



# LANKA IOC PLC [LIOC.N0000]

## DOWNGRADE TO HOLD AND DISCONTINUE COVERAGE

### “SETBACK STRIKES AS DISTRIBUTOR MARGIN CLIPPED”

**Fair Value: FY24E - LKR 145.0 [+32%]**    **Fair Value: FY25E - LKR 130.0 [+19%]**

Total Return with DPS: FY24E - 35% [AER 119%]    Total Return with DPS: FY25E - 21% [AER 15%]

LIOC earnings for 2QFY24 recorded at LKR 5.1Bn, reflecting a significant YoY decline of 59.1%. The decline in earnings was largely attributed to a substantial decrease in the top line by 29.9%YoY, driven by price reductions through cost reflective pricing formula which resulted in a notable contraction in GP margins by 589bps. However, on a QoQ basis, earnings exhibited substantial growth of 106.8%, driven by consecutive fuel price revisions by over 10.0% during the quarter, aligning with the global oil price trend, resulted in a margin expansion of 265bps to 12.6%. Looking ahead, YoY margins are expected to further contract as the fuel pricing formula allows only a 4% distributor margin, while the daily cost-reflecting pricing model is anticipated to erode additional margin gains. Taking into account factors such as margin contractions, delays in the completion of oil tanks, anticipated competition from new market entrants and the stability in global oil market the earnings target for FY24E has been revised downward to LKR 15.4Bn (previous: LKR 25.6Bn) and for FY25E to LKR 12.7Bn (previous: LKR 28.8Bn). Consequently, the fair value for FY24E and FY25E has been adjusted downward to LKR 145.0 and LKR 130.0, respectively. Hence, given the marginal upside on the share, we have revised down our recommendation to **HOLD AND DISCONTINUE COVERAGE**.

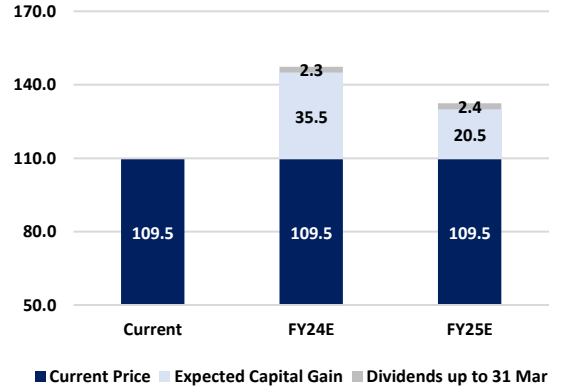
LKR (Mn)	2QFY23	2QFY24	YoY	1HFY23	1HFY24	YoY
<b>Earnings (LKR 'Mn)</b>						
Revenue	87,960	61,700	-30%	137,894	116,446	-16%
Gross profit	16,293	7,793	-52%	31,783	13,258	-58%
EBIT	14,194	5,215	-63%	27,446	7,836	-71%
PBT	14,549	6,216	-57%	26,446	9,221	-65%
Net Profit	12,356	5,059	-59%	22,283	7,505	-66%
<b>Balance Sheet (LKR 'Mn)</b>						
Shareholders' Equity	45,371	66,608	+47%	45,371	66,608	+47%
Borrowings	9,282	-	>100%	9,282	-	>100%
NAVPS	85.2	125.1		85.2	125.1	

