

STOCK INFO.	BLOOMBERG
BSE Sensx: 10,617	ONGC IN
	REUTERS CODE
S&P CNX: 3,110	ONGC. BO

26 July 2006
Buy
Previous Recommendation: Buy
Rs1,138

		YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
		END	(RS B)	(RS B)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
Equity Shares (m)	1,425.9	03/06A	706.4	154.0	108.0	7.4	10.5	2.9	29.8	34.3	2.4	5.1
52-Week Range (Rs)	1,514/854	03/07E	862.0	193.9	136.0	25.9	8.4	2.4	31.7	37.0	2.1	4.1
1,6,12 Rel. Perf. (%)	1/-18/-23	03/08E	798.3	172.6	121.0	-11.0	9.4	2.1	23.9	28.7	1.9	4.2
M.Cap. (Rs b)	1,623.0											
M.Cap. (US\$ b)	34.8											

Consolidated

- Net profit at Rs41.2b is up 24.1% YoY, better than our (Rs37.4b) and street expectations (Rs36.3b). Sharp growth is on the back of higher sales driven by higher crude price realisation, increase in sales volume and favourable exchange rate. Sales (including trading sales) is up 34.3% YoY at Rs146b. Net of trading, sales at Rs130b is up 29.8% YoY.
- Crude price realisation, the key driver of sales growth is up sharply at US\$71.4/bbl (gross) and US\$45/bbl (net of discounts) compared to US\$53.7/bbl and US\$37.5/bbl last year. Total gross discount (on account of subsidy sharing) of Rs51.2b (Rs28.8b last year) and net discount of Rs46.8b.
- Crude sales volume at 6.4m tons is up 2.2% YoY, while gas sales at 5.3bcm is up 3.5% YoY. Exchange rate weakened YoY by 4.4% contributing to better crude price realisation. Some increase in gas prices too would have contributed, though the quantum is likely to be small.
- Reiterate Buy with a target price of Rs1,380/share, upside of 21%. Stock is trading at a P/E of 8.4x FY07E and an EV/boe US\$3.8/boe as compared to global average of US\$10-12/boe. We believe the current valuations discount highly pessimistic expectations, on all fronts - continuation of subsidy sharing indefinitely, no change in gas price realisations and zero reserve accretion.

QUARTERLY PERFORMANCE (STANDALONE)
(Rs Billion)

Y/E MARCH	FY06				FY07				FY06*	FY07E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Net Sales	108.7	126.8	124.8	119.0	146.0	123.9	119.1	123.8	479.2	512.7
Change (%)	5.6	7.3	3.1	-2.1	34.3	-2.3	-4.5	4.0	3.4	7.0
Raw Material and Purchases	9.7	12.7	5.8	9.9	17.5	0.3	0.3	0.3	38.1	18.3
Statutory Levies	25.0	26.6	27.1	18.3	31.1	31.5	31.8	32.8	97.0	127.2
Employee Costs	2.8	2.4	2.5	5.0	3.0	2.5	2.5	4.6	12.7	12.6
Other Exp (incl Stock Adj)	10.2	13.6	15.8	18.5	13.3	13.8	14.0	14.0	58.0	55.0
EBITDA	61.1	71.6	73.6	67.3	81.1	75.8	70.6	72.2	273.5	299.7
% of Net Sales	56.2	56.4	59.0	56.5	55.5	61.2	59.3	58.3	57.1	58.4
% Change	18.5	12.5	17.1	5.5	32.8	5.9	-4.1	7.3	13.1	9.6
Depreciation	13.5	19.4	20.1	31.6	22.3	22.2	20.0	21.1	84.6	85.6
Interest	0.0	0.1	0.1	0.3	0.0	0.0	0.0	0.0	0.5	0.1
Other Income	3.0	8.6	5.6	6.3	4.2	5.0	6.5	7.3	23.5	23.0
PBT	50.5	60.8	59.0	41.7	63.0	58.6	57.1	58.4	212.0	237.0
Tax	17.3	19.4	20.2	17.2	21.8	19.5	19.0	19.5	74.1	79.9
Rate (%)	34.3	31.9	34.2	41.3	34.6	33.4	33.3	33.4	34.9	33.7
PAT*	33.2	41.4	38.9	24.5	41.2	39.0	38.0	38.9	137.9	157.1
Change (%)	43.8	22.3	11.3	-35.6	24.1	-5.7	-2.1	58.9	6.2	14.0

E: MOfSt Estimates

Note: In the interest of timeliness, this report has not been edited.

