

STOCK INFO.	BLOOMBERG
BSE Sensex: 10,130	ONGC IN
	REUTERS CODE
S&P CNX: 2,981	ONGC. BO

28 June 2006

Buy

Previous Recommendation: Buy

Rs1,033

Equity Shares (m)	1,425.9
52-Week Range (Rs)	1,514/854
1,6,12 Rel. Perf. (%)	-7/-22/-38
M.Cap. (Rs b)	1,473.2
M.Cap. (US\$ b)	31.9

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS B)	(RS B)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
03/06A	706.4	154.0	108.0	7.4	9.6	2.7	29.8	34.3	2.4	4.6
03/07E	851.2	193.9	136.0	25.9	7.6	2.2	31.7	37.0	2.1	3.7
03/08E	804.3	176.6	123.8	-8.9	8.3	1.9	24.3	29.3	1.7	3.7

Consolidated

- 4QFY06 PAT (including extra-ordinaries) at Rs30.9b was down 18.7% YoY on account of higher fuel marketing loss sharing and higher DD&A charges of Rs8.7b. EBITDA at Rs67.3b was up 5.5% YoY. FY06 standalone PAT at Rs144.3b was up 11.2% YoY, driven by higher crude prices, despite higher loss sharing and lower crude volumes. Consolidated PAT at Rs154b was up 5.9% YoY, driven by ONGC's domestic operations.
- While Brent crude prices were higher at US\$62/bbl (compared to US\$57/bbl in 3QFY06 and US\$47.7/bbl in 4QFY05), higher loss sharing at Rs34.1b set off a large part of the gains, leading to an EBITDA growth of just 5.5% YoY. Higher DD&A charges too impacted profits.
- FY06 PAT growth of 11.2% YoY was driven by higher crude prices. However, loss sharing of Rs119.6b, up from Rs41b last year set off the gains. Earnings were also impacted by the fire accident at Bombay High, which pulled down production of crude by 8% YoY at 24.4m ton.
- ONGC trades at a steep discount (US\$4/boe) to global oil company valuations (US\$10-12/boe) on account of subsidy sharing and regulated gas prices. Deregulation of gas prices is happening though at a very slow pace, while the latest policy on subsidy sharing effectively caps further losses and loss sharing. The pace of acquisition of global E & P assets continues to remain strong and we believe that OVL would be the future growth driver for ONGC. The stock trades at a P/E of 7.6x FY07E. Maintain **Buy**.

QUARTERLY PERFORMANCE (STANDALONE)

(Rs Billion)

Y/E MARCH	FY05				FY06				FY05	FY06
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Net Sales	102.9	118.2	121.0	121.5	108.7	126.8	124.8	119.0	463.6	479.2
Change (%)	30.9	36.4	67.5	46.0	5.6	7.3	3.1	-2.1	44.5	3.4
Raw Material and Purchases	13.6	12.1	14.8	12.4	9.7	12.7	5.8	9.9	52.9	38.1
Statutory Levies	23.2	25.5	25.9	25.3	25.0	26.6	27.1	18.3	99.8	97.0
Employee Costs	3.2	2.8	2.1	1.9	2.8	2.4	2.5	5.0	10.0	12.7
Other Exp (incl Stock Adj)	11.5	14.2	15.3	18.2	10.2	13.6	15.8	18.5	59.2	58.0
EBITDA	51.5	63.6	62.9	63.8	61.1	71.6	73.6	67.3	241.8	273.5
% of Net Sales	50.1	53.8	51.9	52.5	56.2	56.4	59.0	56.5	52.1	57.1
% Change	14.8	30.2	66.6	40.4	18.5	12.5	17.1	5.5	36.7	13.1
Depreciation	16.2	15.3	12.9	17.6	13.5	19.4	20.1	31.6	62.0	84.6
Interest	0.1	0.0	0.2	0.1	0.0	0.1	0.1	0.3	0.4	0.5
Other Income	3.0	4.7	4.6	4.9	3.0	8.6	5.6	6.3	17.3	23.5
PBT	38.2	53.0	54.4	51.0	50.5	60.8	59.0	41.7	196.7	212.0
Tax	15.2	19.1	19.5	13.0	17.3	19.4	20.2	17.2	66.8	74.1
Rate (%)	39.6	36.1	35.8	25.6	34.3	31.9	34.2	41.3	34.0	34.9
PAT	23.1	33.8	34.9	38.0	33.2	41.4	38.9	24.5	129.8	137.9
Change (%)	8.1	19.8	103.3	91.2	43.8	22.3	11.3	-35.6	49.8	6.2