### Margin contraction of 589bps hampers profitability to LKR 5.1Bn

In 2QFY24, LIOC reported a profit of LKR 5.1Bn, reflecting a YoY contraction of 59.1% amidst the steep decline in GP margin by 589bps on the back of decline in top line of 29.9%YoY attributed to the significant reduction in automated fuel prices. However, on a QoQ basis, earnings reported a substantial growth of 106.8%, attributable to a significant increase in revenue of 12.7% to LKR 61.7Bn. This growth was primarily driven by the consecutive local fuel price revisions for 3-months straight since Jul 2023, in line with the global oil price trend. During the quarter, local fuel prices of Octane 92 and Auto Diesel were revised up to LKR 361.0 (+13.5%) and LKR 341.0 (+10.0%), respectively, amidst the significant volatility in global Brent oil prices, which peaked at USD 93.3 per barrel in mid-Sep 2023. Consequently, the GP margin expanded by 265bps on a QoQ basis to 12.6%, as inventory was sourced at lower prices at the beginning of the quarter. On the global front, EIA expects a relatively balanced global oil market as the ongoing OPEC+ production cuts will offset growth from non-OPEC countries. Although the conflict between Israel and Hamas has not impacted the physical oil supply, uncertainties may exert upward pressure on crude oil prices in the coming months. Hence, EIA forecast Brent oil price to increase from an average of USD 90.0/b in 4Q2023 to USD 93.0/b in 2024.

### Regulated distributor margins and Daily cost reflective fuel pricing formula to erode supernormal margins

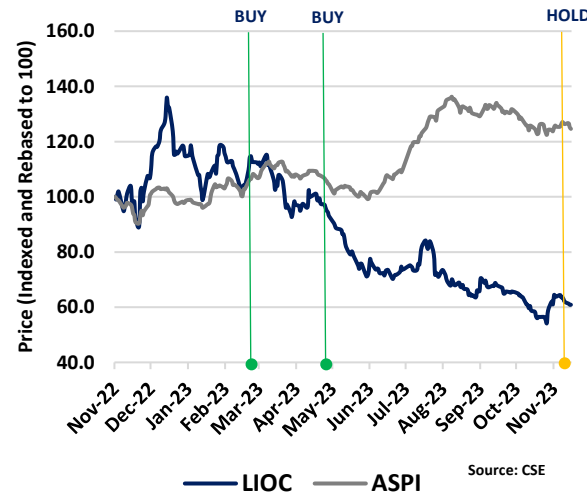
In an effort to mitigate the adverse effects of fluctuating global oil prices and to streamline the entry of new participants into the fuel market, the Ministry of Power and Energy implemented a 4% margin on all fuel products, effective from Jul 2023. This strategic measure aims to incentivize and support the integration of new players into the market while sustaining the profit margins. Hence, margins are expected to contract on a YoY basis compared to the abnormal profits reported during the comparative year as the existing players were benefiting from higher distributor margin since the beginning of the year. Accordingly, we expect GP margin of LIOC to decline to 10.9% in FY24E which may hamper the profitability to LKR 15.3Bn. Additionally, as the ministry has decided to introduce a daily cost-reflecting pricing formula for fuel which is scheduled to be implemented in Feb 2024, we expect margins to contract further to 9.0% in FY25E, therefore, revising down the earnings forecast for FY25E to LKR 12.7Bn.



### FIRST CAPITAL RESEARCH

Tharusha Ashokgar    +94 11 263 9866  
tharushaash@firstcapital.lk

Price Movement of LIOC vs ASPI (Indexed and rebased to 100)



#### Minimum Return for BUY:

**Buy Below for FY25E [AER of 18.0% with DPS]: LKR 105.38.**  
LIOC categorized as 'Grade B' counter

#### Disclosure on Shareholding:

First Capital Group or the covering analyst did not hold 1% or more of the total outstanding share capital of LIOC during the five trading days prior to the issuance of this document

Retail prices of LIOC Fuels	Jun-23	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23
Octane 92 Petrol	318.0	328.0	348.0	361.0	365.0	356.0
Auto Diesel	310.0	308.0	306.0	341.0	351.0	356.0

**Phase one of redeveloping Trinco terminal's oil tanks faces delays**

The first phase of redeveloping the 10 upper oil tanks at the Trinco terminal, a joint venture between CPC and LIOC, has encountered delays and is anticipated to be completed by the end of FY24E, while the remaining tanks are expected to be completed by FY25E. As the redevelopment of 61 tanks is a time-intensive process, we have excluded its impact from our current assumptions, considering the substantial time required for the benefits to materialize. The capacity of each tank holds 12,000 tons, providing considerable storage for bunkering, thereby enabling LIOC to capitalize on fluctuations in global oil prices. These oil tanks will be further utilized for storing petroleum products and potentially leasing them to local and regional bunkering players.

