Indiabulls

OIL AND NATURAL GAS CORPORATION LTD
RESEARCH

EQUITY RESEARCH **April 04, 2008**

RESULTS REVIEW

Share Data

Market Cap	Rs. 2,151.4 bn
Price	Rs. 1,005.85
BSE Sensex	15,343.1
Reuters	ONGC.BO
Bloomberg	ONGC IN
Avg. Volume (52 Week)	0.3 mn
52-Week High/Low	Rs. 1,386.9 / 770
Shares Outstanding	2,138.9 mn

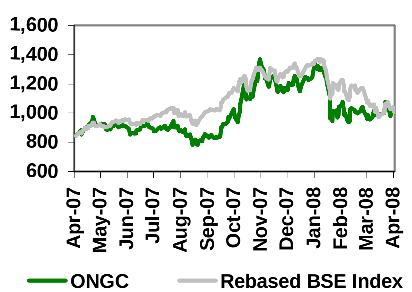
Valuation Ratios (Consolidated)

Year to 31 March	2008E	2009E
EPS (Rs.)	106.8	123.1
+/- (%)	28.6%	15.3%
PER (x)	9.4x	8.2x
EV/ Sales (x)	2.2x	2.0x
EV/ EBITDA (x)	4.7x	4.2x

Shareholding Pattern (%)

Promoters	74
FIIs	8
Institutions	5
Public & Others	13

Relative Performance



Oil and Natural Gas Corporation Ltd. Buy

On the road to recovery

For the quarter ended Dec'07, Oil and Natural Gas Corporation Limited (ONGC) reported a decline of 2.9% yoy in net sales, mainly because of a higher subsidy discount given to the oil marketing companies (OMCs). The increase in subsidy, a reversal in trend as against the previous two quarters, resulted in a decline in average realisation per barrel from USD 91.19 to USD 54.52 per barrel. EBITDA went down 9.8% yoy and EBITDA margin decreased 412 bps to 53.1% due to higher subsidy discounts, rupee appreciation, and an increase in operating expenses. However, the fall in adj. net profit was restricted to 6.5% yoy due to higher other income and a decline in depreciation.

Going forward, the Company seems to be on the road to recovery. During the quarter, it discovered nine oil fields and ONGC Videsh Ltd. (OVL), a wholly owned subsidiary, also won two exploration blocks. In addition, ONGC is revamping its ageing infrastructure at the oilfields and is using the Enhanced Oil Recovery (EOR) and Improved Oil Recovery (IOR) techniques to extract more oil from its wells. However, the recent proposal of the government to end a tax holiday for the projects coming on stream after Apr'09 can provide a setback to the Company's expansion plans as ONGC plans to set up two new refineries in India besides raising the capacity of its Mangalore refinery. Moreover, the likelihood of an ad hoc increase in subsidy sharing and further rupee appreciation continue to remain major concerns.

At the current price of Rs. 1,005.85, the stock is trading at a forward P/E of 9.4x for FY08E and 8.2x for FY09E. Based on our valuation and result analysis, we upgrade our rating from Hold to Buy, with a revised target price of Rs. 1,235 for FY09E.

Key Figures (Standalone)

Quarterly data	Q3'07	Q2'08	Q3'08	QoQ%	YoY%	9M'07	9M'08	YoY%
(Figures in Rs mn, except per share data)								
Net Sales	155,645	154,139	151,208	(1.9%)	(2.9%)	442,358	442,225	(0.0%)
EBITDA	89,093	84,153	80,318	(4.6%)	(9.8%)	240,585	243,694	1.3%
Adj. Net Profit	46,683	50,975	43,665	(14.3%)	(6.5%)	129,613	140,746	8.6%
Margins(%)								
EBITDA	57.2%	54.6%	53.1%			54.4%	55.1%	
NPM	30.0%	33.1%	28.9%			29.3%	31.8%	
Per Share Data (Rs.)								
Normalised EPS	21.8	23.8	20.4	(14.3%)	(6.5%)	60.6	65.8	8.6%

Result Highlights

A higher subsidy discount pressurised the top line

For the quarter ended Dec'07, net sales declined 2.9% yoy to Rs. 151.2 bn, led by higher subsidy discount (Rs. 60.8 bn as against Rs. 22 bn during Q3'07) given to the OMCs. The higher subsidy discount resulted in reduced average realisation per barrel, from USD 91.19 to USD 54.52, thereby translating into USD 36.67 of subsidy per barrel during the quarter. Adding to the decline in net sales was the sharp appreciation of the rupee. During the quarter, yoy crude oil production remained flat at 6.62 MMT; however, the production of natural gas rose 0.9% yoy to 5.78 BCM.

EBITDA decreased 9.8% yoy to Rs. 80.3 bn and EBITDA margin went down 412 bps to 53.1%. The reduction in EBITDA margin was a result of higher raw material costs, increase in the purchase cost of traded goods, higher statutory levies, and a rise in other expenditure. However, the decline in EBITDA margin was partiallly contained by a reduction in employee costs.

For the quarter ended Dec'07, adj. net profit went down 6.5% yoy to Rs. 43.7 bn and net profit margin declined 112 bps yoy to 28.9%. However, the fall in net profit margin was lower than the fall in EBITDA margin as a result of lower depreciation charge and higher other income. The fall in net profit could have been much lower had the effective tax rate not increased 78 bps yoy (34.6% of profit before tax as against 33.8% in Q3'07).

