

Oil and Natural Gas Corporation Ltd

Numbers ahead of expectations; Maintain BUY

ONGC adjusted PAT at Rs 58.1bn (excl. one-time refund of Rs19bn on gas pool a/c for contribution made earlier) was much ahead of our and street expectation of ~Rs 49.7bn and Rs 53.4bn respectively. The better than expected profit was mainly due to b) higher crude oil realization at US\$ 64.8/bbl (US\$ 62.7/bbl in Q2FY11 and US\$ 57.7/bbl in Q3FY10) and b) lower recouped costs at Rs 36.4bn on account of lower dry wells write off of Rs 13.6bn

We maintain our positive stance on the stock with BUY rating and expect the company to gain from a) marginal improvement in crude oil production during FY12-13 and stable realization at ~USD62/bbl, b) higher gas production and improved gas realization (higher proportion of non-APM gas and higher gas price for non-priority customers) and c) better performance from OVL both on production and crude oil realisation front.. Also , the company's shareholders have approved the share split and issue of bonus shares with record date of 9th Feb 2011, paving the way for ensuing FPO in Mar' 11.

Production stable; crude oil realisation improved to USD 64.8/bbl: Crude oil production from own fields stood at 6.21 MMT (6.15 MMT in Q2FY11 and 6.13 in Q3FY10) while gas production was stable at ~5.8 bcm. Gross crude oil realisation improved to US\$ 89.3/bbl resulting in higher net realisation of US\$ 64.8/bbl. Subsidy burden stood at Rs 42.2bn as compared to Rs 30.2bn in Q2FY11 and Rs 35.5bn in Q3FY11.

Royalty issue with Cairn still unresolved: ONGC paid a royalty of Rs3.8bn (Rs 8.3 bn for 9MFY11) towards Cairn's share of crude production from Rajasthan block. The production from the block currently stands at 125kbpd, with a plan to ramp to 175kbpd in near future. With production likely to increase in coming quarters, ONGC royalty burden will further increase. ONGC is in discussion with Gol to be absolved from paying Cairn's share of royalty. We expect a decision on the issue to be taken before the Cairn-Vedanta deal and ONGC's FPO.

Maintain BUY while cutting down the target price of Rs 1400/sh: To factor delay in diesel de-regulation and resultant higher subsidy sharing, we have revised our EPS forecast for FY11/FY12/FY13 to Rs 115/Rs 126/Rs 131 (~5% lower than our earlier forecast). However, in light of Q3FY11 results and positive oil & gas production guidance for FY12, we maintain our BUY rating with a revised TP of Rs1400/sh (Rs 1470/sh earlier) based on 10.5x 1yr forward earnings. At CMP the stock is trading at a P/E of 8.6x and EV/EBITDA of 3.8x FY13E.

Financial highlights

(Rs mn)	FY10	FY11E	FY12E	FY13E
Revenue	1,017,546	1,133,483	1,155,493	1,250,444
Growth (%)	(2.7)	11.4	1.9	8.2
Adj net income	194,657	247,319	270,645	280,755
Growth (%)	(1.3)	27.1	9.4	3.7
FDEPS (Rs)	91.0	115.6	126.5	131.3
Growth (%)	(1.3)	27.1	9.4	3.7

Profitability and return ratios

(%)	FY10	FY11E	FY12E	FY13E
EBITDA margin	43.7	45.1	47.6	46.9
EBIT margin	25.3	30.1	32.3	31.6
Adj PAT margin	19.1	21.8	23.4	22.5
ROE	19.9	22.7	21.8	19.9
ROIC	17.8	20.9	20.3	18.9
ROCE	27.4	32.1	31.0	29.1

