OIL AND NATURAL GAS CORPORATION LTD
RESEARCH

EQUITY RESEARCH | **September 2, 2009**

RESULTS REVIEW

Oil and Natural Gas Corporation Ltd. — Hold

Share Data

Market Cap	Rs. 2,474.14 bn
Price	Rs. 1,156.75
BSE Sensex	15,467.46
Reuters	ONGC.BO
Bloomberg	ONGC IN
Avg. Volume (52 Week)	0.4 mn
52-Week High/Low	Rs. 1,229.8 / 538.1
Shares Outstanding	2,138.9 mn

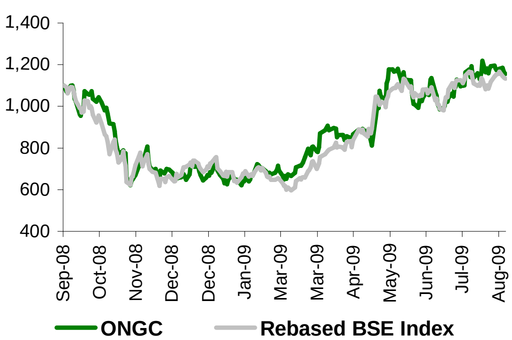
Valuation Ratios (Consolidated)

Year to 31 March	2010E	2011E
EPS (Rs.)	111.3	120.4
+/- (%)	20.3%	8.2%
PER (x)	10.4x	9.6x
EV/ Sales (x)	1.9x	1.7x
EV/ EBITDA (x)	4.7x	4.3x

Shareholding Pattern (%)

Promoters	74
FIIs	6
Institutions	7
Public & Others	13

Relative Performance



Mixed results, lower sales compensated by lower subsidy burden

Oil and Natural Gas Corporation Ltd.'s (ONGC's) net sales were down 25.8% yoy to Rs.148.8 bn in Q1'10, on account of a drop in production volumes, lower price realisations (USD 58 per barrel vs. USD 69 per barrel in Q1'09), and the discontinuation of the trading of MRPL products since April 2009. However, the EBITDA margin stood at 64.3%, improving by 567 bps yoy due to lower subsidy burden, which was down 95.6% yoy to Rs. 4.3 bn. Also, employee costs were down 13% yoy to Rs. 2.5 bn. Net profit, however, declined 26.5% to Rs. 48.5 bn, mainly due to an increase in DD&A expenses related to the cost of two dry wells written-off in the KG offshore basin.

Proposed subsidy-sharing formula provides relief – The Secretary of Petroleum recently announced that under-recoveries on the sale of domestic LPG and kerosene will be borne by the Government. This has brought enough reasons to cheer for upstream companies such as ONGC. At current exchange rates and crude oil prices hovering at around USD 70 per barrel, Oil Marketing Companies (OMCs) are expected to incur around Rs. 300 bn of under-recoveries on the sale of LPG and kerosene.

Delay in production, cause for concern – Three platforms that were to come up in fiscal FY09 were delayed and the delay continued into the first quarter as well, leading to a decline in the expected production. Though production from one of the projects, C-Series, is likely to start soon, the other two platforms may be delayed further.

However, new discoveries are a silver lining – The future volume growth of the Company seems attractive as the Company has been able to

Key Figures (Standalone)

Quarterly data	Q1'09	Q4'09	Q1'10	QoQ%	YoY%
(Figures in Rs mn, except per share data)					
Net Sales	200,522	137,038	148,793	8.6%	(25.8%)
EBITDA	117,554	59,095	95,671	61.9%	(18.6%)
Adj. Net Profit	65,929	22,068	48,479	119.7%	(26.5%)
Margins(%)					
EBITDA	58.6%	43.1%	64.3%		
NPM	32.9%	16.1%	32.6%		
Per Share Data (Rs.)					
Normalised EPS	30.8	10.3	22.7	119.7%	(26.5%)

Reserve replacement trends positive for the future

improve its reserve base consistently by enhancing its existing fields and by making new discoveries. The reserve replacement ratio has been positive for five consecutive years (1.44x in FY09, 68.9 mn toe of accretion). The Company also made 10 new discoveries in Q1'10, and has earmarked Rs. 60 bn as exploration capex for FY09-10. Below are some of the key developments on the exploration front:

- ***Three significant discoveries*** – The Company has made significant discoveries in three new blocks – gas discovery in Krishna Godavari basin in Andhra Pradesh (of an estimated reserve of 10 trillion cubic feet of gas) can prove as rich as the Reliance Industries's D-6 block, which at its peak is expected to double India's current natural gas output; oil in Charada-3 offshore block in Cambay basin, Gujarat; and oil and gas in Matar in Vadodara district, Gujarat. The discoveries are still at their early stages and the management is yet to provide guidance on the reserves.
- ***Ultra-deep water operations started*** **-** ONGC has hired a deep water rig from Reliance and has started drilling operations in the Kerala–Konkan basin off Kochi in August 2009. The preliminary results from the project are expected to be available in 100 days. In addition, the company has placed orders for hiring of two more ultra-deep water rigs, which are likely to be mobilised by the end of 2010 and early 2011.
- ***Plans to invest USD 204 mn in Kazakh oil block*** – During the quarter ONGC, along with its partner LN Mittal Group, obtained the Government's approval to buy 25% stake in the Satpayev Oil Block in the Caspian Sea in Kazakhstan. The Company estimates the oil reserves at approximately 256 million tonnes and expects an output of 287,000 barrels per day (bpd) from the field. Kazakhstan's national oil firm KazMunaiGaz holds 75% stake in the block and will operate the field.

