MOTILAL OSWAL

ONGC

STOCK INFO.	BLOOMBERG
BSE Sensex: 13,846	ONGC IN
	REUTERS CODE
S&P CNX: 3,971	ONGC. BO

Equity Shares (m)	2,138.9
52-Week Range (Rs)	1,009/620
1,6,12 Rel. Perf. (%)	-1/-9/-37
M.Cap. (Rs b)	1,876.7
M.Cap. (US$ b)	42.5

28 December 2006 **Buy**

Previous Recommendation: Buy Rs877

YEAR END	NET SALES (RS B)	PAT (RS B)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
03/06A	706.4	154.0	72.0	7.4	12.2	3.4	29.8	34.3	2.6	5.9
03/07E	875.6	190.0	88.8	23.4	9.9	2.8	31.1	36.3	2.0	4.8
03/08E	805.0	175.7	82.1	-7.5	10.7	2.4	24.4	29.2	2.2	4.8

Consolidated

Despite bright business prospects, ONGC trades at a steep discount to regional and global oil players. Key positives:

1. Domestic operations looking up: The large gas discovery in the prolific KG basin, pegged at 21TCF by media reports, apart from creating large value for ONGC, has also removed a key concern about the lack of success in ONGC's domestic exploration program. Completion of IOR/EOR program by 2QFY08, ramp-up of production at Panna-Mukta-Tapti and the 30% stake in Cairn Energy's Rajasthan block, too would aid growth.

2. Global arm, OVL remains a key growth engine: ONGC Videsh Limited (OVL), ONGC's 100% subsidiary, remains a key growth engine. The next large reserve accretion for ONGC is likely to come from OVL given the appraisal of five global discoveries currently in progress.

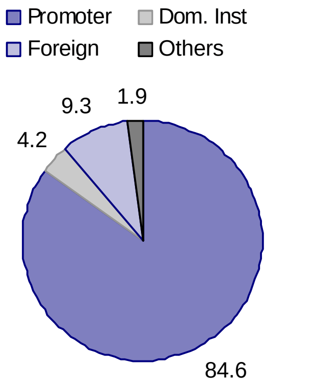
3. Gas price deregulation – re-rating trigger: Our earnings as well as DCF estimates build in just the JV gas price changes, which are already in the bag. We estimate the cumulative earnings impact at Rs12.8b as against Rs32.8b on complete deregulation of gas pricing.

4. Fuel marketing loss sharing – budget could provide relief: We believe that potential duty rationalization in the budget would ensure zero under-recoveries on auto fuels, providing a significant relief to ONGC.

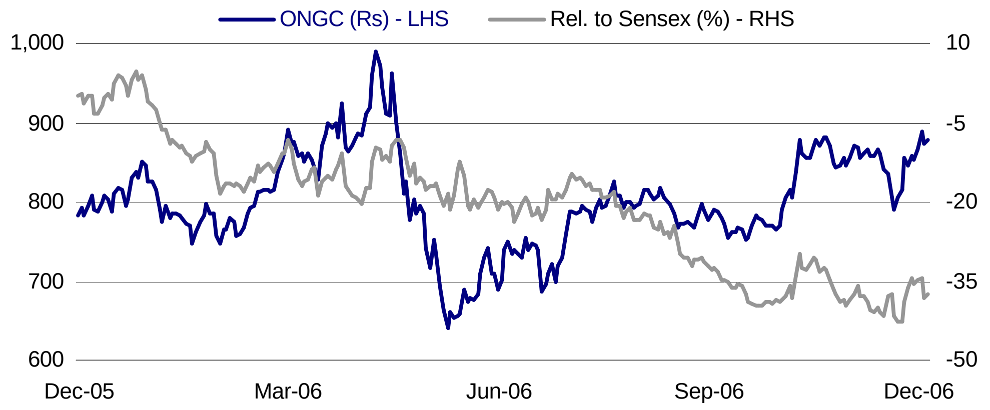
5. Fall in crude price within a range does not materially impact earnings: The fall in under-recoveries in line with crude, ensures very limited earnings impact, between US$50-70/bbl. ONGC's crude price realization has ranged between US$37-45/bbl, when international crude prices were ranging between US$50-70/bbl.