What's New? Target Rating Estimates

CMP	TARGET	RATING	RISK
Rs 1133	Rs 1400	BUY	MEDIUM

BSE	NSE	BLOOMBERG
500312	ONGC	ONGC IN

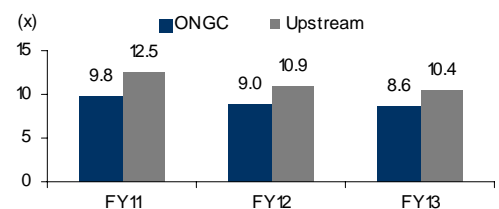
Company data

Market cap (Rs mn / US\$ mn)	2,416,942/50,353
Outstanding equity shares (mn)	2139
Free float (%)	25.8
Dividend yield (%)	2.8
52-week high/low (Rs)	1473/996
2-month average daily volume	1,067,620

Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
ONGC	1,133	(12.2)	(13.1)	(10.1)
BSE Oil Index	9,368	(11.0)	(13.8)	(8.7)
Sensex	18,396	(8.1)	(7.7)	2.4

P/E comparison



Valuation matrix

(x)	FY10	FY11E	FY12E	FY13E
P/E @ CMP	12.4	9.8	8.9	8.6
P/E @ Target	15.4	12.1	11.1	10.7
EV/EBITDA @ CMP	5.1	4.4	4.1	3.8

In the interest of timeliness this report has not been edited.





Result highlights

Fig 1 - Actual vs estimated performance

(Rs mn)	Actual	Estimate	% Variance
Revenue	189,062	181,436	4.2
EBITDA	116,336	110,140	5.6
Adj net income	58,116	49,777	16.8
FDEPS (Rs)	27.2	23.3	16.6

Source: RCML Research

Fig 2 - Quarterly performance

(Rs mn)	Q3FY11	Q3FY10	% Chg YoY	Q2F11	% Chg QoQ
Revenue	189,062	155,062	21.9	184,352	2.6
Expenditure	72,726	61,715	17.8	71,134	2.2
Operating profit	116,336	93,347	24.6	113,218	2.8
Other income	6,693	-301	-2321.3	9,062	-26.1
Interest	54	29	85.7	9	497.8
Depreciation	36,410	46,758	-22.1	44,001	-17.3
PBT	86,564	46,259	87.1	78,270	10.6
Tax	28,449	15,723	80.9	24,382	16.7
PAT	58,116	30,536	90.3	53,888	7.8
Extraordinary Income	12,717				
Reported PAT	70,832	30,536	132.0	53,888	31.4
EBITDA margin (%)	48%	48%	0.0	48%	
FDEPS (Rs)	27.2	14.3	90.2	25.2	7.8

Source: Company, RCML Research

Fig 3 - Revised estimates

Key parameters (Rs mn)	FY11E			FY12E			FY13E		
	Old	New	% Chg	Old	New	% Chg	Old	New	% Chg
Revenue	1,155,460	1,133,483	2	1,184,258	1,155,493	2	1,279,209	1,250,444	2
EBITDA margin (%)	45.8	45.1		48.3	47.6		47.6	46.9	
Net profit	258,775	247,319	5	285,363	270,645	5	295,303	280,755	5
FDEPS (Rs)	121	115.6	4.7	133.4	126.5	5.4	138.1	131.3	5.2

Source: RCML Research

Sales agreement with GAIL: During the quarter ONGC entered into a three year contract with GAIL for purchase and marketing of its gas. Gail currently markets ~50mmscmd of ONGC's gas. As understanding, was also reached to market a portion of petrochemical products from ONGC's, Rs195bn venture OPaL, under construction at Dahez SEZ, Gujarat

Guidance for FY12: ONGC intends to add 283.5mtoe in FY12 to its 3P reserves of 1619mtoe, with the largest accretion of 95mtoe being from East Coast deepwater assets. ONGC is in talks with international oil majors to develop the technically challenging KG basin block, with an investment of US\$ 10bn. The company aims to bring the block on production by FY15. ONGC has a planned expenditure of ~Rs 300bn for FY12, of which ~ Rs 109bn would be incurred on capital projects and Rs 93bn on exploratory drilling. OVL on the other hand, is under negotiations with the government of Kazakhstan to pick up a 25% stake in Satpayev block by Feb '11.



