Terminals Ltd (CPSTL)**, a state owned entity which is in the business of storage and distribution of petroleum products. The CPSTL is also known as the "Common User Facility" with the storage for all fuel retailers being carried out at this facility. LIOC currently nominates 3 members to the 9 member board of directors of CPSTL. Partial ownership in this fuel storage facility provides a strategic advantage to LIOC, to ensure the continued availability of fuels to its customers.

The 33.3% ownership stake in CPSTL provides a strategic advantage to LIOC, in terms of fuel storage and distribution.

Operating Landscape

The key revenue drivers for LIOC are the volume growth for fuel and oil products, market share, and pricing factors such as the global oil prices and the exchange rate. Macro economic factors, such as GDP growth and inflation would in turn affect the volume growth for fuel. In CY2023 the economy came out of recessionary conditions recording YoY GDP growth of 1.6% and 4.5% in Q3 CY23 and Q4 CY23, respectively. Real GDP is expected to expand by 2% to 3% in CY2024E. Hence the economic turnaround and lower inflation bodes well for consumer disposable income and companies such as LIOC are expected to benefit. Further, removal of the fuel quota is expected to benefit revenue streams of all fuel retailers.

Figure 04: Exchange Rate (1 USD -> LKR)



Source: CBSL

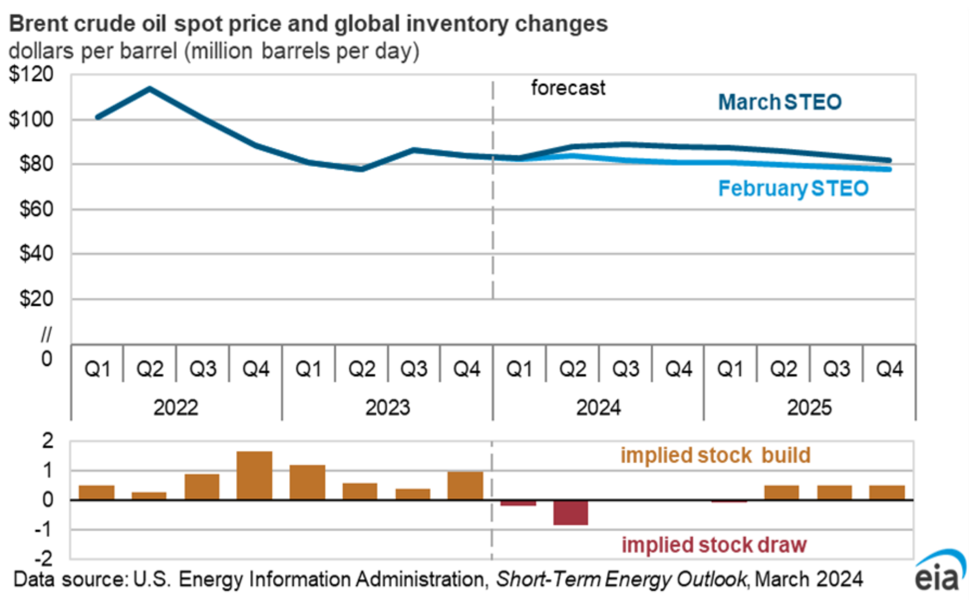
The LKR has appreciated by ~9% against the USD in the YTD 2024

Global Oil Prices Expected To Remain Relatively Flat In 2024 and 2025

Global oil production is expected to slightly increase by 0.4 million b/d in 2024 down from an increase of 1.8 million b/d in 2023 (Source: U.S Energy Information Administration, Short Term Energy Outlook, and March 2024). Although anticipated OPEC production cuts limit growth in 2024, production outside of OPEC nations, namely the United States, Guyana, Brazil and Canada, supports overall oil production. Further, global oil demand is projected to grow by 1.4 million b/d in both 2024 and 2025. Higher or lower demand growth could impact global inventory levels and oil prices.

The U.S Energy Information Administration forecasts the Brent crude oil price to decrease from an average of USD 88/b in 2Q24 to USD 87/b in 2024 amidst a tighter oil market. Oil prices are forecasted to decrease further to USD 85/b in 2025 led by increasing inventories.

Figure 03: Brent Crude Oil Forecast



Source: U.S Energy Information Administration, March 2024

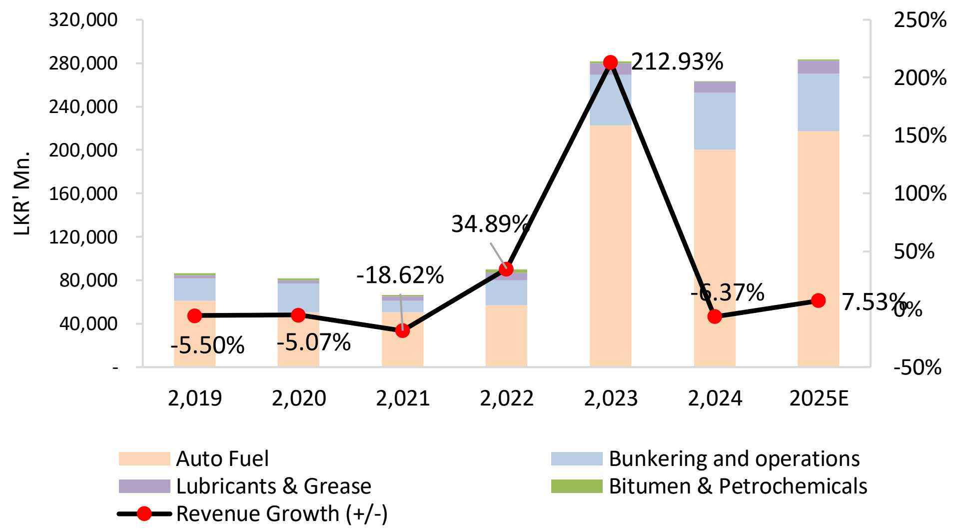
LKR Appreciation Benefits LIOC

The Sri Lankan rupee (LKR) has appreciated by ~9% in the year to date April 2024. Dampened import demand along with an external current account surplus has supported the appreciation of the LKR. With the Fuel Price Formula in place, we expect consumer demand for fuel to be boosted. Further, LIOC would be able to lock in inventory at a lower cost for future use.

Investment Case

LIOC has fairly diversified revenue mix; nonetheless auto fuel continues to be the main revenue generator accounting for ~76% of the company's revenue in FY2024. The other key segments are Bunkering (~ 20% of total revenue in FY23), and Lubricants (4% of revenue).

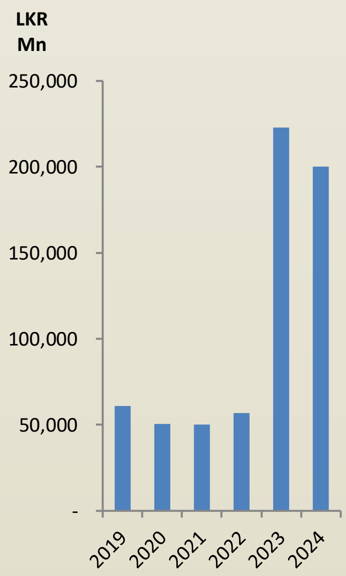
Figure 05: LIOC Revenue Growth



Source: LIOC Annual Reports, SC Securities Research

During the year ended March 2023, Sri Lanka was faced with an economic crisis brought on by high debt repayments, low forex reserves and insufficient fiscal balances. During this period there were only two fuel retailers in the domestic market namely, Ceylon Petroleum Corporation (CPC) and LIOC. CPC, being the state owned entity was unable to import sufficient fuel due to lack of foreign reserves. Further, the default sovereign rating also created a situation where credit facilities were unavailable from international banks. In this situation LIOC was able to record a notable YoY growth of 293% in sales volume, due to having easier access to fuel supplies. Further, amidst the currency crisis, LIOC was also able to supply industries in dollars which yielded further volume growth. However, the contribution from bunkering (to sales turnover) came down to 16% in FY23 from 26% in FY22 mostly due to the economic unrest and low vessel movements.

