

BSE SENSEX	S&P CNX	CMP: INR283	TP: INR322	Buy								
17,707	5,368											
Bloomberg	ONGC IN											
Equity Shares (m)	8,555.5											
52-Week Range (INR)	326/242											
1,6,12 Rel. Perf. (%)	-2/-6/1											
M.Cap. (INR b)	2,421.2											
M.Cap. (USD b)	49.3											
		Year	Net Sales	PAT	EPS	EPS	P/E	P/BV	RoE	RoCE	EV/	EV/
		End	(INR B)	(INR B)	(INR)	GR. (%)	(X)	(X)	(%)	(%)	BoE	EBITDA
		03/10A	1,018	194	22.7	-2.0	-	-	20.2	19.4	-	-
		03/11A	1,176	210	24.5	8.1	11.5	2.1	19.5	18.8	6.9	4.3
		03/12E	1,452	257	30.0	22.5	9.4	1.8	20.9	20.1	6.4	3.7
		03/13E	1,645	268	31.3	4.2	9.0	1.6	19.1	18.2	5.9	3.3

*Consolidated, EV/BOE on 1P basis

- ONGC posted 6% YoY and 25% QoQ decline in EBITDA for 3QFY12 to INR106.6b, higher than our estimate of INR102b (adjusted for subsidy). Other expenditure was INR31.4b, lower than our estimate of INR35b; this aided EBITDA performance. Adjusted PAT declined 20% YoY and 46% QoQ to INR46.4b v/s our estimate of INR44b.
- Reported PAT was INR67.4b, boosted by one-time prior period royalty gain of INR31.4b from Cairn India for the period August 2009 to September 2011 and higher other income at INR13.5b (v/s our estimate of INR10.4b), led by higher yield on cash reserves.
- Net realization at USD45/bbl (v/s USD64.8/bbl in 3QFY11 and USD83.6/bbl in 2QFY12) was slightly lower than our subsidy-adjusted estimate of USD46/bbl, which follows lower gross realization at USD111.8/bbl (v/s our estimate of USD112.5/bbl).
- Upstream subsidy burden stood at 37.9% in 9MFY12. However, for 3QFY12, upstream subsidy burden was at 47%, as actual 1HFY12 upstream subsidy was based on 33% sharing. For the full year, we continue to model 40% upstream sharing given the (1) precarious government finances, which would result in higher burden on upstream companies, and (2) significantly high FY12 gross under-recovery at ~INR1.3t (up 67% YoY).
- **Key things to watch for:** (1) clarity on Sudan and Syria production for OVL, and (2) subsidy sharing.
- We currently model Brent oil price of USD112 /100 /95 /90 /bbl for FY12 / FY13 / FY14 / long term, and upstream sharing at 40% in FY12 and 38.7% in FY13.
- We are positive on ONGC from a longer term perspective due to expected rationalization of subsidy sharing and potential reserve accretion from its large E&P acreage. ONGC trades at a ~45% discount to its global peers on EV/BOE (1P basis). Near-term profits will remain impacted due to high under-recoveries and lower production from OVL, led by geopolitical tensions.
- The stock trades at 9.4x FY12E EPS of INR30. Our SOTP-based target price is INR322. Maintain **Buy**.

Quarterly performance (Standalone)

Y/E March									(INR Billion)	
	FY11				FY12				FY11	FY12E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Net Sales	136.7	181.9	185.9	154.0	162.0	226.2	181.2	175.1	658.4	744.4
Change (%)	-8.2	20.6	21.4	4.6	18.5	24.3	-2.5	13.7	9.8	13.1
EBITDA	80.4	110.9	113.1	72.6	92.7	141.6	106.6	94.1	377.0	434.9
Change (%)	-15.4	27.7	23.9	-11.3	15.3	27.7	-5.8	29.6	6.2	15.4
D,D & A	31.1	44.0	36.4	47.9	41.2	32.8	45.3	51.2	159.4	170.5
Interest	0.0	0.0	0.1	0.2	0.0	0.1	0.0	0.1	0.3	0.2
Other Income	5.6	11.4	28.9	13.0	9.3	14.4	44.9	11.0	58.9	79.7
PBT	54.8	78.3	105.5	37.5	60.7	123.2	106.2	53.8	276.2	343.8
Tax	18.2	24.4	34.7	9.6	19.8	36.7	38.7	17.2	86.9	112.5
Rate (%)	33.2	31.2	32.9	25.7	32.5	29.8	36.5	32.0	31.5	32.7
PAT	36.6	53.9	70.8	27.9	40.9	86.4	67.4	36.6	189.2	231.4
Adjusted PAT	36.6	53.9	58.1	25.7	40.9	86.4	67.4	36.6	174.3	231.4
Change (%)	-24.5	5.9	90.2	-31.9	11.8	60.4	16.1	42.1	8.1	32.7

