

Company Flash

25 June 2009 | 7 pages

Oil & Natural Gas (ONGC.BO)

Conference

Takeaways from India Investor Conference, June 24-26

- Takeaways from Mumbai** — ONGC presented at our India Investor Conference on June 25. Below are key takeaways from management:
- Plans for oil reforms still under discussion** — ONGC management indicated that ministry-level discussions are on to consider ways and means to free fuel pricing and make subsidy sharing more transparent and predictable. Given the fiscal implications and US\$70 oil, decision making could take some time. Gas price deregulation could be partial initially but could come with a roadmap for the long term.
- Deepwater exploration should pick up** — ONGC has two deepwater rigs but has contracted 3 ultra-deepwater rigs – one from Reliance in 4Q for 4 years and two more in end-2010/early-2011. This will provide ONGC the tools to drill appraisal wells in KG-98/2 and prepare FDP in 2010. The company has also constituted a focus group for East Coast, though production from KG-98/2 is likely in another 2 years. The recent IE discovery in KG block is however at an extremely early stage and therefore not quantifiable.
- 4Q impacted by higher DD&A** — Higher survey costs and dry wells led to depressed PAT in 4Q. The company takes into account the dry wells for a part of the June quarter also in the 4Q accounts. It also stated that the renewal of the jack-ups at \$130,000-160,000/day in the last two years have also put pressure on costs, which get accentuated in periods of sharp crude declines like the last quarter.

Sell/Medium Risk	3M
Price (25 Jun 09)	Rs1,025.20
Target price	Rs820.00
Expected share price return	-20.0%
Expected dividend yield	2.4%
Expected total return	-17.6%
Market Cap	Rs2,192,772M US\$45,338M

Price Performance (RIC: ONGC.BO, BB: ONGC IN)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2007A	177,696	83.08	15.4	12.3	3.3	29.0	3.5
2008A	198,723	92.91	11.8	11.0	2.8	27.7	3.1
2009E	235,868	110.28	18.7	9.3	2.4	27.7	3.5
2010E	175,252	81.94	-25.7	12.5	2.1	17.8	2.4
2011E	201,917	94.40	15.2	10.9	1.8	18.1	2.4

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

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Fiscal year end 31-Mar	2007	2008	2009E	2010E	2011E
Valuation Ratios					
P/E adjusted (x)	12.3	11.0	9.3	12.5	10.9
EV/EBITDA adjusted (x)	6.0	5.0	4.1	4.6	3.8
P/BV (x)	3.3	2.8	2.4	2.1	1.8
Dividend yield (%)	3.5	3.1	3.5	2.4	2.4
Per Share Data (Rs)					
EPS adjusted	83.08	92.91	110.28	81.94	94.40
EPS reported	83.08	92.91	110.28	81.94	94.40
BVPS	309.51	361.94	433.98	487.71	554.46
DPS	36.00	32.00	36.00	25.00	25.00
Profit & Loss (RsM)					
Net sales	862,762	1,018,349	1,192,209	1,090,609	1,146,849
Operating expenses	-638,486	-752,396	-880,813	-872,729	-888,537
EBIT	224,276	265,953	311,396	217,881	258,312
Net interest expense	1,058	-2,153	-1,406	-1,349	-1,297
Non-operating/exceptionals	52,240	45,431	50,694	50,766	50,137
Pre-tax profit	277,574	309,232	360,684	267,298	307,151
Tax	-98,454	-106,999	-121,190	-89,812	-103,203
Extraord./Min.Int./Pref.div.	-1,424	-3,509	-3,627	-2,234	-2,031
Reported net income	177,696	198,723	235,868	175,252	201,917
Adjusted earnings	177,696	198,723	235,868	175,252	201,917
Adjusted EBITDA	343,953	404,831	463,155	381,321	426,000
Growth Rates (%)					
Sales	16.2	18.0	17.1	-8.5	5.2
EBIT adjusted	8.4	18.6	17.1	-30.0	18.6
EBITDA adjusted	12.9	17.7	14.4	-17.7	11.7
EPS adjusted	15.4	11.8	18.7	-25.7	15.2
Cash Flow (RsM)					
Operating cash flow	385,721	350,302	429,654	321,635	372,911
Depreciation/amortization	119,678	138,878	151,759	163,440	167,689
Net working capital	92,901	15,289	39,189	-15,214	5,351
Investing cash flow	-197,369	-210,154	-199,659	-204,659	-204,659
Capital expenditure	-186,873	-189,907	-186,428	-191,428	-191,428
Acquisitions/disposals	-253	-7,015	0	0	0
Financing cash flow	-89,476	-74,943	-87,408	-57,883	-57,861
Borrowings	-6,336	-666	-3,635	-226	-203
Dividends paid	-85,468	-75,972	-85,468	-59,353	-59,353
Change in cash	98,877	65,205	142,586	59,093	110,391
Balance Sheet (RsM)					
Total assets	1,102,252	1,246,846	1,446,771	1,551,695	1,715,800
Cash & cash equivalent	225,104	270,880	479,064	576,993	727,516
Accounts receivable	48,167	70,469	81,658	74,699	78,551
Net fixed assets	249,410	280,312	276,852	292,292	305,278
Total liabilities	431,936	461,271	503,605	489,977	509,065
Accounts payable	78,824	98,444	95,520	102,333	113,978
Total Debt	16,005	9,445	3,617	3,255	2,930
Shareholders' funds	670,316	785,575	943,165	1,061,719	1,206,735
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	39.9	39.8	38.8	35.0	37.1
ROE adjusted	29.0	27.7	27.7	17.8	18.1
ROIC adjusted	17.5	21.1	24.3	16.4	19.8
Net debt to equity	-31.2	-33.3	-50.4	-54.0	-60.0
Total debt to capital	2.3	1.2	0.4	0.3	0.2