6. Valuations attractive: ONGC trades at a steep discount to regional and global oil players. We believe that ONGC could trade at over US$8/bbl (Rs1,325/share) in a free market scenario. We reiterate **Buy**, with an SOTP-based target price of Rs967, an upside of over 10%, without factoring in the potential upside from recent discoveries in the KG basin, IOR/EOR programs and deregulation of gas prices.

SHAREHOLDING PATTERN SEP-06 (%)



STOCK PERFORMANCE (1 YEAR)



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While ONGC's burgeoning overseas operations are likely to drive growth going forward, its domestic operations are also looking up. Possible gas price de-regulation is a potential re-rating trigger. Valuations are attractive at an EV/boe of US$5.3/bbl. We recommend **Buy** with a target price of Rs967, an upside of over 10%.

1. Domestic operations looking up

The large gas discovery in the prolific KG basin, pegged at 21TCF by media reports, apart from creating large value for ONGC, has also removed a key concern about the lack of success in ONGC's domestic exploration program. However, formal acknowledgement or certification of the reserves is still some time away.

If confirmed, the reserve size of 21TCF would be comparable to ONGC's existing 1P gas reserve of 465bcm, though it is not clear if the indicated reserve size is 1P, 2P or 3P. Assuming the indicated size is 2P, time to production of about 7 years, a similar production sharing contract and capex and operating costs as that of Reliance's D6, the discovery could be valued at Rs214-267b or Rs100-125/share for ONGC.

It is too early for the market to discount this, given the uncertainties attached to the large number of variables involved in arriving at the value. However, given the prospectivity of the basin (Reliance's gas reserve in the basin is likely to be raised from 23.2TCF to 50TCF, while GSPC is in the process of developing its 20TCF gas reserve), further upside to the indicated reserve size is a distinct possibility.

Also, potential for higher valuation of reserves exists. Latest deliberations on the pricing of gas from NELP blocks indicate possible floor and cap of US$4.5-6.5/mmbtu, which is better than the highest prevailing landfall price of US$4.75/mmbtu being charged by the Panna-Mukta-Tapti (PMT) consortium and compares much more favorably to existing, though disputed, contracts priced at US$2.3-2.4/mmbtu by Reliance with NTPC and RNRL (which triggered the debate on pricing of gas from NELP blocks). Higher prices would lead to better value for reserves in NELP blocks.

The discovery also removes a key concern for ONGC on the lack of significant exploration success in its large exploration effort. ONGC's exploration expenditure over the last three years has risen considerably, exceeding Rs50b per year. Till the KG basin discovery, ONGC's annual ultimate reserve accretions over the last five years have been relatively small (40-50bcm as defined by ONGC). Lack of significant success has led to large write-offs in its books, apart from pegging it back vis-à-vis its competitors.

The completion of its IOR/EOR (improved oil recovery / enhanced oil recovery) program by 2QFY08 is likely to lead to a 2-5% growth in output (2% over the next two years and 5% subsequently), arresting the natural decline in production while enhancing the production from these fields by over 70m toe over the life of the reserve or 7% of total proven reserves.

The PMT consortium, in which ONGC has a 40% stake, intends to ramp up its gas production by ~70% and oil output by ~33% 1QFY08. Higher production would benefit ONGC.

Also, 30% stake in Cairn Energy's prolific Rajasthan block, would lead to a further production as well as valuation upside. The IPO valuation of Cairn Energy indicates the market's willingness to take a stronger call on long-term average crude prices closer to US$50/bbl. At that price, we believe, ONGC's stake in the fields would be value accretive, despite the royalty payment mandated by the PSC to cover 100% stake in the company, instead of its 30% stake. Also, a waiver of 70% royalty by the Government is a possibility.

2. OVL – the new growth engine

ONGC Videsh Limited (OVL), the global arm and 100% subsidiary of ONGC, remains a key growth engine for ONGC. We expect OVL to record a 43% CAGR in net profit during FY07-09. OVL's share in ONGC's consolidated profits would rise sharply from 5.6% in FY06 to 16.3% by FY09, while its share in production would rise from 9.1% to 14.3%. Near term production growth is primarily on the back of commencement of operations at Sakhalin and Sudan.