3QFY11/4QFY11 other income incl. Gas pool account credit of INR19b/2.9b and 3QFY12 incl. INR31b Cairn royalty reimbursement

E: MOSL Estimates

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Update on OVL

- Concerns on OVL's Sudan and Syria production: Sudan and Syria production which account for ~25% of the OVL's total production has declined led by political unrest and sanctions. (a) Syrian production has come down led by European sanctions which made evacuation of crude difficult. (b) Sudan production has been impacted led by separation of country in two parts-North and South which resulted in disputes pending for resolution. South Sudan has shut down its entire production from Jan-2012. OVL holds 25% interest in block which is currently producing 57kbpd from earlier normal production of 120kbpd.
- Imperial energy is currently producing at 14-15kbpd.
- Production from Venezuela is expected to start from Dec-12 with initial production of ~20kbpd.

Other key highlights

- ONGC has made 5 discoveries in 3QFY12 and total 20 discoveries till date in current fiscal year. Five deepwater wells are scheduled to be drilled in 4QFY12.
- Accounted INR6.27b as revenue in 3QFY12 for its share in Rajasthan block.
- Other income at INR13.5b (v/s est. of INR10.4b) was higher on account of higher cash balance and higher yields.
- Higher tax rate at 36.5% in 3QFY12 was on account of difference between taxable and accounting profit as company get higher deduction on R&D expenses.
- **Upstream sharing at 37.9% in 9MFY12; we model 40% for full year:** Upstream sharing in gross under recoveries was 37.9% in 9MFY12 as against 38.7% in FY11. With worsening fiscal situation of government and full year under-recoveries set to cross INR1.3t, we model upstream subsidy sharing for FY12 higher than last year at 40% but kept its at 38.7% in FY13 on expectation of diesel price hikes post the elections.

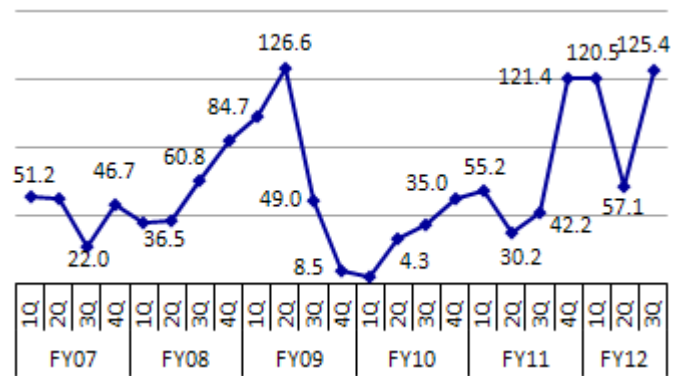
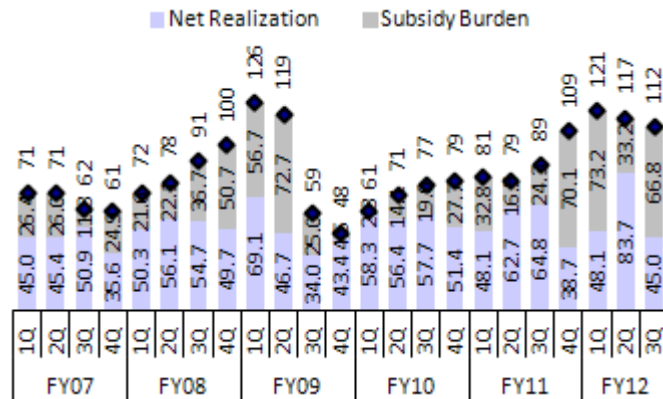
ONGC performance comparison snapshot (INR b)