E: MOSt Estimates

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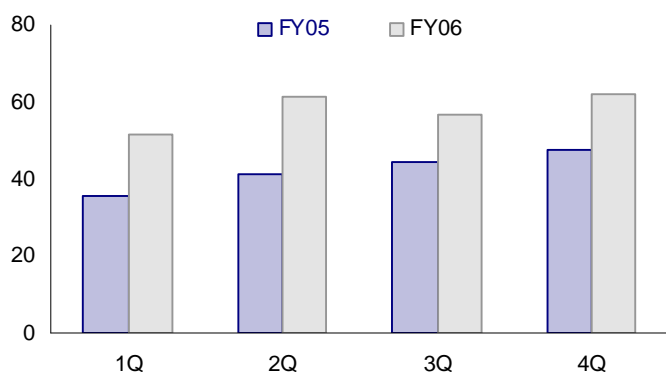
4QFY06 PAT (including extra-ordinaries) at Rs30.9b was down 18.7% YoY on account of higher fuel marketing loss sharing and higher DD&A charges of Rs8.7b. EBITDA at Rs67.3b was up 5.5% YoY. FY06 standalone PAT at Rs144.3b was up 11.2% YoY, driven by higher crude prices, despite higher loss sharing and lower crude volumes. Consolidated PAT at Rs154b was up 5.9% YoY, driven by ONGC's domestic operations. Both ONGC and OVL profits were below expectations.

Crude prices were the key earnings driver

4QFY06 Brent crude prices were higher at US\$62/bbl (compared to US\$57/bbl in 3QFY06 and US\$47.7/bbl in 4QFY05), driving earnings, though higher loss sharing and lower volumes YoY set off part of the gains. FY06 crude prices too were higher, with Brent crude at US\$58/bbl, compared to US\$42.2/bbl in FY05. ONGC's gross crude price realisation in FY06 was US\$59.66/bbl, while net realisation was just US\$42.34/bbl, a discount of US\$17.3/bbl (effective). Lower crude production was factor contributing towards higher per unit discount.

ONGC continues to benefit from higher crude prices, as it remains positively geared to crude prices, despite the fuel loss sharing burden based on the 1/3rd upstream sharing formula. ONGC management indicated that the Government policy is to allow ONGC to benefit from rising crude prices and hence, we understand that a situation wherein ONGC's realisation would be capped is unlikely to arise.

BRENT CRUDE PRICE TREND (US\$/BBL)



Source: Company/ Motilal Oswal Securities

Higher loss sharing continues to limit profit growth

4QFY06 loss sharing was up sharply at Rs34.1b, as against Rs9.9b last year, setting off a large part of the gains on account of higher crude prices, limiting EBITDA growth to just 5.5% YoY. FY06 loss sharing was Rs119.6b, as against Rs41.5b last year. Based on Government's estimate on fuel marketing losses for the year FY07, we expect the loss sharing for ONGC to increase to Rs218b and have built this higher outgo in our estimates.

Lower crude production too hurts

Lower crude production too impacted profits in FY06. Crude output at 24.4m tons was down 8% YoY, while gas output was largely flat at 22.57bcm. However, crude production is expected to bounce back sharply with FY07 MoU target of 27.35m tons and gas output target of 21.97bcm, driving earnings growth in FY07.

OIL & GAS PRODUCTION

	FY05	FY06
Oil (m/ton)	26.48	22.40
Gas (bcm)	22.97	22.57

Source: Company/ Motilal Oswal Securities

Higher non-cash charges impact reported profits

ONGC has changed the pipeline depreciation policy. The new depreciation rate of 100%, led to higher depreciation charges of Rs4.3b for the quarter and Rs11.7b for FY06. Revision of abandonment liability estimate based on latest costs led to an increase in provisions to the tune of Rs41.3b, with a profit impact for current quarter and year at Rs4.5b. Change in policy of expensing cost of exploratory type stratigraphic test wells led to an increase in profits by Rs534m.

