

RESULTS

REVIEW

## Oil and Natural Gas Corporation Ltd.

Estimates unchanged; Upgrade to BUY

BUY

Analyst

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Nifty: 5,512; Sensex: 18,396

CMP	Rs1,136
Target Price	Rs1,320
Potential Upside/Downside	+16%

## Key Stock Data

Sector	Oil & Gas
Bloomberg/Reuters	ONGC IN/ONGC.BO
Shares o/s (mn)	2,138.9
Market cap. (Rs mn)	2,428,904
Market cap. (US\$ mn)	53,102
3-m daily average vol.	131,481

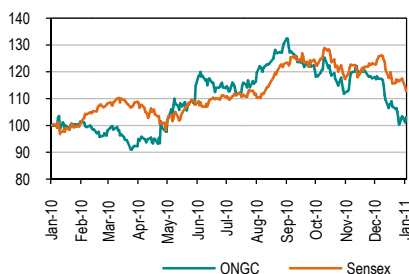
## Price Performance

52-week high/low	Rs1,472/997
	-1m -3m -12m
Absolute (%)	(12) (13) 3
Rel to Sensex (%)	(4) (5) (10)

## Shareholding Pattern (%)

Promoters	74.2
FII/IRIs/OCBs/GDR	4.7
MFs/Banks/FIs	7.6
Non Promoter Corporate	11.7
Public & Others	1.8

## Relative to Sensex



Source: Capitaline

## Summary

Oil and Natural Gas Corp's (ONGC) adjusted net profit came above expectation, while its net sales and EBITDA margin came in line with estimates. The company received Rs19 bn from gas pool account during the quarter, which led to 132% YoY jump in net profit to Rs70.8 bn in Q3FY11. However, adjusting this, ONGC's net profit increased 91% YoY to Rs58.3 bn, surpassing our expectation of Rs56 bn driven by higher-than-expected other income. The company's other income increased to Rs9.9 bn during the quarter, against our expectation of Rs6.5 bn. The company's revenue and margin growth was driven by a) 12.3% YoY increase in net oil realization to US\$64.8/bbl, b) revision in APM gas price and c) 3.7% higher oil sales volumes at 5.9mmt due to increased production from Rajasthan basin. The company expects ~4% CAGR in its oil and gas production volumes during FY10-FY13.

We are keeping our estimates unchanged and expect the company's net crude oil realization to be US\$59/bbl in FY11 and US\$60.2/bbl in FY12. We however, have revised our WACC assumption to 12.5% from 11.7% due to change in risk free rate of return and increase in market risk. Therefore, our revised target price stands at Rs1,320 from earlier Rs1,440. However, considering that the stock has corrected significantly in recent times, we are upgrading the stock from ACCUMULATE to **BUY**.

## Result Highlights

- Higher oil volumes and prices led to 21% increase in revenue, in line with estimate**  
 The company's revenue increased 21.4% YoY to Rs186 bn in Q2FY11, in line with our expectations. ONGC's revenue growth was driven by a) 12.3% YoY increase in net oil realization to US\$64.8/bbl, b) revision in APM gas price to US\$4.2/mmbtu from US\$2.1/mmbtu and c) 3.7% higher oil sales volumes at 5.9mmt due to increased production from Rajasthan basin. However, growth was partially offset by 3% YoY decline in gas sales volumes to 5.1bcm.
- Higher net realization led to margin expansion; in line with expectation**  
 ONGC shared 81.2% of total upstream share of under-recoveries (33.3% of total) during the quarter, which came at Rs42.2 bn, in line with our expectation of Rs43 bn. Coupled with this, higher crude oil prices led to higher net realization of US\$64.8/bbl in Q3FY11 against US\$57.7/bbl in Q3FY10. Further, natural gas price realization stood at Rs6.8/scm in Q3FY11 compared to Rs3.8/scm in Q3FY10. Consequently, the company's EBITDA margins improved 117bps YoY to 60.9%, in line with our expectations.
- Higher other income and one-off payment inflated PAT**  
 The company received Rs19 bn from gas pool account in the form of TDRs, which led the spike in the company's reported net profit at Rs70.8 bn in Q3FY11 from Rs30.5 bn in Q3FY10. After adjusting for this, ONGC's adjusted net profit increased 90.9% YoY to Rs58.3 bn, ahead of our expectations due to higher-than-expected other income. The company's other income increased to Rs9.9 bn during the quarter, against our expectation of Rs6.5 bn. The higher other income was driven by a) change in interest rate in Site restoration fund from 5% earlier to 8.5% (impact: +Rs1.4 bn), b) increased receivables from GOI on account of North-East Gas (impact: +Rs0.7 bn) and higher miscellaneous receipts (+Rs1.2 bn).

