

## EARNINGS REVIEW

## Oil &amp; Natural Gas Corp. (ONGC.BO)

Buy

Equity Research

## Below expectations: High subsidy burden hits headline numbers

## What surprised us

ONGC's 1QFY12 net profit of Rs41 bn, up 47% qoq, was slightly below our estimate of Rs42bn and B'berg consensus of Rs43bn. Net oil realization at US\$48.8/bbl came in below our estimate of US\$50/bbl. Domestic oil production volumes were up 2% yoy, mainly from Cairn India's Rajasthan volume, while oil volumes from the nominated blocks were down only 2% yoy, indicating good control on the natural decline. We note OVL's oil production volumes were up 3.3% yoy. Cash profit was up 7% yoy. Though oil and gas production volumes were largely in line with our expectations, sales volumes were 4% lower than estimated, which coupled with high subsidy burden for the qtr of Rs120bn dented net realizations.

## What to do with the stock

Post the fuel price hikes and duty cuts on crude and products in end-June, we expect the total under-recoveries on petroleum products to be relatively lower in the rest of the quarters of FY12E. In addition, if upstream companies have to bear only one-third of the subsidy burden as in 1QFY12, our full year FY12E net realization of US\$53/bbl would have significant upside risk. We also believe ONGC's overseas assets have oil price leverage and should be ONGC's focus going forward to drive the next level of growth. ONGC is trading at FY12E EV/DACF of 5.5X vs. an 8-yr historical range of 4.0x-9.5X. We reiterate our Conviction Buy on ONGC; our EV/GCI vs. CROCI/WACC-based 12-m TP of Rs340 implies 24% upside. Key risks: 1) high subsidy burden; 2) lower volume from legacy fields, and; 3) overpaying for acquisitions.

## ONGC's net Profit was up 47% qoq and 12% yoy

(in Rs. mn) Particulars	qoq			yoy		
	1QFY12	4QFY11	% chg	1QFY12	1QFY11	%chg
Net Sales	164,019	161,079	1.8	164,019	138,230	18.7
Total Expenditure	69,320	81,357	(14.8)	69,320	56,298	23.1
EBITDA	94,700	79,723	18.8	94,700	81,932	15.6
Net Profit	40,949	27,909	46.7	40,949	36,611	11.8

Source: Company data, Goldman Sachs Research

## INVESTMENT LIST MEMBERSHIP

Asia Pacific Buy List

Asia Pacific Conviction Buy List

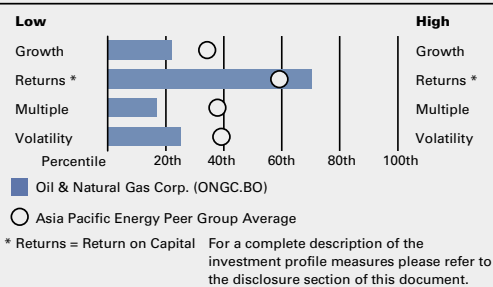
Coverage View: Neutral

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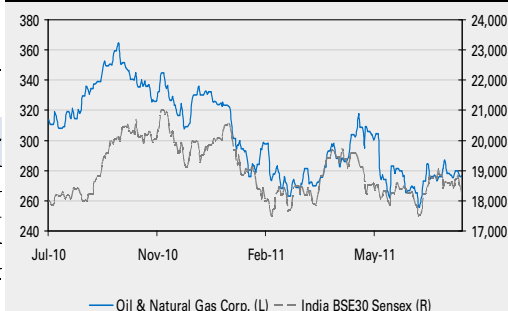
## Investment Profile



Key data	Current
Price (Rs)	276.65
12 month price target (Rs)	340.00
Market cap (Rs mn / US\$ mn)	2,366,892.4 / 53,689.3
Foreign ownership (%)	6.4

	3/10	3/11E	3/12E	3/13E
EPS (Rs)	22.68	26.91	33.32	36.31
EPS growth (%)	(2.0)	18.6	23.8	9.0
EPS (diluted) (Rs)	22.68	26.91	33.32	36.31
EPS (basic pre-ex) (Rs)	22.68	26.91	33.32	36.31
P/E (X)	12.2	10.3	8.3	7.6
P/B (X)	2.3	2.0	1.9	1.6
EV/EBITDA (X)	5.0	4.0	3.3	2.9
Dividend yield (%)	3.0	3.1	3.2	3.3
ROE (%)	20.1	21.2	23.6	22.7
CROCI (%)	12.9	13.0	14.3	14.5

## Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	(12.9)	(2.6)	(11.9)
Rel. to India BSE30 Sensex	(7.8)	(1.6)	(13.1)

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 7/28/2011 close.

