OIL AND NATURAL GAS CORPORATION LTD
RESEARCH

EQUITY RESEARCH | **December 1, 2008**

RESULTS REVIEW

Oil and Natural Gas Corporation Ltd. — Hold

Share Data

Market Cap	Rs. 1,457.1 bn
Price	Rs. 681.25
BSE Sensex	8,839.9
Reuters	ONGC.BO
Bloomberg	ONGC IN
Avg. Volume (52 Week)	0.5 mn
52-Week High/Low	Rs. 1,356.7 / 538.1
Shares Outstanding	2,138.9 mn

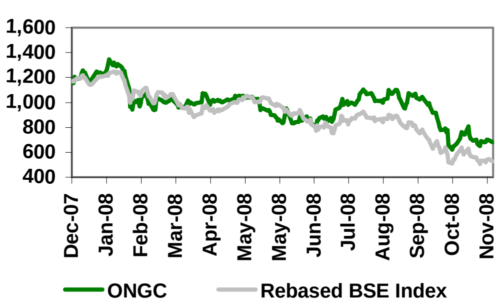
Valuation Ratios (Consolidated)

Year to 31 March	2009E	2010E
EPS (Rs.)	80.0	78.2
+/- (%)	(13.9%)	(2.2%)
PER (x)	8.5x	8.7x
EV/ Sales (x)	1.3x	1.4x
EV/ EBITDA (x)	3.4x	3.5x

Shareholding Pattern (%)

Promoters	74
FIIs	6
Institutions	6
Public & Others	13

Relative Performance



Falling crude prices eroding the valuation

During Q2'09, Oil and Natural Gas Corporation Limited (ONGC)'s standalone net sales increased 12.9% yoy to Rs. 174.1 bn. While the surge in the global crude prices and the weakening rupee were expected to drive ONGC's financials, its performance was dented by the excessive subsidy burden (Rs. 126.7 bn) it had to shoulder in order to limit the losses of the oil marketing companies (OMCs). As a result, ONGC's standalone adj. net profit declined 5.7% yoy to Rs. 48.1 bn. For the upcoming quarters, we believe that:

Net realisations to remain depressed: Due to the global economic crisis, oil prices have fallen by more than 60% from their peak of USD 147/bbl in mid-July to the current lows of USD 50/bbl. This is mainly due to the dampening fuel demand from the major consuming nations. Meanwhile, the International Energy Agency (IEA) has lowered its oil demand forecasts by 500,000 bopd for H2'08 and by 400,000 bopd for 2009. Thus, with reducing demand, we expect oil prices to be under pressure till FY10, thereby adversly affecting the Company's net realisations.

However, we believe that once the global economy revives, demand for crude oil and natural gas will recover, mainly due to increased demand from developing economies such as India and China. The IEA has forecast that demand for oil will increase from 85 mb/d in 2007 to 106 mb/d by 2030, even after considering the full impact of the current economic crisis. Consequently, we believe that crude oil should recover to USD 75-80/bbl in the long term.

Key Figures (Standalone)

Quarterly data	Q2'08	Q1'09	Q2'09	QoQ%	YoY%
(Figures in Rs mn, except per share data)					
Net Sales	154,139	200,522	174,074	(13.2%)	12.9%
EBITDA	84,840	117,554	85,054	(27.6%)	0.3%
Adj. Net Profit	50,975	65,929	48,084	(27.1%)	(5.7%)
Margins(%)					
EBITDA	54.8%	58.6%	48.6%		
NPM	32.9%	32.9%	27.5%		
Per Share Data (Rs.)					
Normalised EPS	23.8	30.8	22.5	(27.1%)	(5.7%)

Subsidy pressure to ease off: Though the government had earlier fixed the subsidy burden for ONGC at Rs. 385 bn for FY09, we believe that the volatility in crude prices has forced the government to revert back to its old policy of sharing one-third of the subsidy. As a result, the Company's subsidy burden for Q2'09 was the highest ever at Rs. 126.7 bn. With the government reverting back to its previous subsidy-sharing arrangement and crude prices expected to stay at lower levels in the upcoming quarters, we expect the subsidy-sharing pressure to ease off for the Company. Thus, the fall in crude prices will be partially offset by the lower subsidy burden.

Production to increase from FY10: Though lower realisations on account of reduced crude prices will exert pressure on the top line in FY10, we believe that the commencement of operations at Mangala from mid-2009 will help ease off this pressure. ONGC holds a 30% interest in the block, while Cairn India Limited owns the remaining 70%. Mangala field has a total peak production target of 125,000 boepd.

Valuation

At the current market price (CMP) of Rs. 681.25, the stock is trading at a forward P/E of 8.5x for FY09E and 8.7x for FY10E. We have valued the Company by using the Sum-of-the-Parts (SOTP) valuation technique. We have valued the ONGC operations by using DCF, assuming a WACC of 14% and a terminal growth of 5%; for subsidiary ONGC Videsh (OVL), we have applied the EV/BOE multiple of USD 13.5/bbl. All the other investments have been valued at the CMP. Thus, using SOTP, we have arrived at a target price of Rs. 756 per share, which provides an upside potential of 11% from the CMP. Considering the recent downturn in the crude oil prices and our valuation, we reiterate our Hold rating on the stock.

