

# Oil & Natural Gas Corp Ltd - BUY

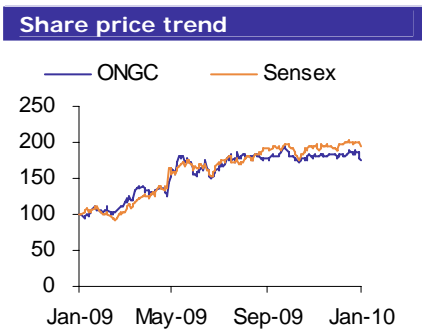
CMP Rs1,140, Target Rs1,308

Sector: Oil & Gas	
Sensex:	17,051
CMP (Rs):	1,140
Target price (Rs):	1,308
Upside (%):	14.7
52 Week h/l (Rs):	1274 / 614
Market cap (Rscr) :	243,832
6m Avg vol ('000Nos):	1,422
No of o/s shares (mn):	2,139
FV (Rs):	10
Bloomberg code:	ONGC IB
Reuters code:	ONGC.BO
BSE code:	500312
NSE code:	ONGC

Prices as on 21 Jan, 2010

Shareholding pattern	
<b>December '09</b>	<b>(%)</b>
Promoters	74.1
Institutions	12.2
Non promoter corp hold	12.0
Public & others	1.7

Performance rel. to sensx			
(%)	1m	3m	1yr
ONGC	(4.4)	(2.4)	(16.8)
Reliance	0.9	(3.8)	(7.2)
Cairn	0.2	(0.5)	(10.6)
GAIL	0.6	7.9	10.4



- ⊕ Net sales surge 23.7% yoy despite absence of MRPL trading activities primarily on account of 70.5% yoy jump in crude oil realizations (lower under recoveries)
- ⊕ Sales volumes for crude oil and natural gas remained flat at 5.7mn tons and 5.25bcm respectively
- ⊕ OPM expands 1,950bps yoy and 205bps qoq owing to a substantial fall in overheads as a percentage of sales
- ⊕ PAT growth restricted by reversal of interest income from OVL and four fold jump in dry well write-offs
- ⊕ Increase in production from JV fields and OVL would be key to earnings growth in near term
- ⊕ We upgrade ONGC from SELL to BUY considering its steep discount to global E&P majors

## Result table

(Rs m)	Q3 FY10	Q3 FY09	% yoy	Q2 FY10	% qoq
<b>Net sales</b>	<b>155,061</b>	<b>125,387</b>	<b>23.7</b>	<b>151,916</b>	<b>2.1</b>
Purchases (Trading)	(46)	(16,557)	(99.7)	-	-
Raw material	(1,259)	(22)	5,543.5	(864)	45.7
Personnel costs	(3,047)	(3,910)	(22.1)	(2,847)	7.1
Statutory levies	(31,033)	(24,585)	26.2	(29,846)	4.0
Other overheads	(26,330)	(29,279)	(10.1)	(30,014)	(12.3)
<b>Operating profit</b>	<b>93,347</b>	<b>51,033</b>	<b>82.9</b>	<b>88,345</b>	<b>5.7</b>
<b>OPM (%)</b>	<b>60.2</b>	<b>40.7</b>	<b>1,950 bps</b>	<b>58.2</b>	<b>205 bps</b>
Depreciation	(46,758)	(28,603)	63.5	(23,561)	98.5
Interest	(29)	(41)	(28.7)	(35)	(17.2)
Other income	(301)	11,187	(102.7)	11,393	(102.6)
<b>PBT</b>	<b>46,258</b>	<b>33,576</b>	<b>37.8</b>	<b>76,142</b>	<b>(39.2)</b>
Tax	(15,723)	(8,828)	78.1	(25,246)	(37.7)
<b>Effective tax rate (%)</b>	<b>34.0</b>	<b>26.3</b>		<b>33.2</b>	
<b>Reported PAT</b>	<b>30,536</b>	<b>24,748</b>	<b>23.4</b>	<b>50,896</b>	<b>(40.0)</b>
<b>PAT margin (%)</b>	<b>19.7</b>	<b>19.7</b>	<b>(4) bps</b>	<b>33.5</b>	<b>(1,381) bps</b>
Ann. EPS (Rs)	57.1	46.3	23.4	95.2	(40.0)

Source: Company, India Infoline Research

## Net sales jump 23.7% yoy on back of 70% jump in crude oil realizations

Oil and Natural Corporation Ltd (ONGC) reported net sales growth of 23.7% yoy to Rs155bn much in line with our expectations. The growth was despite absence of trading activities of MRPL products in Q3 FY10. After adjusting Q3 FY09 statistics for MRPL sales, net sales of ONGC were higher by 42.4% yoy. The growth was primarily on account of a 70% jump in net crude oil realizations from US\$33.8/bbl in Q3 FY09 to US\$70.5/bbl in Q3 FY10 on 30% higher gross realizations and 24% lower discounts. Sales volumes for crude oil and natural gas remained flat at 5.7mn tons and 5.25bcm respectively. Natural gas revenues were lower by 4.5% yoy owing to 5.3% fall in realizations. Revenues from VAP surged by 34.2% on back of 47.7% and 34% jump in naphtha and C2-C3 sales. While naphtha revenues were higher on account of 73% higher realizations, jump in C2-C3 sales was driven by 23% higher volumes.