	3Q FY11	2Q FY12	3Q FY12	YoY Chg.(%)	QoQ Chg.(%)	Comments
Net sales	185.9	226.2	181.2	-2.5	-19.9	Net realization at USD45/bbl v/s USD64.8/bbl in 3QFY11 and USD83.6/bbl in 2QFY12
RM & Purchases	1.9	1.4	1.2	-34.0	-11.2	
Staff cost	2.9	3.3	3.4	15.7	2.9	
Statutory levies	38.9	46.5	38.7	-0.4	-16.8	Lower levies led by lower net realization
Other expenditure	29.1	33.4	31.3	7.8	-6.0	
Total Exp	72.7	84.6	74.7	2.7	-11.7	
EBITDA	113.1	141.6	106.6	-5.8	-24.7	
Interest	-0.1	-0.1	0.0	-65.8	-71.5	
D,D & A	-36.4	-32.8	-45.3	24.5	38.2	Higher YoY and QoQ due to higher dry well write-offs and depletion expenses
Other income	9.9	14.4	13.5	36.6	-6.3	Higher other income led by higher cash balance and higher yields
Profit before tax	105.5	123.2	106.2	0.6	-13.8	
Total Tax	-34.7	-36.7	-38.7	11.6	5.4	
Adj. Net profit	58.1	86.4	67.4	16.1	-22.0	
Effective tax rate (%)	32.9	29.8	36.5	11.0	22.3	Higher tax rate led by difference between taxable & accounting profit as company get higher deduction on R&D expenses

- Subsidy payout of INR125b; net realization at USD47/bbl:** ONGC's subsidy payout stood at INR125b as directed by Government that upstream companies have to share 37.9% of gross under-recoveries in 9MFY12. Gross realization in 3QFY12 was at USD111.7/bbl, while the subsidy payout was at USD66.8/bbl resulting in net realization of USD45/bbl (v/s est. of USD46/bbl), down 31% YoY and 46% QoQ.

ONGC: Net realization at USD45/bbl (USD/bbl)

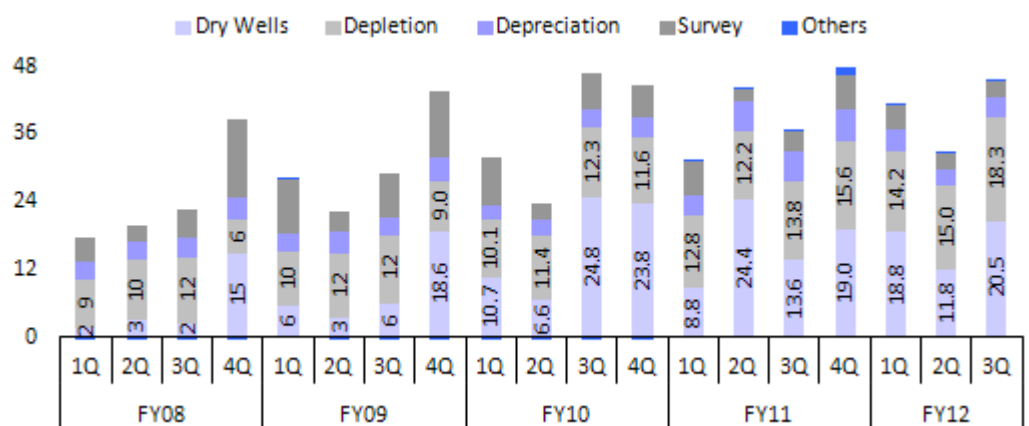
3QFY12 subsidy at INR125b; 9MFY12 upstream sharing at 37.9% (INRb)



Source: Company/MOSL

- D,D&A marginally lower than estimate:** ONGC's D,D&A expenses in 3QFY12 stood at INR45.3b (v/s est. of INR47b); up 24% YoY and 38% QoQ. The sharp increase was led by higher dry-well write-off at INR20.5b and higher depletion due to capitalization of six well platform and one process platform. ONGC drilled 33 exploratory wells (26 onshore, 3 shallow, 4 deepwater) and 59 development wells (52 onshore and 7 shallow water) in 3QFY12.