Figure 06: Auto Fuel – Sales



Source: LIOC Annual reports

FY2023 showed the highest sales turnover for LIOC led by Volume Growth and the Fuel Price Formula

Auto Fuel: Will Continue To Be the Key Revenue Generator

LIOC currently holds around 19-20% market share in the Auto Fuel Market. LIOC primarily imports refined petroleum products for sale in the domestic market. CPC continues to hold the monopoly on kerosene and heavy fuel oil mostly used in power generation. In May 2022 the fuel pricing mechanism in the domestic market was revised to a cost based fuel price formula. Thus the practice of controlled prices with fuel retail prices being at artificially low levels were abandoned; with fuel prices now being reflective of market forces. The fuel price formula is in line with the requirements the IMF program which the government is currently implementing. **Therefore, we expect the Fuel Price Formula to continue which will provide a definite advantage to LIOC and other fuel retailers in the market.**

In terms of the Pricing Formula, Fuel Prices will be reviewed bi-monthly or monthly and reflects input costs, exchange rate, taxation, profit margin and other costs.

Figure 07: Fuel Price Formula

CEYLON PETRELEUM CORPORATION
ESTIMATED PRICING OF IMPORTED REFINED PETROLEUM PRODUCTS
(Subject to available data up to today)

1st April 2024
Mar 2024 - IMPORT PRICES
IN LAST MONTH (01.03-31.03)

		Type of Product				
		Petrol 92	Petrol 95	Lanka Auto Diesel	Lanka Super Diesel	Kerosene
V_1	**Landed Cost Per Litre in Rs**	**205.79**	**232.44**	**213.73**	**214.54**	**207.50**
V_{1a}	Cost Per Bbl /USD	105.44	119.09	109.51	109.92	106.32
	DAP Terms Per Barrel in USD	105.123	118.738	109.179	109.594	106.000
	Losses due to evaporation & contamination of products-0.3% Per Barrel in USD	0.32	0.36	0.33	0.33	0.32
V_{1b}	Exchange Rate Per US Dollar (Average CBSL TT selling rate of immediate passed 30 days)	310.13	310.13	310.13	310.13	310.13
	No of Litres per barrel	158.9	158.9	158.9	158.9	158.9
V_2	**Processing Cost Per Litre in Rs**	**19.39**	**21.88**	**16.65**	**18.13**	**11.85**
V_{2a}	L/C Opening Charges	0.11		0.05	0.11	
V_{2b}	Bill Acceptance Charges	0.08		0.04	0.08	
V_{2c}	Jetty and Pipeline charges (Local Port Charges)	0.36	0.66	0.06	0.75	0.67
V_{2d}	Throughput Charges	3.90	3.90	3.59	3.59	4.11
V_{2e}	Evaporation Loss Given to Dealer (0.5%)	1.80	2.13			
V_{2f}	Transport Cost	2.17	2.17	2.17	2.17	2.17
V_{2g}	Exchange Rate Variation					
V_{2h}	Dealer Margin (2.96% on selling price)	10.98	13.02	10.74	11.43	4.90
V_3	**Stockholding Cost**	**3.04**	**3.56**	**2.88**	**3.14**	**2.27**
	Stockholding Cost Per 30 Days (Buffer Stock)	3.04	3.56	2.88	3.14	2.27
	Cost per liter (Without taxes and Dealer Margin)	**217.24**	**244.86**	**222.51**	**224.38**	**216.73**
	Cost with Dealer Margin	**228.22**	**257.89**	**233.26**	**235.80**	**221.63**
V_4	**Taxation**	**130.44**	**162.31**	**107.47**	**133.11**	**3.00**
	Taxes per litre (imposed by the government)	130.44	162.31	107.47	133.11	3.00
	Petroleum Sector Infrastructure Development levy (6% per litre) - not considered in calculations since this has not been implemented yet	-	-	-	-	-
V_5	**Other Cost** 2% of total cost per litre exclusive taxes & dealer margin. This is to cover up administrative expenses, depreciation cost, personnel cost, operational cost and other cost elements and depreciation.	4.34	4.90	4.45	4.49	4.33
V 6	**Profit Margin up to 4% of Total Cost Per Litre** — Product / %					
	Petrol 92 — **1.50**	4.60				
	Petrol 95 — **4.00**		14.33			
	Lanka Auto Diesel — **3.00**			8.70		
	Lanka Super Diesel — **4.00**				12.58	
	Kerosene — **-**					-
V 7	**Cost Saving from the Refinery Production**	(3.35)	-	(8.66)	-	(15.57)
	(A) Formula based Price Per Litre in Rs	370.95	439.43	362.52	385.98	244.54
	(B) Current Retail Price Per Litre in Rs	371.00	440.00	363.00	386.00	245.00
	Price Difference (B)-(A) +/(-)	**0.05**	**0.57**	**0.48**	**0.02**	**0.46**

Taxes	LP 92	LP 95	LAD	LSD	KERO
CID per Ltr	-	21.00	-	15.00	-
Excise Duty per Ltr	72.00	72.00	50.00	57.00	-
SSCL 1.25% effective rate on retail price	3.79	4.50	3.73	3.97	3.00
VAT @ 18%	54.64	64.81	53.73	57.14	-
Total Taxes	**130.44**	**162.31**	**107.47**	**133.11**	**3.00**

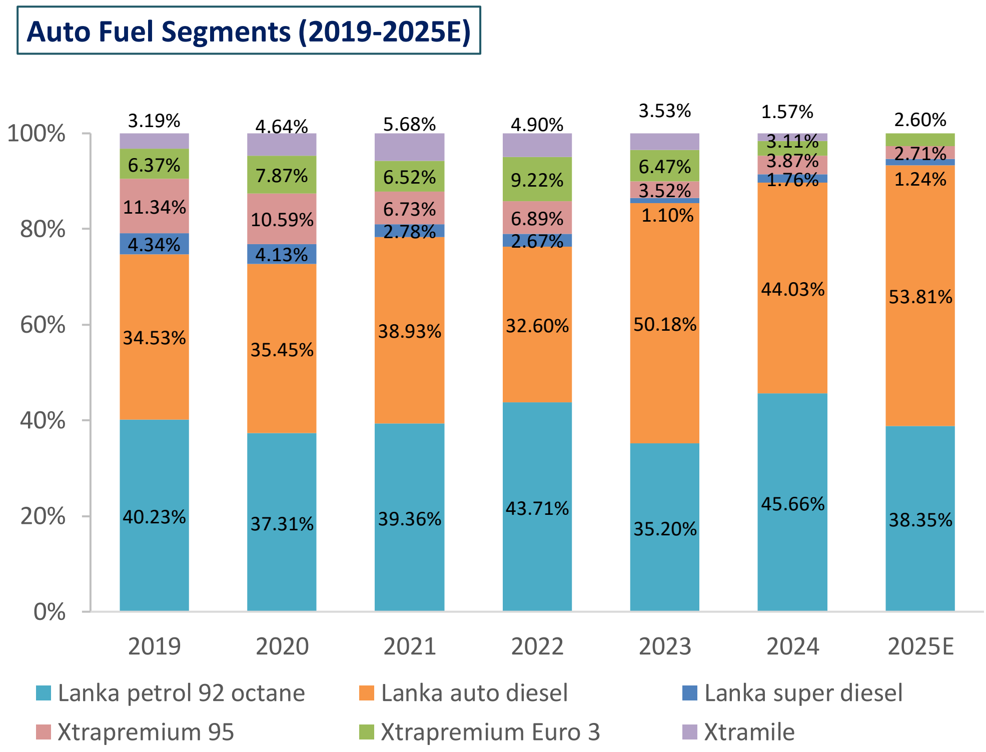
Note:

- Actual average premium and PLATTs of the goods received (BK 06 for LP92, BK 55 for LP95, BK8 & BK11 for LAD, BK11 for LSD) in last month have been considered.
- Although there are no import of P95 in above period, the cost of the last shipment of P95 considered due to the availability of stocks.
- Dealer margin on Petrol & Diesel have been computed without considering the Cap.
- The refinery benefit/loss has been factored based on the February production quantity & cost and sales quantity.
- As Kero unloading started on 31.03.2024, the pricing of the Kero shipment considered based on the average of first two days platts due to unavailability of second two days platts.

Source: CPC, EconomyNext

LIOC purchases its inventory from global oil traders, based on tender. LIOC has the ability to purchase fuel in bulk at lower global prices – Singapore Platts price is applied as supplies are mainly from Singapore traders. The Company also applies “Trigger Pricing” to safeguard against price volatility.

Figure 08: Auto Fuel Segments



Source: LIOC Annual Reports, SC Securities Research

Being the top contributor to LIOC's revenue, we expect auto fuel to comprise around 70-80% of the total revenue, going forward.

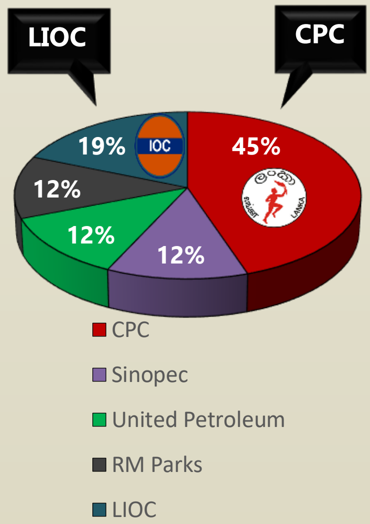
LIOC placed adds to open 96 additional fuel retail outlets, of which 36 were opened in CY2023. The company expects to have around 270+ sheds in operation by mid CY2024, and grow to a total of 310. Thus we expect LIOC's market share in the auto fuel market (in revenue terms) to grow to ~22% with the additional sheds.

New Players Enter Sri Lanka's Fuel Retail Industry, Enhancing Competition

The oil import bill constitutes a significant component of Sri Lanka's imports. Thus in order to save the foreign exchange reserves of the country which can then be directed towards other payments, the Sri Lankan government took a policy decision to liberalize the fuel retail industry. Accordingly three new players namely, China's "Sinopec", Australia's "United Petroleum" and USA's "RM Parks" in collaboration with "Shell" were selected to enter the domestic fuel retail market. Each new player was given 150 fuel stations previously managed by the CPC as well as authority to establish an additional 50 fuel stations in new locations. This move has removed the duopoly previously held by LIOC and CPC and led to a more competitive market structure. The new players are given a 20 year license to operate in the domestic fuel industry.

As fuel is a standardized product, we do not expect significant price competition to take place in the fuel retail industry. Fuel retailers would need to cover their costs within a 4% net margin per litre that is guaranteed by the government. Instead we see competition taking place in the form of service improvements amongst all fuel retailers. The end beneficiary of the enhanced competition will be the customers.

Figure 09: Expected Share of Filling Stations



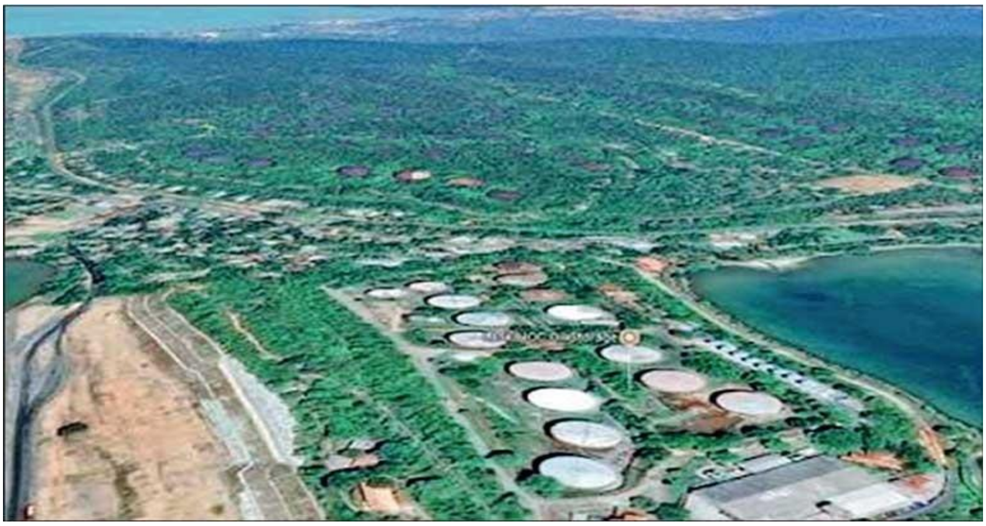
Source: LIOC, SC Securities Research

LIOC expects to have over 300 sheds in operation in the near term. CPC has around 740 sheds, whilst the remaining fuel retailers will have 200 each.

Trincomalee Oil Tanks Will Improve Storage Capacity and Enhance Revenue Generation

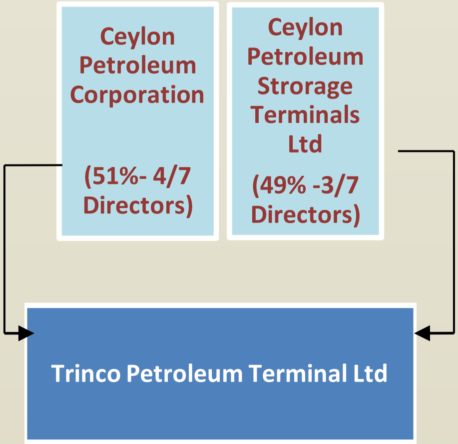
Built in the 1920s under British Colonial Rule, the Trincomalee Oil Farm consists of 99 Tanks spread across an area of 827 acres. Each Tank has a holding capacity of 10,000 MT which can be utilized to store any kind of liquid.

Figure 10: Trincomalee Oil Tank Farm



Source: Satellite Image

Figure 11: Joint Venture Structure



Source: LIOC Annual Report FY23

In January 2022, a joint venture company Trinco Petroleum Terminals Pvt Ltd (TPTL) was set up between the state owned CPC and LIOC. Under the JV, the CPC (51% ownership) and LIOC (49% ownership) would refurbish and utilize 61 oil tanks in the Upper Tank Farm, as a strategic storage and bunkering hub of South Asia. Initially, nine out of ten tanks were selected for Phase 1 development, and a few tanks are operational now. Post development, **LIOC gets the distinct benefit of expanding its storage capacity and revenue generation potential.** Further, LIOC's bunkering services at the key Trincomalee Port would benefit from the additional storage.