We believe, the next large reserve accretion for ONGC could come from OVL. OVL holds five discovered blocks across the world, which are currently being appraised. We believe that reserves are likely to be declared over the next 12-30 months.

OVL's pace of acquisition of global E&P blocks as well as equity oil acquisition remains robust. It acquired 12 blocks last year and has finalized 6 acquisitions in the current year, till date.

LIST OF E&P BLOCKS FOR OVL

S. NO	COUNTRY	PROJECT	PARTICIPATING COMPANIES	CURRENT STATUS
1.	Vietnam	Block 06.1 (offshore)	OVL 45%, BP 35%; PetroVietnam 20%	Producing Natural Gas & Condensate
2.	Sudan	GNOP (onland)	OVL 25%; CNPC 40% Petronas 30%; Sudapet 5%	Producing Oil
3.		Block 5A (onland)	OVL 24.125%; Perronas 68.875%; Sudapet 7%	Producing Oil, under further development
4.		Pipeline Project (onland)	OVL 90%, OIL 10%	Pipeline Constructed & is on lease
5.	Russia	Sakhalin-1 (offshore)	OVL 20%; Exxon 30% Sodeco 30%; SMNG-S 11.5% RN Astra 8.5%	Producing Oil & Gas, and under further development
6.	Brazil	BC 10 (offshore) 2005-06	OVL 15 %; RD Shell (35%) & Petrobras (50%)	Discovered, under Development
7.	Iran	Farsi Offshore	OVL 40%, IOC 40%, OIL 20%	Exploration
8.	Sudan	Block 5B (onland)	OVL 23.5%; Petronas 41%; Lundin 24.5%; Sudapet 11%	Exploration
9.	Myanmar	Block A-1 (offshore)	OVL 20%, GAIL 10%, Daewoo 60%, Kogas 10%	Appraisal (with gas discovery)
10.		Block-A3 (offshore)	OVL 20 %, Daewoo- 60%, Kogas 10%, GAIL-10%	Exploration
11.	Libya	NC-188 & 189 (onland)	OVL 49%, TPOC 51%	Exploration
12.		Block 81-1 (onland)	OVL 100%	Exploration
13.	Syria	Block 24 (onland)	OVL 60%, IPR 40%	Exploration
14.		Himalaya (4 PSCs onland)	Shell & Syrian Petroleum Corporation	Producing Asset
15.	Iraq	Block 8 (onland)	OVL 100%	Exploration
16.	Egypt	B 6; North Ramadan (offshore)	OVL 70%, IPR 30%	Exploration (with discovery)
17.	Qatar	Najwat Najim (offshore)	OVL 100%	Exploration (with discovery)
18.	Cuba	Blocks 24, 25, 26, 27, 29, 36, 35 A (offshore)	OVL 30%, Repsol 40% Norsk Hydro 30%	Under Exploration
19.	Nigeria, STP- JDZ	Block 2 (offshore)	OVL 13.5%, Equator Exploration 9.07%, Sinopec/Adax/EHRC 65% and others 12.5%	Exploration
20.	Vietnam	Block 127 (offshore)	OVL 100%	Exploration
21.		Block 128 (offshore)	OVL 100%	Exploration
22.	Nigeria	Blocks 209 & 212 (offshore)	OMEL 100%	Exploration
23.	Cuba	Blocks 34 & 35 (offshore)	OVL 100%	Exploration

Source: Company/Motilal Oswal Securities

3. Gas price deregulation – re-rating trigger

Regulated gas prices have had significant negative impact on ONGC's earnings and valuations. ONGC suffers significantly lower than market gas pricing due to government regulations; the condition is further aggravated by the price cross-subsidization of the JV partners' share of production. ONGC's gas price realization is a lowly US$1.42/mmbtu as against US$3.86-4.75/mmbtu for free-priced domestic gas.

However, pricing is increasingly market driven, with part of APM gas (about 20%) now completely deregulated, while prices of the remaining gas have been raised from the earlier Rs2,850/tscm to Rs3,200/tscm. While complete deregulation is unlikely over the next 2-3 years, volume of APM gas itself is shrinking, in an environment where volume of free-priced gas is set to increase manifold. APM gas consumption by regulated sectors like power and fertilizer is likely to drop to less than 20% in 4-5 years. Administered pricing would not be maintainable when more than 80% of gas consumed is free-priced, leading to complete deregulation.