SOTP Valuation	Rs./Share	Valuation Method
ONGC	521	DCF Valuation
ONGC Videsh	189	EV/BOE-2P reserves @ USD 13.5 per barrel
Investments		
MRPL	20	Market Value Of Investments
IOC	20	Market Value Of Investments
GAIL	4	Market Value Of Investments
Petronet LNG	1	Market Value Of Investments
Total Value Per Share	**756**	

Result Highlights (Standalone)

Higher subsidies pressurised the margins

For the quarter ended September 2008, ONGC's net sales increased 12.9% yoy to Rs. 174.1 bn. While its gross realisation stood at Rs. 119.39 per barrel, led by the hike in crude prices witnessed during the quarter, net realisation fell sharply to Rs. 46.72 per barrel. The fall in net realisation was a result of the highest-ever subsidy burden incurred by the Company, which increased threefold to Rs. 126.7 bn, compared with Rs. 38 bn in Q2'08. The EBITDA margin contracted 619 bps to 48.6%, led by a higher subsidy burden, increased other expenditures, and the higher purchase costs of traded goods. Adj. net profit for the quarter went down 5.7% yoy to Rs. 48.1 bn, and the net profit margin declined 545 bps to 27.5%. The decline in the net profit margin reflects a trickle-down effect from the lower EBITDA margin. In addition, a higher effective tax rate pressurised the net profit margin.

Production Data

Quarterly	Q2'08	Q2'09	YoY%
ONGC			
Crude Oil (MMT)	6.50	6.44	(0.9%)
Natural Gas (BCM)	5.71	5.62	(1.6%)
JVs			
Crude Oil (MMT)	0.51	0.42	(17.6%)
Natural Gas (BCM)	0.64	0.81	26.5%
Total			
Crude Oil (MMT)	7.00	6.85	(2.1%)
Natural Gas (BCM)	6.35	6.43	1.3%

Key Events

- ONGC's foreign subsidiary, OVL, got the clearance from the Russian government to acquire the Imperial Energy Corporation.
- The Company made a major discovery in KG basin. It has already made several discoveries in the basin, including the ultra-deep discovery of 2,841 metres in 2006. It targets a production of 20,000 bopd by 2012-13 and will increase it to a peak of 150,000 bopd by 2016-17.
- ONGC and its partners won 20 oil and gas exploration blocks out of the 44 blocks awarded under the NELP-VII round of auction. Of these 20

blocks, three are for deep-water, five are for shallow-water, and the balance 12 are on-land blocks.

- OVL won two oil and gas blocks, CPO-5 and SSJN-7, in Colombia.

Key Risks

Our rating is sensitive to the following risks:

- Any change in the subsidy-sharing scheme
- A delay in the production from the Mangala field

Outlook

Despite higher crude prices and a weaker rupee, ONGC's Q2'09 results were adversely affected by the highest-ever subsidy burden incurred by it. However, with falling crude oil prices, we expect the Company's subsidy burden to fall in the upcoming quarters. After reaching an all-time high of USD 147/bbl, crude prices are now trading around USD 50/bbl mainly due to the dampening fuel demand from the major consuming nations as a result of the global economic crisis. Thus, we expect oil prices to average around USD 60-65/bbl till FY10. Though lower crude prices will reduce the Company's net realisations, it will ease off the subsidy pressure from the Company to a large extent as currently the prices are trading around the break-even point for the OMCs, which is USD 60/bbl. Though lower realisations on account of reduced crude prices will exert pressure on the top line in FY10, we believe that the commencement of operations from the Mangala field from mid-2009 will help ease off this pressure.

The Company made a major discover in the KG basin in November 2008. In addition, its foreign subsidiary OVL is carrying out aggressive exploration plans. ONGC has also won 20 blocks under the NELP-VII round of auction, which further adds to its resource base. Thus, with new discoveries in the offing, the Company has a good growth potential.

At the CMP of Rs. 681.25, the stock is trading at a forward P/E of 8.5x for FY09E and 8.7x for FY10E. We have used the SOTP valuation and have arrived at a target price of Rs. 756 per share. Considering the recent downturn in the crude oil prices and our valuation, we reiterate our Hold rating on the stock.

Key Figures (Consolidated)

Year to March	FY06	FY07	FY08	FY09E	FY10E	CAGR (%)
(Figures in Rs mn, except per share data)						(FY08-10E)
Net Sales	706,424	822,529	967,824	996,457	946,634	(1.1%)
EBITDA	310,744	351,253	404,338	389,752	379,780	(3.1%)
Adj. Net Profit	153,977	177,696	198,723	171,111	167,286	(8.3%)
Margins (%)						
EBITDA	44.0%	42.7%	41.8%	39.1%	40.1%	
NPM	21.8%	21.6%	20.5%	17.2%	17.7%	
Per Share Data (Rs.)						
Normalised EPS	72.0	83.1	92.9	80.0	78.2	(8.3%)
PER (x)	12.1x	10.6x	7.3x	8.5x	8.7x	

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