BUY

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Oil & Natural Gas Corporation Ltd (Q3 FY08)

January 23, 2008

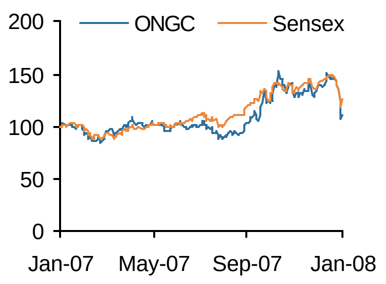
Stock data

Sensex:	17,594
CMP (Rs):	990
Target price (Rs):	1,350
Upside (%):	36.4
52 Week h/l (Rs):	1,387/750
Market cap (Rs cr)	211,750
6m Avg vol BSE&NSE ('000 nos):	1,857.6
No of o/s shares (mn):	2,139
FV (Rs):	10
Bloomberg code:	ONGC IN
Reuters code:	ONGC.BO
BSE code:	500312
NSE code	ONGC

Shareholding pattern

December 2007	(%)
Promoters	74.1
Foreign & institutions	13.1
Non promoter corp hold	10.9
Public & others	1.9

Share price trend



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- Increased subsidy burden impacts revenue and profitability.
- Production of oil and gas remain flat in Q3 FY08.
- Domestic production set to increase from marginal fields and through IOR/EOR initiatives.
- Incremental volumes from OVL expected as projects enter the development phase.
- Undervalued in comparison to global peers on EV/BOE. We recommend a BUY with a target price of Rs1,350.

Result table

(Rs mn)	Q3 FY08	Q3 FY07	Growth
	(3)	(3)	Yoy (%)
Gross sales	152,176	156,313	(2.6)
Excise duty	(968)	(668)	44.8
Net sales	151,208	155,645	(2.9)
Expenditure	(70,891)	(66,553)	6.5
Operating profit	80,318	89,093	(9.8)
Other income	8,630	7,045	22.5
Interest	(114)	(77)	48.6
Depreciation	(22,118)	(25,576)	(13.5)
Profit before tax	66,716	70,485	(5.3)
Tax	(23,051)	(23,802)	(3.2)
Net Profit	43,665	46,683	(6.5)
Equity Capital	21,389	21,389	
EPS Rs annualized	81.7	87.3	
OPM(%)	53.1	57.2	

Source: Company, India Infoline Research

Flat sale volumes and higher subsidy burden leads to fall in revenues

ONGC registered 2.9% yoy fall in revenues in Q3 FY08 to Rs152bn. The fall was primarily on account of flat volumes for both oil and gas. During the quarter ONGC sold 6mn tons of crude and 5.3bcm of gas. On a qoq basis the net realizations for crude oil were down 2.5% despite 17.9% jump in gross realizations. The fall was driven by 71.2% rise in per barrel subsidy burden.

Trend in gross and net realizations

(US$/bbl)	Q1 FY07	Q2 FY07	Q3 FY07	Q4 FY07	Q1 FY08	Q2 FY08	Q3 FY08
Gross realization	71.3	71.6	61.7	60.5	71.8	77.4	91.2
Subsidy discount	26.4	26.2	11.3	24.8	21.7	21.4	36.7
Net realization	44.9	45.4	50.4	35.7	50.1	55.9	54.5

Source: Company, India Infoline Research

Rise in statutory levies and overheads dent operating margins

During Q3 FY08, operating profit declined by 9.8% yoy and operating margins dipped by 410bps to 53.1%. The fall was driven by 172bps and 196bps increase in statutory levies and other expenses as a percentage of sales. Higher trading of MRPL products would have also contributed to some fall in margins.

Higher other income and lower dry well write offs lower fall in PAT

ONGC reported a 22.5% jump in other income to Rs8.6bn. Depreciation declined by 13.5% to Rs22bn as dry well write offs decreased by 69% on a yoy basis. This translated into only 6.5% fall in PAT to Rs43.7bn. The fall would have been lower had it not been for 80bps increase in effective tax rate to 34.6%.