In the case of OVL too, goodwill write off of about Rs4.5b led to higher DD&A charges, impacting profits.

Dry well write offs in the current year were lower YoY at about Rs15b as against Rs21b last year, on account of improved exploration success rate.

Downgrading estimates

We are downgrading our consolidated FY07 and FY08 earnings estimates to account for higher fuel marketing loss sharing and higher non-cash charges, partly cushioned by higher crude prices. Our new Brent crude assumption is US\$70/bbl, up from US\$58/bbl.

REVISED ESTIMATES (RS M)

	FY07E			FY08E		
	OLD	NEW	% CH.	OLD	NEW	% CH.
Net Sales	753,726	851,245	12.9	775,249	804,308	3.7
EBITDA	407,660	382,300	-6.2	417,763	363,951	-12.9
Net Profit	213,669	193,891	-9.3	212,379	176,559	-16.9
EPS (Rs)	150	136	-9.3	149	124	-16.9
Brent Price*	56	70	25.0	56	62	10.7

* (US\$/bbl)

Source: Motilal Oswal Securities

Outlook

Domestic operations continue to look up...

ONGC added 51.3m ton to its recoverable reserve across 10 new discoveries, with reserve replacement ratio reaching 110%, highest in the last 4 years. Also, IOR / EOR efforts are expected to add between 65-70m tons to recoverable reserves over the next 3-4 years. Exploration efforts have increased with an exploration capex of Rs39b last year. ONGC spud 105 wells last year. Exploration expenditure as well as work programme are scheduled to increase in FY07 as well as coming years.

CBM is expected to start production in 2007 and this is not built into our estimates as well as street estimates since details are not available. This could be a source of some earnings upside. We believe plateau production could range between 3-4 MMSCMD.

...while costs remain competitive

ONGC's finding and lifting costs continue to remain highly competitive with last 5 year average finding costs at just over US\$2/bbl (costs over last 4 years have fluctuated quite wildly on depending on the success rate of exploration efforts), while lifting cost is below US\$5/bbl.

OVL – future growth engine

- ✍ OVL continues to remain a key growth engine for ONGC. On the production front, Sudan 5A block has commenced production yesterday and is expected to produce 40,000 bpd of oil, with OVL's share being 10,000 bpd (0.5m tpa). This is not part of our estimates.
- ✍ Outlook for OVL's reserve accretion as well as production is very encouraging. OVL has 4 discovered blocks - Brazil, Myanmar, Qatar and Egypt, which would add to the reserves as and when the assessment is complete. The management also indicated that Nigeria and Cuba exploration blocks are particularly highly prospective among the overseas exploration asset portfolio.

Valuation and view

ONGC trades at a steep discount (US\$4/boe) to global oil company valuations (US\$10-12/boe) on account of subsidy sharing and regulated gas prices. Deregulation of gas prices is happening, though at a very slow pace, while the latest policy on subsidy sharing effectively caps further losses and loss sharing. The pace of acquisition of global E & P assets continues to remain strong and we believe that OVL would be the future growth driver for ONGC. The stock trades at a P/E of 7.6x FY07E. Maintain **Buy**.

ONGC: an investment profile

A Fortune 500 company, ONGC is the largest company in India in terms of market capitalization. It is the largest E&P company, with proven reserves in excess of 1b TOE. It acquired a majority stake in the loss making MRPL and turned it around. Its overseas subsidiary, OVL has acquired E&P assets in Sakhalin (Russia), Sudan, Libya, Iran, Iraq, Vietnam, Myanmar and is now acquiring stake in Equador.