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Oil & Natural Gas

Company description

ONGC is India's largest E&P company. Through its subsidiary ONGC Videsh, the company has invested in overseas crude equity. It has ventured downstream, picking up a majority stake in Mangalore Refineries, and it intends to set up a petro-products retailing network

Investment strategy

We rate ONGC as Sell/Medium Risk, with a target price of Rs820. Weakness in crude has started hurting ONGC, despite lower subsidy sharing, as realizations on JV and international crude suffer. Continuing losses on cooking fuels should ensure continuance of the subsidy sharing mechanism in FY10 and cap upside even if crude recovers to higher levels. Despite talks of deregulation, we feel that even if petrol and diesel prices are partly deregulated, LPG and kerosene would continue to be loss-making, implying a subsidy burden on ONGC.

Valuation

Our target price of Rs820 is based on 10x FY10E P/E, at the higher end of ONGC's historical median band of 7-11x. Our target multiple factors in: (i) 10-15% increase in market multiples post elections, and (ii) increased probability of partial sector de-regulation post the strong mandate. We continue to value ONGC on traditional valuation parameters as against NAV/SOTP approach due to it being a going concern. Given that its existing fields face declining or mature production profiles, it will be incorrect to value the new discoveries (say KG gas) separately in an SOTP since the new fields would anyway be required to compensate for the decline in mature fields. In terms of asset valuation, ONGC's current EV/boe of US\$7.2 (on 1P reserves) is unlikely to get further re-rated given limited benefit from higher crude as well as subsidized gas prices.

Risks

We assign a Medium Risk rating on account of continued uncertainty on subsidy sharing and low visibility on a reduction in ONGC's burden despite reduced downstream under-recoveries. Upside risks to our estimates are: (1) ONGC has made substantial investments in overseas oil blocks, through its subsidiary ONGC Videsh, in Sudan, Vietnam, and Russia. ONGC remains aggressive in the search for oil equity overseas and is usually an interested bidder in such asset sales. Value accretive overseas acquisitions pose upside risks to our estimates. (2) Rupee depreciation benefits ONGC through higher domestic realisations. Continued devaluation of the rupee could pose risks to our estimates. (3) Government interference in the Indian oil sector (e.g. making upstream oil companies bear LPG/kerosene subsidy losses and gasoline/diesel retailing losses) has been a concern for the sector. Positive policy announcements leading to complete deregulation of the sector and removal of subsidy-sharing by upstream companies could significantly impact ONGC's earnings. If any of these risks has a greater impact than we anticipate, ONGC's share price could exceed our target price.

Appendix A-1

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Oil & Natural Gas (ONGC.BO)

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Fundamental Research

Analyst: Rahul Singh

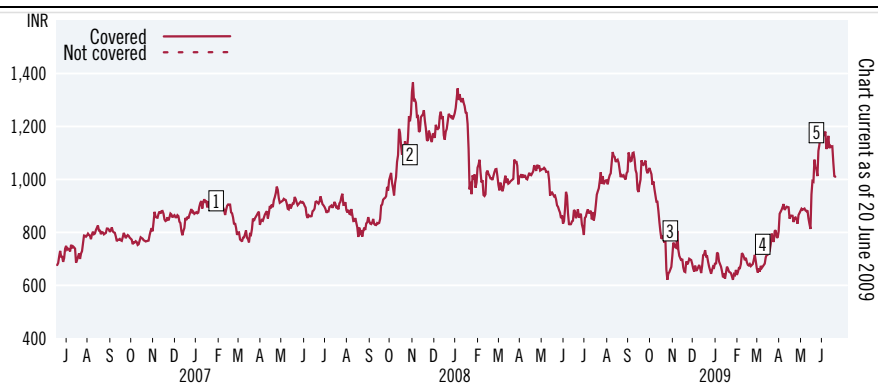


Chart current as of 20 June 2009

	Date	Rating	Target Price	Closing Price
1	30-Jan-07	1M	*1,100.00	914.60
2	30-Oct-07	*1L	*1,400.00	1,219.55

	Date	Rating	Target Price	Closing Price
3	30-Oct-08	*1M	*850.00	650.05
4	10-Mar-09	*3M	*587.00	665.75

	Date	Rating	Target Price	Closing Price
5	24-May-09	3M	*820.00	1,045.30

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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