Presently, LIOC is searching for another JV partner for TPTL as CPC is expected to undergo restructuring by the government.

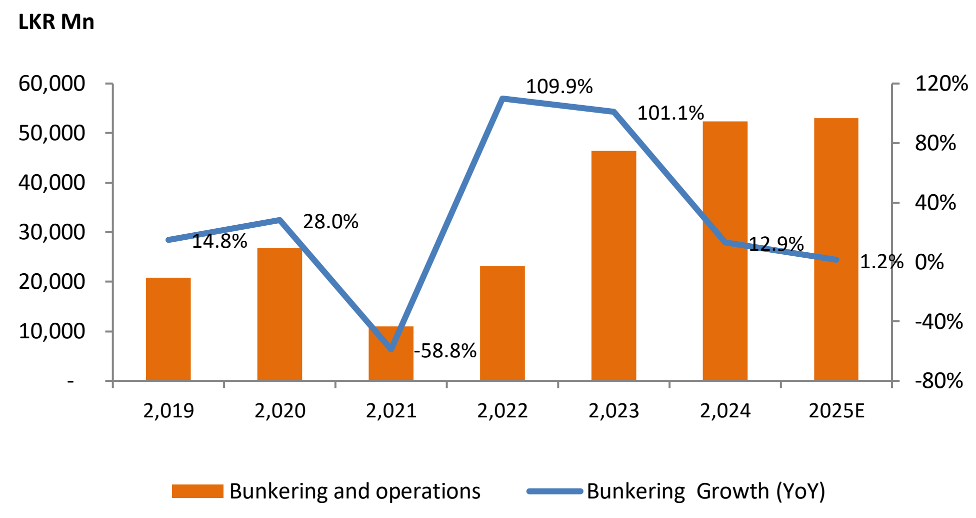
Bunkering Business Expected To Show Steady Growth

LIOC operates as the sole bunker fuel supplier in the Trincomalee Port

LIOC is one of the leading bunker fuel suppliers having a significant market share of 33% in the overall market. LIOC provides its bunkering services in the ports of Colombo, Trincomalee, Galle and Hambantota. The company provides Low Sulfar Fuel Oil (0.5%S), IFO 380cst (3.5%S) and LSMGO at the Sri Lankan ports. Further, it owns three fully equipped barges which operate across the different locations.

During FY2023, the company sold 150,000 Metric Tons (MT) of bunker fuel compared with 166,000 MT in the prior year. The reduction was mainly due to the economic unrest and low vessel movements during the year. Further, LIOC switched to an inventory light model in order to minimize exposure to market price movements. Hence it was decided discontinue bulk purchases (which were stored in the oil terminals in Colombo and Trincomalee) and instead purchase inventory in smaller quantities from local supplier SINOPEC. The company also utilizes pipeline supplies, which do not require a barge, which has proven to be cost-effective. LIOC further aims for strategic pricing and prompt sales, to further mitigate against losses from price changes.

Figure 12: Bunkering Sales



Source: LIOC Financial Statements, SC Securities Research

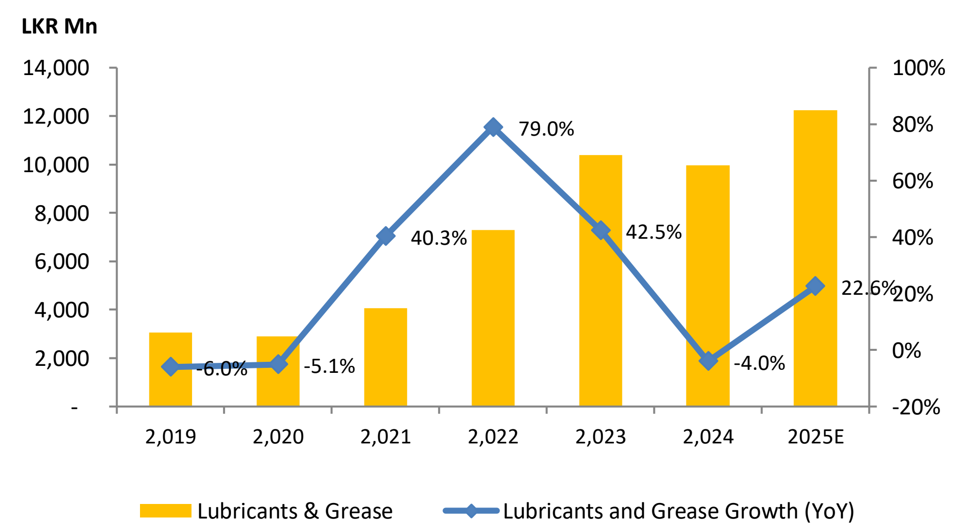
The bunkering segment is expected to showcase growth in the next few years. In FY2025E we estimate bunkering sales to be in the range of LKR 53 Bn with a segment share of 19%. The East Coast Indian ports do provide some level of competition, particularly in the VLSFO product; however, LIOC is able to offer its gasoil at more competitive prices which offsets this disadvantage.

Moreover, the Sri Lankan government has entered into a deal with Chinese energy company SINOPEC to build a new oil refinery in the southern port of Hambantota, focusing on export markets. We view this move positively as the addition of a refinery will help to lower the port's bunker prices and improve bunker sales overall.

Improved Macroeconomic Conditions Will Support Lubricants Business

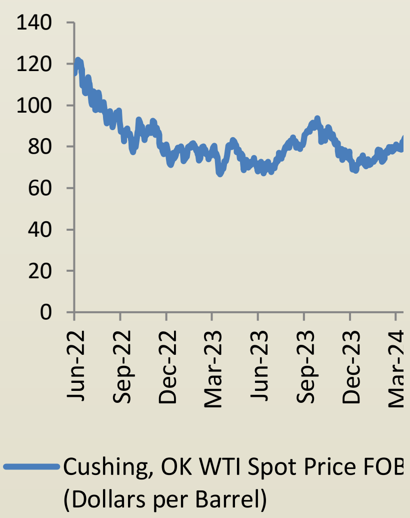
LIOC presently is the 2nd largest player in the lubricants market, holding a market share of approximately 21%. It is the sole distributor of the "**Servo"** brand of lubricants.

Figure 14: Lubricants and Grease Sales



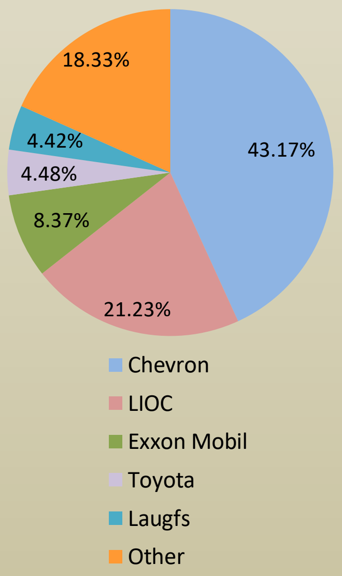
Source: LIOC Financial Statements, SC Securities Research

Figure 13: Cushing Oklahoma WTI Spot Price FOB



Source: U.S Energy Information Administration (EIA)

Figure 15: Q3 2023 Lubricant Market Share

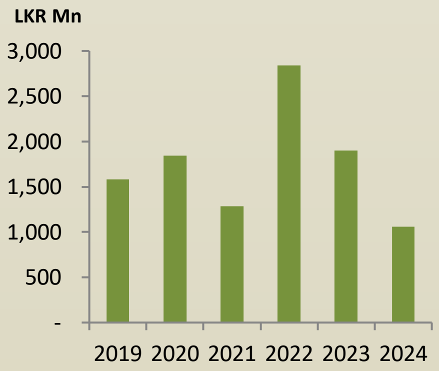


Source: Public Utilities Commission of Sri Lanka (PUCSL)

During FY2023, LIOC opened 64 new Servo shops and appointed two new distributors to its network. LIOC also introduced new products in strategic partnerships with TVS Lanka and Honda, via Stafford Motor Company.

