# ONGC

8 November 2011

2QFY12 Result Update

Reuters: ONGC.BO Bloomberg: ONGC IN

## Higher realisation boosts earnings; we upgrade our TP

**ONGC reported net profit of Rs86.42bn for 2QFY12 (up 60% YoY, 111% QoQ) compared to Bloomberg consensus estimate of Rs65.63bn and our estimate of Rs54.23bn on the back of all-time high realisation from nomination fields. Sales were up 24% YoY and 40% QoQ at Rs226bn compared to Bloomberg consensus estimate of Rs208bn and our expectation of Rs190bn. We believe 2QFY12 net realisation of US$83.70/bbl should be treated as one of the freebies allowed by the government, possibly ahead of the run-up to the follow-on public offer (FPO), and in next two quarters the realisation should be at the normal level of US$55-60/bbl to average realisation of US$60/bbl in FY12, given that under-recoveries for the year are likely to be Rs1,200bn if fuel prices remain unchanged. We maintain our Buy rating on ONGC with a target price of Rs338 (revised upwards from Rs322), but there is an upside risk to our TP if the government sticks to its 33% subsidy sharing formula for FY12 as it did in the first two quarters of the year.**

**Realisation from nomination fields at all-time high**: ONGC posted an all-time high net realisation of US$83.70/bbl in 2QFY12 as the government computed subsidy based on the 33% subsidy sharing mechanism. Upstream companies' total subsidy burden was Rs71.25bn in 2QFY12 compared to Rs145bn in 1QFY12. ONGC shared subsidy burden of Rs57.13bn, which resulted in subsidy of US$33.24/bbl in 2QFY12 compared to US$72.53/bbl in 1QFY12. Higher crude oil prices led to a 48% YoY increase in gross realisation to US$116.94/bbl. We believe the realisation will moderate to the normal level of US$55-60/bbl in FY12, given the overhang of higher under-recoveries of Rs1,200bn.

## BUY

**Sector:** Oil & Gas

**CMP:** Rs283

**Target Price:** Rs338

**Upside:** 19%

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**Key Data**

| | |
|---|---|
| Current Shares O/S (mn) | 8,555.5 |
| Mkt Cap (Rsbn/US$bn) | 2,420.3/49.3 |
| 52 Wk H / L (Rs) | 349/248 |
| Daily Vol. (3M NSE Avg.) | 4,556,236 |

**Price Performance (%)**

| | 1 M | 6 M | 1 Yr |
|---|---|---|---|
| ONGC | 7.0 | (7.3) | (16.2) |
| Nifty Index | 8.1 | (4.8) | (16.3 |

*Source: Bloomberg*

| Y/E March (Rsbn) | Q1 FY11 | Q2 FY11 | Q3 FY11 | Q4 FY11 | Q1FY12 | Q2FY12 | YOY (%) | QOQ (%) |
|---|---|---|---|---|---|---|---|---|
| Revenue | 136.66 | 181.94 | 185.86 | 153.96 | 161.99 | 226.16 | *24.3* | *39.6* |
| Raw material | 1.35 | 1.46 | 1.41 | 1.99 | 1.49 | 1.65 | *12.9* | *10.9* |
| Employee cost | 2.79 | 3.06 | 2.91 | 4.27 | 3.10 | 3.28 | *7.1* | *5.8* |
| Statutory levies | 28.67 | 38.70 | 38.87 | 33.02 | 37.31 | 46.53 | *20.3* | *24.7* |
| Other expenditure | 24.36 | 27.89 | 29.08 | 41.63 | 28.13 | 33.37 | *19.6* | *18.6* |
| EBITDA | 80.36 | 110.85 | 113.14 | 72.61 | 92.67 | 141.60 | *27.7* | *52.8* |
| *EBITDA Margin (%)* | *58.80* | *60.93* | *60.87* | *47.16* | *57.21* | *62.61* | *168.0* | *540.0* |
| Depreciation | 31.14 | 44.00 | 36.41 | 47.88 | 41.22 | 32.78 | *(25.5)* | *(20.5)* |
| EBIT | 50.79 | 69.22 | 98.91 | 31.85 | 53.48 | 111.91 | *61.7* | *109.3* |
| *EBIT Margin (%)* | *37.17* | *38.04* | *53.21* | *20.68* | *33.01* | *49.48* | *1,144.0bps* | *1,647.0bps* |
| Other income | 4.07 | 9.06 | 6.69 | 5.86 | 7.27 | 11.33 | *25.0* | *55.9* |
| PBT | 54.83 | 78.27 | 105.54 | 37.54 | 60.71 | 123.17 | *57.4* | *102.9* |
| Tax | 18.22 | 24.38 | 34.71 | 9.63 | 19.76 | 36.75 | *50.7* | *86.0* |
| PAT | 36.61 | 53.89 | 70.83 | 27.91 | 40.95 | 86.43 | *60.4* | *111.1* |
| EPS | 4.28 | 6.30 | 8.28 | 3.26 | 4.79 | 10.10 | *60.4* | *111.1* |

