

Buy

ONGC



Industry: Oil & Gas

Industry View: Neutral

Result Update

“Confluence of positives boosts performance”

ONGC posted strong Q2 FY12 results with net sales & production volume in line with our estimates whereas lower dry well expenses, lower tax rate & higher other income resulted in better than expected net profit.

Q2 FY12 subsidy halves q-o-q to \$33.2/bbl (\$32.4/bbl expected)

Q2 FY12 subsidy burden of Rs 57,134.4 mn (\$33.2/bbl) was just 1.3% ahead of our estimate of Rs 56,419.1 mn (\$32.4/bbl). While it was double the subsidy burden of \$16.5/bbl in Q2 FY11, it was less than half of the Q1 FY12 figure of \$72.5/bbl. Thus, net realization rebounded from \$48.8/bbl in Q1 FY12 to \$83.7/bbl in Q2 FY12, 4.7% above our estimate of \$80/bbl due to higher gross realization.

Q2 FY12 production in line with our estimates

Oil output from nomination blocks at 6.04 MMT improved by 0.11 MMT q-o-q but was 0.11 MMT lower y-o-y. JV crude output at 0.8 MMT was up 0.1 MMT y-o-y but down 0.03 MMT q-o-q. Gas production from nomination blocks at 5.83 bcm was up 0.23 bcm q-o-q & 0.03 bcm y-o-y. JV gas output at 0.56 bcm was flat q-o-q & up 0.11 bcm y-o-y. VAP production of 797 MMT was up 10.7% q-o-q & 6% y-o-y.

Q2 FY12 net sales at Rs 229.2 bn versus estimate of Rs 230.6 bn

Total crude sales for Q2 FY12 stood at Rs 172.7 bn, 0.4% higher than our estimate. While nomination crude sales at Rs 143.2 bn was 3% above our estimate, JV crude sales of Rs 29.6 bn was 10% lower than our estimate as ONGC did not account for cost recoverability of royalty from the Rajasthan field in this quarter. Total gas sales for Q2 FY12 stood at Rs 34.7 bn, 4.8% below our estimate on account of lower than expected gas sale quantities. VAP sales of Rs 28.1 bn was above expectation on account of better than expected realizations.

Confluence of positives boosts performance

Statutory levies at Rs 46.5 bn were higher by 25% sequentially, staff expenses and other expenses were up 6% & 20% sequentially. Due to higher than expected net realization, operating profit of Rs 144.7 bn was 4.6% above our estimate of Rs 138.3 bn and OPM improved by 540 bps sequentially. Other income stood at Rs 11.3 bn, 9% higher than our estimate, due to higher than expected yields. Q2 FY12 dry well expense at Rs 11.8 bn was significantly lower than Rs 18.8 bn in Q1 FY12 & Rs 24.4 bn in Q2 FY11. This resulted in DD&A expense being 26% lower than our estimate. Tax rate for Q2 FY12 came in at 29.8% (33% expected) due to reversal of Rs 1.3 bn on R&D expenses being made tax deductible.

Consequently, net profit above expectations

Net profit at Rs 86.4 bn was much above expectations and was also up 111% sequentially. EPS for the quarter was Rs 10.1, against Rs 4.8 in Q1 FY12 & Rs 6.3 in Q2 FY11.

Stock Data

Current Market Price (₹)	278
Target Price (₹)	320
Potential upside (%)	15
Reuters	ONGC.BO
Bloomberg	ONGC IN

What's Changed

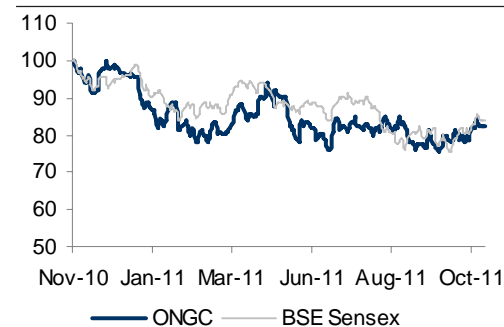
Target Price (₹)	353 to 320
F2012 EPS (₹)	33.6 to 30.9
F2013 EPS (₹)	35.1 to 31.6

Key Data

Market Cap (₹bn)	2,378
52-Week Range (₹)	349/ 227
Avg. Daily Trading Value (₹mn)	1,306
Promoters (%)	74
FII Holding (%)	5
DII Holding (%)	7
Public & Others Holding (%)	14

Fiscal YE	FY 11	FY 12E	FY 13E
Revenues (₹ bn)	1,176	1,408	1,395
EBITDA (%)	41.2	42.8	44.7
PAT (%)	19.1	18.8	19.4
EPS (₹)	26.2	30.9	31.6
EPS growth (%)	16	18	2
P/E (x)	10.6	9.0	8.8
P/B(x)	2.1	1.8	1.6
EV/EBITDA (x)	3.9	3.2	3.0
ROCE(%)	24	26	23
ROE(%)	21	21	19
Dividend yield (%)	3	3	3