D,D&A expenses higher due to higher dry well expenses



Source: Company/MOSL

Upstream sharing at 37.9% in 9MFY12; Model 40% for full year

- Upstream sharing in gross under recoveries was 47% in 3QFY12 and 37.9% in 9MFY12.
- Gross under recoveries in FY12 are significantly above FY11 (+67%) led by continued high oil prices.
- Hence, we believe that the government is unlikely to reduce the subsidy burden on the upstream companies. We model FY12 upstream subsidy sharing at 38.7%, similar to FY11.

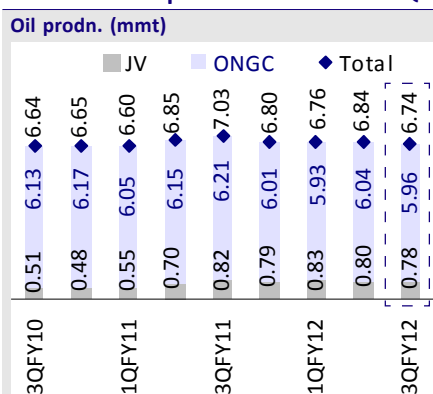
We model upstream sharing at 40% for FY12 and 38.7% for FY13 (INR b)

	FY07	FY08	FY09	FY10	FY11	FY12E	FY13E
Fx Rate (INR/USD)	45.2	40.3	46.0	47.5	45.6	47.6	50.0
Brent (USD/bbl)	64.4	82.3	84.8	69.6	86.3	112.2	100.0
Gross Under recoveries (INR b)							
Auto Fuels	208	426	575	144	375	754	550
Domestic Fuels	286	347	458	316	405	550	505
Total	494	773	1,033	461	780	1,304	1,055
Sharing (INR b)							
Oil Bonds/Cash	241	353	713	260	410	756	552
Upstream	205	257	329	145	303	522	409
OMC's sharing	48	163	-9	56	67	26	94
Total	494	773	1,033	461	780	1,304	1,055
Sharing (%)							
Government	49	46	69	56	53	58	52
Upstream	42	33	32	31	39	40	39
OMC's sharing	10	21	-1	12	9	2	9
Total	100	100	100	100	100	100	100

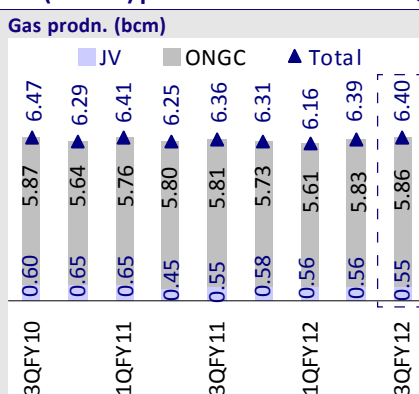
3QFY12 operational highlights

- Oil production (excl. JV) stood at 5.96mmt (-4% YoY, -1.2% QoQ); while sales (excl. JV) were at 4.89mmt (-4.8% YoY, -2.1% QoQ).
- Gas production (excl. JV) stood at 5.86bcm (+0.8% YoY, +0.6% QoQ); while sales (excl. JV) were at 4.53bcm (-1.5% YoY, -0.4% QoQ).
- JV oil production at 0.78mmt (-5% YoY, -2.6% QoQ), while JV gas production stood at 0.55bcm (-0.9% YoY, -2.9% QoQ).

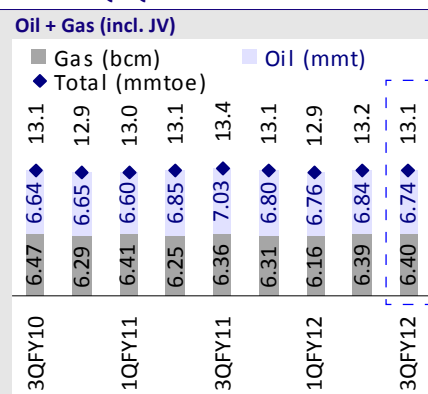
Oil standalone production down 1% QoQ



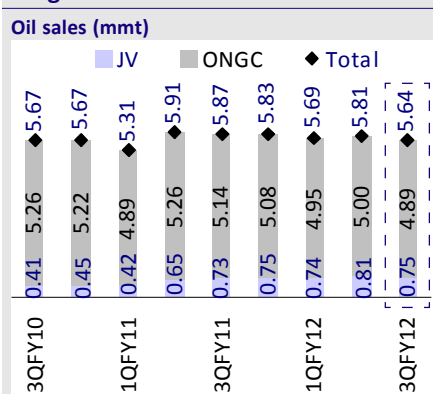
Gas (incl. JV) production remains flat QoQ