Increase in production from OVL: a major trigger

OVL currently has 40 projects spread over 17 countries; six of them are producing properties and five are discovered properties. OVL discovered oil in North Ramadan Block 6 in Egypt (OVL has 70% stake). The hydrocarbon reserves are expected to be more than 200mn barrels of oil. Also, OVL and a Sinopec subsidiary acquired Omimex in Columbia in September 2006. Omimex produces 18,500 barrels of oil per day and holds reserves of about 300mn barrels of oil. The company also struck hydrocarbon reserves in Farsi Offshore block in Iran. The extent of reserves is yet to be estimated for the block. Production from the Sudan 5A field (OVL has 24.125% stake) is expected to increase from the current levels of 32,000 barrels per day to 50,000 barrels of oil by year-end. The deepwater Block BC-10 in Brazil has a potential to produce 100,000 barrels of oil per day (OVL share 15%). Hence, production from OVL could be a major growth trigger for the future. OVL had an internal target of 7.5MMTOE for FY07 and it achieved 7.9MMTOE. For FY08, it has set a target of at least 8MMTOE, which we believe can be overshot.

Exploration and Production portfolio of OVL

Producing Properties		Discovered Properties	
Country: block	**Participating int**	**Country: block**	**Participating int**
Vietnam : Block 6.1	45%	Brazil : BC - 10	15%
Sudan: GNOP (Jt Op)	25%	Qatar : Najwat Najem (Op)	100%
Sudan: Block 5A	24%	Egypt : North Ramadan (Jt Op)	70%
Russia : Sakhalin - I	20%	Myanmar : A - 1	20%
Syria : AFPC	13-14.5%	Myanmar : A - 3	20%
Colombia: Omimex (Jt Op)	50%		
Exploration properties			
Country: block	**Participating int**	**Country: block**	**Participating int**
Iraq: Block-8 (Op)	100%	Nigeria: Block - 279 (Op)	30%
Iran: Farsi (Op)	40%	Nigeria: Block - 285 (Op)	45%
Libya: Block-188, 189	49%	Nigeria: Sao Tome JDZ	14%
Libya: Block-81-1 (Op)	100%	Myanmar: Block AD- 2, 3 & 9	100%
Libya: Block 43 (Op)	100%	Turkmenistan: Block 11 & 12	100%
Syria : Block - 24	60%	Congo Brazville: MTPN	100%
Vietnam: Block - 127 (Op)	100%	Colombia: RC- 8	40%
Vietnam: Block - 128 (Op)	100%	Colombia: RC- 9, 10	50%
Cuba: Repsol (6 blocks)	30%	Brazil: Seal 4, S-17, BAR-3	25%
Cuba: Block 34& 35	100%	Brazil: Block 470	
Sudan: 5B	24%	Brazil: Block 1413	

Source: Company

Increased viability for development of marginal fields

With prices of crude oil on a sustained upward movement and expectations of prices sustaining at current levels, development of marginal fields has now become economically viable. During FY07, 0.49MMT of crude oil and 22.6 mmscm of gas were produced from ONGC's marginal fields. Currently, there are 90 fields under the monetization scheme and the company has plans to monetize 31 more fields.

Capex plan for development of marginal fields

Name of Cluster	Investment	Envisaged Production			Duration	No of fields
	Rs bn	Gas (BCM)	Oil (MMT)	Condensate (MMT)	years	
C-Series	32.0	15.14	0	6.13	15	6
B-22	23.2	6.56	2.46	1.13	10	4
B-193	32.5	5.12	5.57	0.75	15	8

Source: Company

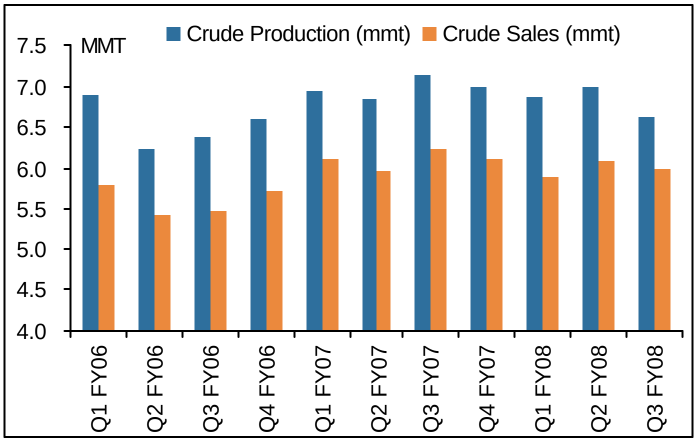
IOR/EOR plans to increase production from existing fields

From FY96 to FY00, crude oil production at 15 key fields of ONGC was on a constant decline (from 24.08MMT to 19.58MMT) as fields started ageing. However, the company implemented 12 IOR/EOR projects in these fields over the next five years, which arrested the decline. The production levels from these fields since then have been in the range of 20MMT to 21MMT. Currently, the company has six projects under implementation and hopes to gain 110MT of oil until 2030 from the IOR/EOR initiatives.