Despite a decline in sales volume, lubricants segment recorded a robust profit increase of over 3.5x in FY23, over the prior year's profit.

Figure 17: Bitumen and Petrochemical Sales

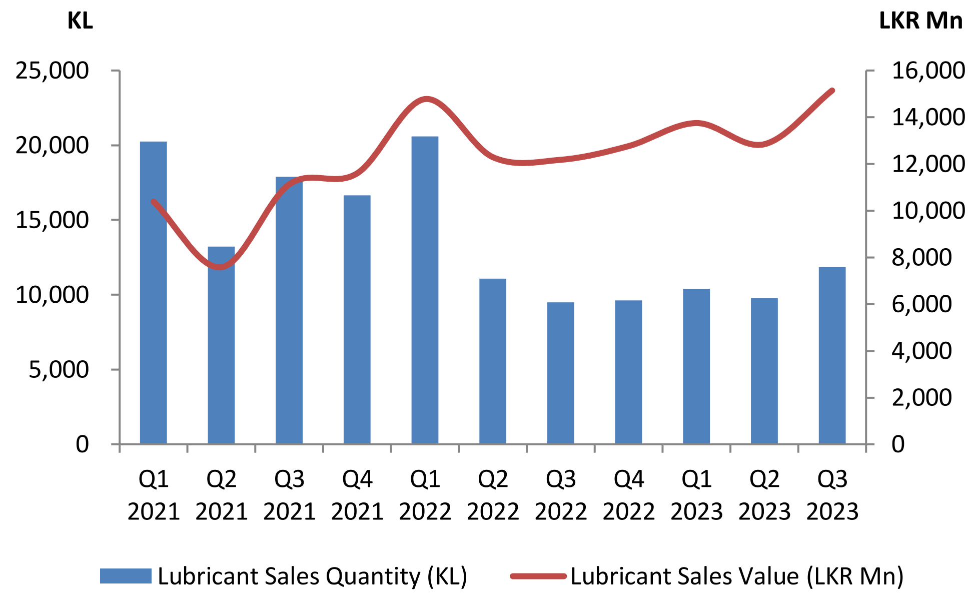


Source: LIOC Annual Reports

Bitumen and Petrochemicals are expected to comprise ~1% of total revenue in the near term.

The "Servo" brand supplies lubricants for automotive, industrial and marine applications. Majority of the "Servo" lubricants are processed at LIOC's lube blending plant in Trincomalee and distributed via a wide network of distributors (31) and Servo shops. (247).

Figure 16: Lubricant Market Quarterly Sales and Volumes



Source: PUCSL, SC Securities Research

As shown in the above graph, lubricant market volumes started contracting from Q2 2022 due to restricted fuel imports into the country. However, lubricant volume growth became positive in Q3 CY23 (by 25% YoY), due to removal of the fuel quota and improved consumer spending. Despite volumes contracting, lubricant market sales have grown in the recent quarters supported by sound pricing.

In the future, product innovations and strategic partnerships are expected to support LIOC's lubricant segment. The resumption of long distance travel and growth in tourism industry are also expected to aid the lubricants market. We estimate the lubricants segment to contribute ~4% to LIOC's total revenue in FY25E with total sales of ~LKR 12 Bn. Further, the newly added grease manufacturing plant in Trincomalee has negated the need for grease imports as it is able to cater to the entire country's demand. The same has improved LIOC's bottom-line as the profit per litre has significantly increased led by local production.

Bitumen and Petrochemicals Have Good Future Prospects

LIOC holds a strong position in the Bitumen market, offering four different varieties of Bitumen for industrial and road construction applications. Due to a halt in road projects since CY2022 the domestic demand for Bitumen has significantly reduced. Due to this LIOC has shifted its focus towards nearby export markets. During FY23, the company ventured into the Nepalese market which showed favorable growth prospects. Going forward, LIOC targets to achieve a significant growth in Bitumen exports, as domestic demand remains sluggish.

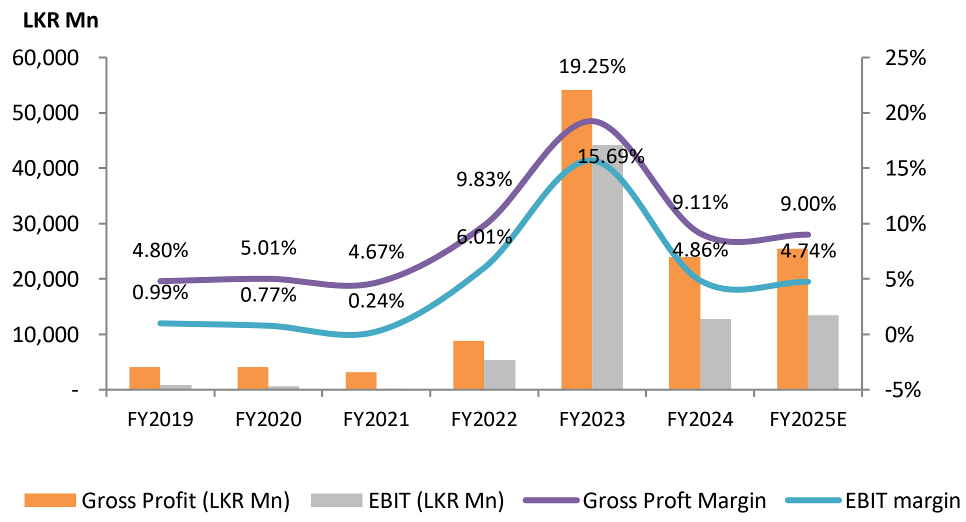
Petrochemicals are a relatively new segment which LIOC ventured into under the brand name "Propel" (a well known Indian brand). Petrochemicals are an evolving industry and shows good potential for revenue generation, going forward, given the positive macro-economic outlook.

Financial Outlook

During FY2023, LIOC recorded strong revenue growth (213% YoY) to LKR 281.49 Bn mostly due to strong performance in its auto fuel segment. The extraordinary growth in auto fuels was led by volume growth due shortages of fuel in the state-owned CPC and upward adjustments in prices due to the Fuel Price Formula. The fuel crisis has subsequently subsided with the improved foreign exchange situation and addition of new players into the fuel market. In FY2024, total revenue growth was more subdued due mostly to fuel rationing and reached LKR 263.57 Bn (6% YoY decline). We forecast revenue growth of ~ 7.5% to LKR 283 Bn in FY2025E with the addition of new LIOC fuel stations and growth in the Bunkering and Lubricant segments.

The Company's Gross Profit (GP) margins were in the range of 5% from FY2019 to FY2021, due to the artificial price ceilings imposed on fuel during this period. However, the GP margin increased to 19.25% in FY2023 due mostly to the market reflective pricing and high volume growth in auto fuel. In the more normalized environment post-economic crisis, the GP margin has reduced to 9.11% in FY2024. We forecast normalized GP margins of ~ 8.5 to 9.0% going forward, with the assumption of global oil prices remaining stable. Future margins are expected to remain modest since the Fuel Price Formula only allows a 4% profit margin per litre to fuel suppliers.