### OPM improves 1,950bps yoy and 205bps qoq

During Q3 FY10, ONGC reported 82.9% yoy increase in operating profit and 1,950bps yoy jump in OPM to 60.2%. The key reasons for the jump in OPM were 1) exclusion of no profit trading activities of MRPL products, 2) jump in realizations and 3) 10.1% fall in overheads (637bps yoy fall as a percentage of net sales). However on a comparable basis (excluding MRPL sales in Q3 FY09), OPM was higher by 1,332bps as driven by lower overheads and fall in statutory levies as a percentage of sales.

### Higher depreciation and one time reversal restrict profit growth

Depreciation (including depletion, amortization and impairment loss) was higher by 63.5% yoy. This was owing to four fold jump in dry wells write off during the quarter. Further, other income was negative Rs301mn on account of Rs4.6bn one time reversal in lieu of interest income on loans to subsidiaries. ONGC Board in its 198th meeting held on 27th November, 2009 decided to extend interest free loan to OVL wef April 01, 2009 for a period of two years leading to reversal of interest charged for H1 FY10. Resultantly, PAT growth was restricted to 23.4% yoy to Rs30.5bn.

### Upgrade to BUY, considering steep valuation discount to global peers

ONGC trades at 57% discount to global peers on the basis of EV/boe of proved reserves. Considering the subsidy overhang, we believe that ONGC's discount is warranted. However, with ONGC currently sharing only auto fuel burden we believe the discount should narrow down. We value ONGC at US\$8/boe proved reserves (ONGC + OVL) of 949MTOE. 71% stake in MRPL is valued at Rs40 per share giving a combined target price of Rs1,308. Upgrade from SELL to BUY. Key concern to our call is an adverse change in subsidy sharing pattern, whereby upstream companies are asked to bear some portion of cooking fuel under recoveries as well.

### Cost analysis

As a % of net sales	Q3 FY10	Q3 FY09	bps yoy	Q2 FY10	bps qoq
Purchases (Trading)	0.0	13.2	(1,318)	0.0	3
Raw materials	0.8	0.0	79	0.6	24
Personnel Costs	2.0	3.1	(115)	1.9	9
Statutory levies	20.0	19.6	41	19.6	37
Other overheads	17.0	23.4	(637)	19.8	(278)
<b>Total costs</b>	<b>39.8</b>	<b>59.3</b>	<b>(1,950)</b>	<b>41.8</b>	<b>(205)</b>

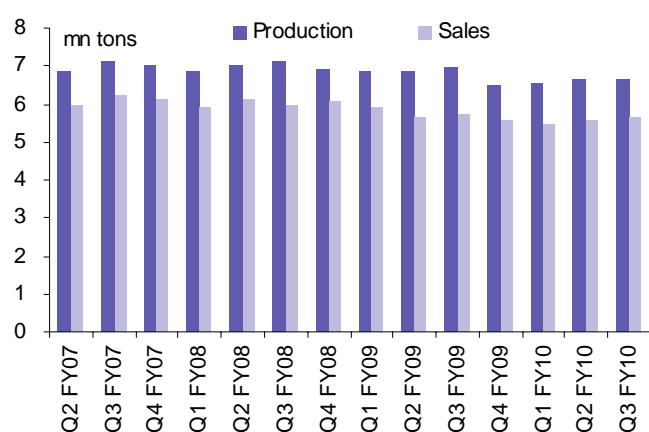
Source: Company, India Infoline Research