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# Oil & Natural Gas Corp.: Summary Financials

Profit model (Rs mn)	3/10	3/11E	3/12E	3/13E	Balance sheet (Rs mn)	3/10	3/11E	3/12E	3/13E
<b>Total revenue</b>	<b>1,017,545.7</b>	<b>1,176,183.9</b>	<b>1,415,094.2</b>	<b>1,497,044.6</b>	Cash & equivalents	219,986.3	275,645.6	389,865.1	484,002.1
Cost of goods sold	(295,583.3)	(269,998.9)	(362,996.6)	(381,646.4)	Accounts receivable	76,542.9	96,748.2	27,969.3	29,642.5
SG&A	(175,935.2)	(210,353.1)	(251,181.6)	(267,482.1)	Inventory	84,130.1	94,152.5	108,421.3	113,368.8
R&D	--	--	--	--	Other current assets	131,946.3	110,796.5	111,301.9	111,847.8
Other operating profit/(expense)	(102,531.6)	(153,447.0)	(157,363.9)	(162,338.8)	<b>Total current assets</b>	<b>512,605.7</b>	<b>577,342.8</b>	<b>637,557.6</b>	<b>738,861.3</b>
<b>EBITDA</b>	<b>443,495.6</b>	<b>542,384.9</b>	<b>643,552.2</b>	<b>685,577.3</b>	Net PP&E	1,011,591.0	1,083,674.8	1,200,164.8	1,300,155.9
Depreciation & amortization	(187,188.3)	(201,418.5)	(210,810.0)	(222,308.9)	Net intangibles	95,385.5	92,455.0	92,455.0	92,455.0
<b>EBIT</b>	<b>256,307.3</b>	<b>340,966.4</b>	<b>432,742.2</b>	<b>463,268.4</b>	Total investments	51,593.1	60,551.2	60,551.2	60,551.2
Interest income	52,727.6	31,460.1	31,710.1	35,660.1	Other long-term assets	8,413.2	8,413.2	10,913.2	13,413.2
Interest expense	(5,021.9)	(5,694.7)	(5,893.3)	(7,693.3)	<b>Total assets</b>	<b>1,679,588.5</b>	<b>1,822,436.9</b>	<b>2,001,641.8</b>	<b>2,205,436.6</b>
Income/(loss) from uncons. subs.	0.0	0.0	0.0	0.0	Accounts payable	164,946.6	164,639.2	184,659.7	192,119.9
Others	0.0	0.0	0.0	0.0	Short-term debt	0.0	0.0	0.0	0.0
<b>Pretax profits</b>	<b>304,013.0</b>	<b>366,731.8</b>	<b>458,558.9</b>	<b>491,235.1</b>	Other current liabilities	141,585.6	144,464.9	145,973.0	147,919.8
Income tax	(107,314.4)	(133,690.2)	(169,603.4)	(175,906.7)	<b>Total current liabilities</b>	<b>306,532.2</b>	<b>309,104.1</b>	<b>330,632.7</b>	<b>340,039.8</b>
Minorities	(3,240.4)	(2,842.1)	(3,926.7)	(4,705.7)	Long-term debt	62,669.3	68,603.3	131,081.9	120,081.9
<b>Net income pre-preferred dividends</b>	<b>193,458.3</b>	<b>230,199.5</b>	<b>285,028.7</b>	<b>310,622.6</b>	Other long-term liabilities	277,502.6	267,892.9	258,180.8	246,665.7
Preferred dividends	0.0	0.0	0.0	0.0	Total long-term liabilities	340,171.8	336,496.2	389,262.7	366,747.6
<b>Net income (pre-exceptionals)</b>	<b>193,458.3</b>	<b>230,199.5</b>	<b>285,028.7</b>	<b>310,622.6</b>	<b>Total liabilities</b>	<b>646,704.0</b>	<b>645,600.3</b>	<b>719,895.4</b>	<b>706,787.4</b>
Post-tax exceptionals	577.1	0.0	0.0	0.0	<b>Preferred shares</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Net income</b>	<b>194,035.3</b>	<b>230,199.5</b>	<b>285,028.7</b>	<b>310,622.6</b>	<b>Total common equity</b>	<b>1,016,452.9</b>	<b>1,158,734.9</b>	<b>1,260,286.2</b>	<b>1,473,335.4</b>
EPS (basic, pre-exception) (Rs)	22.68	26.91	33.32	36.31	Minority interest	16,431.6	18,101.7	21,460.1	25,313.8
