

STOCK INFO. BLOOMBERG
 BSE Sensex: 9,849 ONGC IN
 REUTERS CODE
 S&P CNX: 2.975 ONGC. BO

30 January 2006

Buy

Rs1,236

Previous Recommendation: Buy

Equity Shares (m)	1,425.9
52-Week Range (Rs)	1,296/787
1,6,12 Rel. Perf. (%)	0/3/1
M.Cap. (Rs b)	1,762.4
M.Cap. (US\$ b)	39.9

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS B)	(RS B)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
03/05A	597.5	143.4	100.6	52.9	12.3	3.7	32.4	35.4	2.9	6.3
03/06E	702.4	190.1	133.3	32.6	9.3	3.0	35.8	39.9	2.4	4.9
03/07E	778.5	221.9	155.6	16.7	7.9	2.4	33.8	40.5	2.1	3.9

Consolidated

- ONGC's 3QFY06 net profit at Rs38.9b was up 11.3% YoY, marginally ahead of our estimates, on the back of higher crude and gas prices despite higher LPG / kerosene loss sharing and lower crude production, YoY.
- Crude price realisation was up at US\$43.7/bbl, net of discount of US\$15.2/bbl (not including Rs2b of discounts on LPG and kerosene) as compared to US\$41.3/bbl post discount last year (3QFY05).
- The government announced higher subsidy sharing of Rs28.4b up 114% YoY to cover petrol and diesel losses (since 1QFY06) along with the usual LPG / kerosene losses. However, subsidy sharing was flat sequentially compared to Rs28.3b in 2QFY06.
- Oil and gas production at 6.37m tons and 6.32bcm respectively were down 10.3% YoY and 1.9% YoY on account of the fire accident at MHN field.
- OVL's aggressive global E & P asset acquisition momentum is likely to continue, over the next 18 - 24months, given ONGC's target of achieving US\$50b turnover by FY10. The stock trades at P/E of 7.7x (adjusted for investments) and EV/EBITDA of 3.9x FY07 estimates. We reiterate **Buy**. Our target price is under review for a possible.

QUARTERLY PERFORMANCE (STANDALONE)

(Rs Billion)

Y/E MARCH	FY05				FY06				FY05	FY06E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Net Sales	102.9	118.2	121.0	121.5	108.7	126.8	124.8	145.1	463.6	505.4
Change (%)	30.9	36.4	67.5	46.0	5.6	7.3	3.1	19.5	44.5	9.0
Raw material and purchases	13.6	12.1	14.8	12.4	9.7	12.7	5.8	15.8	52.9	43.9
Statutory Levies	23.2	25.5	25.9	25.3	25.0	26.6	27.1	32.4	99.8	111.1
Employee Costs	3.2	2.8	2.1	1.9	2.8	2.4	2.5	4.1	10.0	11.8
Other Exp (incl Stock Adj)	11.5	14.2	15.3	18.2	10.2	13.6	15.8	10.8	59.2	50.3
EBITDA	51.5	63.6	62.9	63.8	61.1	71.6	73.6	82.1	241.8	288.3
% of Net Sales	50.1	53.8	51.9	52.5	56.2	56.4	59.0	56.6	52.1	57.0
% Change	14.8	30.2	66.6	40.4	18.5	12.5	17.1	28.7	36.7	19.2
Depreciation	16.2	15.3	12.9	17.6	13.5	19.4	20.1	13.9	62.0	66.9
Interest	0.1	0.0	0.2	0.1	0.0	0.1	0.1	0.4	0.4	0.6
Other Income	3.0	4.7	4.6	4.9	3.0	8.6	5.6	0.2	17.3	17.5
PBT	38.2	53.0	54.4	51.0	50.5	60.8	59.0	68.0	196.7	238.3
Tax	15.2	19.1	19.5	13.0	17.3	19.4	20.2	18.2	66.8	75.1
Rate (%)	39.6	36.1	35.8	25.6	34.3	31.9	34.2	26.8	34.0	31.5
PAT	23.1	33.8	34.9	38.0	33.2	41.4	38.9	49.8	129.8	163.2
Change (%)	8.1	19.8	103.3	91.2	43.8	22.3	11.3	31.1	49.8	25.7

E: MOST Estimates

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ONGC's 3QFY06 net profit at Rs38.9b was up 11.3% YoY, marginally ahead of our estimates, on the back of higher crude and gas prices despite higher LPG / kerosene loss sharing and lower crude production, YoY.