Table: Financial snapshot

(Rs mn)

Year	Revenue	EBITDA	EBITDA (%)	Adj. PAT	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoE (%)	RoCE (%)
FY09	1,045,884	417,005	39.9	197,296	92.2	12.4	5.5	23.2	22.4
FY10	1,017,546	443,896	43.6	194,035	90.7	12.6	5.1	20.0	19.1
FY11E	1,117,444	518,242	46.4	238,030	111.3	10.3	4.4	21.8	21.0
FY12E	1,193,597	560,784	47.0	262,692	122.8	9.3	4.1	21.0	20.4

Source: Company; IDBI Capital Research

### ■ Drilled 96 wells; 5 discoveries during the quarter

The company announced five discoveries during the quarter, out of which 4 were gas and 1 was oil and gases both. ONGC made two discoveries in Western Offshore basin, while one discovery each was announced in Mahanadi offshore, Cauvery and Western onshore basins. Further, the company drilled 96 wells during the quarter which include three deepwater, 15 shallow water and 78 onshore wells. Out of 96 wells, 29 wells were exploratory and appraisal wells, comprising 3 deep water, 7 shallow water and 19 onshore wells.

## Outlook and Valuation

We expect ONGC's crude oil production to grow 3.5% YoY and 3.3% YoY in FY11E and FY12E and gas production to remain flat over the next two years. We are keeping our estimates unchanged and expect the company's net crude oil realization to be US\$59/bbl in FY11 and US\$60.2/bbl in FY12. As upstream has to bear only one-third of the total under-recoveries, we believe ONGC's realization would improve in a rising crude oil price scenario. We believe diesel deregulation is unlikely in near term given the higher crude oil price and higher inflation level. We have revised our WACC assumption to 12.5% from 11.7% due to change in risk free rate of return and increase in market risk. Therefore, we have revised our target price downwards to Rs1,320 from earlier Rs1,440. As its valuation has corrected significantly in the recent month, we are upgrading the stock from ACCUMULATE to **BUY**.

**Table: Actual Vs Estimates**

(Rs mn)

	Actual	Estimated	% Variance
Net sales	185,864	185,139	0.4
EBITDA	113,138	111,251	1.7
EBITDA margin (%)	60.9	60.1	78bps
Adjusted PAT	58,306	55,969	4.2
Adjusted EPS (Rs)	27.3	26.2	4.2