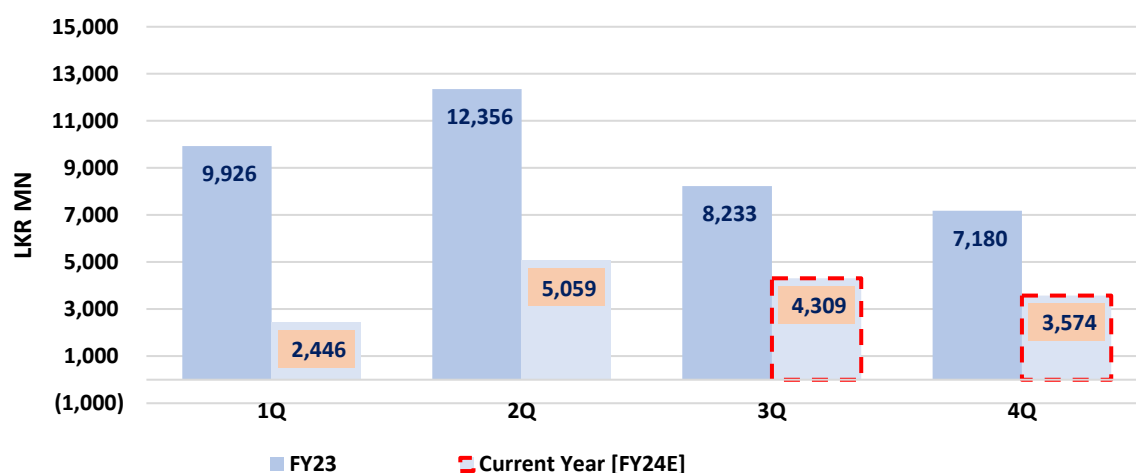
**New entrants in the fuel market to intensify competition**

In the liberalization process, three new players secured licenses to participate in the local fuel market. Accordingly, Sinopec finalized its agreement and initiated operations in a few locations in Sep 2023, while RM Parks is set to commence its operation by the end of Dec 2023. However, United Petroleum Australia, the third new fuel retailer, is facing delays due to a request contrary to the initially stated conditions. Despite the influx of new players, LIOC is poised to maintain its market leadership position in terms of the number of sheds as the new entrants have been granted licenses to operate 150 existing sheds each owned by the CPC, in addition to 50 new sheds each. However, it is anticipated that this expansion may intensify competition in the fuel retail market from FY25E onwards. In terms of pricing, Sinopec initially entered the market by offering a discount of LKR 3.00 per liter on both petrol and diesel. However, in response to significant fluctuations in the global oil market and to offset potential losses per liter, prices were revised to align with those of CPC and LIOC in Nov 2023.

**Earnings and FV revised down for FY24E and FY25E – DOWNGRADED TO HOLD**

In light of the regulated distributor margin being set at 4.0%, the potential for increased competition, and the decision to implement a daily automated price revising system which may hamper the margins, coupled with delays in the operation of the TPT oil tanks, we have revised our earnings outlook for LIOC to LKR 15.4Bn (previous: LKR 25.6Bn) for FY24E and LKR 12.7Bn (previous: LKR 28.8Bn) for FY25E. Accordingly, the fair value for FY24E and FY25E adjusted downward to LKR 145.0 and LKR 130.0, respectively. Hence, given the marginal upside on the share, we have revised our recommendation to **HOLD AND DISCONTINUE COVERAGE**.

