INDIA RESEARCH

ONGC

Rs682
UNDER REVIEW

VISIT NOTE

Mkt Cap: Rs1459bn; US$29bn

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We recently met the management of ONGC to get an update on the company's businesses and visibility on volumes, its capex plans and margin profile. Our discussion reveals that the company is better placed with respect to net realizations in Q4FY09, which are expected to be ~US$42/ bbl vis-à-vis $34/ bbl in Q3, driven primarily by the assurance of the government that there would be no additional subsidy burden on upstream players in the quarter. Volumes are, however, likely to remain flat in FY10 with a marginal increase in FY11. On the capex front, the company does not expect any deferment of its plans for FY10 and FY11, as oil prices – at US$40/ bbl and above – are still in the comfortable zone for ONGC. Given the relative stability in oil prices over the last few months, ONGC would register a lower subsidy burden for FY10 and, therefore, lower discounts on gross realizations.

Key financials

Year to March 31	Net sales (Rs m)	yoy chg (%)	Net profit (Rs m)	EPS (Rs)	yoy chg (%)	EV/E (x)	PE (x)
2006	706,808		153,976	72.0		4.9	9.5
2007	822,616	16	177,696	83.1	15	4.2	8.2
2008	967,822	18	198,723	92.9	12	3.7	7.3

Source: Company, IDFC-SSKI Research

KEY TAKEAWAYS FROM THE MANAGEMENT MEETING

❑ Rising offshore exploration activity a burden on costs

The increase in exploration activity offshore has led to a corresponding change in ONGC's rig portfolio, thereby necessitating higher costs of leasing drilling rigs. The company is looking at expanding its deepwater rig portfolio further, and has ordered two ultra deepwater rigs for delivery in December 2010. Notably, the rates for leasing these rigs are quite steep (in excess of US$500,000/d apiece). As rig rates have shown relative resilience to the fall in crude oil prices over the last six months, we expect drilling costs to remain high for ONGC.

ONGC – rig portfolio

	Offshore	Ultra deepwater
Number of rigs	29	2
Owned	9	1
Hired	20	1
Average rates	US$153k/d	US$357k/d
New Leases		2
Rates		US$529k/d – Sewan Marine
		US$636k/d - Vantage
Expected date of delivery		Dec 2010

Source: Company, IDFC-SSKI Research

❑ Future production to be more gas than oil

While ONGC has been hunting for more oil & gas reserves worldwide to augment India's energy basket, the search for additional oil is becoming harder given that easy-to-find reserves have run out. Further, most fields being discovered currently are a mixture of natural gas and oil with a predominance of the former. This has two implications:

⇒ The production from these fields cannot be easily brought to India and has to be monetized in the country of origin, and

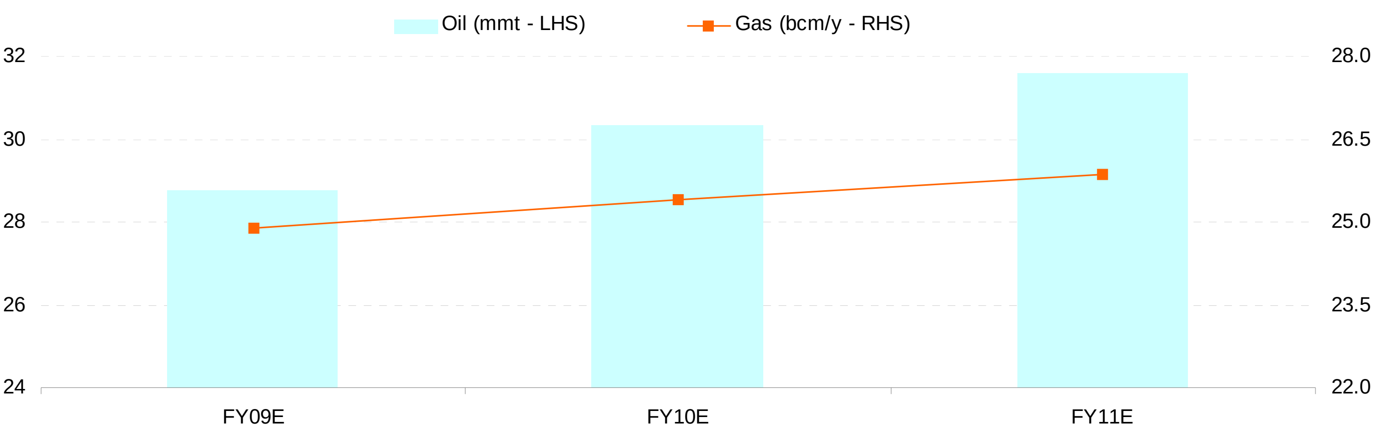
⇒ The crude oil requirement of India has to continue to be imported