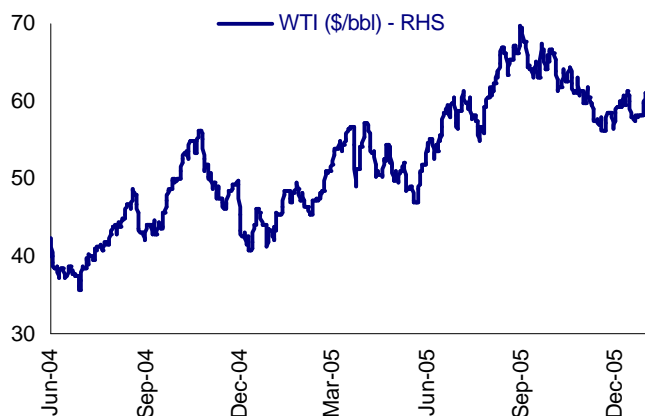
Higher oil & gas prices drive earnings growth

Higher crude oil and natural gas prices were the key drivers of earnings growth in 3QFY06. Crude price realisation was up at US\$43.7/bbl, net of discount of US\$15.2/bbl (not including Rs2b of discounts on LPG and kerosene) as compared to US\$41.3/bbl post discount last year (3QFY05). Gross realisation at US\$58.9/bbl was in line with benchmark Bonnylight which was up 32% YoY at US\$58.7/bbl. Lower crude volumes (on account of MHN fire accident), effectively pushes up per unit discount.

While realization was up 5.8% YoY, sales was up just 3.1% YoY on account of lower trading sales.

Gas prices were revised up with effect from July 2005. We estimate weighted average price increase (across various end uses) at about 25%. Prices for fertilizer and power end-use were raised by Rs350/kscm, while prices were completely deregulated for other end-uses. However, the proportion of other endusers of APM (Administered price mechanism) gas was just about 20%.

INTERNATIONAL CRUDE OIL PRICE TREND

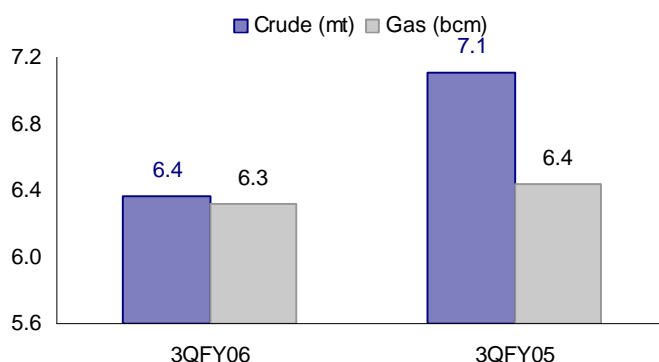


Source: Company/Motilal Oswal Securities

Volumes take a hit on account of MHN fire accident

Production volumes were hit by the fire accident at MHN field. Oil production at 6.37m tons (including JVs) was down 10.3% YoY, while gas production at 6.32bcm was down 1.9% YoY. However volumes are recovering and are expected to reach normal levels over the next 6 months.