## Quarterly Earnings



## Estimate Revision

In LKR Mn	FY24E-O	FY24E-R	% Change	FY25E-O	FY25E-R	% Change
<b>Earnings Estimate</b>						
Revenue	303,297	245,733	-19%	373,093	257,336	-31%
Profit Before Tax	36,569	18,998	-48%	41,100	15,617	-62%
Net Profit	25,598	15,388	-40%	28,770	12,650	-56%
Adjusted EPS (LKR)	48.1	28.9		54.0	23.8	
YoY Growth (%)	-32%	-59%		12%	-18%	
<b>Balance Sheet Estimate</b>						
Shareholders' Equity	81,506	74,491	-9%	105,668	85,910	-19%
Borrowings	4,022	-	-100%	3,820	-	-100%
<b>Adjusted NAVPS</b>	<b>153.1</b>	<b>139.9</b>		<b>198.5</b>	<b>161.3</b>	
<b>Ratio Estimate</b>						
<b>ROE (%)</b>	<b>31%</b>	<b>21%</b>		<b>27%</b>	<b>15%</b>	
<b>PER (x)</b>	<b>2.3</b>	<b>1.5</b>		<b>2.0</b>	<b>3.8</b>	
<b>PBV (x)</b>	<b>0.7</b>	<b>1.0</b>		<b>0.6</b>	<b>0.8</b>	

## Valuation Table

P/E 31 March	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
<b>Estimates (LKR 'Mn)</b>							
Revenue	81,947	66,686	89,951	281,488	245,733	257,336	275,777
Gross profit	4,106	3,113	8,845	54,182	26,769	23,289	21,278
EBIT	635	161	5,410	44,177	15,147	11,969	9,672
<b>Net Profit</b>	<b>422</b>	<b>883</b>	<b>4,818</b>	<b>37,696</b>	<b>15,388</b>	<b>12,650</b>	<b>10,914</b>
<b>Basic EPS (LKR)</b>	<b>0.8</b>	<b>1.7</b>	<b>9.0</b>	<b>70.8</b>	<b>28.9</b>	<b>23.8</b>	<b>20.5</b>
YoY Growth (%)	5%	109%	446%	682%	-59%	-18%	-14%
<b>Valuations</b>							
<b>PER (x)</b>	<b>138.2</b>	<b>66.1</b>	<b>12.1</b>	<b>1.5</b>	<b>3.8</b>	<b>4.6</b>	<b>5.3</b>
<b>PBV (x)</b>	<b>3.0</b>	<b>2.9</b>	<b>2.4</b>	<b>1.0</b>	<b>0.8</b>	<b>0.7</b>	<b>0.6</b>
<b>Dividend Yield (%)</b>	<b>0.7%</b>	<b>0.8%</b>	<b>2.1%</b>	<b>3.7%</b>	<b>2.1%</b>	<b>2.2%</b>	<b>2.8%</b>
NAVPS	36.5	37.4	45.6	115.0	139.9	161.3	179.5
DPS (LKR)	0.8	0.9	2.3	4.0	2.3	2.4	3.1
Dividend Payout	95%	51%	25%	6%	8%	10%	15%

## Valuation Summary

Expected LIOC price	FY24E	FY25E
PER based target price	144.5	142.5
DCF Valuation based target price	143.1	124.2
Average Target Price	143.8	133.4
Target price after Rounding off	145.0	130.0

Return	FY24E	FY25E
Target Price	145.0	130.0
Current Price	109.5	109.5
Capital Gain (LKR)	35.50	20.50
Dividends upto 31 Mar (LKR)	2.31	2.38
Capital Gain %	32%	19%
Dividend Yield %	2%	2%
Total Return %	35%	21%
Annualized Return %	119%	15%

## Discounted Cash flow Valuation

DCF based Valuation	FY24E	FY25E
Enterprise Value	38,918	24,158
(-) Debt	-	-
(+) Cash	37,271	41,986
Total Value of Equity	76,189	66,144
No. of shares	532	532
Target Price	143	124