Figure 18: LIOC's Gross Profit | Operating Profit (EBIT)

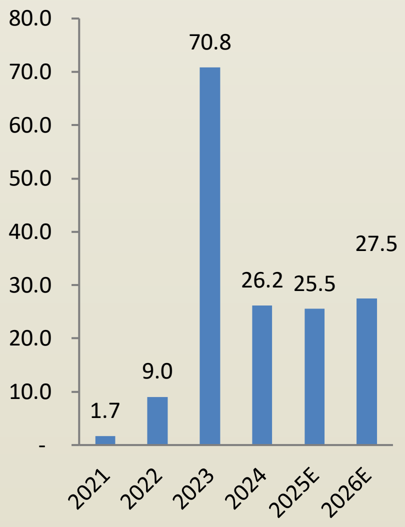


Source: LIOC Annual Reports, SC Securities Research

Our EBIT forecast is LKR 13.4 Bn for FY2025E and LKR 15.4 Bn for FY2026E. Future EBIT margins are expected to be in the range of ~5%. The expected expansion in the top line should aid an increase in operating profits. Due to the addition of new sheds the Company expects higher Capex in the FY2024- FY2026 period. The outlay for each new shed is ~LKR 50 Mn with 30+ new filling outlets expected during FY2025E. Further, additional Capex will be required for Phase 2 development of the Trincomalee oil tanks. However, the timelines for Phase 2 are not yet finalized.

Our Net profit estimate for FY2025E is LKR 13.6 Bn similar to the FY24 net profit (LKR 13.9 Bn), with a Return on Equity (RoE) of 17.2%. The cost reflective pricing model and more competitive market structure are envisaged to decrease the higher margins seen in FY23 and FY24.

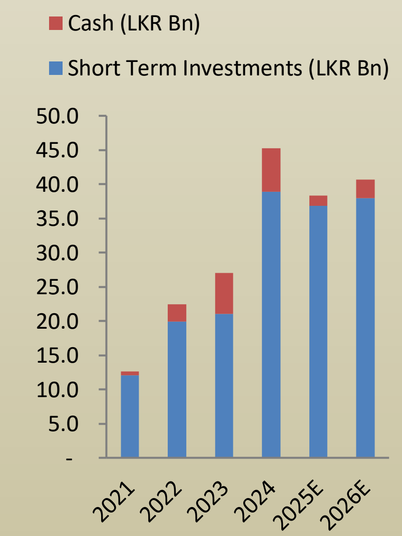
Figure 19: Earnings per Share (LKR)



Source: LIOC Financials, SC Securities Research

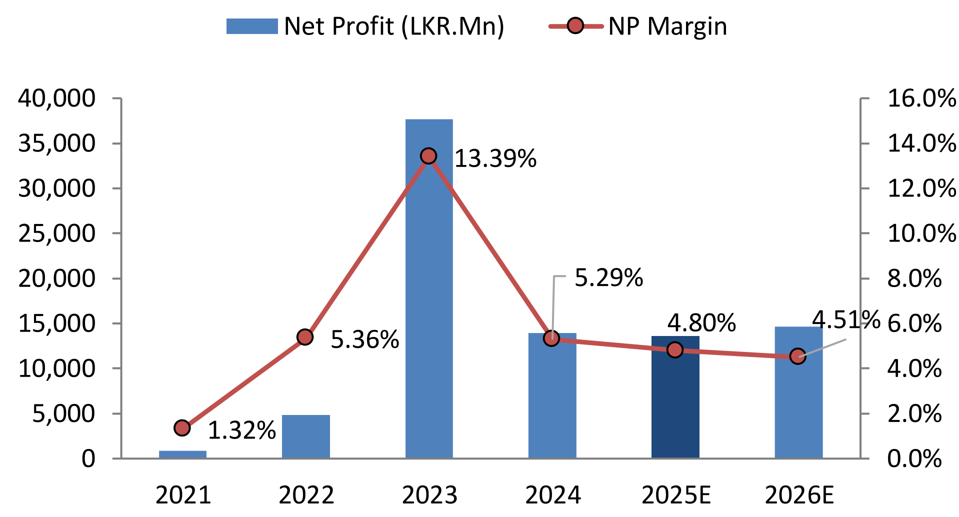
LIOC may utilize its strong cash reserves for funding expansion initiatives and may potentially increase its dividend payout

Figure 20: ST Investments and Cash Balances



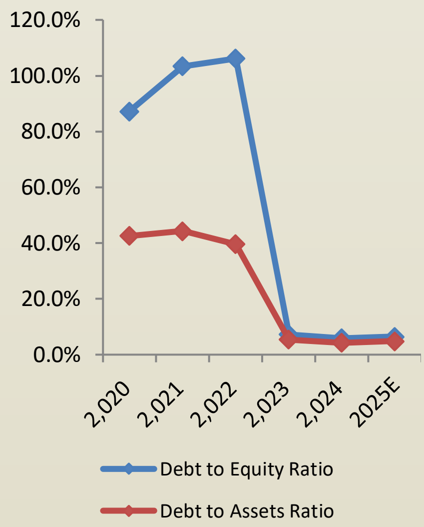
Source: LIOC Financials, SC Securities Research

Figure 21: LIOC's Net Profit | Net Profit Margin (NP Margin)



Source: LIOC Annual Reports, SC Securities Research

Figure 22: LIOC has low gearing presently

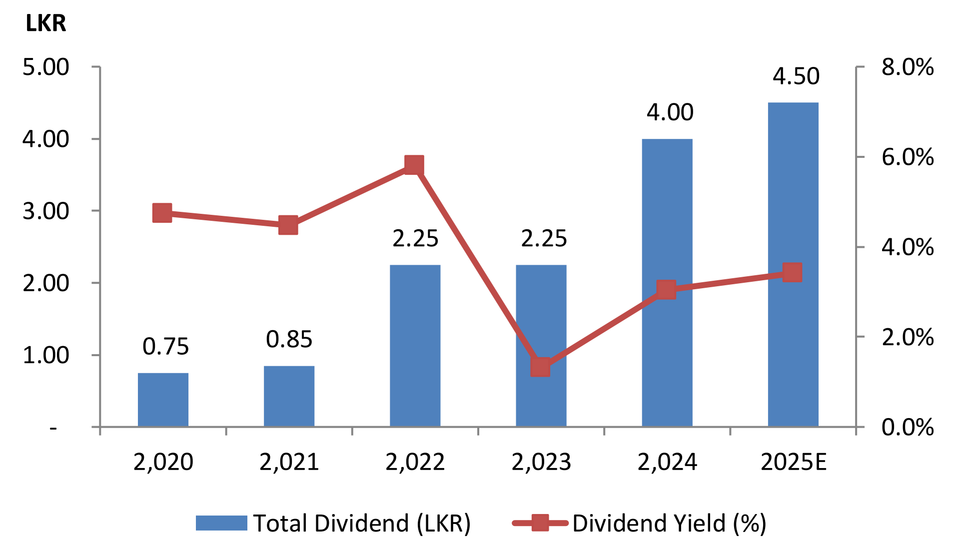


Source: LIOC Financials, SC Securities Research

Due to strong profitability the total cash and short term investments grew to LKR 45.2 Bn by end March 2024. LIOC was able to utilize its strong cash balances to bring down its debt levels to LKR 4.3 Bn in March 2024 from LKR 27.5 Bn in June 2022. The current interest bearing borrowings are for working capital purposes. We forecast short term investments and cash of LKR 38 Bn by end March 2025E, given the Capex requirements this year. LIOC could utilize its cash reserves for funding additional fuel stations, refurbishment of the Trinco oil tanks and may potentially increase its dividend payout.