Source: Company; IDBI Capital Research

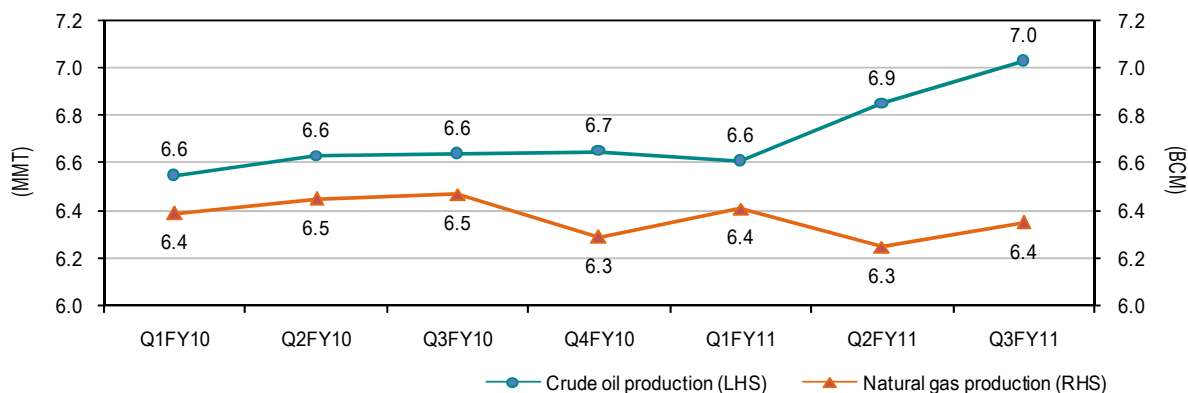
**Table: Quarterly performance**

(Rs mn)

Year-end: March	Q3FY11	Q3FY10	% Chg YoY	Q2FY11	% Chg QoQ
Net sales	185,864	153,145	21.4	181,936	2.2
Expenditure	72,726	61,715	17.8	71,085	2.3
EBITDA	113,138	91,430	23.7	110,851	2.1
EBITDA margin (%)	60.9	59.7	117bps	60.9	(6)bps
Other income	9,890	1,615	512.3	11,429	(13.5)
Interest	54	29	85.7	9	497.8
Depreciation	36,410	46,758	(22.1)	44,001	(17.3)
PBT	99,091	46,258	114.2	78,270	26.6
Tax	28,259	15,723	79.7	24,382	15.9
Adjusted PAT	58,306	30,536	90.9	53,888	8.2
Adjustments	12,527	0	-	0	-
Reported PAT	70,832	30,536	132.0	53,888	31.4
Adjusted EPS (Rs)	27.3	14.3	90.9	25.2	8.2
Subsidy	42,225	34,970	20.7	30,190	39.9
Net realisation (US\$/bbl)	64.8	57.7	12.3	62.8	3.3

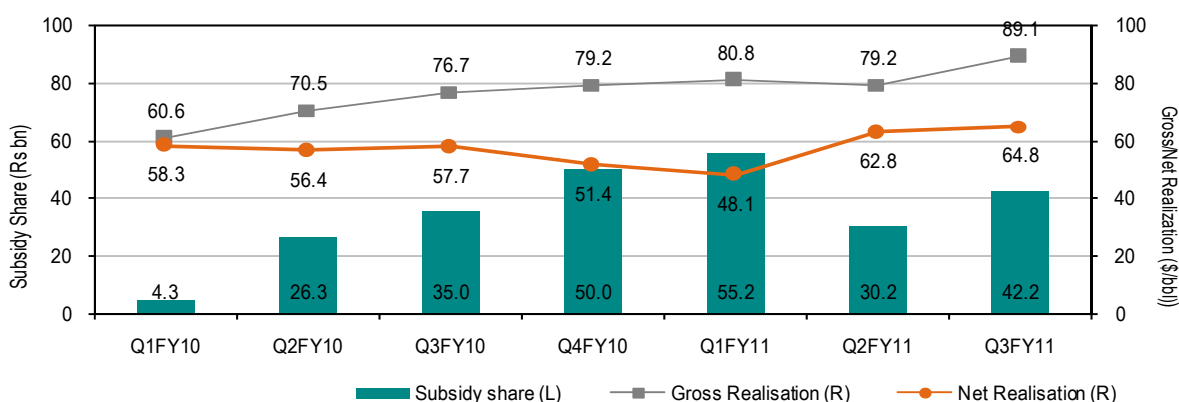
Source: Company; IDBI Capital Research

Figure: Production Volume trend



Source: Company

Figure: Subsidy sharing trend



Source: Company

Table: Segmental performance

(Rs mn)