Key investment arguments

- ✍ OVL has emerged as the key growth driver with large growth potential
- ✍ With over 1b TOE of proven reserves, aggressive E&P and asset acquisition program, ONGC holds large growth potential.
- ✍ Current valuations more than reflect loss sharing and gas pricing issues

Key investment risks

- ✍ Government policy remains the biggest risk

Recent developments

- ✍ OMEL acquired 2 blocks in Nigeria.
- ✍ OVL has acquired stake in Brazil block

Valuation and view

- ✍ P/E at 7.6x FY07E is not demanding.
- ✍ The stock quotes at US\$4/boe compared to global average of between US\$10-12/boe.
- ✍ Reiterate **Buy**.

Sector view

- ✍ There is widespread consensus on cheap crude price environment being passe.
- ✍ We expect the strong crude price environment to continue.
- ✍ Gas price revisions continue and complete deregulation appears inevitable
- ✍ ONGC is well positioned to reap the benefits of higher crude prices and potential complete deregulation of gas pricing.

COMPARATIVE VALUATIONS

		ONGC	GAIL
P/E (x)	FY07E	7.6	9.0
	FY08E	8.3	9.1
P/BV (x)	FY07E	2.2	1.9
	FY08E	1.9	1.7
EV/Sales (x)	FY07E	1.7	1.2
	FY08E	1.7	1.0
EV/EBITDA (x)	FY07E	3.7	4.5
	FY08E	3.7	3.7

SHARE-HOLDING PATTERN (%)

	MAR.06	DEC.05	MAR.05
Promoters	86.2	86.2	86.2
Domestic Institutions	3.1	3.1	2.7
FII's/FDIs	8.5	8.4	8.1
Others	2.2	2.3	3.1

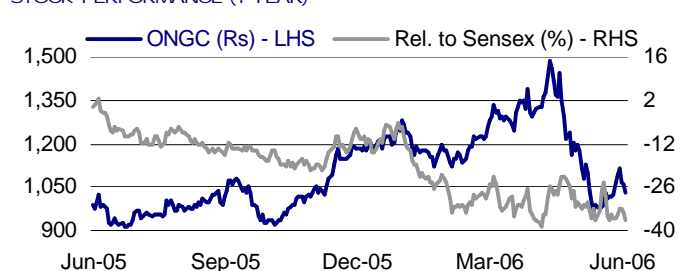
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	136.0	133.7	1.7
FY08	123.8	138.1	-10.3

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
1,033	-	-	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006	2007E	2008E
Net sales	436,471	597,464	706,373	851,245	804,308
Growth (%)	26.4	36.9	18.2	20.5	-5.5
Government levies	102,546.1	131,131.2	140,289.8	197,266.0	192,613.5
Pipeline costs (trans & fr	6,095	10,320	9,546	9,752	9,932
Other operating costs	130,789	172,224	245,793	261,927	237,812
Operating costs	239,430	313,675	395,629	468,945	440,357
EBIDTA	197,041	283,790	310,744	382,300	363,951
% of Net Sales	45.1	47.5	44.0	44.9	45.3
Debt charges (incl exch l	-3,822	-1,877	-1,597	-931	-840
Exploration write-offs	-1,343	-3,281	-103,549	-56,526	-60,726
Deprn, depltn, amrtsn (D	-65,525	-73,586	0	-51,290	-55,871
Other income	22,410	19,577	34,211	24,145	25,144
PBT	148,761	224,622	239,808	297,698	271,658
Tax	-46,100.9	-74,689.5	-70,412.2	-97,219.5	-88,827.2
Rate (%)	36.2	35.4	35.4	34.5	34.6
PAT	94,881	145,206	154,875	194,988	177,607
Growth (%)	-9.1	53.0	6.7	25.9	-8.9
Net profit (adjusted)	94,881	145,206	154,875	194,988	177,607
Growth (%)	-9.1	53.0	6.7	25.9	-8.9
Net profit post MI	93,803	143,390	153,976	193,891	176,559