Relative Price Performance



One Year Indexed

(%)	1 Month	3 Months	12 Months
Absolute	3	0	(18)
BSE Relative	(5)	(7)	(2)

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Deepak Darisi

deepak_darisi@lkpsec.com

+91 22 6635 1220

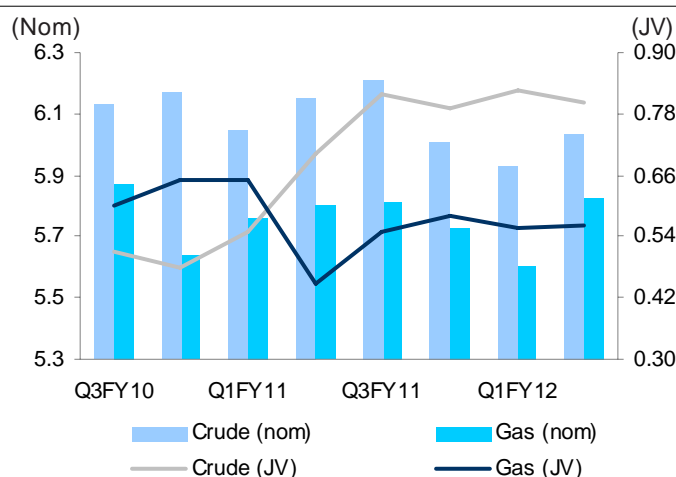
Financial Highlights (Standalone)

(₹mn)	Q2FY12	Q1FY12	%QoQ	Q2FY11	%YoY	H1FY11	H1FY10	%YoY
Net Sales	229,254	164,019	39.8	184,303	24.4	393,273	322,533	21.9
Statutory levies	46,532	37,306	24.7	38,696	20.3	83,838	67,367	24.4
Staff expenses	3,276	3,098	5.7	3,059	7.1	6,374	5,848	9.0
Other expenses	34,759	28,916	20.2	29,330	18.5	63,675	54,167	17.6
Operating profit	144,686	94,700	52.8	113,218	27.8	239,386	195,150	22.7
OPM (%)	63.1%	57.7%	5.4	61.4%	1.7	60.9%	60.5%	0.4
Other income	11,330	7,270	55.8	9,062	25.0	18,599	13,134	41.6
DD&A	32,782	41,225	(20.5)	44,001	(25.5)	74,006	75,143	(1.5)
Interest	65	40	62.8	9	617.6	105	37	187.2
Taxes	36,747	19,755	86.0	24,382	50.7	56,502	42,605	32.6
PAT	86,422	40,949	111.0	53,888	60.4	127,371	90,499	40.7
EPS	10.1	4.8	110.9	6.3	60.3	14.9	10.6	40.7

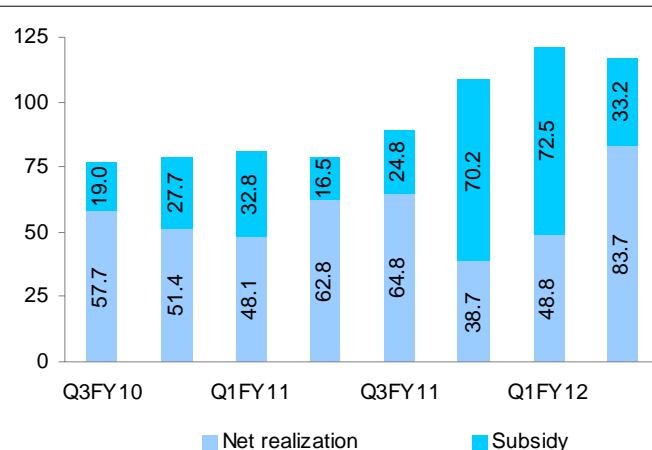
Operational Highlights

	Q2FY12	Q1FY12	q-o-q (%)	Q2FY11	y-o-y (%)
Gross realization (\$/bbl)	116.9	121.3	(3.6)	79.2	47.6
Subsidy discount (\$/bbl)	33.2	72.5	(54.2)	16.5	101.2
Net realization (\$/bbl)	83.7	48.8	71.5	62.8	33.3
Crude production (MMT)	6.84	6.76	1.2	6.85	(0.1)
Nomination	6.04	5.93	1.9	6.15	(1.8)
JV	0.80	0.83	(3.6)	0.70	14.3
Gas production (bcm)	6.39	6.16	3.7	6.25	2.2
Nomination	5.83	5.60	4.1	5.80	0.5
JV	0.56	0.56	0.0	0.45	24.4
VAP production ('000 tons)	797	720	10.7	752	6.0
Upstream subsidy (Rs mn)	71,244.8	145,088.3	(50.9)	37,648.5	89.2
Upstream sector's share (%)	33%	33%	0.0	33%	0.0
ONGC's subsidy (Rs mn)	57,134.4	120,462.6	(52.6)	30,190.8	89.2
ONGC's share in upstream (%)	80.2	83.0	(2.8)	80.2	0.0