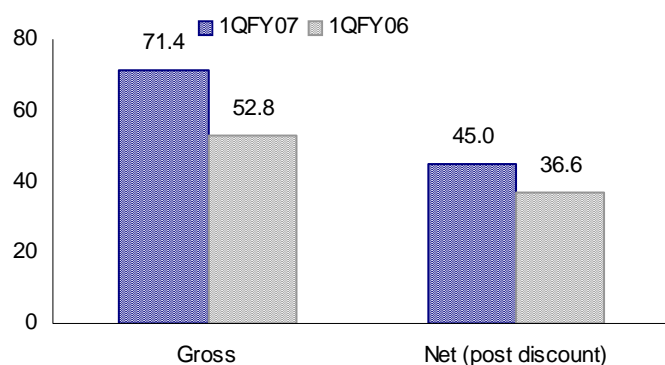
1QFY07 PAT at Rs41.2b was up 24.1% YoY, above expectations, despite a sharp increase in fuel marketing loss sharing YoY. Higher crude prices, higher sales volume and favourable exchange rates were the key drivers of profit growth. EBITDA at Rs81.1b was up 32.8% YoY.

Crude price was the key earnings driver

ONGC's crude price realisation at US\$71.4/bbl (before loss sharing) was up sharply compared to US\$52.8/bbl last year. Net realisation (net of discounts on account of loss sharing) of US\$45/bbl (discount of US\$26.4/bbl) was up 23% YoY compared to US\$36.6/bbl (discount of US\$16.2/bbl) last year. Weakening of rupee by 4.4% YoY further contributed to the improvement in price realisation.

ONGC continues to benefit from higher crude prices, as it remains positively geared to crude prices, despite the fuel loss sharing burden based on the 1/3rd upstream sharing formula (which remains unchanged despite the sharp increase in crude prices and fuel marketing losses YoY). ONGC management indicated that the Government policy is to allow ONGC to benefit from rising crude prices and hence, we understand that a situation wherein ONGC's realisation would be capped is highly unlikely.

CRUDE PRICE REALISATION (US\$/BBL)



Source: Company/ Motilal Oswal Securities

Sales volume growth is the other driver

Crude and gas sales volume were up YoY. While crude sales was up 2.2% YoY at 6.4m tons, gas sales was up

3.5% YoY at 5.3bcm. However, crude production remained flat YoY, though gas output was up 5.3% YoY driven by both ONGC's output increase as well as JV contribution. While oil and gas sales volumes are higher than trend for FY07, oil production volumes lag. However, we attribute this to Bombay High throughput issues, which are expected to be corrected shortly.

OIL & GAS PRODUCTION AND SALES VOLUME

	PRODUCTION			SALES		
	1QFY07	1QFY06	% CH.	1QFY07	1QFY06	% CH.
Oil (m tons)	6.9	6.9	0.4	6.4	6.3	2.2
Gas (bcm)	6.1	5.8	5.3	5.3	5.1	3.5

Source: Company/ Motilal Oswal Securities

Higher DD&A charges impact reported profit growth

DD&A charges are up 65% YoY at Rs22.3b, but in line with our forecast as well as the higher exploration expenditure.

Outlook

OVL – future growth engine

OVL continues to remain a key growth engine for ONGC. OVL reports that it has made “several significant hydrocarbon forays” in 1QFY07, the most significant being acquisition of 15% stake in Brazilian block which has the capability to produce 1,00,000bpd. (5mtpa). It also reports signing of MoU with Petro Ecuador for co-operation in energy sector.

Outlook for OVL's reserve accretion as well as production is very encouraging. OVL has 4 discovered blocks - Brazil, Myanmar, Qatar and Egypt, which would add to the reserves as and when the assessment is complete. The management also indicated that Nigeria and Cuba exploration blocks are particularly highly prospective among the overseas exploration asset portfolio.

We continue to reiterate that OVL would be the key growth driver for ONGC over the next 5 years.

Domestic operations continue to look up...

Addition to ultimate reserves through IOR / EOR efforts is expected between 65-70m tons next 3 years, while production rates are likely to improve marginally as JVs ramp up output, IOR / EOR efforts produce results and marginal fields are put to production.

Key concerns

Interim report of Tariff Commission (sent for feedback from ONGC) on pricing of gas has indicated a price of Rs3450/tscm based on its cost working. As against this, the land fall producer price today is Rs3200/mscm for APM gas to fertiliser and power endusers. While the recommended price is 7.8% higher than prevailing price, the recommendation would effectively cap the pricing, ruling out APM gas price deregulation.

ONGC, on its part has contended the basis and calculation of cost components, while demanding free pricing at the outset and indicating the serious drawbacks of cost based pricing. While, the draft report per se need not be a cause

for alarm (given the changes that were done to gas pipeline tariff interim vs final report, where the basis for calculation of tariff itself was changed), we believe, the cost plus basis, is a wrong starting point and raises the risk of possible cap on APM gas prices.

