

November 07, 2011

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Rating	BUY
Price	Rs277
Target Price	Rs346
Implied Upside	24.9%
Sensex	17,563

(Prices as on November 04, 2011)

Trading data

Market Cap. (Rs bn)	2,368.2
Shares o/s (m)	8,555.6
3M Avg. Daily value (Rs m)	1326.7

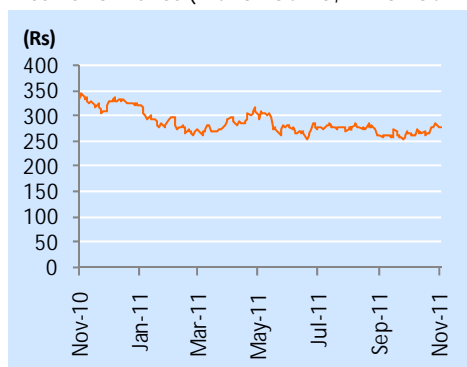
Major shareholders

Promoters	74.14%
Foreign	5.17%
Domestic Inst.	6.99%
Public & Other	13.70%

Stock Performance

(%)	1M	6M	12M
Absolute	4.8	(10.6)	(19.1)
Relative	(5.9)	(5.7)	(3.1)

Price Performance (RIC: ONGC.BO, BB: ONGC IN)



Source: Bloomberg

ONGC's 2QFY12 PAT were above estimates at Rs86.4bn up 111% QoQ and 60% QoQ, due to lower-than-expected DD&A cost and higher than anticipated other income. While ONGC's Q2FY12 revenue (Rs 226.2bn, up 39.6% QoQ) was 4.2% ahead of estimate of Rs217bn, EBITDA (Rs141.5bn, 52.8% QoQ) was line with estimate of Rs140.2bn. Net realization for the quarter were all time high at US\$83.7/bbl as subsidy burden declined 52.5% QoQ. DD&A expenditure (Rs32.8bn) was 20% lower on QoQ basis against the estimate of Rs37.5bn due to lower drywell write-offs. Other income at Rs14.2bn was higher than estimate of Rs8bn. We do not read much out of the current quarterly performance as the same is based on provisional 33% subsidy sharing mechanism. We maintain a **BUY** on the stock.

■ **Net realisation at record US\$83.7/bbl:** Crude oil sales at 5.81MMT were line with expectation of 5.78MMT. Natural gas production (nominated + JV) at 6.39 BCM was up 2.2% YoY and 3.6% QoQ. Net realisation during the quarter stood at US\$83.7/bbls. The same was in line with our expectation of US\$82.3/bbls. Increase in net realisations was largely a function of lower subsidy burden of Rs 57.1bn down 52.5% QoQ due to lower total under-recoveries at Rs 216bn (Rs 435bn in Q1FY12). EBITDA during the quarter was in line with our expectation at Rs141.5bn up 52.8% QoQ was line with estimate of Rs140.2bn. The same was higher by 27.7% on the YoY basis.

■ **Outlook:** ONGC has underperformed the benchmark indices over the last one year by a substantial margin owing to headwinds in form of lack of subsidy sharing mechanism and a technical overhang on account of the impending FPO. However, we believe the scenario will evolve positively with likely clarity over the subsidy sharing mechanism before the impending ONGC FPO. At 3.7x FY2013E EV/EBITDA, 8.8x FY2013E EPS, we believe the stock provides an attractive entry level for long term investors. We value ONGC at 11x FY2013E EPS arriving at a fair value estimate of Rs346/share.