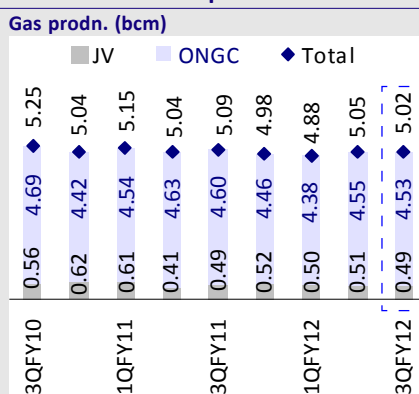
Overall production (incl. JV) down 2% YoY and 1% QoQ



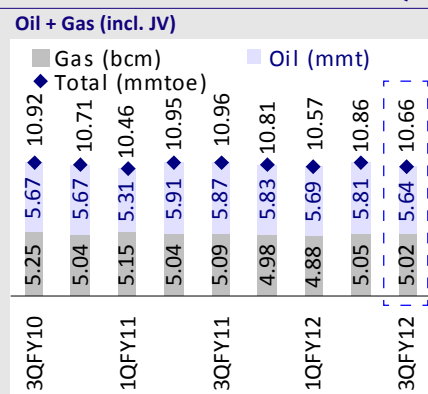
Marginal decline in oil sales



Gas sales flat on sequential basis



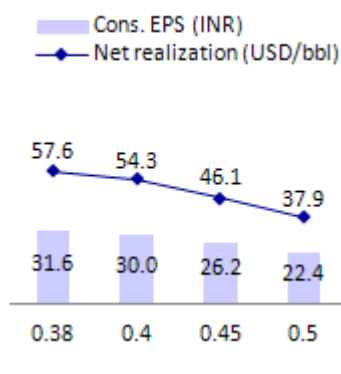
Overall sales down 3% YoY and 2% QoQ



Valuation and view

- Upstream subsidy burden in 9MFY12 stood at 37.9%, however for 3QFY12 was at 47% as actual 1HFY12 upstream subsidy was based on 33% sharing. For full year FY12 we continue to model 40% upstream sharing given the (1) precarious government finances which would result in higher burden on upstream companies and (2) significantly high FY12 gross under recovery at ~INR1.3 trillion (up 67% YoY).
- Key things to watch out would be (1) clarity on Sudan and Syria production for OVL and (2) subsidy sharing. We continue to believe that over the long term, while reforms in the sector are extremely necessary, in the near-term, price hikes are inevitable. We believe that the political compulsions would ease post the five state assembly elections. As headline inflation has reduced from double-digits to 7.4% in December 2011 and is likely to moderate further in 1HCY12, we expect some price hikes.
- We currently model Brent oil price of USD112 /100 /95 /90 /bbl in FY12 / FY13 / FY14 / long term; upstream sharing at 40% in FY12 and 38.7% in FY13.
- We are positive on ONGC from a longer term perspective due to an expected rationalization (over long-term) of subsidy sharing and potential reserve accretion from its large E&P acreage. ONGC trades at a ~45% discount to its global peers on EV/BOE (1P basis). Near term profits will remain impacted due to high under recoveries and lower production from OVL led by geopolitical tensions.
- The stock trades at 9.4x FY12 EPS of INR30. Our SOTP-based target price for ONGC is INR322/sh. Maintain **Buy**.

EPS sensitivity to upstream sharing for FY12



Valuation summary

	USDB	INRB	INR/sh	Valuation method
ONGC Domestic	33	1,663	194	DCF basis
OVL	14	678	79	2P reserves @ USD4.6/boe (same as ONGC)
Rajasthan Royalty	1	68	8	30% stake; DCF based
Net Cash	5	234	27	FY13 End
Listed Investments	2	107	12	MRPL, IOC, GAIL & Petronet LNG; 20% discount to our target/market price
Target Price	55	2,751	322	
Upside Potential (not factored in target price)				
KG-DWN-98/2	0.7	35	4	DCF based
Gas Price Hike	1.6	79	9	NPV of APM hike to US\$5/mmbtu
NELP acreage upsides	-	-	-	-
Total	57.3	2,865	335	

ONGC: an investment profile

Company description

ONGC, a Fortune 500 company, is an eminent exploration and production (E&P) company in India. With over 300 discoveries, it has established in-place reserves of 6.9b ton of oil equivalent (btoe), with ultimate reserves of 2.4btoe. It currently accounts for ~68% of India's domestic oil and gas production. Through its 100% subsidiary ONGC Videsh Limited (OVL), it has equity investments in E&P blocks in 16 countries. Downstream presence is marked through its subsidiary (71.6% stake), MRPL.