However, the management is of the view that ONGC's business is to discover hydrocarbons and that both oil and gas can be monetized depending on which geography it is found in.

❑ Production to show marginal increases in FY10 and FY11

The gradual decline in domestic fields of ONGC (7-8%) has meant that any increase in production from new fields is more or less offset by the decline in the older fields. While Enhanced Oil Recovery (EOR) and other activities have kept the decline rate to relatively lower levels, ONGC's production is likely to show little growth over the next two years.

ONGC – volume growth over FY09-11E

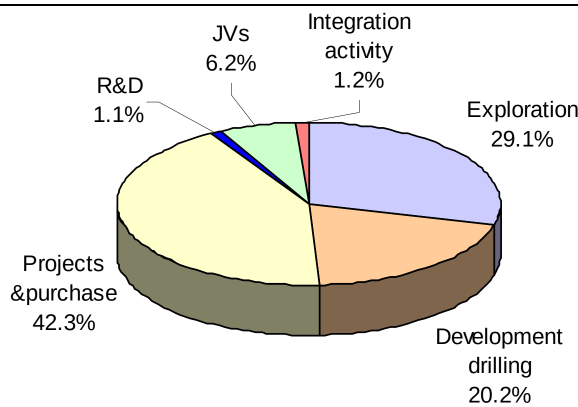


Source: IDFC-SSKI Research, Company

❑ Capex plans unchanged

The management has categorically stated that all of ONGC's minimum work commitments at various assets would be done as scheduled, as the company has no problems with oil prices remaining in the US$40-45/bbl range. According to the management, the average costs of production (including levies) remains at US$30-35/bbl, and ONGC continues to make profits at any price above that. ONGC forecasts capex of Rs210bn in FY10, 8% higher than in FY09.

Capex estimate for FY10E



Source: Company, Industry sources, IDFC-SSKI Research

❑ KG plans would take time

ONGC had recently announced, along with news of a new oil find in block KG-DWN-98/2, its plans to spend up to US$5.3bn in the KG basin to produce 25 mmscmd of gas and 8,000 b/d of oil from the block. However, more specific plans with regard to this block are still being worked out in the form of a field development plan (FDP) and no more details are being disclosed till the plan is submitted to the authorities.

❑ Imperial acquisition – no clarity yet

ONGC remains bullish on the acquisition of Imperial, stating that the move offers long-term benefits. ONGC is currently in the process of evaluating the asset portfolio of Imperial to better judge the capex requirements and production estimates for the same. Imperial currently produces ~10,000 boed from its fields. The stated target before the acquisition by ONGC was to reach 25,000 boed by FY11 and 85,000 boed by FY14.

❑ Our view – lower subsidies to prop up realizations in the near term

With oil prices in the US$40-45/bbl range, the government has absolved upstream companies from any more subsidy burden for Q4FY09, which would translate into a near-term upside on net realisations for ONGC. We expect a low discount burden in FY10 as well, which bodes well for realisations in the year. With production remaining steady and realisations improving, we expect ONGC to have a better year in terms of both revenues and profitability.

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Explanation of Ratings:

1. Outperformer: More than 10% to Index
2. Neutral: Within 0-10% to Index
3. Underperformer: Less than 10% to Index

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