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2004	2005	2006	2007E	2008E
Share Capital	14,259	14,259	14,259	14,259	14,259
Reserves	393,138	466,324	537,701	658,847	763,166
Net Worth	407,397	480,583	551,960	673,106	777,425
Debt	62,535	40,603	26,173	25,239	22,321
Deferred Tax	54,250	57,894	69,175	73,882	78,318
Liability for Abandonmen	80,292	80,941	87,621	93,688	99,196
Minority Interest	4,275	6,204	6,845	7,942	9,040
Capital Employed	608,748	666,225	741,775	873,857	986,301
Gross Fixed Assets	496,759	519,966	570,712	616,499	667,931
Less: Depreciation	379,711	403,277	438,204	476,425	519,668
Capital WIP	13,520	87,775	48,903	60,753	71,321
Net Fixed Assets	130,569	204,464	181,411	200,826	219,584
Producing properties	246,708	245,554	332,969	364,341	391,171
Pre-producing properties	45,402	23,888	32,634	43,066	45,072
Investments (incl. m	30,307	26,555	24,284	21,819	22,651
Goodwill	14,591	13,683	12,775	11,867	10,959
Cash & bank balances	64,564	66,035	80,436	113,529	159,339
Inventories	35,529	43,730	54,970	61,485	59,037
Loans & advances	55,236	72,474	48,936	76,826	94,939
Other current assets	37,281	40,898	47,570	53,636	59,144
Total current assets	221,920	270,228	291,749	377,720	440,972
Current liabilities	55,569	77,026	88,296	98,939	97,333
Provisions	25,180	41,122	45,751	46,844	46,776
Net current assets	141,171	152,080	157,702	231,937	296,863
Application of Fund:	608,748	666,225	741,775	873,857	986,301

E: MOST Estimates

RATIOS					
Y/E MARCH	2004	2005	2006	2007E	2008E
Basic (Rs)					
EPS	65.8	100.6	108.0	136.0	123.8
Cash EPS	118.1	157.8	190.8	215.4	209.3
Book Value	285.7	337.0	387.1	472.0	545.2
DPS	24.0	40.0	45.0	45.0	45.0
Payout	36.5	39.8	41.7	33.1	36.3
Valuation (x)					
P/E		10.3	9.6	7.6	8.3
Cash P/E		6.5	5.4	4.8	4.9
EV / EBITDA		5.2	4.6	3.7	3.7
EV / Sales		2.5	2.0	1.7	1.7
Price / Book Value		3.1	2.7	2.2	1.9
Dividend Yield (%)		3.9	4.4	4.4	4.4
Profitability Ratios (%)					
RoE	24.6	32.3	29.8	31.7	24.3
RoCE	28.3	35.5	34.3	37.0	29.3
Turnover Ratios					
Debtors (No. of Days)	30	23	28	28	32
Fixed Asset Turnover (x)	3.4	3.6	3.7	4.5	3.8
Leverage Ratio					
Net Debt / Equity (x)	0.0	-0.1	-0.1	-0.1	-0.2

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006	2007E	2008E
OP/(Loss) before Tax	197,041	283,790	310,744	382,300	363,951
Interest Paid	-3,822	-1,877	-1,597	-931	-840
Direct Taxes Paid	-46,746	-75,772	-73,651	-98,004	-89,615
(Inc)/Dec in Wkg. Capita	-49,901	-19,250	8,072	-41,646	-19,922
CF from Op. Activit	96,572	186,891	243,567	241,719	253,575
(Inc)/Dec in FA & CWIP	-56,652	-122,017	-178,830	-161,914	-158,478
(Pur)/Sale of Investmen	296	3,752	2,272	2,465	-832
Inc from Invst	22,410	19,577	34,211	24,145	25,144
CF from Inv. Activit	-33,946	-98,688	-142,348	-135,304	-134,166
Issue of Shares	0	0	0	0	0
Inc / (Dec) in Debt	510	-21,932	-14,430	-934	-2,918
Dividends Paid (incl.tax)	-38,607	-64,800	-72,388	-72,388	-72,388
CF from Fin. Activit	-38,097	-86,732	-86,818	-73,322	-75,306
Inc / (Dec) in Cash	24,529	1,471	14,401	33,093	44,103
Add: Opening Balance	40,035	64,564	66,035	80,436	113,529
Closing Balance	64,564	66,035	80,436	113,529	157,631



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Disclosure of Interest Statement	ONGC
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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