PRODUCTION DATA

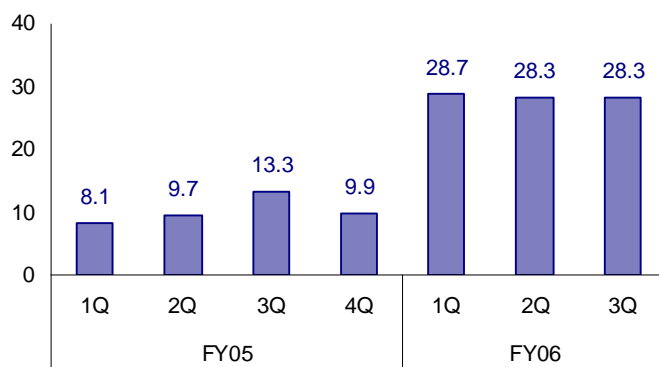


Source: Company/Motilal Oswal Securities

Loss sharing limits pricing gains

3QFY06 loss sharing of Rs28.4b, was up 114% YoY as Government widened the scope of loss sharing to cover petrol and diesel marketing losses (since 1QFY06) along with the usual LPG / kerosene losses. However, subsidy sharing was flat sequentially compared to Rs28.3b in 2QFY06.

SUBSIDY LOSSES (RS B)



Source: Company/Motilal Oswal Securities

ONGC has paid US\$15.2/bbl as discount during the quarter towards loss sharing, as against US\$17.3/bbl last quarter (on account of lower volumes last quarter).

The Parliament has approved additional grants of Rs57.5b as part of government's 1/3rd share of the fuel marketing losses. While the primary beneficiaries of this move are the oil marketing companies, this reduces the overhang on ONGC on possible increase in loss sharing proportion, which is a large positive.

Also, fresh proposals to tackle losses on oil marketing companies books are being considered, which if approved could remove loss sharing on the part of upstream players, providing large earnings as well as valuation upside.

DDA up due to accounting policy change

3QFY06 DD&A was up 56.4% YoY, on account of a change in accounting policy for pipelines. The excess depreciation in the current quarter on account of the policy change was Rs3b.

Large growth on the anvil

OVL has emerged as a key growth driver for ONGC. We expect OVL's aggressive global E & P asset acquisition

momentum to continue, over the next 18 - 24 months, given ONGC's target of achieving US\$50b turnover by FY2010. OVL has acquired more than seven E & P assets over the last 6 months. There are large opportunities opening up globally, thanks to the strong crude price environment and under investment between 1998 – 2003 period.

Upside to domestic gas prices likely

Domestic gas prices have remained unchanged over the last six months, despite wild swing in prices globally. However, prices for FY07 are likely to move up, given the pricing indications from PMT JV and ONGC's sale to non-power / non-fertiliser endusers. A US\$1/mmbtu increase (from current US\$3.86/mmbtu) on JV gas and non-fertiliser and non-power endusers would provide an upside of Rs10.9b in pre-tax earnings. Such an increase would also help push the case for total deregulation of gas prices, as gap between regulated and de-regulated gas prices widen.

Valuation and view

We reiterate our **Buy** recommendation on the stock. It trades at P/E of 7.7x (adjusting for value of investments) and EV/EBITDA of 3.9x FY07 estimates. Reiterate **Buy**. Our target price is under review for a possible.

ONGC: an investment profile

A Fortune 500 company, ONGC is the largest company in India in terms of market capitalization. It is the largest E&P company, with proven reserves in excess of 1b toe. It acquired a majority stake in the loss making MRPL and turned it around. Its overseas subsidiary, OVL has acquired E&P assets in Sakhalin (Russia), Sudan, Libya, Iran, Iraq, Vietnam, Myanmar.

Key investment arguments

- ✍ OVL has emerged as the key growth driver with large growth potential
- ✍ With over 1b toe of proven reserves, aggressive E&P and asset acquisition program, and potential downstream merger program, ONGC holds large growth potential.
- ✍ Current valuations are yet to reflect the strong crude price trend.

Key investment risks

- ✍ With competition pushing returns down, acquisition of overseas E&P assets could be at a lower IRR.

Recent developments

- ✍ The Parliament has approved additional grants of Rs57.5b as part of government's 1/3rd share of the fuel marketing losses.
- ✍ Oil production at 6.37m tons (including JVs) was down 10.3% YoY, while gas production at 6.32bcm was down 1.9% YoY due to the fire at Bombay High.