Valuations

To factor delay in diesel de-regulation and resultant higher subsidy sharing, we have revised our EPS forecast for FY11/FY12/FY13 to Rs 115/Rs 126/Rs 131 (~5% lower than our earlier forecast). However, in light of Q3FY11 results and positive oil & gas production guidance for FY12, we maintain our BUY rating with a revised TP of Rs1400/sh (Rs 1470/sh earlier) based on 10.5x 1yr forward earnings. At CMP the stock is trading at a P/E of 8.6x and EV/EBITDA of 3.8x FY13E.

Fig 4 - Key Assumptions

	Unit	FY10	FY11E	FY12E	FY13E
Crude Oil Production					
Domestic	mmtpa	26.5	28.0	29.1	29.4
OVL	mmtpa	6.4	6.7	7.4	7.7
Total	mmtpa	32.9	34.7	36.5	37.1
Crude Oil Sales	mmtpa	28.8	29.7	31.2	31.7
Domestic Crude prices					
FOB Price (Bonny Light)	US\$/bl	75.4	83.5	77.0	77.0
Gross realisation (post sub)	US\$/bl	58.5	55.8	62.3	61.9
Net realisation (after taxes)	US\$/bl	44.2	41.1	47.7	47.3
OVL crude prices					
Net realisation (after taxes)	US\$/bl	40.5	49.1	45.8	45.8
Natural Gas Production					
Domestic	bcm	25.6	25.9	27.1	29.0
OVL	bcm	2.4	2.7	2.9	3.0
Total	bcm	28.0	28.6	30.0	32.1
Natural Gas Sales	bcm	23.0	23.6	25.0	26.9
Gas Prices					
Domestic gas prices	US\$/mmbtu	2.2	4.2	4.5	4.5
OVL gas prices	US\$/mmbtu	2.7	2.9	3.1	3.4
MRPL					
Refinery throughput	mmtpa	12.5	12.5	12.6	13.8
Gross refining margins (GRMs)	US\$/bl	5.5	5.1	5.9	6.2
ONGC share in under-recoveries					
ONGC's share	Rs bn	116	187	88	92
Exchange Rate	Rs/US\$	47.5	46.0	44.0	44.0

Source: RCML Research

Fig 5 - SOTP Valuation

	USD mn	Rs/share	Comment
Core Business	64,920	1,366	10.5x FY13E EPS
Exploration upside from KG-98/2 block	1,660	35	6.4 TCF reserves at USD 4/boe
No of Equity Shares (in mn)	2,139		
Value of the company	66,580	1,401	

Source: RCML Research



Standalone financials

Profit and Loss statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Revenues	1,017,546	1,133,483	1,155,493	1,250,444
Growth (%)	(2.7)	11.4	1.9	8.2
EBITDA	444,518	511,637	550,208	586,816
Growth (%)	6.6	15.1	7.5	6.7
Depreciation & amortisation	187,188	170,322	177,354	191,411
EBIT	257,330	341,314	372,854	395,406
Growth (%)	(2.0)	32.6	9.2	6.0
Interest	5,022	5,454	5,694	10,138
Other income	52,727	47,058	50,172	52,880
EBT	305,035	382,919	417,333	438,148
Income taxes	107,138	133,133	144,027	154,036
Effective tax rate (%)	35.1	34.8	34.5	35.2
Extraordinary items	-	-	-	-
Min into / inc from associates	3,397	2,653	2,886	3,626
Reported net income	194,657	247,319	270,645	280,755
Adjustments	-	-	-	-
Adjusted net income	194,657	247,319	270,645	280,755
Growth (%)	(1.3)	27.1	9.4	3.7
Shares outstanding (mn)	2,138.9	2,138.9	2,138.9	2,138.9
FDEPS (Rs) (adj)	91.0	115.6	126.5	131.3
Growth (%)	(1.3)	27.1	9.4	3.7
DPS (Rs)	33.0	52.0	42.0	43.0