Key investment arguments

- **Await clarity on subsidy rationalization:** Any move by the government to rationalize subsidy would result in increased earnings predictability for the company leading to increase the valuation multiples. We currently model upstream subsidy sharing at 38.7% in FY12/FY13 estimates.
- **Large NELP acreage to provide long-term growth:** ONGC has more than 50 % of the total NELP exploration acreage allotted. Of this, around 66% acreage is in high potential deep water. As bulk of this acreage is yet to be explored, we believe there is huge potential for hydrocarbon discoveries. ONGC has met with initial success in the KG block - the country's and its first ultra -deep water discovery UD-1. With increased efforts towards E&P, we expect the company to report more oil and gas finds, going forward.

- **Increased capex, IOR/EOR projects to provide production growth:** Impressive RRR>1 for last 6 years. Production likely to be flat in short-term, however we expect volume growth in long term led by IOR/EOR, marginal fields and monetization of the discovered fields. Increased capex in the large unexplored NELP acreage could result in significant reserve accretion in future.

Key investment risks

- Upstream subsidy sharing of at least 38.7% could become the new normal, if the crude oil prices remain high and the OMCs prevented from raising retail prices of fuels.
- Acquisition of overseas assets at high valuations against stiff competition from China.
- Slowdown in deep water development due to technological barriers.

Recent developments

- Cairn India reimbursed royalty of INR31.4b to ONGC for Aug-09 to Sep-11 period for Rajasthan block.
- ONGC has announced 20 discoveries in FY12 till date.
- ONGC declared interim dividend of INR6.25/share for FY12.

Valuation and view

- The stock trades at 9.4x FY12E EPS of INR30.
- Our SOTP-based target price for ONGC stands at INR322/sh. Maintain **Buy**.

Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
283	322	13.8	Buy

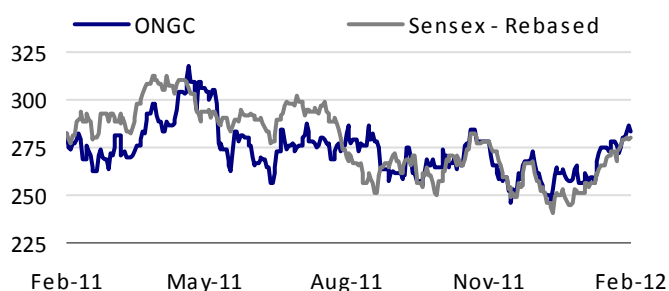
Shareholding pattern (%)

	Dec-11	Sep-11	Dec-10
Promoter	74.1	74.1	74.1
Domestic Inst	6.8	7.0	7.6
Foreign	5.3	5.2	4.7
Others	13.7	13.6	13.5

EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY12	30.0	31.2	-3.7
FY13	31.3	33.0	-8.1

Stock performance (1 year)



Financials and valuation

Income Statement		(INR Billion)				
Y/E March	2009	2010	2011	2012E	2013E	
Net Sales	1,046	1,018	1,176	1,452	1,645	
Growth (%)	8.1	-2.7	15.6	23.4	13.3	
Government Levies	180	166	192	231	270	
Other Operating Costs	434	402	483	657	760	
Total Operating Costs	614	568	676	888	1,030	
EBIDTA	432	449	500	564	615	
% of Net Sales	41.3	44.2	42.5	38.8	37.4	
Debt Charges	2	5	4	7	6	
D,D&A	154	187	206	217	250	
Other Income	51	53	69	59	50	
Prov, writie-offs prior p	15	6	16	-29	2	
PBT	312	304	343	428	407	
Tax	110	107	115	150	136	
Rate (%)	35.3	35.2	33.5	35.0	33.3	
PAT	202	197	228	278	271	
Adj PAT	202	197	213	259	271	
Growth (%)	-4.0	-2.1	8.1	21.2	4.8	
Minority int., assoc pri	4	3	4	2	3	
Net Profit post MI	198	194	210	257	268	