Gearing levels have reduced significantly, with the debt to equity ratio at 0.06x in March 2024. We expect future gearing to be at a similar level, going forward. LIOC's investment portfolio (~LKR 39 Bn currently) is invested in Bank deposits, Unit Trusts and other short term investments.

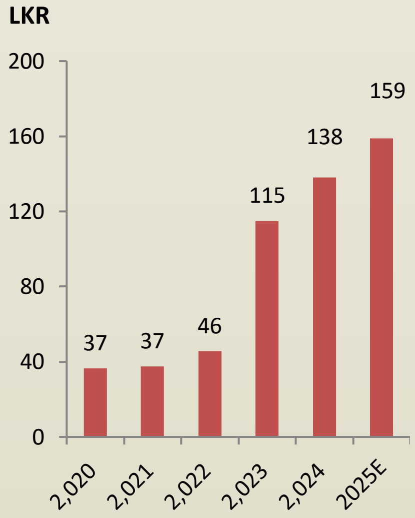
Figure 23: Total Dividend | Dividend Yield



Source: LIOC Annual Reports, SC Securities Research

LIOC has maintained healthy dividend payouts in the past. For FY2024 the company paid a dividend of LKR 4.0 per share (in cash), with a dividend yield of 3.0%. We expect future dividend yields of 3%-5% in the future, similar to the past.

Figure 24: Net Asset Value per Share (NAVPS)



Source: LIOC Financials, SC Securities Research

Valuation

For our Discounted Cashflow (DCF) valuation we have assumed a risk free rate of 10% (the 1-year T-bill rate), a terminal growth rate of 3.0% and Beta of 1.86 (based on ASPI and LIOC stock prices). We have maintained a target debt to equity ratio of 6:94 as LIOC has a strong cash position which is expected to continue.

Thus we have estimated a Weighted Average Cost of Capital (WACC) of 22%. Based on the DCF model we derive an equity value of LKR 80.6 Bn which translates to an **intrinsic value of LKR 151.40 per share**.

Based on the net asset approach, we assign a forward price–to- book value (PBV) ratio of 1x to derive a value of LKR 159.0 per share.

LIOC currently trades at a 4Q trailing Price to Earnings (PE) Ratio of 5x which is well below the historical PE ratios ranging from 5.55x-22x. We assign a forward PE ratio of 6x (below the broad market PER) given the risks associated with the fuel retail industry, and arrive at value of LKR 153 per share.

Based on the above valuation methods, we estimate a blended **Target Price of LKR 155 per share** (an equal weight is assigned to the values derived from each of the 3 methods). The same translates to an upside of 17.3% per share. We recommend **BUY** on LIOC.

Key Risks to Valuation

I. **Fluctuations in Global Oil Prices** – Global oil prices can be impacted by geopolitical changes such as the wars, which can result in supply side shocks. Price changes can impact LIOC's profit margins as cost of sales comprises ~90% of the total revenue

II. **Threats of New Players** - New players have entered into the fuel industry since 2023. Currently, no significant price competition takes place as fuel retailers' price petrol and diesel as per the mandated Fuel Price Formula. Nonetheless, the intensified competition could possibly suppress LIOC's margins and market share, going forward.

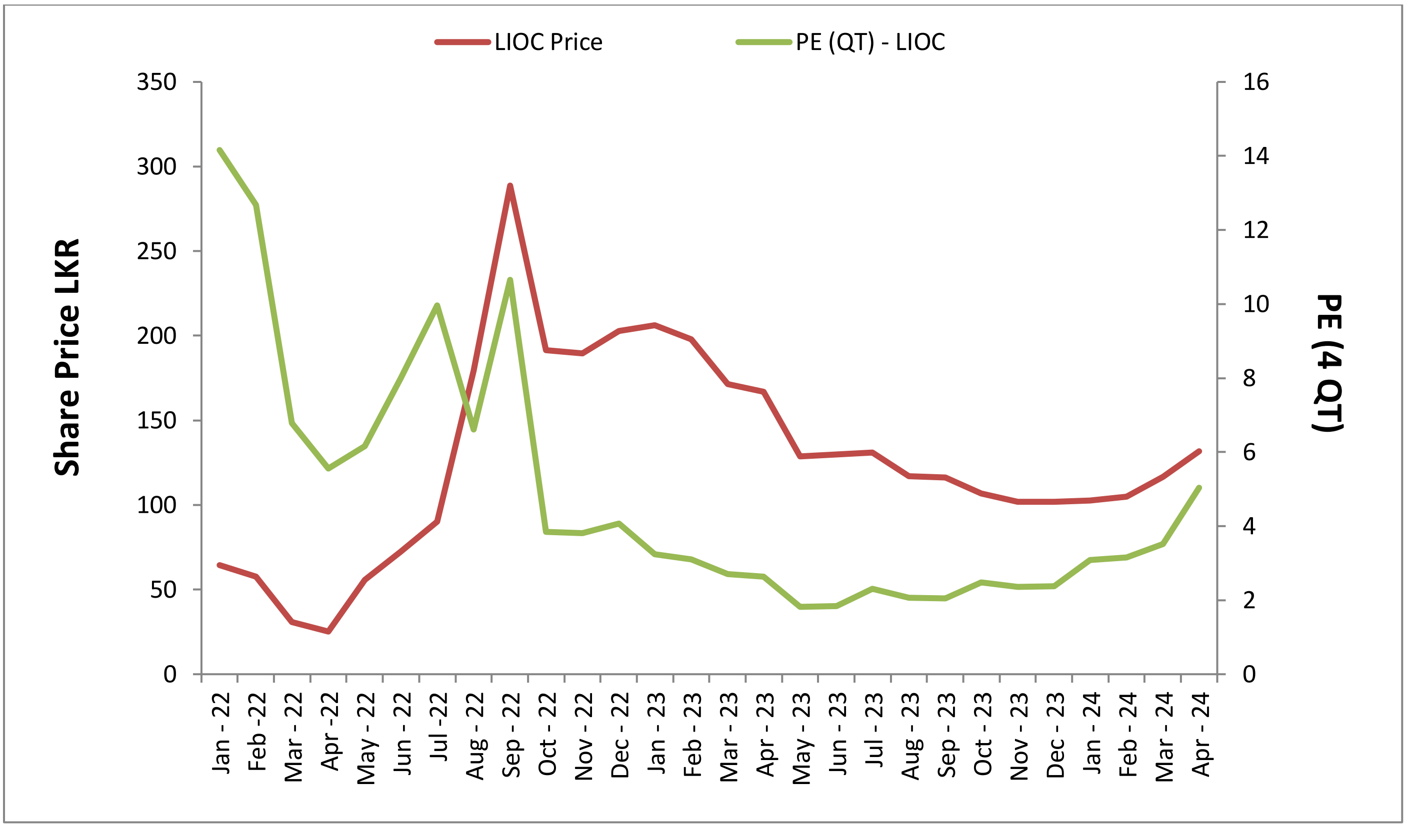
III. **Changes in Government Policy** – At present, the Fuel Price Formula enables LIOC and other fuel retailers to recover its costs, ensuring profitability. However, any changes to the pricing formula may impact future profits.