EPS (basic, post-exception) (Rs)	22.68	26.91	33.32	36.31	<b>Total liabilities &amp; equity</b>	<b>1,679,588.5</b>	<b>1,822,436.9</b>	<b>2,001,641.8</b>	<b>2,205,436.6</b>
EPS (diluted, post-exception) (Rs)	22.68	26.91	33.32	36.31	<b>BVPS (Rs)</b>	<b>118.81</b>	<b>135.44</b>	<b>147.31</b>	<b>172.21</b>
DPS (Rs)	8.25	8.50	8.75	9.00					
Dividend payout ratio (%)	36.4	31.6	26.3	24.8					
Free cash flow yield (%)	3.9	4.9	5.8	8.2					
Growth & margins (%)	3/10	3/11E	3/12E	3/13E	Ratios	3/10	3/11E	3/12E	3/13E
Sales growth	(2.7)	15.6	20.3	5.8	CROCI (%)	12.9	13.0	14.3	14.5
EBITDA growth	6.4	22.3	18.7	6.5	ROE (%)	20.1	21.2	23.6	22.7
EBIT growth	(2.4)	33.0	26.9	7.1	ROA (%)	12.0	13.1	14.9	14.8
Net income growth	(2.0)	18.6	23.8	9.0	ROACE (%)	20.1	23.5	27.4	27.6
EPS growth	(2.0)	18.6	23.8	9.0	Inventory days	92.4	120.5	101.8	106.1
Gross margin	71.0	77.0	74.3	74.5	Receivables days	27.8	26.9	16.1	7.0
EBITDA margin	43.6	46.1	45.5	45.8	Payable days	189.0	222.8	175.6	180.2
EBIT margin	25.2	29.0	30.6	30.9	Net debt/equity (%)	(15.2)	(17.6)	(20.2)	(24.3)
					Interest cover - EBIT (X)	NM	NM	NM	NM
Cash flow statement (Rs mn)	3/10	3/11E	3/12E	3/13E	Valuation	3/10	3/11E	3/12E	3/13E
Net income pre-preferred dividends	193,458.3	230,199.5	285,028.7	310,622.6	P/E (analyst) (X)	12.2	10.3	8.3	7.6
D&A add-back	187,188.3	201,418.5	210,810.0	222,308.9	P/B (X)	2.3	2.0	1.9	1.6
Minorities interests add-back	0.0	0.0	0.0	0.0	EV/EBITDA (X)	5.0	4.0	3.3	2.9
Net (inc)/dec working capital	(16,194.8)	(9,132.1)	(22,616.3)	(6,876.9)	EV/GCI (X)	0.9	0.8	0.8	0.7
Other operating cash flow	(60,380.2)	(86,661.7)	(90,949.0)	(91,946.9)	Dividend yield (%)	3.0	3.1	3.2	3.3
<b>Cash flow from operations</b>	<b>304,071.6</b>	<b>335,824.2</b>	<b>382,273.4</b>	<b>434,107.7</b>					
Capital expenditures	(212,531.2)	(219,800.0)	(245,800.0)	(240,800.0)					
Acquisitions	(16,564.4)	0.0	0.0	0.0					
Divestitures	0.0	0.0	0.0	0.0					
Others	0.0	0.0	0.0	0.0					
<b>Cash flow from investments</b>	<b>(229,095.6)</b>	<b>(219,800.0)</b>	<b>(245,800.0)</b>	<b>(240,800.0)</b>					
Dividends paid (common & pref)	(80,781.5)	(84,320.4)	(87,358.7)	(90,796.8)					
Inc/(dec) in debt	(164.1)	23,955.5	65,104.8	(8,373.8)					
Common stock issuance (repurchase)	0.0	0.0	0.0	0.0					
Other financing cash flows	0.0	0.0	0.0	0.0					
<b>Cash flow from financing</b>	<b>(80,945.6)</b>	<b>(60,364.9)</b>	<b>(22,253.9)</b>	<b>(99,170.6)</b>					
<b>Total cash flow</b>	<b>(5,969.6)</b>	<b>55,659.3</b>	<b>114,219.5</b>	<b>94,137.0</b>					

Note: Last actual year may include reported and estimated data.  
Source: Company data, Goldman Sachs Research estimates.

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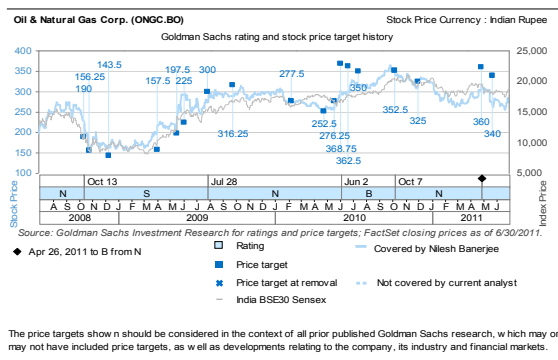
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## Price target and rating history chart(s)



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