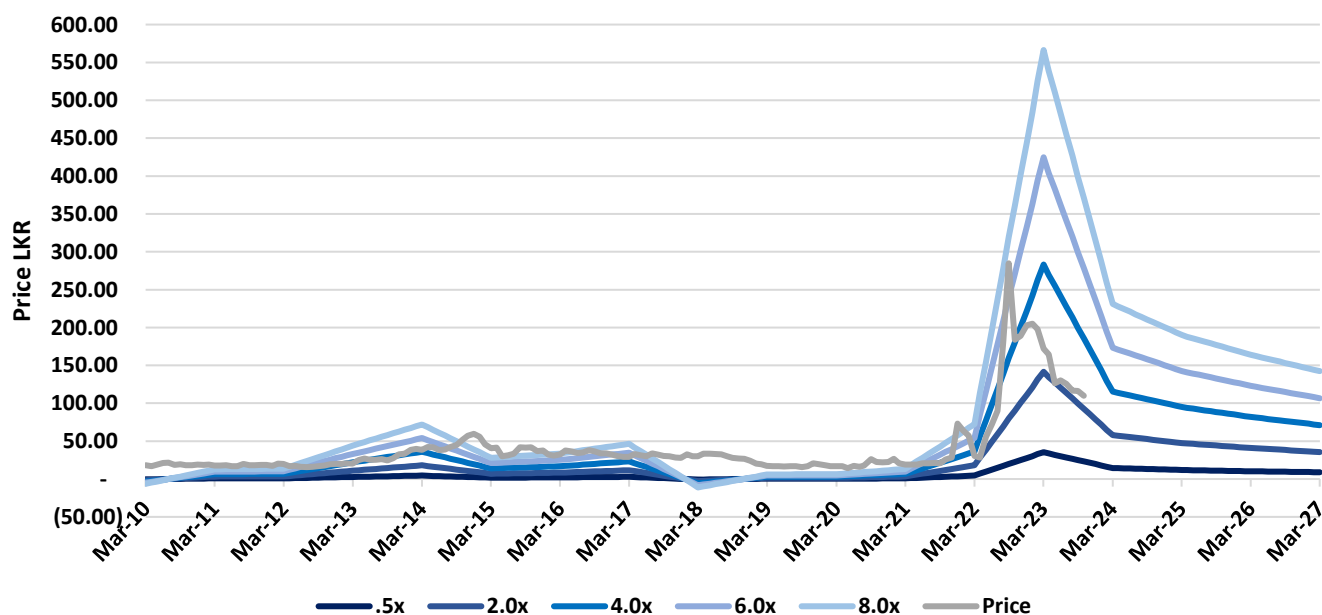
COE	FY24E	FY25E
$R_f$	12.0%	10.0%
$R_m$	20%	18%
Growth %	3%	3%
$\beta$	1.3	1.3
$K_e = R_f + \beta (R_m - R_f)$	22%	20%

## PER Valuation

PER based Valuation	FY24E	FY25E
Earnings (LKR 'Mn)	15,388	12,650
No. of Shares ('Mn)	532	532
EPS	28.9	23.8
Expected Average PER	5.0x	6.0x
Target Price	144	143

WACC	FY24E	FY25E
$K_e$	22%	20%
$K_d$ (Post Tax)	18%	18%
D/E Assumption	10 / 90	10 / 90
Terminal Growth (%)	3%	3%
WACC	22%	20%

