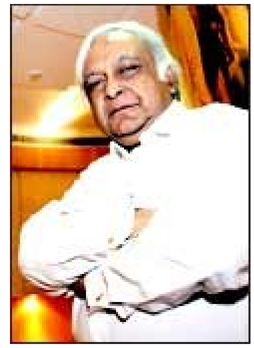
Dry Well, Not Black Gold

Financials apart, ONGC's performance over the past few years has been anything but impressive.

By Balaji Chandramouli



Media and investor darling: But Raha seems to have ignored the physicals

The government's recent decision not to give Subir Raha, the high-profile Chairman and Managing Director of the Oil and Natural Gas Corporation Ltd (ONGC) an extension is being seen as the fallout of several factors.

One is the rather adverse report issued by an independent inquiry committee which was investigating the July 2005 accident on the Mumbai High North platform of ONGC which resulted in the death of 22 people and a loss of around Rs 1,800 crore.

The other is some negative feedback on Raha's style of functioning which was given by his former boss, the former petroleum minister Mani Shankar Aiyar. For those who came in late, Raha and Aiyar had fallen out over the latter's decision to appoint V.K. Sibal, Director General, Hydrocarbons DGH, as a director on the board of ONGC. Aiyar was also reportedly unhappy with Raha's autonomous style of functioning.

While these factors have been widely publicised, another, one that reflects poorly on Raha's track record as CMD, hasn't. "Digging dry wells is a learning experience," Raha once famously remarked during a press conference a few years ago, but fact is, the man, and the company, may have dug more dry wells than was acceptable.

ONGC's flagship exploration initiative, Sagar Samridhi, a deep water oil and gas exploration programme, hasn't thrown up any big finds. If no one seems to have minded, it is because ONGC is darling of the bourses, and Raha, touted as one of India's best managers, both courtesy the company's financial performance.

Much of that has come on the back of rising crude prices. Five years ago, when Raha took over, ONGC realised less than $20 (Rs 900) per barrel of crude oil. Today, it rakes in around $55 (Rs 2,475). It is estimated that every dollar increase in the price of crude benefits ONGC to the extent of Rs 850 crore a year.

Deteriorating Physicals

All, it would appear, is not well at ONGC. Even a cursory look at the physical performance of the company is revealing: ONGC's production of crude oil has remained stagnant; and it has not made any significant new finds. Thus, ONGC has been lifting more oil from its discovered blocks than it can find in its new blocks-in oil industry lingo this is called the reserve accretion ratio, and ONGC's has been declining. At the same time it has also been producing less oil than it should. "If one applies global averages, ONGC should be producing 80 million tonnes per year. However, over the last five years, production has remained stagnant at 24-25 million tonnes," points out DGH Sibal.

Meanwhile, the company has gone on an overdrive to acquire overseas producing properties, with limited success. On the domestic front, it is diversifying into the SEZ (special economic zone) business, without addressing the issues facing its floundering core business, exploration and production, and the logical downstream diversification, retailing petrol and diesel.

A look at the core of ONGC's business reveals that after Mumbai High in the 1970s, the company has not made any significant discoveries. This, in a context where new entrants such as Reliance Industries Ltd and GSPC (Gujarat State Petroleum Corporation Ltd) have, literally, struck it rich. Reliance's find in the Krishna Godavari basin at 7 trillion cubic feet is good enough to power the entire state of Andhra Pradesh.

The key to striking oil and gas is the interpretation of seismic data. Since the cost of drilling a well is upwards of Rs 130 crore, the intensity of evaluation holds the key. Unfortunately, in ONGC's model of operation, there is little time for this. Hired rigs, which cost as much as Rs 2 crore a day, account for the most expensive operating part of the procedure.

ONGC hires these rigs on a time charter basis. Regardless of whether they are utilised or not, ONGC pays a 'standby' charge, which can be as high as 90 per cent of the price paid while it is in operation. Pressure to keep the rigs in action cuts into the company's efficiency of the evaluation process. Not surprisingly, around Rs 3,000 crore has gone down the drain on this account in the last three years, with an embarrassing 20 dry wells to show for the effort.

In contrast, Reliance hires rigs on a job charter basis. It calls in the rig only after exhaustively analysing the seismic data. ONGC defends its decision to hire rigs on a time-charter basis on the grounds that "...there is perennial short supply of drilling rigs."

Have Money, Will Buy

Unable to find oil and gas in India, ONGC has aggressively gone about trying to acquire discovered properties overseas, its war chest filled with the gains accrued from selling 25 million tonnes of crude oil in the domestic market.

While it has bagged producing as well exploration properties across the world, the competitiveness of the acquisition price, especially given the upward pressure generated by Chinese participation in the same market, is questionable. "Judging the future crude oil prices is an important factor, but it is very difficult to predict it," says Atul Chandra, President, Reliance Industries Ltd, and former head of ONGC Videsh Ltd (OVL), the overseas acquisition arm of ONGC.

Another key aspect of evaluation lies in the ability to estimate the reserves of the producing block beyond that perceived by the market. Given ONGC's track record on the domestic front, its ability to read reserves needs to improve. In fact, some time ago, OVL exited a block in Myanmar, only to return after paying a penalty, when its partner Daewoo struck gas.

If ONGC's strategy has worked thus far, it is because it has made its major acquisitions of discovered properties in a low global oil price regime. The Sudan ($690 million or Rs 3,150 crore) and Sakhalin ($2.77 billion or Rs 12,465 crore) properties were acquired when crude prices were in the low 20s.

In these times of high oil prices, it is not an accident that the domestic private sector is not pursuing discovered blocks. "In the current high oil price scenario, good producing properties are not available in the market as no one has a reason to sell them," says Chandra. "A commercially prudent company would not target discovered properties at present until oil price volatility improves."

Where properties are available, the political risk is often times on the high side. Recently, the government turned down an attempt by OVL to acquire a producing block in Nigeria. With stagnating oil production, and a tendency to resort to the soft option of acquiring producing properties where true E&P skills remain untested, ONGC, under the stewardship of a new CMD, has a lot of home work to do.

Over the past several months, the company has lost over 200 personnel, some of them geologists and drilling engineers, whose demand has grown ever since Reliance struck gas a few years ago. While ONGC's manpower count (36,000) is high, it continues to hire at the wrong end: Kakinada Refineries and Petrochemicals Ltd has hired close to 300 personnel, while there is no project in sight. Evidently, the officiating ONGC chief R.S. Sharma has a lot on his plate to sort out.