Oil & Gas production (mmtoe)



Quarterly crude realizations (\$/bbl)



Royalty on Rajasthan field yet to be treated cost recoverable

While Cairn India has treated royalty as a cost recoverable item in its Q2 FY12 results, ONGC hasn't done the same as the final agreements are yet to be signed. The management has conveyed that it has paid Rs 25.1 bn till Q2 FY12 towards Cairn India's share of the royalty burden. We expect ONGC to treat royalty as cost recoverable from Q3 FY12 onwards. The management has said that this amount will not be refunded via cash, but would be adjusted against future production from the Rajasthan field. Accordingly, we expect ONGC to earn a higher entitlement of the revenues from Rajasthan and we expect profit petroleum shared by ONGC from the field to be adjusted against the excess royalty that has been already paid by the company, thus, helping near term earnings.

Outlook on production

ONGC: The management has conveyed that out of the 7 mmscmd of gas allocated from the marginal fields, 3 mmscmd has started flowing through pipelines, with the remaining 4 mmscmd expected to flow in H2 FY12. Phase 3 of Mumbai High redevelopment is expected to be complete by end-FY13. The company has guided towards crude production level of 26-27 MMT by FY14-15 as against current levels of 24 MMT. FY12 target for crude production is 23.735 MMT from nomination fields & 3.407 MMT from JVs. Gas production is targeted at 23.457 bcm from nomination fields & 2.049 bcm from JVs.

OVL: H1 FY12 crude output of 3.39 MMT was up 4.3% y-o-y while gas production of 1.16 bcm was down 11.8% y-o-y. Gas production from the Vietnam block has dropped due to lower off-take in the rainy season and should continue its normal production rate going forward. Production from the Imperial field has dropped to 15,400 bpd from 18,000 bpd due to punitive taxation regime in that country which is acting as a deterrent to raising the output level. Production from Syria has declined from 86 kbpd to 70 kbpd due to economic sanctions imposed on that country. We expect production to get a boost in FY13-14 due to production start from Carabobo & Myanmar as well as increasing production from Sakhalin. Production target for FY12 stands at 9.448 MMT.

Upstream subsidy sharing expected at 57% for H2 FY12

The upstream sector's share of the gross under recoveries, which was fixed at ~33% during FY08-10, had been increased suddenly to ~39% in FY11. Since our FY12 & FY13 estimates of gross under-recovery at Rs 904 bn & Rs 700 bn are not significantly lower than the gross under recovery of Rs 782 bn in FY11, we assume 39% of the gross subsidy burden to be borne by the upstream sector in perpetuity. Taking into account the fact that the upstream sector has shared 33% of the subsidy burden in H1 FY12, we expect the upstream sector to share 57% of the total under recoveries for H2 FY12 which will be a big negative for crude realizations and the stock price.

Outlook and Valuation

We believe the stock would react to news flow regarding the subsidy sharing pattern that would emerge over the course of this year and the price band that would be fixed for the FPO (expected in Dec 2011). We expect consolidated revenue & PAT to post FY11-13 CAGR of 8.9% & 9.7% respectively. We estimate EPS of Rs 30.9 and Rs 31.6 in FY12 & FY13 respectively. Our SOTP valuation for ONGC yields a target price of Rs 320. Our price target translates into EV/boe of \$5.6/boe and FY12E & FY13E P/E of 10.4x and 10.1x respectively.

Financial Summary

Income statement

YE Mar (₹mn)	FY11	FY12E	FY13E
Revenue	1,176,141	1,408,096	1,394,667
Variation in stocks	(8,917)	(3,932)	(3,832)
Operating expenses	587,608	713,213	675,040
Staff expenses	17,155	19,996	20,444
Other Exp	95,629	76,804	79,184
Operating Profit	484,665	602,015	623,831
<i>Operating Margin(%)</i>	<i>41.2</i>	<i>42.8</i>	<i>44.7</i>
Other Income	69,247	46,877	53,874
DDA	206,263	230,125	253,476
EBIT	347,649	418,767	424,228
<i>EBIT Margin(%)</i>	<i>29.6</i>	<i>29.7</i>	<i>30.4</i>
Interest	4,374	5,449	4,997
PBT	343,275	413,318	419,232
<i>PBT Margin(%)</i>	<i>29.2</i>	<i>29.4</i>	<i>30.1</i>
Tax	114,913	145,010	145,375
Consolidated PAT	224,559	264,785	270,410
<i>PAT Margin(%)</i>	<i>19.1</i>	<i>18.8</i>	<i>19.4</i>