## PER Chart



## Appendix I: Statement of Income and Expenses

Statement of Financial Performance (LKR Mn)	FY20	FY21	FY22	FY23E	FY24E	FY25E	FY26E
<b>P/E 31st Mar</b>							
Revenue	81,947	66,686	89,951	281,488	245,733	257,336	275,777
Cost of Sales	-77,841	-63,573	-81,107	-227,306	-218,964	-234,047	-254,499
<b>Gross Profit</b>	<b>4,106</b>	<b>3,113</b>	<b>8,845</b>	<b>54,182</b>	<b>26,769</b>	<b>23,289</b>	<b>21,278</b>
Other Operating Income / (Expense)	83	252	116	116	173	260	390
Administrative Expenses	-1,505	-1,401	-1,639	-3,314	-5,406	-5,404	-5,653
Selling and Distribution Expenses	-2,049	-1,803	-1,912	-6,807	-6,389	-6,176	-6,343
<b>Operating Profit</b>	<b>635</b>	<b>161</b>	<b>5,410</b>	<b>44,177</b>	<b>15,147</b>	<b>11,969</b>	<b>9,672</b>
Finance Income	942	1,303	1,364	3,454	5,051	4,206	4,038
Finance Expenses	-978	-476	-1,162	-2,929	-1,200	-558	-400
<b>Profit Before Taxation</b>	<b>599</b>	<b>988</b>	<b>5,612</b>	<b>44,702</b>	<b>18,998</b>	<b>15,617</b>	<b>13,310</b>
Income Tax Expense	-177	-105	-793	-7,006	-3,610	-2,967	-2,396
<b>Profit for the Year</b>	<b>422</b>	<b>883</b>	<b>4,818</b>	<b>37,696</b>	<b>15,388</b>	<b>12,650</b>	<b>10,914</b>
EPS	0.8	1.7	9.0	70.8	28.9	23.8	20.5

## Appendix III: Statement of Financial Position

Statement of Financial Position (LKR Mn)	FY20	FY21	FY22	FY23E	FY24E	FY25E	FY26E
<b>as at 31st Mar</b>							
<b>ASSETS</b>							
<b>Non Current Assets</b>							
Property, Plant and Equipment	4,113	4,019	3,857	3,904	4,679	5,567	6,051
Investment	4,394	4,394	4,394	4,901	4,901	4,901	4,901
TPTL Investment	-	-	49	-	-	-	-
Intangible Assets	675	674	674	674	674	674	674
Right -of-use Assets	91	63	80	48	48	48	48
Other Receivables at Amortized Cost	149	119	142	148	148	148	148
Bank Deposits	-	10,222	1,462	-	-	-	-
Deferred Tax Asset (Net)	189	261	-	-	-	-	-
	<b>9,610</b>	<b>19,753</b>	<b>10,658</b>	<b>9,675</b>	<b>10,450</b>	<b>11,338</b>	<b>11,822</b>
<b>Current Assets</b>							
Inventories	13,295	9,625	27,257	38,027	38,089	38,600	38,609
Trade Receivables	3,568	2,585	3,965	4,515	8,601	13,381	17,925
Other Receivables at Amortized Cost	323	1,707	667	806	806	806	806
Other Current Assets	65	79	108	2,154	2,585	2,585	2,585
Income Tax Receivables	186	18	-	-	-	-	-
Short Term Investments	12,660	12,041	19,892	21,046	31,568	32,358	33,652
Cash and Bank Balances	51	599	2,524	5,990	5,702	9,629	15,856
	<b>30,149</b>	<b>26,654</b>	<b>54,413</b>	<b>72,538</b>	<b>87,350</b>	<b>97,358</b>	<b>109,433</b>
<b>Total Assets</b>	<b>39,760</b>	<b>46,407</b>	<b>65,071</b>	<b>82,213</b>	<b>97,800</b>	<b>108,696</b>	<b>121,255</b>
<b>EQUITY AND LIABILITIES</b>							
Stated Capital	7,577	7,577	7,577	7,577	7,577	7,577	7,577
Retained Earnings	11,870	12,347	16,709	53,198	66,456	77,875	87,525
Other Reserves	-	-	-	458	458	458	458
<b>Total Equity</b>	<b>19,446</b>	<b>19,924</b>	<b>24,286</b>	<b>61,233</b>	<b>74,491</b>	<b>85,910</b>	<b>95,559</b>
<b>Non Current Liabilities</b>							
Defined Benefit Obligation (Net)	11	14	12	15	15	15	15
Right -of-use Lease Liability	63	38	46	50	50	50	50
Deferred Tax Liability	-	-	380	541	541	541	541
	<b>74</b>	<b>52</b>	<b>438</b>	<b>606</b>	<b>606</b>	<b>606</b>	<b>606</b>
<b>Current Liabilities</b>							
Trade and Other Payables	3,251	5,808	14,504	14,827	21,624	21,102	21,511
Lease Liability	34	33	42	2	2	2	2
Interest Bearing Borrowings	16,955	20,590	25,778	4,468	-	-	2,500
Income Tax Payable	-	-	22	1,077	1,077	1,077	1,077
	<b>20,239</b>	<b>26,431</b>	<b>40,347</b>	<b>20,374</b>	<b>22,704</b>	<b>22,181</b>	<b>25,090</b>
<b>Total Equity and Liabilities</b>	<b>39,760</b>	<b>46,407</b>	<b>65,071</b>	<b>82,213</b>	<b>97,800</b>	<b>108,696</b>	<b>121,255</b>
<b>NAVPS</b>	<b>36.5</b>	<b>37.4</b>	<b>45.6</b>	<b>115.0</b>	<b>139.9</b>	<b>161.3</b>	<b>179.5</b>