Pending complete deregulation, the drop in APM gas itself could ring in significant relief for ONGC, as the proportion of APM gas in ONGC's product mix is set to drop from about 95% to less than 50% over the next 4-5 years.

While complete deregulation could still be 4-5 years away, we estimate the impact at Rs178b or Rs83/share. However, our earnings as well as DCF estimates build in just the JV gas price changes, which are already in the bag.

4. Fuel marketing loss sharing – budget could provide relief

We expect auto fuel duty rationalization in the coming budget to relieve auto fuels from under-recoveries. Any such effort or event, which reduces overall marketing under-recoveries, would deliver significant benefit for upstream players, especially ONGC. We estimate that a 2.5% cut in duties on auto fuels would reduce loss sharing by Rs12b for ONGC.

5. Fall in crude price within a range does not materially impact earnings

Fall in crude price within US$50-70/bbl, does not impact earnings significantly. Peak crude price realization for ONGC has been within the range of US$35-45/bbl, when global crude prices ranged between US$50-70/bbl. We have witnessed changes in duties and increase in retail prices, which cushioned the under-recoveries when crude prices were at their peak. In a falling crude price environment, the earnings decline too is likely to be within that range.

6. Valuations attractive; recommend Buy

ONGC is attractively valued at a P/E of 10.7x, an EV/EBITDA of 4.8x FY08E and an EV/boe of US$5.3/bbl. At the current market price, the stock offers a dividend yield of 3.4%. The company's standalone EV/boe is low at US$4.6/bbl (assuming an EV/boe of US$7.5/bbl for OVL), at a steep discount to regional and global oil players that trade at valuations ranging from US$9/bbl to US$12/bbl. Chevron's acquisitions of Unocal's E&P assets were at US$9.4/bbl.

We believe that ONGC could trade at US$8/bbl (Rs1,325/share) in a free market scenario. While regulated gas pricing and LPG/kerosene loss sharing could warrant some discount to regional/global valuations, we believe that the current discount is not justified. ONGC's lifting costs are among the lowest in the world and its oil price realizations are higher than its global counterparts. We recommend **Buy,** with an SOTP-based target price of Rs967, an upside of 10.2% from current market price, without factoring in the potential upside from recent discoveries in the KG basin, IOR/EOR programs and deregulation of gas prices.

INCOME STATEMENT (Rs Million)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Net Sales	**597,464**	**706,373**	**875,551**	**804,985**	**763,215**
Growth (%)	*36.9*	*18.2*	*24.0*	*-8.1*	*-5.2*
Government Levies	131,131.2	140,289.8	183,628.0	193,168.4	190,944.8
Pipeline Costs (Trans &	10,320	9,546	9,760	9,937	10,124
Other Operating Costs	172,224	245,793	305,856	239,244	212,982
Operating Costs	313,675	395,629	499,243	442,350	414,051
EBIDTA	**283,790**	**310,744**	**376,308**	**362,636**	**349,164**
% of Net Sales	*47.5*	*44.0*	*43.0*	*45.0*	*45.7*
Debt Charges (incl Excl	-1,877	-1,597	-934	-844	-815
Exploration Write-offs	-3,281	-103,549	-56,526	-60,726	-67,555
Deprn, Depltn, Amrtsn (	-73,586	0	-51,318	-55,900	-62,055
Other Income	19,577	34,211	24,160	25,159	26,741
PBT	**224,622**	**239,808**	**291,690**	**270,324**	**245,481**
Tax	-74,689.5	-70,412.2	-95,172.0	-88,368.9	-79,956.7
Rate (%)	*35.4*	*35.4*	*34.5*	*34.6*	*34.6*
PAT	145,206	154,875	191,095	176,749	160,614
Growth (%)	*53.0*	*6.7*	*23.4*	*-7.5*	*-9.1*
Net Profit (Adj.)	145,206	154,875	191,095	176,749	160,614
Growth (%)	*53.0*	*6.7*	*23.4*	*-7.5*	*-9.1*
Net Profit post MI	143,390	153,976	189,998	175,700	159,588