### Cost analysis (excluding trading of MRPL products)

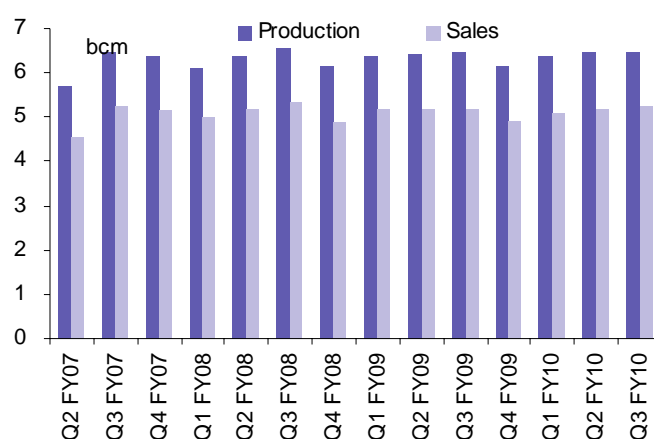
As a % of net sales	Q3 FY10	Q3 FY09	bps yoy	Q2 FY10	bps qoq
Raw materials	0.8	0.0	79	0.6	24
Personnel Costs	2.0	3.6	(163)	1.9	9
Statutory levies	20.0	22.6	(257)	19.6	37
Other overheads	17.0	26.9	(992)	19.8	(277)
<b>Total costs</b>	<b>39.8</b>	<b>53.1</b>	<b>(1,332)</b>	<b>41.8</b>	<b>(206)</b>

Source: Company, India Infoline Research

### Trend in crude oil production and sales

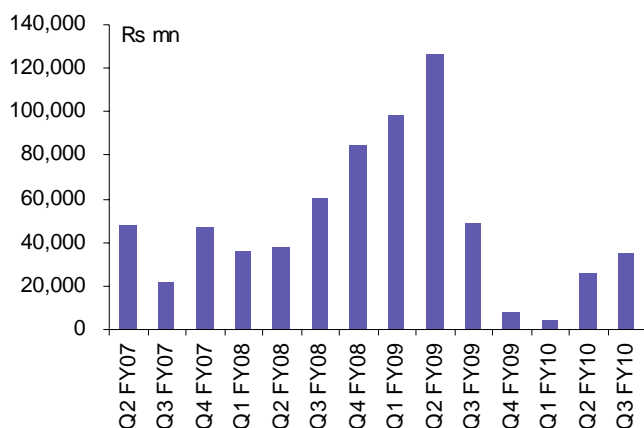


### Trend in gas production and sales

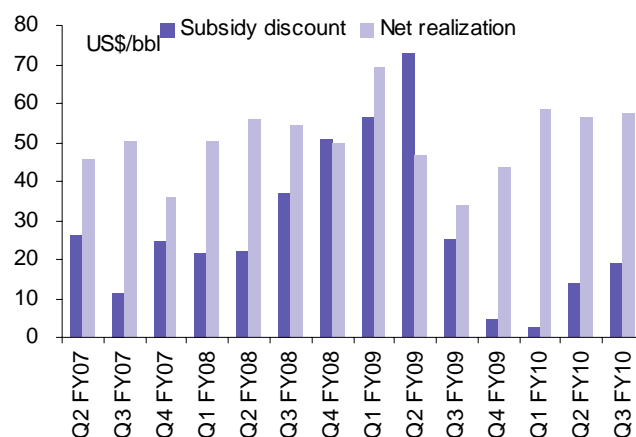


Source: Company, India Infoline Research

## Trend in subsidy burden



## Trend in realizations



Source: Company, India Infoline Research

## Financial summary

Y/e 31 Mar (Rs m)	FY09	FY10E	FY11E	FY12E
Revenues	1,053	1,175	1,222	1,238
yoy growth (%)	8.8	11.6	4.0	1.3
Operating profit	411	489	514	512
OPM (%)	39.0	41.6	42.0	41.4
Pre-exceptional PAT	198	220	241	240
Reported PAT	198	220	241	240
yoy growth (%)	(0.4)	11.2	9.6	(0.4)

EPS (Rs)	92.5	102.9	112.8	112.4
P/E (x)	3.7	3.3	3.0	3.1
Price/Book (x)	0.8	0.7	0.6	0.6
EV/EBITDA (x)	1.4	1.3	1.2	1.2
Debt/Equity (x)	0.1	0.1	0.1	0.1
RoE (%)	18.7	22.5	21.7	19.1
RoCE (%)	22.1	25.2	23.8	21.1

Source: Company, India Infoline Research

## Valuation discount of ONGC

Company	EV/Boe
Exxon Mobil	14.2
Chevron	14.3
Shell	13.5
Conoco Phillip	10.9
Apache	16.2
Occidental	21.7
Anadarko	18.4
Woodside	32.3
Petrochina	15.1
CNOOC	22.2
ENI	10.4
Repsol	13.5
Average	16.9
ONGC	7.3
Discount	(56.7)

Source: Company, Bloomberg, India Infoline Research

**Recommendation parameters for fundamental reports:**

**Buy** – Absolute return of over +10%

**Market Performer** – Absolute return between -10% to +10%

**Sell** – Absolute return below -10%

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