Key financials (Y/e March)	2010	2011	2012E	2013E
Revenues (Rs m)	1,016,627	1,176,106	1,431,743	1,553,662
Growth (%)	(2.6)	15.7	21.7	8.5
EBITDA (Rs m)	444,073	484,364	586,502	614,898
PAT (Rs m)	194,010	224,560	253,827	268,969
EPS (Rs)	22.7	26.2	29.7	31.4
Growth (%)	71.1	15.7	13.0	6.0
Net DPS (Rs)	15.9	8.7	10.4	11.0

Source: Company Data; PL Research

Profitability & Valuation	2010	2011	2012E	2013E
EBITDA margin (%)	43.7	41.2	41.0	39.6
RoE (%)	20.0	20.7	20.7	19.5
RoCE (%)	16.4	17.3	17.7	17.0
EV / sales (x)	1.2	2.0	1.6	1.5
EV / EBITDA (x)	2.7	5.0	4.0	3.7
PE (x)	12.2	10.5	9.3	8.8
P / BV (x)	1.2	2.1	1.8	1.6
Net dividend yield (%)	5.7	3.1	3.8	4.0

Source: Company Data; PL Research

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Exhibit 1: Q2FY12 Result Overview (Rs m)

Y/e March	Q2FY12	Q2FY11	YoY gr. (%)	Q1FY12	H1FY12	H1FY11	YoY gr. (%)
Net Sales	226,163	181,936	24.3	161,990	388,153	318,592	21.8
Expenditure							
Raw material	1,392	1,441	(3.4)	789	2,181	1,914	14.0
<i>% of net sales</i>	<i>0.6</i>	<i>0.8</i>		<i>0.5</i>	<i>0.6</i>	<i>0.6</i>	
Personnel cost	3,276	3,059	7.1	3,098	6,374	5,848	9.0
<i>% of net sales</i>	<i>1.4</i>	<i>1.7</i>		<i>1.9</i>	<i>1.6</i>	<i>1.8</i>	
Other operating expenses	79,899	66,585	20.0	65,433	145,332	119,621	21.5
<i>% of net sales</i>	<i>35.3</i>	<i>36.6</i>		<i>40.4</i>	<i>37.4</i>	<i>37.5</i>	
EBITDA	141,596	110,851	27.7	92,670	234,266	191,209	22.5
<i>Margin (%)</i>	<i>62.6</i>	<i>60.9</i>		<i>57.2</i>	<i>60.4</i>	<i>60.0</i>	
Depreciation	32,782	44,001	(25.5)	41,225	74,006	75,143	(1.5)
EBIT	108,814	66,851	62.8	51,445	160,259	116,066	38.1
Interest	65	9	617.6	40	105	37	187.2
Other Income	14,420	11,429	26.2	9,299	23,719	17,075	38.9
PBT	123,169	78,270	57.4	60,704	183,873	133,104	38.1
Total taxes	36,747	24,382	50.7	19,755	56,502	42,605	32.6
<i>ETR (%)</i>	<i>29.8</i>	<i>31.2</i>		<i>32.5</i>	<i>30.7</i>	<i>32.0</i>	
PAT	86,422	53,888	60.4	40,949	127,371	90,499	40.7

Source: Company Data, PL Research

Exhibit 2: Segmental Breakup (Rs m)

Y/e March	Q2FY12	Q2FY11	YoY gr. (%)	Q1FY12	H1FY12	H1FY11	YoY gr. (%)
Segment Revenue							
Offshore E&P	164,564	132,400	24.3	117,980	282,544	241,461	17.0
Onshore E&P	65,398	52,357	24.9	46,731	112,128	81,974	36.8
Total revenue	229,962	184,757	24.5	164,711	394,673	323,435	22.0
EBIT							
Offshore E&P	93,085	57,389	62.2	48,665	141,750	105,753	34.0
<i>EBIT (%)</i>	<i>56.6</i>	<i>43.3</i>		<i>41.2</i>	<i>50.2</i>	<i>43.8</i>	
Onshore E&P	21,212.4	14,231.0	49.1	6,913.3	28,125.7	17,435.9	61.3
<i>EBIT (%)</i>	<i>32.4</i>	<i>27.2</i>		<i>14.8</i>	<i>25.1</i>	<i>21.3</i>	
Total EBIT	114,297	71,620	59.6	55,579	169,876	123,189	37.9
<i>EBIT (%)</i>	<i>49.7</i>	<i>38.8</i>		<i>33.7</i>	<i>43.0</i>	<i>38.1</i>	
Less: Interest payment	65	9	617.6	40	105	37	187.2
Less: other unallocable exp net of income	(8,937)	(6,659)	34.2	(5,166)	(14,103)	(9,952)	41.7
PBT before extraordinary items	123,169	78,270	57.4	60,704	183,873	133,104	38.1
Extraordinary gain	-	-		-	-	-	
PBT after extraordinary items	123,169	78,270	57.4	60,704	183,873	133,104	38.1