IV. **Availability of substitutes**: Currently, LIOC operates mainly in the auto fuel market. Most vehicles in Sri Lanka yet run on auto fuel; thus ensuring steady demand. However, electric vehicles are becoming increasingly popular which may result in lower fuel demand over the long term. Thus LIOC would need to grow and diversify its business lines in order to stay relevant as an energy and fuel supplier in the future.

V. **Currency Depreciation**: Any sharp dips in the LKR:USD exchange rate could weigh on LIOC's profits margins by increasing cost of sales.

LIOC Price Movement

The share is currently trading at a 4Qtr PER of 5x, and at a significant discount to the broad market PER of 11x. Based on the current valuation we expect further upside to the LIOC share price.



Source: CSE, SC Securities Research. Market Price as of 29th[th] April 2024.

Summarized Financial Statements – Lanka IOC PLC

Income Statement

LKR Mn	FY22	FY23	FY24	FY25E	FY26E	FY27E
Revenue from contracts with customers	89,951	281,488	263,569	283,405	325,067	359,682
Cost of sales	(81,107)	(227,306)	(239,550)	(257,899)	(295,811)	(327,310)
Gross profit	**8,845**	**54,182**	**24,018**	**25,506**	**29,256**	**32,371**
Other income	116	116	236	254	291	322
Selling and distribution expenses	(1,912)	(6,807)	(7,896)	(8,502)	(9,752)	(10,790)
Administrative expenses	(1,639)	(3,314)	(3,549)	(3,816)	(4,377)	(4,843)
Results from operating activities	**5,410**	**44,177**	**12,809**	**13,442**	**15,418**	**17,060**
Finance cost	(1,162)	(2,929)	(759)	(477)	(434)	(360)
Finance income	1,364	3,454	5,033	3,031	2,245	2,520
Profit before tax	**5,612**	**44,702**	**17,083**	**15,996**	**17,229**	**19,219**
Income tax expense	(793)	(7,006)	(3,138)	(2,399)	(2,584)	(2,883)
Profit for the year	**4,818**	**37,696**	**13,945**	**13,597**	**14,645**	**16,337**

Statement of Financial Position

LKR Mn	FY22	FY23	FY24	FY25E	FY26E	FY27E
ASSETS						
Property, Plant and Equipment	3,857	3,904	4,900	5,983	8,394	8,516
Other Non Current Assets	6,801	5,771	6,287	6,313	6,342	6,364
	10,658	**9,675**	**11,187**	**12,295**	**14,736**	**14,880**
Inventories	27,257	38,027	26,302	41,959	48,127	53,251
Trade and other receivables	4,741	7,474	19,100	18,746	20,169	21,417
Cash and Short Term Investments	22,416	27,036	45,206	38,308	40,714	51,029
	54,413	**72,538**	**90,608**	**99,013**	**109,010**	**125,698**
Total Assets	**65,071**	**82,213**	**101,795**	**111,308**	**123,746**	**140,577**
EQUITY AND LIABILITIES						
Capital and reserves						
Total equity	24,286	61,233	73,470	84,671	96,653	110,327
Non-current liabilities	438	606	104	138	171	199
Trade and other payables	14,504	14,827	22,682	19,838	22,755	25,178
Interest Bearing Borrowings	25,778	4,468	4,307	5,426	2,930	3,633
Other Current Liabilities	64	1,079	1,232	1,235	1,237	1,239
Total Liabilities	**40,785**	**20,980**	**28,325**	**26,637**	**27,093**	**30,250**
Total Equity and Liabilities	**65,071**	**82,213**	**101,795**	**111,308**	**123,746**	**140,577**

Source: LIOC Financial Statements, SC Securities Research

Financial Ratios – Lanka IOC PLC

Parameter	FY22	FY23	FY24	FY25E	FY26E	FY27E
GP Margin	9.83%	19.25%	9.11%	9.00%	9.00%	9.00%
EBIT Margin	6.01%	15.69%	4.86%	4.74%	4.74%	4.74%
NP Margin	5.36%	13.39%	5.29%	4.80%	4.51%	4.54%
Return on Equity (%)	21.80%	88.16%	20.70%	17.20%	16.15%	15.79%
Return on Assets (%)	8.64%	51.19%	15.16%	12.76%	12.46%	12.36%
Current ratio	1.35	3.56	3.21	3.74	4.05	4.18
Quick Ratio	0.67	1.69	2.28	2.15	2.26	2.41
Inventory Turnover (days)	82.99	52.42	49.01	59.38	59.38	59.38
Debtors Turnover (days)	13.29	5.50	9.34	10.91	10.91	10.91
Creditors Turnover (days)	45.71	23.55	28.58	28.08	28.08	28.08
Debt to Equity ratio	106.14%	7.30%	5.86%	6.41%	3.03%	3.29%
Debt to Assets ratio	39.62%	5.44%	4.23%	4.88%	2.37%	2.58%
Earnings per share (LKR)	9.05	70.79	26.19	25.54	27.50	30.68
Price to Earnings (x)	4.29	2.42	4.46	5.16	4.79	4.29
Net Asset value per share (LKR)	45.61	115.00	137.98	159.02	181.52	207.20
Price to Book value (x)	0.85	1.49	0.85	0.83	0.73	0.64
Dividend per share (LKR)	2.25	2.25	4.00	4.50	5.00	5.00
Dividend Yield (%)	5.80%	1.31%	3.42%	3.42%	3.80%	3.80%
Number of Shares (Mn)	532	532	532	532	532	532

Source: LIOC Financial Statements, SC Securities Research

Shareholder List – Top 20 Shareholders

Name of the Shareholder	No. of shares	% holding
Indian Oil Corporation limited, India	400,000,005	75.12%
Sri Lanka Insurance Corporation Ltd - Life Fund	7,975,875	1.50%
J.B.Cocoshell (Pvt) Ltd	6,206,090	1.17%
Bank of Ceylon A/c Ceybank Unit Trust	5,161,333	0.97%
Mr. K.A.S.R. Nissanka	4,450,519	0.84%
Peoples Leasing & Finance PLC/ Mr.D.M.P.Disanayake	4,034,762	0.76%
Mrs. S. Amarasekara	2,531,500	0.48%
Employees Provident Fund	2,346,558	0.44%
Sri Lanka Insurance Corporation Ltd - General Fund	2,148,947	0.40%
Hatton National Bank PLC - Senfin growth Fund	2,139,185	0.40%
Hatton National Bank PLC / Mr. Elayathamby Thavagnasundaram	2,078,038	0.39%
Odyssey Capital Partners (Private) Limited	2,070,945	0.39%
Employees Trust Fund Board	1,868,959	0.35%
Mr. N. Samarasuriya	1,704,000	0.32%
DFCC Bank PLC A/C NO.02	1,550,000	0.29%
Assetline Finance Leasing Co.Ltd / British American Technologies (Pvt) Ltd	1,451,796	0.27%
Acuity Partners (Pvt) Limited / Mr. Elayathamby Thavagnanasooriyam / Mr.	1,278,624	0.24%
Amana Bank PLC / Mr. Modammed Nayaz Deen	1,093,242	0.21%
Jafferjee Brothers Exports (Private) Limited	1,041,200	0.20%
Deutsche Bank AG as Trustee for JB Vantage Value Equity Fund	996,128	0.19%
Others	80,337,999	15.09%
Total	**532,465,705**	**100.00%**

Source: LIOC Financial Statements, March 2024

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Sell: FV more than 10% below Current Trading Price

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