Key Events

Nine oil and gas discoveries were made during the quarter

- During the quarter, the Company made nine oil and gas discoveries. Out of these, four are from the new prospects and five are new pool discoveries in the earlier established fields.
- At its board meeting held on Feb 25, 2008, the Company announced that it has made four oil and gas discoveries between Jan 21, 2008 to Feb 24, 2008. Onshore discoveries had been made in well Kosamba-41, well Chaklasi-8 (both in western onshore), and in well

Mekrang-7 in Assam. The offshore discovery was made in well B-12-11 in PEL Block BOFF 1, 2, 3 in the Arabian Sea.

- At the meeting held on Feb 25, 2008, the Company's board also approved three major investment proposals: (a) the reconfiguration of Dahej Petrochemicals Project with a revised capex of Rs. 124.4 bn (down from Rs. 135.4 bn), (b) setting up a gas-processing capacity at Hazira involving an outlay of Rs. 3.7 bn, and (c) an acquisition of 30% additional stake in Gulf-A at a cost of USD 57.2 mn.
- In order to enhance the oil recovery from the PY-3 field (in Cauvery offshore), ONGC approved the capex of USD 35.9 mn for Phase-III development. This is expected to enhance the recovery by 10.52 MMSTB, with ONGC holding 40% stake in the field.

A capex of Rs. 25.5 bn has been approved for the pipeline network at the Mumbai Offshore

- The Company plans to strengthen the pipeline network for oil and gas transportation at the Mumbai Offshore fields. As a result, ONGC has approved the three-year 2nd Pipeline Replacement Project, involving a cost of Rs. 25.5 bn. Leighton Holding Ltd., an Australian construction company, bagged the contract to construct the 200 km of fixed and flexible pipelines at a cost of USD 720 mn.

ONGC Videsh Ltd. bagged two exploration blocks in Brazil

- OVL, a wholly owned subsidiary, bagged two exploration blocks in Brazil: the deep water Block 470 in Espirito Santo Basin and the shallow water Block 1413 in Santos Basin.
- OVL has also bid for Block No. 1 in the Mannar Offshore basin in the Sri Lankan oil fields.

Key Risks

Key risks to our rating include:

- An unanticipated decline in the estimated average price realisation per barrel
- Any change in the subsidy sharing scheme
- Further appreciation of the rupee

Outlook

The Company is investing heavily to increase its oil and gas finds

ONGC is investing heavily in its Exploration and Production (E&P) business. Over the past nine months ending Dec'07, the Company has made a total of 19 discoveries of which 9 are from new prospects and 5 from new pool. OVL is also undertaking aggressive steps to increase its oil and gas finds. During the quarter, OVL won two exploration blocks in Brazil and acquired a 30% participating interest in the Block 11-12, offshore Turkmenistan, under its JV (ONGC Mittal Energy Ltd). OVL also got the Union Cabinet's approval to invest USD 102.2 mn in the Qatar project for the E&P activities. All in all, the Company is poised for high growth on the back of new oil and gas discoveries.

ONGC is using IOR and EOR techniques to increase its production from existing wells

In addition to finding new fields, the Company is planning to revamp its ageing infrastructure across the country at an estimated investment outlay of Rs. 150 bn. Once its Assam Renewal Project is completed in three years, ONGC will revamp the old equipment in its fields in Gujarat and the east coast. Further, ONGC is using the IOR and EOR techniques to recover more oil from its wells in Mumbai High, Heera, Neelam, Gandhar, Kaloi, Sanand, North Kadi, Santhal, Balol, Jotana, Sobhasan, Lakwa, Geleki, and Rudra Sagar. Using these techniques has helped increase the combined production by 9.3%, from 52,200 tons a day in Apr'00 to 57,078 tons a day by Mar'07. The total incremental oil gain is expected to be 110.82 mn tons by 2029-30 and the total approved cost of the IOR and EOR schemes has been pegged at Rs. 140.6 bn.

End of a tax holiday for projects coming on stream after Apr'09 pose a major threat to ONGC's expansion plans

The Company is also diversifying by undertaking new projects. ONGC recently entered the wind energy sector by partnering with Suzlon Energy for its pilot project in Gujarat, to produce 50 MW for ONGC's consumption. The Company also plans to invest Rs. 6 bn for generating nearly 1,500 MW of power by using wind energy. However, the recent proposal of the government to end a tax holiday for the projects coming on stream after Apr'09 can provide a setback to the Company's expansion plans. This is because ONGC plans to set up two new refineries in India (one at Kakinada in the east coast and another in Rajasthan) besides raising the capacity of its Mangalore refinery in the west coast to 300,000 bpd. Moreover, the likelihood of an ad hoc increase in subsidy sharing and further rupee appreciation continue to remain major concerns.

At the current price of Rs. 1,005.85, the stock is trading at a forward P/E of 9.4x for FY08E and 8.2x for FY09E. Based on our valuation and result analysis, we arrive at a target price of Rs. 1,235 for FY09E. Since this target price is 23% more than the current price, we upgrade our rating to Buy.

Key Figures (Consolidated)

Year to March	FY05	FY06	FY07	FY08E	FY09E	CAGR (%)
(Figures in Rs mn, except per share data)						(FY07-09E)
Net Sales	597,054	706,424	822,529	930,981	1,033,007	12.1%
EBITDA	280,713	310,744	351,253	427,724	479,763	16.9%
Adj. Net Profit	143,391	153,977	177,696	228,469	263,397	21.7%
Margins (%)						
EBITDA	47.0%	44.0%	42.7%	45.9%	46.4%	
NPM	24.0%	21.8%	21.6%	24.5%	25.5%	
Per Share Data (Rs.)						
Normalised EPS	67.0	72.0	83.1	106.8	123.1	21.7%
PER (x)	8.8x	12.1x	10.6x	9.4x	8.2x	

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