Valuation and view

We reiterate our Buy recommendation with a target price of Rs1,380/share, an upside of 21%. Stock is trading at a P/E of 8.2x FY07E and an EV/boe US\$3.8/boe as compared to global average of US\$10-12/boe. We believe the current valuations discount highly pessimistic expectations, on all fronts - continuation of subsidy sharing indefinitely, no change in gas price realisations and zero reserve accretion. Deregulation of gas prices is happening, though at a very slow pace, while the latest policy on subsidy sharing effectively caps further losses and loss sharing. The pace of acquisition of global E & P assets continues to remain strong and we believe that OVL would be the future growth driver for ONGC. The stock trades at a P/E of 8.4x FY07E. Maintain **Buy** with a target price of Rs1,380/share, an upside of 21%.

ONGC: an investment profile

A Fortune 500 company, ONGC is the largest company in India in terms of market capitalization. It is the largest E&P company, with proven reserves in excess of 1b TOE. It acquired a majority stake in the loss making MRPL and turned it around. Its overseas subsidiary, OVL has acquired E&P assets in Sakhalin (Russia), Sudan, Libya, Iran, Iraq, Vietnam, Myanmar and is now acquiring stake in Equador.

Key investment arguments

- OVL has emerged as the key growth driver with large growth potential
- With over 1b TOE of proven reserves, aggressive E&P and asset acquisition program, ONGC holds large growth potential.
- Current valuations more than reflect loss sharing and gas pricing issues

Key investment risks

- Government policy remains the biggest risk

Recent developments

- OVL has acquired stake in Brazil block
- OVL has signed an MoU with Petro Ecuador for co-operation in the energy sector

Valuation and view

- P/E at 8.4x FY07E is not demanding.
- The stock quotes at US\$3.8/boe compared to global average of between US\$10-12/boe.
- Reiterate **Buy**.

Sector view

- Strong crude price environment is expected to continue
- Gas price revisions continue and we believe deregulation is inevitable
- ONGC is well positioned to reap the benefits of higher crude prices and potential complete deregulation of gas pricing.

COMPARATIVE VALUATIONS

		ONGC	GAIL
P/E (x)	FY07E	8.4	9.1
	FY08E	9.4	9.0
P/BV (x)	FY07E	2.4	1.9
	FY08E	2.1	1.7
EV/Sales (x)	FY07E	1.8	1.2
	FY08E	1.9	1.1
EV/EBITDA (x)	FY07E	4.1	5.0
	FY08E	4.2	4.3

SHAREHOLDING PATTERN (%)

	JUN.06	MAR.06	JUN.05
Promoters	84.2	86.2	86.2
Domestic Institutions	4.0	3.1	2.7
FII's/FDIs	9.5	8.5	8.5
Others	2.2	2.2	2.6

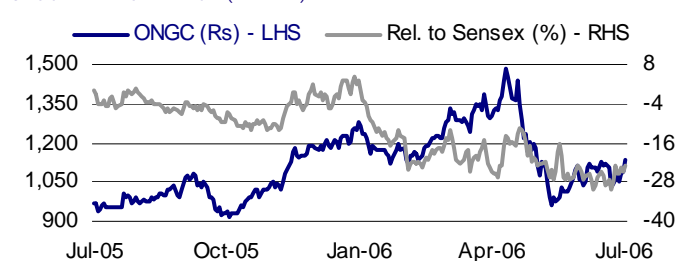
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	136.0	131.7	3.3
FY08	121.0	138.2	-12.4

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
1,138	1,380	21.3	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT (Rs Million)					
Y/E MARCH	2004	2005	2006	2007E	2008E
Net sales	436,471	597,464	706,373	861,968	798,308
Growth (%)	26.4	36.9	8.2	22.0	-7.4
Government levies	102,546.1	131,131.2	140,289.8	191,266.0	192,613.5
Pipeline costs (trans & fr	6,095	10,320	9,546	9,752	9,932
Other operating costs	130,789	172,224	245,793	278,650	237,812
Operating costs	239,430	313,675	395,629	479,668	440,357
EBIDTA	197,041	283,790	310,744	382,300	357,951
% of Net Sales	45.1	47.5	44.0	44.4	44.8
Debt charges (incl exch li	-3,822	-1,877	-1,597	-931	-840
Exploration write-offs	-1,343	-3,281	-103,549	-56,526	-60,726
Depn, depltn, amrtsn (DI	-65,525	-73,586	0	-51,290	-55,871
Other income	22,410	19,577	34,211	24,145	25,144
PBT	148,761	224,622	239,808	297,698	265,658
Tax	-46,100.9	-74,689.5	-70,412.2	-97,219.5	-86,847.2
Rate (%)	36.2	35.4	35.4	34.5	34.6
PAT	94,881	145,206	154,875	194,988	173,629
Growth (%)	-9.1	53.0	6.7	25.9	-11.0
Net profit (adjusted)	94,881	145,206	154,875	194,988	173,629
Growth (%)	-9.1	53.0	6.7	25.9	-11.0
Net profit post MI	93,803	143,390	153,976	193,891	172,581