Cash flow statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Net income + Depreciation	395,766	429,193	459,517	484,314
Non-cash adjustments	21,795	3,247	3,571	-
Changes in working capital	18,972	(20,285)	(24,932)	(10,987)
Cash flow from operations	436,532	412,154	438,157	473,327
Capital expenditure	(313,261)	(294,005)	(286,908)	(355,265)
Change in investments	(16,790)	8,504	(5,080)	(81)
Other investing cash flow	-	-	-	-
Cash flow from investing	(330,051)	(285,501)	(291,988)	(355,346)
Issue of equity	(0)	(0)	-	0
Issue/repay debt	(2,922)	(17,363)	5,735	5,448
Dividends paid	(80,098)	(126,100)	(101,888)	(104,310)
Other financing cash flow	(25,558)	7,218	(69)	(50)
Change in cash & cash eq	(2,098)	(9,592)	49,946	19,069
Closing cash & cash eq	223,858	214,266	264,212	283,282

Economic Value Added (EVA) analysis

Y/E March	FY10	FY11E	FY12E	FY13E
WACC (%)	8.7	8.7	8.7	8.7
ROIC (%)	17.8	20.9	20.3	18.9
Invested capital (Rs mn)	1,440,539	1,589,751	1,692,253	1,888,404
EVA (Rs mn)	130,602	194,109	195,798	191,678
EVA spread (%)	9.1	12.2	11.6	10.2

Balance sheet

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Cash and cash eq	223,858	214,266	264,213	283,282
Accounts receivable	71,424	88,609	70,532	79,671
Inventories	82,400	91,436	88,899	102,951
Other current assets	127,983	135,958	144,442	153,468
Investments	51,593	43,089	48,169	48,250
Gross fixed assets	1,413,591	1,579,808	1,739,126	1,917,562
Net fixed assets	755,426	903,966	998,245	1,152,543
CWIP	256,164	231,307	246,581	256,137
Intangible assets	-	-	-	-
Deferred tax assets, net	165	-	-	-
Other assets	95,385	95,385	95,385	95,385
Total assets	1,664,397	1,804,017	1,956,466	2,171,686
Accounts payable	226,819	226,359	180,343	194,629
Other current liabilities	103,076	111,997	120,854	129,646
Provisions	75,158	89,530	98,482	105,425
Debt funds	62,669	45,305	51,040	56,488
Other liabilities	174,593	177,840	181,411	181,411
Equity capital	21,389	21,389	21,389	21,389
Reserves & surplus	992,676	1,118,637	1,287,394	1,463,841
Shareholder's funds	1,022,083	1,152,986	1,324,335	1,504,086
Total liabilities	1,664,398	1,804,017	1,956,466	2,171,686
BVPS (Rs)	477.9	539.1	619.2	703.2

Financial ratios

Y/E March	FY10	FY11E	FY12E	FY13E
Profitability & Return ratios (%)				
EBITDA margin	43.7	45.1	47.6	46.9
EBIT margin	25.3	30.1	32.3	31.6
Net profit margin	19.1	21.8	23.4	22.5
ROE	19.9	22.7	21.8	19.9
ROCE	27.4	32.1	31.0	29.1
Working Capital & Liquidity ratios				
Receivables (days)	25	27	21	22
Inventory (days)	89	91	95	97
Payables (days)	144	133	109	107
Current ratio (x)	1.7	1.7	2.0	2.1
Quick ratio (x)	1.4	1.4	1.7	1.7
Turnover & Leverage ratios (x)				
Gross asset turnover	0.8	0.8	0.7	0.7
Total asset turnover	0.6	0.7	0.6	0.6
Interest coverage ratio	51.2	62.6	65.5	39.0
Adjusted debt/equity	6.1	3.9	3.9	3.8
Valuation ratios (x)				
EV/Sales	2.2	2.0	1.9	1.8
EV/EBITDA	5.1	4.4	4.1	3.8
P/E	12.4	9.8	8.9	8.6
P/BV	2.4	2.1	1.8	1.6



Quarterly trend

Particulars	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11
Revenue (Rs mn)	155,062	160,023	138,230	184,352	189,062
YoY growth (%)	23.7	15.7	(7.5)	21.4	21.9
QoQ growth (%)	2.1	3.2	(13.6)	33.4	2.6
EBITDA (Rs mn)	93,347	94,180	81,932	113,218	116,336
EBITDA margin (%)	60.2	58.9	59.3	61.4	61.5
Adj net income (Rs mn)	30,536	37,764	36,611	53,888	58,116
YoY growth (%)	23	71	(24)	6	90
QoQ growth (%)	(40)	24	(3)	47	8