Key Events

BC-10 Brazil commences production - ONGC Videsh Ltd., along with its partners Shell (operator) and Petrobras of Brazil, started oil and gas production on 13 July 2009 in BC-10 Block, at a production rate of about 15,000 bpd. The FPSO can process upto ~100,000 bpd, 50 mmscmd of natural gas, and can store nearly 1.5 million barrels of oil for shipment. OVL has 15% participative interest in the block through ONGC Campos Ltd, a fully-owned subsidiary of OVL.

Expected reduction in subsidy burden to increase profitability in the coming quarters

Result Highlights (Standalone) & Outlook

ONGC reported a 25.8% yoy decline in net sales to Rs.148.8 bn for Q1'10, while the adj. net profit dipped 26.5% yoy to Rs. 48.5 bn. The decline in revenues is attributable to the delay in production schedules, lower crude oil prices, and the discontinuation of the sale of MRPL products since April 2009. Net realizations at USD 58.3 per barrel were down 15.7% yoy in the first quarter of this year. While subsidy burden came down, net profit was hit by increased DD&A expenses related to the cost of the dry wells in the KG offshore basin. Though the production schedules continue to be delayed in the second quarter, we expect net sales to pick up on the back of the recovery in crude oil prices. In addition, the recent announcement by the Secretary of Petroleum, RS Pandey, informing that the Government will bear the entire subsidy burden of cooking fuels is hugely positive for ONGC. As such, the Company's profitability from its Natural Gas segment is expected to improve in the upcoming quarters. Also, the recent increase in petrol and diesel prices by Rs. 4 per litre and Rs.2 per litre, respectively, is likely to result in lower subsidy burden for the Company.

Valuation

At the current price of Rs. 1,161.7 the stock is trading at a forward P/E of 10.4x FY10E. We have valued ONGC's standalone business by using the DCF method and ONGC Videsh Ltd. (OVL) by using peer-based EV/2P reserves of USD 12.5/boe. Other investments of the Company have been taken at market values. Based on our valuation, we have arrived at a target price of Rs. 1,251. Since the target price does not provide significant upside to the CMP we reiterate our **Hold** rating.

Key Figures (Consolidated)

Year to March	FY07	FY08	FY09	FY10E	FY11E	CAGR (%)
(Figures in Rs mn, except per share data)						(FY09-11E)
Net Sales	822,529	967,824	1,045,694	1,228,150	1,328,469	12.7%
EBITDA	351,253	404,338	411,778	492,657	532,899	13.8%
Adj. Net Profit	177,696	198,723	197,928	238,057	257,557	14.1%
Margins (%)						
EBITDA	42.7%	41.8%	39.4%	40.1%	40.1%	
NPM	21.6%	20.5%	18.9%	19.4%	19.4%	
Per Share Data (Rs.)						
Normalised EPS	83.1	92.9	92.5	111.3	120.4	14.1%
PER (x)	10.6x	12.5x	12.6x	10.4x	9.6x	

Disclaimer

This report is not for public distribution and is only for private circulation and use. The Report should not be reproduced or redistributed to any other person or person(s) in any form. No action is solicited on the basis of the contents of this report.

This material is for the general information of the authorized recipient, and we are not soliciting any action based upon it. This report is not to be considered as an offer to sell or the solicitation of an offer to buy any stock or derivative in any jurisdiction where such an offer or solicitation would be illegal. It is for the general information of clients of Indiabulls Securities Limited. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. You are advised to independently evaluate the investments and strategies discussed herein and also seek the advice of your financial adviser.

Past performance is not a guide for future performance. The value of, and income from investments may vary because of changes in the macro and micro economic conditions. Past performance is not necessarily a guide to future performance.

This report is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon as such. Any opinions expressed here in reflect judgments at this date and are subject to change without notice. Indiabulls Securities Limited (ISL) and any/all of its group companies or directors or employees reserves its right to suspend the publication of this Report and are not under any obligation to tell you when opinions or information in this report change. In addition, ISL has no obligation to continue to publish reports on all the stocks currently under its coverage or to notify you in the event it terminates its coverage. Neither Indiabulls Securities Limited nor any of its affiliates, associates, directors or employees shall in any way be responsible for any loss or damage that may arise to any person from any error in the information contained in this report.

The analyst for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject stock and no part of his or her compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report. No part of this material may be duplicated in any form and/or redistributed without Indiabulls Securities Limited prior written consent.

The information given herein should be treated as only factor, while making investment decision. The report does not provide individually tailor-made investment advice. Indiabulls Securities Limited recommends that investors independently evaluate particular investments and strategies, and encourages investors to seek the advice of a financial adviser. Indiabulls Securities Limited shall not be responsible for any transaction conducted based on the information given in this report, which is in violation of rules and regulations of National Stock Exchange or Bombay Stock Exchange.