Source: Company Data, PL Research

**Exhibit 3: Operational Performance**

	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12
Production- oil (MMT)						
ONGC	6.06	6.15	6.21	6.01	5.93	6.04
JV	0.55	0.7	0.82	0.79	0.83	0.80
Total	6.61	6.85	7.03	6.80	6.76	6.84
Production - gas (bcm)						
ONGC	5.76	5.8	5.81	5.73	5.61	5.83
JV	0.65	0.45	0.55	0.58	0.56	0.56
Total	6.41	6.25	6.36	6.31	6.16	6.39
Total (Oil & Gas) (mmtoe)	13.02	13.10	13.39	13.11	12.92	13.23
Production VAP (tmt)						
	769	752	780	828	720	797
Sales - Oil (mmt)						
ONGC	4.89	5.26	5.14	5.08	4.95	5.00
JV	0.42	0.65	0.73	0.75	0.74	0.81
Total	5.31	5.91	5.87	5.83	5.69	5.81
Sales - Gas (bcm)						
ONGC	4.54	4.63	4.6	4.46	4.38	4.55
JV	0.61	0.41	0.49	0.52	0.5	0.51
Total	5.15	5.04	5.09	4.98	4.88	5.05
Total (Oil & Gas) (mmtoe)	10.46	10.95	10.96	10.81	10.57	10.79
Sales VAP (tmt)						
	801	728	790	845	696	801

Source: Company Data, PL Research



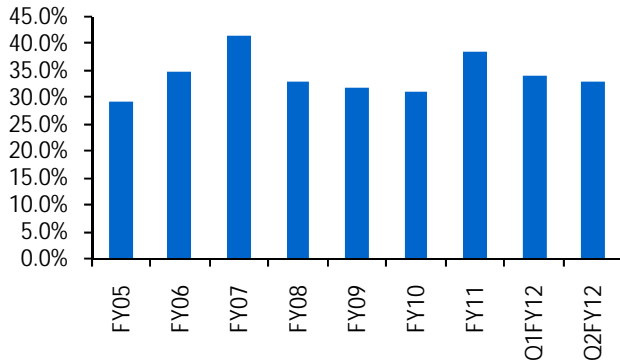
Result Highlights

Crude sales volumes flat, net realisation at record US\$83.7/bbls: ONGC's crude production (nominated + JV) at 6.84 MMT was flat on YoY basis (6.85MMT), while the same registered 1.2% QoQ growth as production normalised post production issues at offshore platform in 1QFY12. Crude oil sales at 5.81MMT were line with expectation of 5.78MMT. Natural gas production (nominated + JV) at 6.39 BCM was up 2.2% YoY and 3.6% QoQ as Uran cooling towers were reinstated after a shutdown in Q1FY12. VAP sales of 801tmt (up 15.1% QoQ) were higher than the estimated 650TMT. Gross realisation was during the quarter at US\$116.9/bbls. Subsidy burden during the quarter stood at Rs 57.1bn. Net realisation during the quarter stood at US\$83.7bbl. The same was in line with our expectation of US\$82.3/bbl. Increase in net realisations was largely a function of lower subsidy burden of Rs 57.1bn down 52.5% QoQ due to lower total under-recoveries at Rs 216bn (Rs 435bn in Q1FY12) due to retail price revision in June 2011 and provisional subsidy sharing of 33% by the upstream companies.

EBITDA in line with estimates: EBITDA during the quarter was in line with our expectation at Rs141.5bn up 52.8% QoQ was line with estimate of Rs140bn. The same was higher by 27.7% on the YoY basis.