Key Ratios

YE Mar	FY11	FY12E	FY13E
Per Share Data (₹)			
EPS	26.2	30.9	31.6
CEPS	38.6	44.0	47.0
BVPS	134.8	157.3	179.0
DPS	8.7	8.7	8.7
Growth Ratios(%)			
Revenue	15.6	19.7	(1.0)
EBITDA	9.3	24.2	3.6
Consolidated PAT	15.7	17.9	2.1
Cash PAT	19.3	13.8	6.9
Valuation Ratios (X)			
PE	10.6	9.0	8.8
P/CEPS	7.2	6.3	5.9
P/BV	2.1	1.8	1.6
EV/Sales	1.8	1.5	1.5
EV/EBITDA	3.9	3.2	3.0
Turnover Ratios (Days)			
Receivable Days	26.2	26.2	27.0
Payable Days	88.0	91.8	92.8
Inventory Days	52.2	45.3	50.7
Profitability Ratios (%)			
ROCE	23.8	25.6	23.4
ROE	20.7	21.2	18.8
Dividend payout	33.3	28.3	27.7
Dividend yield	3.1	3.1	3.1

Source: Company, LKP Research

Balance sheet

YE Mar (₹mn)	FY11	FY12E	FY13E
SOURCES OF FUNDS			
Equity Share Capital	42,778	42,778	42,778
Reserves & Surplus	1,110,495	1,302,941	1,488,844
Total Networth	1,153,272	1,345,719	1,531,621
Total debt	62,912	57,692	51,692
Other liabilities	330,049	314,514	318,514
Total Liabilities	1,546,234	1,717,925	1,901,827
APPLICATION OF FUNDS			
Net block	268,651	447,936	538,450
Capital WIP	273,786	208,334	186,434
Net Producing prop.	571,896	633,579	690,036
Pre producing prop.	102,379	112,778	124,404
Investments	33,561	34,326	25,534
Goodwill	89,929	81,998	76,998
Current Assets			
Cash and Bank	295,955	331,062	383,921
Inventories	85,676	91,263	96,237
Sundry Debtors	97,724	104,758	101,524
Loan, Adv & others	109,963	88,748	71,253
Current Liab & Prov			
Current liabilities	340,366	367,718	341,170
Provisions	50,880	57,554	60,054
Net Current Assets	198,071	190,560	251,710
Misc. expenses	7,961	8,414	8,260
Total Assets	1,546,234	1,717,925	1,901,827

Cash Flow

YE Mar (₹mn)	FY11	FY12E	FY13E
Consolidated PAT	224,559	264,785	270,410
Depreciation & Depletion	105,814	111,281	131,772
Interest	4,374	5,449	4,997
Chng in working capital	(70,326)	(42,618)	8,291
Other operating activities	(36,567)	15,989	(4,154)
CF from operations (a)	437,266	402,695	398,045
Capital expenditure	310,935	297,195	268,470
Chng in investments	(23,489)	(7,165)	(13,792)
CF from investing (b)	(287,446)	(290,030)	(254,678)
Free cash flow	130,706	110,948	134,571
Equity raised/(repaid)	21,389	0	0
Inc/dec in borrowings	243	(5,221)	(6,000)
Dividend paid (incl. tax)	87,389	87,358	87,358
Adj in R&S	(19,353)	15,020	2,850
CF from financing (c)	(85,110)	(77,559)	(90,508)
Net chng in cash (a+b+c)	64,710	35,107	52,859
Closing cash & cash equiv	295,955	331,062	383,921

Research Team

S. Ranganathan	Head of Research	Pharmaceuticals , Agriculture	6635 1270	s_ranganathan@lkpsec.com
Ashwin Patil	Research Analyst	Automobiles & Telecom	6635 1271	ashwin_patil@lkpsec.com
Chaitra Bhat	Research Analyst	Banking & Financial Services	6635 1211	chaitra_bhat@lkpsec.com
Deepak Darisi	Research Analyst	Energy	6635 1220	deepak_darisi@lkpsec.com

Institutional Equities

Pratik Doshi	Director	98210 47676	-	pratik_doshi@lkpsec.com
Hardik Mehta	Sales	98190 66569	6635 1246	hardik_mehta@lkpsec.com
Varsha Jhaveri	Sales	93241 47566	6635 1296	varsha_jhaveri@lkpsec.com
Hitesh Doshi	Sales	93222 45130	6635 1281	hitesh_doshi72@lkpsec.com
Gurdarshan Singh	Dealing	93228 61461	6635 1246	gurdarshan_singh@lkpsec.com
Bharat Shah	Dealing	98337 97256	6635 1210	bharat_shah@lkpsec.com