Year-end: March	Q3FY11	Q3FY10	% Chg YoY	Q2FY11	% Chg QoQ
<b>Revenue</b>					
Crude oil	132,630	117,200	13.2	130,440	1.7
Natural Gas	34,660	20,000	73.3	35,840	(3.3)
LPG	5,990	5,740	4.4	5,440	10.1
Naphtha	14,110	11,020	28.0	10,670	32.2
C2-C3	2,510	2,840	(11.6)	1,750	43.4
<b>Average realisation</b>					
Crude oil (US\$/bbl)	64.8	57.7	12.3	62.8	3.3
Natural Gas (Rs/tcm)	6,809.4	3,809.5	78.7	7,111.1	(4.2)
LPG (US\$/mmt)	509.2	442.6	15.0	460.6	10.6
Naphtha (US\$/mmt)	785.6	659.9	19.1	646.4	21.5
C2-C3 (US\$/mmt)	532.4	438.0	21.6	432.6	23.1
<b>Sales volume</b>					
Crude oil (mmt)	5.9	5.7	3.7	5.9	(0.5)
Natural Gas (bcm)	5.1	5.3	(3.0)	5.0	1.0
LPG (tmt)	262.0	278.0	(5.8)	254.0	3.1
Naphtha (tmt)	400.0	358.0	11.7	355.0	12.7
C2-C3 (tmt)	105.0	139.0	(24.5)	87.0	20.7

Source: Company; IDBI Capital Research

## Financial Summary

### Profit & Loss Account

(Rs mn)

Year-end: March	FY09	FY10	FY11E	FY12E
<b>Revenue</b>	<b>1,045,884</b>	<b>1,017,546</b>	<b>1,117,444</b>	<b>1,193,597</b>
Growth (%)	8.1	(2.7)	9.8	6.8
<b>EBITDA</b>	<b>417,005</b>	<b>443,896</b>	<b>518,242</b>	<b>560,784</b>
Growth (%)	3.0	6.4	16.7	8.2
Depreciation & amortisation	154,304	187,188	192,710	197,018
<b>EBIT</b>	<b>262,701</b>	<b>256,708</b>	<b>325,532</b>	<b>363,767</b>
Growth (%)	(1.2)	(2.3)	26.8	11.7
Interest	2,386	5,022	4,850	4,786
Other income	50,721	52,728	52,753	53,145
<b>EBT</b>	<b>311,037</b>	<b>304,414</b>	<b>373,435</b>	<b>412,126</b>
Income taxes	110,093	107,138	131,430	145,047
Effective tax rate (%)	35.4	35.2	35.2	35.2
Min int / inc from assoc	3,648	3,240	3,975	4,387
<b>Reported net income</b>	<b>197,953</b>	<b>194,035</b>	<b>250,557</b>	<b>262,692</b>
Adjustments	658	-	12,527	-
<b>Adjusted net income</b>	<b>197,296</b>	<b>194,035</b>	<b>238,030</b>	<b>262,692</b>
Growth (%)	(1.2)	(1.7)	22.7	10.4
Shares outstanding (mn)	2,138.9	2,138.9	2,138.9	2,138.9
<b>Adjusted EPS (Rs)</b>	<b>92.2</b>	<b>90.7</b>	<b>111.3</b>	<b>122.8</b>
Growth (%)	(1.2)	(1.7)	22.7	10.4
DPS (Rs)	32.0	32.0	64.0	32.0

### Balance Sheet

(Rs mn)

Year-end: March	FY09	FY10	FY11E	FY12E
Cash and cash eq	225,956	223,842	229,041	214,669
Accounts receivable	71,814	71,424	78,436	83,781
Inventories	65,424	82,400	89,236	95,645
Others current assets	143,953	127,998	132,979	137,979
Investments	34,803	51,593	51,593	51,593
Gross fixed assets	1,697,482	1,933,001	1,993,001	2,113,001
Net fixed assets	637,936	755,427	815,427	935,427
CWIP	247,580	256,164	338,508	421,063
Intangible assets	114,039	95,385	95,385	95,385
Deferred tax assets, net	(92,231)	(102,912)	(117,090)	(132,738)
Other assets	6,506	8,413	8,413	8,413
<b>Total assets</b>	<b>1,455,781</b>	<b>1,569,734</b>	<b>1,721,928</b>	<b>1,911,218</b>
Accounts payable	100,140	126,817	128,919	140,390
Other current liabilities	100,092	99,503	100,770	101,278
Provisions	82,158	75,656	78,129	82,845
Debt funds	65,591	62,669	53,870	48,378
Other liabilities	185,565	191,022	194,997	199,384
Equity capital	21,389	21,389	21,389	21,389
Reserves & surplus	900,846	992,678	1,143,854	1,317,554
Shareholder's funds	922,235	1,014,066	1,165,243	1,338,943
<b>Total liabilities</b>	<b>1,455,781</b>	<b>1,569,734</b>	<b>1,721,928</b>	<b>1,911,218</b>
BVPS (Rs)	441.2	484.1	554.8	636.0