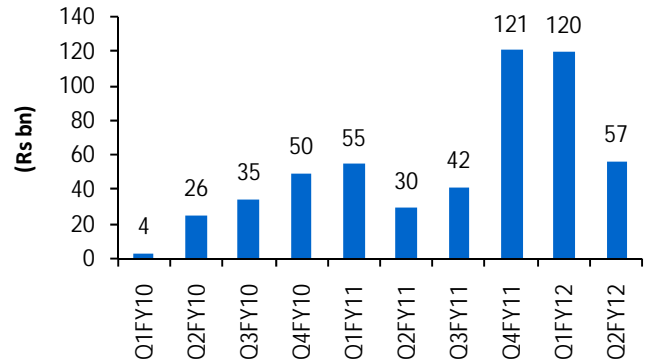
DD&A, Other income surprise, PAT up 111% QoQ: On account of decrease in the dry well write off during the quarter DD&A expenditure was lower than our estimate. The same was largely on account of non-completion of the wells under the exploration stage. DD&A cost during the quarter at Rs32.7bn was 20% lower on QoQ basis against the estimate of Rs37.5bn. Other income was higher than estimate due to higher dividend income during the quarter. Other income at Rs14.4bn was higher than estimate of Rs8bn. On account of higher than anticipated other income and lower than anticipated DD&A cost, PBT was 11.3% higher than our estimates of Rs110bn. Tax rate during the quarter was lower than estimate on account of higher dividend income coupled with tax write back for the prior period. ONGC's 2QFY12 PAT at Rs86.5bn up 111% QoQ and 60% QoQ, due to lower-than-expected DD&A cost and higher than anticipated other income.

Exhibit 4: Share of upstream companies in total Under recoveries



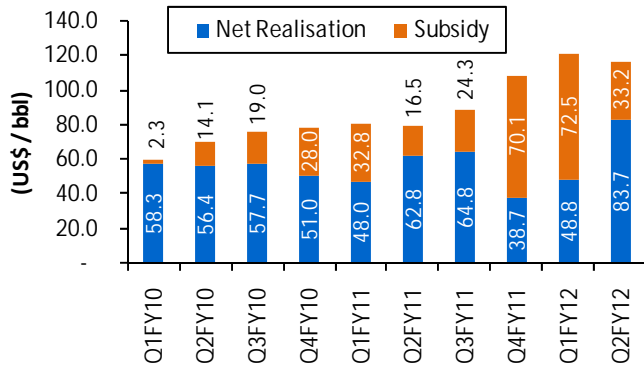
Source: Company Data, PL Research

Exhibit 5: ONGC's Subsidy Burden



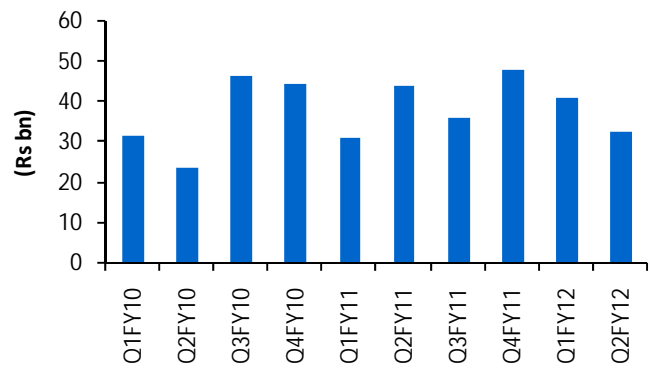
Source: Company Data, PL Research

Exhibit 6: Subsidy and Net Realisation



Source: Company Data, PL Research

Exhibit 7: ONGC's DD&A expense



Source: Company Data, PL Research



Outlook

ONGC has underperformed the benchmark indices over the last one year by a substantial margin owing to headwinds in form of lack of subsidy sharing mechanism and a technical overhang on account of the impending FPO. However, we believe the scenario continues to evolve positively with likely clarity over the subsidy sharing mechanism before the impending ONGC FPO. Current valuations are building in an over pessimistic scenario with regards to sharing of the under-recoveries by the upstream oil and gas companies.