Valuation and view

- ✍ Stock trades at P/E of 7.7x (adjusting for value of investments) and EV/EBITDA of 3.9x FY07 estimates.
- ✍ We reiterate our **Buy** recommendation on the stock. Our target price is under review for an upgrade.

Sector view

- ✍ There is widespread consensus on cheap crude price environment being passe. We expect the strong crude price trend to continue, though a repeat of recent peaks are unlikely.
- ✍ Gas price revision has happened and complete deregulation appears inevitable.
- ✍ ONGC is well positioned to reap the benefits of higher crude prices and potential complete deregulation of gas pricing.

COMPARATIVE VALUATIONS

		ONGC	GAIL
P/E (x)	FY06E	9.3	10.0
	FY07E	7.9	12.1
P/BV (x)	FY06E	3.0	2.3
	FY07E	2.4	2.1
EV/Sales (x)	FY06E	2.4	1.5
	FY07E	2.1	1.4
EV/EBITDA (x)	FY06E	4.9	6.6
	FY07E	3.9	6.0

SHAREHOLDING PATTERN (%)

	DEC.05	SEP.05	DEC.04
Promoters	86.2	86.2	86.2
Domestic Institutions	3.1	2.1	2.9
FII's/FDIs	8.4	8.9	7.2
Others	2.3	2.9	3.8

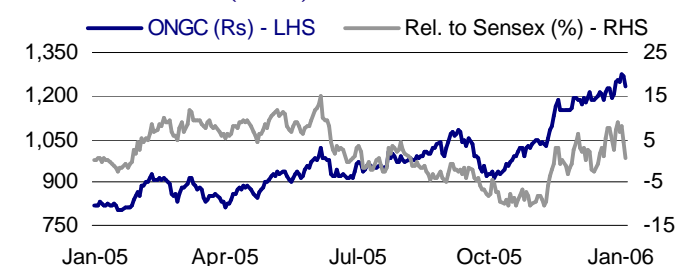
EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	133.3	121.1	10.1
FY07	155.6	141.6	9.9

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
1,236	-	-	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2003	2004	2005	2006E	2007E
Net sales	345,253	436,471	597,473	702,443	778,545
Growth (%)		26.4	36.9	17.6	10.8
Government levies	88,502.3	102,546.1	130,997.9	144,957.7	149,488.8
Pipeline costs (trans & fr	5,500	6,095	6,281	6,405	6,522
Other operating costs	46,035	130,789	179,613	206,337	209,688
Operating costs	140,037	239,430	316,892	357,699	365,699
EBIDTA	205,216	197,041	280,581	344,744	412,846
% of Net Sales	59.4	45.1	47.0	49.1	53.0
Debt charges (incl exch l	-1,681	-3,822	-1,644	-2,896	-1,559
Exploration write-offs	-22,210	-1,343	-36,023	-31,443	-35,448
Deprn, depltn, amrtsn (D	-41,514	-65,525	-37,917	-45,085	-53,932
Other income	20,397	22,410	19,624	19,409	20,656
PBT	160,208	148,761	224,622	284,729	342,563
Tax	-57,192.0	-46,100.9	-74,689.5	-86,753.7	-105,839.2
Rate (%)	34.8	36.2	35.4	32.4	34.5
PAT	104,423	94,881	145,206	192,460	224,462
Growth (%)		-9.1	53.0	32.5	16.6
Net profit (adjusted)	104,423	94,881	145,206	192,460	224,462
Growth (%)		-9.1	53.0	32.5	16.6
Net profit post MI	104,675	93,803	143,390	190,103	221,922