BALANCE SHEET (Rs Million)					
Y/E MARCH	2004	2005	2006	2007E	2008E
Share Capital	14,259	14,259	14,259	14,259	14,259
Reserves	393,188	466,324	537,701	658,847	759,188
Net Worth	407,397	480,583	551,960	673,106	773,447
Debt	62,535	40,603	26,173	25,239	22,321
Deferred Tax	54,250	57,894	69,175	73,882	78,276
Liability for Abandonmer	80,292	80,941	87,621	93,688	99,196
Minority Interest	4,275	6,204	6,845	7,942	9,040
Capital Employed	608,748	666,225	741,775	873,857	982,281
Gross Fixed Assets	496,759	519,966	570,712	616,499	667,931
Less: Depreciation	379,711	403,277	438,204	476,425	519,668
Capital WIP	13,520	87,775	48,903	60,753	71,321
Net Fixed Assets	130,569	204,464	181,411	200,826	219,584
Producing properties	246,708	245,554	332,969	364,341	391,171
Pre-producing properties	45,402	23,888	32,634	43,066	45,072
Investments (incl. m	30,307	26,555	24,284	21,819	22,651
Goodwill	14,591	13,683	12,775	11,867	10,959
Cash & bank balances	64,564	66,035	80,436	112,647	155,813
Inventories	35,529	43,730	54,970	61,485	59,037
Loans & advances	55,236	72,474	48,936	76,826	94,939
Other current assets	37,281	40,898	47,570	53,636	59,144
Total current assets	221,920	270,228	291,749	377,720	436,952
Current liabilities	55,569	77,026	88,296	98,939	97,333
Provisions	25,180	41,122	45,751	46,844	46,776
Net current assets	141,171	152,080	157,702	231,937	292,843
Application of Fund	608,748	666,225	741,775	873,857	982,281

E: MOST Estimates

RATIOS					
Y/E MARCH	2004	2005	2006	2007E	2008E
Basic (Rs)					
EPS	65.8	100.6	108.0	136.0	121.0
Cash EPS	118.1	157.8	190.8	215.4	206.4
Book Value	285.7	337.0	387.1	472.0	542.4
DPS	24.0	40.0	45.0	45.0	45.0
Payout	36.5	39.8	41.7	33.1	37.2
Valuation (x)					
P/E		11.3	10.5	8.4	9.4
Cash P/E		7.2	6.0	5.3	5.5
EV / EBITDA		5.7	5.1	4.1	4.2
EV / Sales		2.7	2.3	1.8	1.9
Price / Book Value		3.4	2.9	2.4	2.1
Dividend Yield (%)		3.5	4.0	4.0	4.0
Profitability Ratios (%)					
RoE	24.6	32.3	29.8	31.7	23.9
RoCE	28.3	35.5	34.3	37.0	28.7
Turnover Ratios					
Debtors (No. of Days)	30	23	28	28	32
Fixed Asset Turnover (x)	3.4	3.6	3.7	4.5	3.8
Leverage Ratio					
Net Debt / Equity (x)	0.0	-0.1	-0.1	-0.1	-0.2

CASH FLOW STATEMENT (Rs Million)					
Y/E MARCH	2004	2005	2006	2007E	2008E
OP/(Loss) before Tax	197,041	283,790	310,744	382,300	357,951
Interest Paid	-3,822	-1,877	-1,597	-931	-840
Direct Taxes Paid	-46,746	-75,772	-73,651	-98,004	-87,635
(Inc)/Dec in Wkg. Capita	-49,901	-19,250	8,072	-42,527	-18,547
CF from Op. Activit	96,572	186,891	243,567	240,838	250,929
(Inc)/Dec in FA & CWIP	-56,652	-122,017	-178,830	-161,914	-158,478
(Pur)/Sale of Investmen	296	3,752	2,272	2,465	-832
Inc from Invst	22,410	19,577	34,211	24,145	25,144
CF from Inv. Activit	-33,946	-98,688	-142,348	-135,304	-134,166
Issue of Shares	0	0	0	0	0
Inc / (Dec) in Debt	510	-21,932	-14,430	-934	-2,918
Dividends Paid (incl.tax)	-38,607	-64,800	-72,388	-72,388	-72,388
CF from Fin. Activit	-38,097	-86,732	-86,818	-73,322	-75,306
Inc / (Dec) in Cash	24,529	1,471	14,401	32,212	41,457
Add: Opening Balance	40,035	64,564	66,035	80,436	112,647
Closing Balance	64,564	66,035	80,436	112,648	154,104



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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

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