We value ONGC at 11x FY2013E EPS (around 10% valuation premium to OIL India's target PE multiple), arriving at a fair value estimates of Rs346/share. The premium is justified given that fact long term growth potential of ONGC vis-à-vis OIL India. While OIL India has better production growth profile in the near term relative to its peer ONGC, one needs to accord premium to ONGC on account of stronger business model (international presence via ONGC Videsh, expertise in operations beyond onshore fields) and better balance sheet composition (lower cash levels in relative OIL as % of the balance sheet size). Moreover, the premium is also justified for ONGC in light of KG basin discoveries (likely to provide volumes growth). At our target price, ONGC will be trading at 4.7x EV/EBITDA a 15% discount to the lower end international averages. At 3.7x FY2013E EV/EBITDA, 8.8x FY2013E EPS, we believe the stock provides an attractive entry level for long term investors. Hence, we maintain a **BUY** on the stock, with a TP of Rs346/share, providing an upside of 25% from the current levels.



Income Statement (Rs m)

Y/e March	2010	2011	2012E	2013E
Net Revenue	1,016,627	1,176,106	1,431,743	1,553,662
Raw Material Expenses	271,866	312,515	469,418	534,357
Gross Profit	744,760	863,591	962,325	1,019,305
Employee Cost	55,525	58,302	61,217	64,278
Other Expenses	245,161	320,926	314,607	340,130
EBITDA	444,073	484,364	586,502	614,898
Depr. & Amortization	187,391	206,284	233,364	244,819
Net Interest	5,022	4,374	8,304	9,490
Other Income	52,728	69,458	45,390	52,577
Profit before Tax	304,388	343,163	390,224	413,165
Total Tax	107,138	114,913	132,676	140,476
Profit after Tax	197,250	228,250	257,548	272,689
Ex-Od items / Min. Int.	3,397	3,750	3,720	3,720
Adj. PAT	194,010	224,560	253,827	268,969
Avg. Shares O/S (m)	4,277.8	8,555.6	8,555.6	8,555.6
EPS (Rs.)	22.7	26.2	29.7	31.4

Cash Flow Abstract (Rs m)

Y/e March	2010	2011	2012E	2013E
C/F from Operations	364,209	296,097	453,641	472,989
C/F from Investing	(258,874)	(229,552)	(299,213)	(292,026)
C/F from Financing	(107,449)	(87,802)	(109,059)	(116,478)
Inc. / Dec. in Cash	(2,114)	(21,257)	45,369	64,485
Opening Cash	225,956	223,842	202,586	247,955
Closing Cash	223,842	202,586	247,955	312,440
FCFF	237,855	318,351	374,230	408,954
FCFE	238,072	318,351	374,230	408,954

Key Financial Metrics

Y/e March	2010	2011	2012E	2013E
Growth				
Revenue (%)	(2.6)	15.7	21.7	8.5
EBITDA (%)	87.1	9.1	21.1	4.8
PAT (%)	242.2	15.7	13.0	6.0
EPS (%)	71.1	15.7	13.0	6.0
Profitability				
EBITDA Margin (%)	43.7	41.2	41.0	39.6
PAT Margin (%)	19.1	19.1	17.7	17.3
RoCE (%)	16.4	17.3	17.7	17.0
RoE (%)	20.0	20.7	20.7	19.5

Balance Sheet

Net Debt : Equity	—	—	—	(0.1)
Net Wrkng Cap. (days)	(163)	(57)	(43)	(41)

Valuation

PER (x)	12.2	10.5	9.3	8.8
P / B (x)	1.2	2.1	1.8	1.6
EV / EBITDA (x)	2.7	5.0	4.0	3.7
EV / Sales (x)	1.2	2.0	1.6	1.5

Earnings Quality

Eff. Tax Rate	35.2	33.5	34.0	34.0
Other Inc / PBT	17.3	20.2	11.6	12.7
Eff. Depr. Rate (%)	12.3	13.2	13.9	13.7
FCFE / PAT	122.7	141.8	147.4	152.0

Source: Company Data, PL Research.