DuPont analysis

(%)	FY09	FY10	FY11E	FY12E	FY13E
Tax burden (Net income/PBT)	0.6	0.6	0.7	0.7	0.6
Interest burden (PBT/EBIT)	1.0	1.0	1.0	1.0	1.0
EBIT margin (EBIT/Revenues)	0.3	0.3	0.3	0.3	0.3
Asset turnover (Revenues/Avg TA)	0.7	0.6	0.6	0.6	0.6
Leverage (Avg TA/Avg equity)	1.7	1.7	1.6	1.5	1.5
Return on equity	18.4	16.3	19.4	18.5	16.9

Company profile

ONGC specializes in the exploration and production of crude oil and gas. The Company has joint ventures in oil fields in Vietnam, Norway, Egypt, Tunisia, Iran and Australia. The Group's other activities include deep sea explorations on the east and west coasts of India, and the exploration of coal bed methane

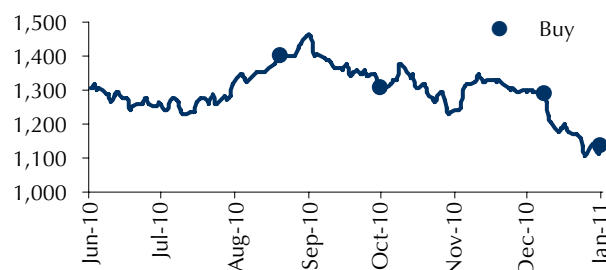
Shareholding pattern

(%)	Jun-10	Sep-10	Dec-10
Promoters	74.14	74.14	74.1
FIs	4.2	4.6	4.7
Banks & FIs	8	7.8	7.6
Public	13.6	13.5	13.5

Recommendation history

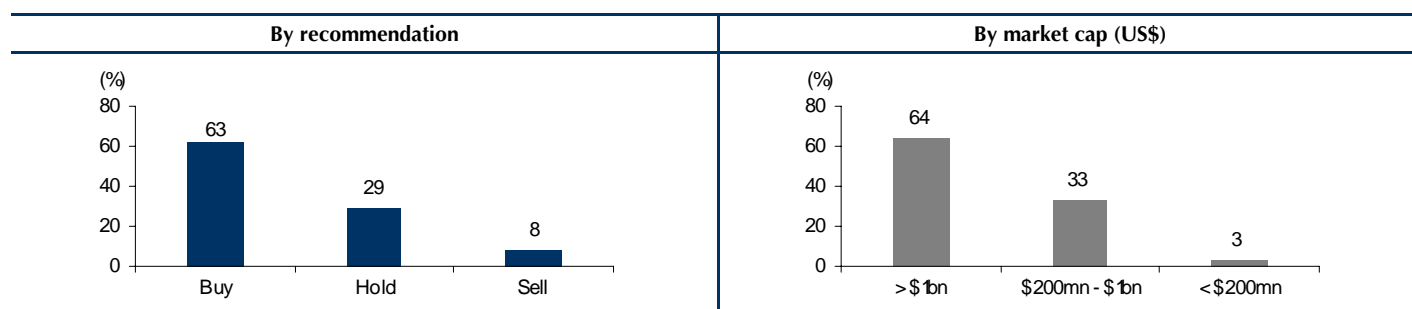
Date	Event	Reco price	Tgt price	Reco
22-Sep-10	Initiating Coverage	1,404	1,510	Hold
29-Oct-10	Results Review	1,304	1,510	Buy
4-Jan-11	Strategy	1,295	1,470	Buy
28-Jan-11	Results Review	1,133	1,400	Buy

Stock performance





Coverage Profile



Recommendation interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and -5%
Sell	Less than -5%

Recommendation structure changed with effect from March 1, 2009

Expected absolute returns are based on share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

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