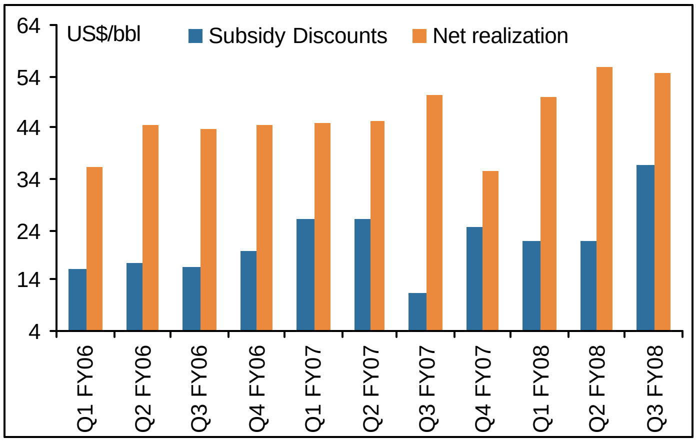
Undervalued compared to global peers

At CMP of Rs1,027, the stock currently trades at US$6.5 per barrel of oil equivalent on its consolidated reserves. However, considering US$7.25/BOE for reserves of ONGC, US$8/BOE for OVL reserves of 215MMTOE and 71.6% stake in MRPL at Rs80 we arrive at a target price of Rs1,350. We maintain our BUY recommendation on the stock.

Crude oil Production and sales

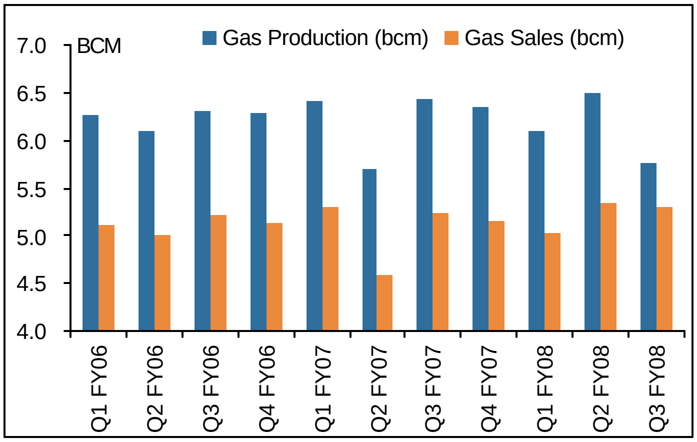


Crude oil realization and subsidy discount

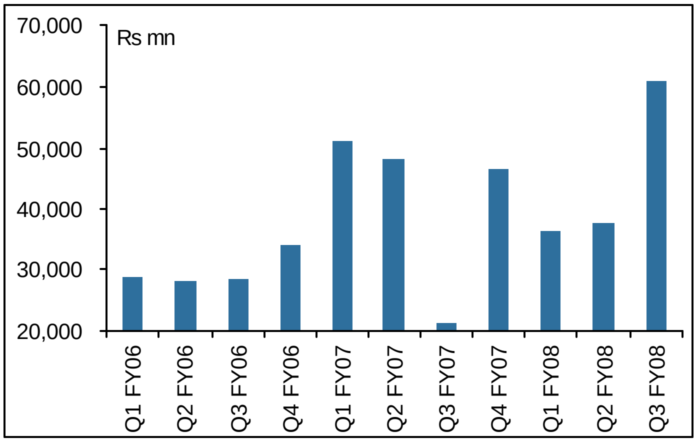


Source: Company, India Infoline Research

Natural gas production and sales



Total subsidy burden



Source: Company, India Infoline Research

Global peer comparison

Company	EV/Boe (US$)
ONGC	6.0
Chevron Corp	13.6
Total	12.9
BP	15.5
Exxon Mobil Corp	19.0
LukOil	4.9
Rosneft	8.7
Average	12.4

Source: Bloomberg