Balance Sheet Abstract (Rs m)

Y/e March	2010	2011	2012E	2013E
Shareholder's Funds	1,014,066	1,151,479	1,300,831	1,459,092
Total Debt	237,260	237,260	237,260	237,260
Other Liabilities	193,789	197,509	201,229	204,950
Total Liabilities	1,445,115	1,586,247	1,739,320	1,901,302
Net Fixed Assets	1,106,977	1,199,703	1,310,942	1,410,726
Goodwill	—	—	—	—
Investments	51,593	51,593	51,593	51,593
Net Current Assets	203,687	252,094	293,927	356,125
<i>Cash & Equivalents</i>	<i>223,842</i>	<i>202,586</i>	<i>247,955</i>	<i>312,440</i>
<i>Other Current Assets</i>	<i>286,090</i>	<i>261,597</i>	<i>287,500</i>	<i>303,148</i>
<i>Current Liabilities</i>	<i>306,246</i>	<i>212,090</i>	<i>241,528</i>	<i>259,464</i>
Other Assets	82,858	82,858	82,858	82,858
Total Assets	1,445,115	1,586,247	1,739,320	1,901,302

Quarterly Financials (Rs m)

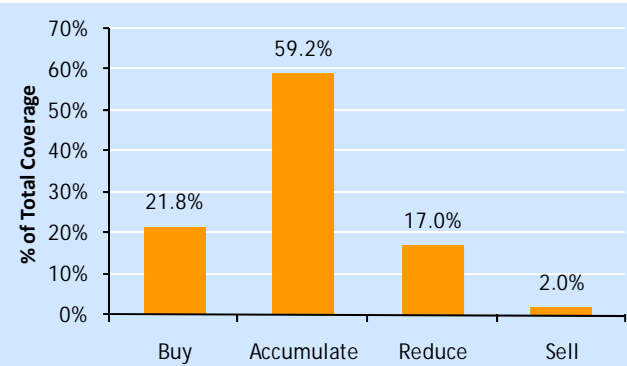
Y/e March	Q3FY11	Q4FY11	Q1FY12	Q2FY12
Net Revenue	185,864	153,962	161,990	226,163
EBITDA	113,138	72,605	92,670	141,596
% of revenue	60.9	47.2	57.2	62.6
Depr. & Amortization	36,410	47,877	41,225	32,782
Net Interest	54	160	40	65
Other Income	28,870	12,973	9,299	14,420
Profit before Tax	105,544	37,542	60,704	123,169
Total Tax	34,712	9,633	19,755	36,747
Profit after Tax	70,832	27,909	40,949	86,422
Adj. PAT	70,832	27,909	40,949	86,422

Key Operating Metrics

Y/e March	2010	2011	2012E	2013E
Dom. Sale of crude oil (MMT)	22.3	22.9	20.1	20.2
Dom. Sale of Natural gas (MCM)	20,598	20,260	20,520	20,914
OVL-Oil Prod. (MMT)	6.5	6.8	7.0	7.1
OVL-Gas Prod. (BCM)	2.4	2.7	2.7	2.7
MRPL Thruput (MT)	12.6	12.6	13.8	15.0
Dom. Gross Realisations (US\$/bbls)	72.7	89.5	116.2	121.2
Dom. Net Realisations (US\$/bbls)	57.3	53.8	57.0	57.2
Subsidy burden (Rs m)	115,540	248,920	391,468	426,523
Subsidy burden (% of subsidy)	25.1	31.9	31.6	42.7
Dom. Realisations of NG (Rs/scm)	3.6	6.4	6.9	6.9

Source: Company Data, PL Research.

Rating Distribution of Research Coverage



PL's Recommendation Nomenclature

BUY	: Over 15% Outperformance to Sensex over 12-months	Accumulate	: Outperformance to Sensex over 12-months
Reduce	: Underperformance to Sensex over 12-months	Sell	: Over 15% underperformance to Sensex over 12-months
Trading Buy	: Over 10% absolute upside in 1-month	Trading Sell	: Over 10% absolute decline in 1-month
Not Rated (NR)	: No specific call on the stock	Under Review (UR)	: Rating likely to change shortly

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