Balance Sheet		(INR Billion)				
Y/E March	2009	2010	2011	2012E	2013E	
Share Capital	21	21	43	43	43	
Reserves	894	984	1,103	1,269	1,447	
Net Worth	916	1,006	1,145	1,312	1,490	
Debt	66	63	63	100	101	
Deferred Tax	92	103	112	121	126	
Liability for Abandonn	171	175	199	202	205	
Minority Interest	14	16	20	22	25	
Capital Employed	1,259	1,362	1,539	1,756	1,946	
Gross Fixed Assets	784	902	999	1,105	1,351	
Less: Depreciation	599	658	731	808	917	
Capital WIP	165	176	274	329	279	
Net Fixed Assets	350	420	542	626	713	
Producing Properties	453	512	572	557	582	
Pre-producing Properti	82	80	102	113	125	
Investments (incl. mkt. :	35	52	34	33	33	
Goodwill	114	95	90	85	80	
Cash & Bank Balances	226	224	287	409	481	
Inventories	65	82	86	84	87	
Sundry debtors	72	71	98	100	100	
Loans & Advances	133	121	110	116	122	
Other Current Assets	11	8	9	9	9	
Total Curr. Assets	507	506	590	718	797	
Current Liabilities	200	227	340	304	317	
Provisions	82	75	51	70	67	
Total current liabilities	282	302	391	374	384	
Net Curr. Assets	225	204	198	343	413	
Total assets	1,259	1,362	1,539	1,756	1,946	

E: MOSL Estimates

Ratios		(INR Billion)				
Y/E March	2009	2010	2011	2012E	2013E	
Basic (INR)						
EPS	23.1	22.7	24.5	30.0	31.3	
Cash EPS	41.6	45.9	49.6	56.5	61.2	
Book Value	107.0	117.5	133.9	153.4	174.1	
DPS	8.0	8.0	9.0	11.0	9.0	
Payout (incl. div tax)	40.9	41.6	56.2	42.8	33.6	
Valuation (x)						
P/E			11.5	9.4	9.0	
Cash P/E			5.7	5.0	4.6	
EV / EBITDA			4.3	3.7	3.3	
EV / Sales			1.8	1.4	1.2	
Price / Book Value			2.1	1.8	1.6	
Dividend Yield (%)			3.1	3.9	3.2	
EV/BOE (USD, 1P basis)			6.9	6.4	5.9	
Profitability Ratios (%)						
RoE	23.4	20.2	19.5	20.9	19.1	
RoCE	22.7	19.4	18.8	20.1	18.2	
Turnover Ratios						
Debtors (No. of Days)	25	26	26.2	24.9	22.1	
Fixed Asset Turnover (3.3	2.6	2.4	2.5	2.5	
Leverage Ratio						
Net Debt / Equity (x)	-0.2	-0.2	-0.2	-0.3	-0.3	

Cash Flow Statement		(INR Billion)				
Y/E March	2009	2010	2011	2012E	2013E	
OP/(Loss) before Tax	311	304	343	428	407	
DD & A	88	89	114	167	201	
Other op. expenses	-11	-8	4	0	0	
Direct Taxes Paid	-102	-77	-105	-141	-130	
(Inc)/Dec in Wkg. Cap	5	-16	70	-23	2	
CF from Op. Activity	290	292	425	432	479	
(Inc)/Dec in FA & CWIP	-216	-213	-277	-237	-318	
(Pur)/Sale of Investm	-65	2	33	1	0	
Loans and Advances						
Inc from Invst	0	0	0	0	0	
CF from Inv. Activity	-282	-211	-244	-237	-318	
Issue of Shares	0	3	4	0	0	
Inc / (Dec) in Debt	48	-3	0	37	0	
Dividends Paid (incl. t	-81	-81	-118	-110	-90	
Interest paid	0	-2	-4	0	0	
CF from Fin. Activity	-33	-83	-118	-73	-90	
Inc / (Dec) in Cash	-25	-2	63	122	71	
Add: Opening Balance	250	226	224	287	409	
Closing Balance	226	224	287	409	481	

Disclosures

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