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2003	2004	2005	2006E	2007E
Share Capital	14,259	14,259	14,259	14,259	14,259
Reserves	342,129	393,138	462,539	571,954	713,341
Net Worth	356,388	407,397	476,798	586,213	727,600
Debt	62,025	62,535	43,574	25,176	17,644
Deferred Tax	47,116	54,250	55,215	60,225	71,460
Liability for Abandonmen	0	80,292	87,117	93,362	99,075
Minority Interest	5,029	4,275	5,923	7,830	9,970
Capital Employed	470,558	608,748	668,627	772,805	925,750
Gross Fixed Assets	475,765	496,759	543,106	588,906	634,088
Less: Depreciation	355,833	379,711	413,327	452,109	494,838
Capital WIP	9,338	13,520	12,377	19,227	31,045
Net Fixed Assets	129,270	130,569	142,155	156,023	170,295
Producing properties	190,493	246,708	276,023	366,174	392,344
Pre-producing properties	34,641	45,402	76,405	37,215	44,602
Investments (incl. m	30,603	30,307	57,202	58,202	58,796
Goodwill	12,790	14,591	14,591	14,591	14,591
Cash & bank balances	40,035	64,564	51,027	112,062	180,727
Inventories	25,635	35,529	43,718	47,367	48,638
Loans & advances	36,427	55,236	45,024	26,434	53,602
Other current assets	28,810	37,281	44,091	50,336	56,050
Total current assets	173,749	221,920	234,964	293,812	405,109
Current liabilities	45,391	55,569	60,791	64,351	70,648
Provisions	55,598	25,180	71,923	88,860	89,338
Net current assets	72,760	141,171	102,250	140,600	245,122
Application of Fund:	470,558	608,748	668,627	772,805	925,750

E: MOST Estimates

RATIOS					
Y/E MARCH	2003	2004	2005E	2006E	2007E
Basic (Rs)					
EPS	73.4	65.8	100.6	133.3	155.6
Cash EPS	117.1	118.1	155.7	190.9	226.9
Book Value	249.9	285.7	334.4	411.1	510.3
DPS	30.0	24.0	40.0	50.0	50.0
Payout	40.9	36.5	39.8	37.5	32.1
Valuation (x)					
P/E		18.8	12.3	9.3	7.9
Cash P/E		10.5	7.9	6.5	5.4
EV / EBITDA		9.1	6.3	4.9	3.9
EV / Sales		4.1	3.0	2.4	2.1
Price / Book Value		4.3	3.7	3.0	2.4
Dividend Yield (%)		19	3.2	4.0	4.0
Profitability Ratios (%)					
RoE	29.4	24.6	32.4	35.8	33.8
RoCE	34.4	28.3	35.4	39.9	40.5
Turnover Ratios					
Debtors (No. of Days)	45	30	25	28	29
Fixed Asset Turnover (x)	5.3	3.4	4.4	4.7	4.8
Leverage Ratio					
Net Debt / Equity (x)	0.1	0.0	0.0	-0.1	-0.2

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2003	2004	2005E	2006E	2007E
OP/(Loss) before Tax	205,216	197,041	280,581	344,744	412,846
Interest Paid	-1,681	-3,822	-1,644	-2,896	-1,559
Direct Taxes Paid	57,192	-46,746	-78,451	-87,259	-106,866
(Inc)/Dec in Wkg. Capita	-58,146	-49,901	15,572	21,977	-36,360
CF from Op. Activit	202,581	96,572	216,059	276,566	268,061
(Inc)/Dec in FA & CWIP	-136,927	-56,652	-139,019	-135,111	-131,496
(Pur)/Sale of Investmen	-190,493	296	-26,895	-1,000	-594
Inc from Invst	-41,514	22,410	19,624	19,409	20,656
CF from Inv. Activit	-368,934	-33,946	-146,290	-116,702	-111,433
Issue of Shares	14,259	0	0	0	0
Inc / (Dec) in Debt	109,141	510	-18,961	-18,398	-7,532
Dividends Paid (incl. tax)	-104,675	-38,607	-64,345	-80,431	-80,431
CF from Fin. Activit	18,725	-38,097	-83,306	-98,829	-87,963
Inc / (Dec) in Cash	-147,628	24,529	-13,537	61,034	68,665
Add: Opening Balance	0	40,035	64,564	51,027	112,062
Closing Balance	40,035	64,564	51,027	112,061	180,727



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Disclosure of Interest Statement

ONGC

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| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |

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