First Capital

# First Capital Holdings PLC

No.2, Deal Place,  
Colombo 3

Tel: +94 11 2145 000  
Fax: +94 11 2145 050

## RESEARCH

Dimantha Mathew	+94 11 2639 853	Tharusha Ashokgar	+94 11 2639 866
Ranjan Ranatunga	+94 11 2639 863	Zaeema Jihan	+94 11 2639 863
Vinodhini Rajapoopathy	+94 11 2639 866	Nethmi Fernando	+94 11 2639 863

## GOVERNMENT SECURITIES SALES

Anjelo Simmons	+94 77 3031 636	Neminda Jayawardena	+94 76 6644 080
Anushka Dissanayake	+94 77 2220 021	Arun Kandasamy	+94 75 4861 506
Anushi Ranawaka	+94 77 3876 819		

## CORPORATE DEBT SALES

Tharusha Ekanayake	+ 94 77 7 809 154
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## EQUITY SALES

CEO	Jaliya Wijeratne	+94 70 2910 042
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### Colombo

Rasika Indra Kumara	+94 77 7072 698	Anjelo LaBrooy	+94 77 7546 645
Isuru Jayawardena	+94 76 7084 953	Dillon Lowe	+94 76 616 0647
Nishantha Mudalige	+94 70 2910 041	Evelyn John	+94 77 779 2452
Anushka Buddhika	+94 71 4310 600	Yudheshan Kannadasan	+94 77 415 5809
Thushara Pathiraja	+94 70 2910 037		

### Negombo

Priyanka Anuruddha	+94 70 2910 035	Priyantha Wijesiri	+94 70 2910 036
--------------------	-----------------	--------------------	-----------------

## UNIT TRUST SALES

Kavin Karunamoorthy	+94 77 0328 060	Imali Abeygunawardena	+94 77 1764 799
---------------------	-----------------	-----------------------	-----------------

## BRANCHES

Kandy	Kurunegala	Matara	Negombo
CSE Branch Office, No. 88, Dalada Veediya, Kandy 20000.	No.174/B2, Negombo Road, Kurunegala. Kurunegala 60000.	CSE Branch Office, 1 st Floor, E.H.Cooray Tower, No.24, Anagarika Dharmapala Mawatha, Matara 81000.	Colombo Stock Exchange Negombo Branch Office, No. 72 A, 2/1, Old Chilaw Road, Negombo 11500.
<b>Manager: Salinda Samarakoon</b>	<b>Manager:</b>	<b>Manager: Rohana Jayakody</b>	<b>Manager:</b>
Tel: +94 81 2236 010	Tel: +94 37 2222 930	Tel: +94 41 2222 988	Tel: +94 31 4937 072

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