BALANCE SHEET (Rs Million)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Share Capital	14,259	14,259	21,389	21,389	21,389
Reserves	466,324	537,701	647,823	751,282	838,502
Net Worth	**480,583**	**551,960**	**669,212**	**772,671**	**859,891**
Debt	40,603	26,173	27,706	25,868	26,985
Deferred Tax	57,894	69,175	73,863	78,295	82,585
Liability for Abandonme	80,941	87,621	93,688	99,196	104,197
Minority Interest	6,204	6,845	7,942	9,040	10,117
Capital Employed	**666,225**	**741,775**	**872,410**	**985,070**	**1,083,776**
Gross Fixed Assets	519,966	570,712	616,499	667,931	729,163
Less: Depreciation	403,277	438,204	476,425	519,668	569,109
Capital WIP	87,775	48,903	60,753	71,321	82,089
Net Fixed Assets	**204,464**	**181,411**	**200,826**	**219,584**	**242,143**
Producing Properties	245,554	332,969	365,074	391,875	432,340
Pre-producing Properti	23,888	32,634	43,240	45,246	43,691
Investments (incl. r	**26,555**	**24,284**	**21,819**	**22,651**	**25,389**
Goodwill	**13,683**	**12,775**	**11,867**	**10,959**	**10,051**
Cash & Bank Balances	66,035	80,436	110,701	157,934	174,373
Inventories	43,730	54,970	61,333	58,996	56,280
Loans & Advances	72,474	48,936	77,207	95,319	113,507
Other Current Assets	40,898	47,570	53,636	59,144	64,145
Total Curr. Assets	**270,228**	**291,749**	**377,120**	**439,962**	**473,571**
Current Liabilities	77,026	88,296	100,692	98,431	96,490
Provisions	41,122	45,751	46,845	46,777	46,919
Net Curr. Assets	**152,080**	**157,702**	**229,583**	**294,754**	**330,162**
Appl. of Funds	**666,225**	**741,775**	**872,410**	**985,070**	**1,083,776**

E: MOSt Estimates

RATIOS

Y/E MARCH	2005	2006	2007E	2008E	2009E
Basic (Rs)					
EPS	**67.0**	**72.0**	**88.8**	**82.1**	**74.6**
Cash EPS	105.2	127.2	141.8	139.1	137.5
Book Value	224.7	258.1	312.9	361.2	402.0
DPS	27	30.0	30.0	30.0	30.0
Payout	39.8	41.7	33.8	36.5	40.2
Valuation (x)					
P/E		12.2	9.9	10.7	11.8
Cash P/E		6.9	6.2	6.3	6.4
EV / EBITDA		5.9	4.8	4.8	5.0
EV / Sales		2.6	2.0	2.2	2.3
Price / Book Value		3.4	2.8	2.4	2.2
Dividend Yield (%)		3.4	3.4	3.4	3.4
Profitability Ratios (%)					
RoE	32.3	29.8	31.1	24.4	19.6
RoCE	35.5	34.3	36.3	29.2	23.8
Turnover Ratios					
Debtors (No. of Days)	23	28	28	32	32
Fixed Asset Turnover (x	3.6	3.7	4.6	3.8	3.3
Leverage Ratio					
Net Debt / Equity (x)	-0.1	-0.1	-0.1	-0.2	-0.2

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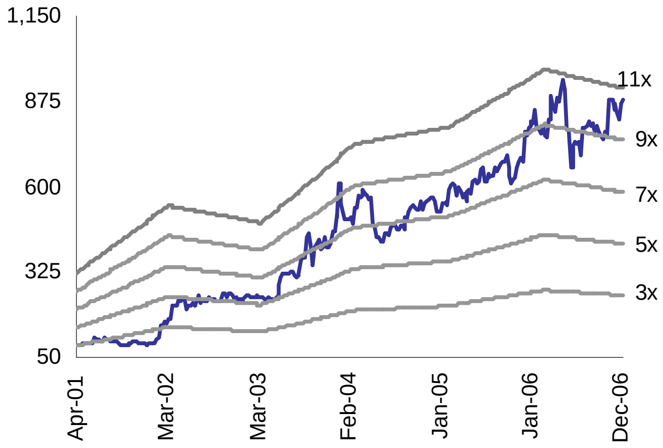

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Disclosure of Interest Statement	ONGC
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No