Source: Company; IDBI Capital Research

### Cash Flow Statement

(Rs mn)

Year-end: March	FY09	FY10	FY11E	FY12E
Net income + Depreciation	285,745	282,664	443,267	459,709
Non-cash adjustments	19,757	39,252	(14,801)	10,355
Changes in working capital	4,825	(16,195)	(16,545)	(14,363)
<b>Cashflow from operations</b>	<b>310,326</b>	<b>305,721</b>	<b>411,920</b>	<b>455,701</b>
Capital expenditure	(216,390)	(212,531)	(335,054)	(399,573)
Change in investments	9,018	(22,485)	-	-
Other investing cashflow	(96,226)	4,326	-	-
<b>Cashflow from investing</b>	<b>(303,598)</b>	<b>(230,691)</b>	<b>(335,054)</b>	<b>(399,573)</b>
Issue of equity	-	0	-	-
Issue/repay debt	49,676	(164)	(8,799)	(5,492)
Dividends paid	(81,030)	(80,781)	(62,869)	(65,008)
Other financing cashflow	-	-	-	-
Change in cash & cash eq	(24,626)	(5,915)	5,199	(14,372)
<b>Closing cash &amp; cash eq</b>	<b>225,956</b>	<b>223,842</b>	<b>229,041</b>	<b>214,669</b>

### Financial Ratios

Year-end: March	FY09	FY10	FY11E	FY12E
<b>Profitability &amp; Return ratios</b>				
EBITDA margin (%)	39.9	43.6	46.4	47.0
EBIT margin (%)	25.1	25.2	29.1	30.5
Net profit margin (%)	18.9	19.1	21.3	22.0
ROE (%)	23.2	20.0	21.8	21.0
ROCE (%)	22.4	19.1	21.0	20.4
<b>Working capital &amp; Liquidity ratios</b>				
Receivables (days)	25	26	24	25
Inventory (days)	55	66	72	72
Payables (days)	79	101	107	105
Current ratio (x)	2.5	2.2	2.3	2.2
Quick ratio (x)	1.1	1.0	1.0	0.9
<b>Turnover &amp; Leverage ratios</b>				
Gross asset turnover (x)	0.7	0.6	0.6	0.6
Total asset turnover (x)	0.8	0.7	0.7	0.7
Interest coverage ratio (x)	110.1	51.1	67.1	76.0
Adjusted debt/equity (x)	0.1	0.1	0.0	0.0
<b>Valuation ratios</b>				
EV/Sales (x)	2.2	2.2	2.0	1.9
EV/EBITDA (x)	5.5	5.1	4.4	4.1
P/E (x)	12.4	12.6	10.3	9.3
P/BV (x)	2.6	2.4	2.1	1.8

### Quarterly Trend

Year-end: March	Q4FY10	Q1FY11	Q2FY11	Q3FY11
Revenues	160,023	136,656	181,936	185,864
YoY growth (%)	27.6	(1.2)	22.3	22.3
EBITDA margin (%)	58.9	58.8	60.9	60.9
Adjusted net profit	37,764	36,611	53,888	58,306
YoY growth (%)	52.6	65.9	11.2	14.6



# Notes

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**BUY:** Absolute return of 15% and above; **ACCUMULATE:** 5% to 15%; **HOLD:** Upto  $\pm 5\%$ ; **REDUCE:** -5% to -15%; **SELL:** -15% and below.

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