*Source: Company, Nirmal Bang Institutional Equities Research*

**Exhibit 1: Financial Summary**

| Y/E March (Rsmn) | FY09 | FY10 | FY11 | FY12E | FY13E |
|---|---|---|---|---|---|
| Revenue | 1,045,884 | 1,017,546 | 1,176,105 | 1,426,982 | 1,518,391 |
| *YoY (%)* | *8.1* | *-2.7* | *15.6* | *21.3* | *6.4* |
| EBITDA | 420,343 | 440,646 | 475,948 | 589,472 | 621,517 |
| *EBITDA (%)* | *40.2* | *43.3* | *40.5* | *41.3* | *40.9* |
| Adj PAT | 197,954 | 194,016 | 224,559 | 281,585 | 295,079 |
| *YoY (%)* | *(0.4)* | *(2.0)* | *15.7* | *25.4* | *4.8* |
| Fully DEPS | 23.1 | 22.7 | 26.2 | 32.9 | 34.5 |
| *RoE (%)* | *23.2* | *20.0* | *20.7* | *22.5* | *20.5* |
| *RoCE (%)* | *19.3* | *15.9* | *15.7* | *17.8* | *16.2* |
| P/E (x) | 12.0 | 12.2 | 10.6 | 8.4 | 8.0 |
| EV/EBITDA (x) | 5.3 | 4.9 | 4.7 | 3.8 | 3.5 |

*Source: Company, Nirmal Bang Institution Equities Research*

**Profit up on multiple benefits:** Other income climbed 25% YoY and 56% QoQ to Rs11.32bn on the back of higher dividend income from Petronet, GAIL (India) and Indian Oil Corporation. Dividend income increased to Rs4bn in 2QFY12 compared to Rs0.4bn in 1QFY12. High interest rates increased interest income to Rs4.78bn in 2QFY12 compared to Rs3.98bn in 1QFY12. Effective tax rate declined to 29.83% in 2QFY12 from 32.54% in 1QFY12 on the back of tax reversal of Rs1.33 bn. DDA (depreciation, depletion and amortisation) expenses dropped 25% YoY and 20% QoQ to Rs32.78bn on lower capitalisation of pipelines.

**Volume growth remained subdued**: Crude oil production from nomination fields declined 2% YoY to 6.037mt, while gas output from nomination fields remained unchanged YoY at 5.825bcm. Though crude oil production from joint venture fields increased 15% YoY to 0.82mt, it declined 3% on sequential basis. Sales volume of value added products increased 10% YoY to 800tmt and per tonne realisation of VAP was up 35% YoY to Rs34,600/tonne. ONGC's management, at its post earnings con-call, indicated that gas volume will remain at 63mmscmd in FY12, despite the decline in production from mature fields, as the output from marginal fields is picking up. Out of 7mmscmd of gas from the west coast marginal fields (GS-15, Bandra formation, Vasai, C series), 3mmscmd of gas is flowing through and the rest 4 mmsmcd is expected to flow in the second-half of FY12. First deep water G1 field is likely to be operational in February-March 2013, with an initial run rate of 3-4mmscmd.

**Royalty burden up on Rajasthan field's contribution:** Royalty burden was up as ONGC is absorbing the entire royalty burden of Rajasthan field. Royalty on crude oil increased 44% to Rs25.32bn from Rs17.54bn on sequential basis. On the Rajasthan field, ONGC paid royalty of Rs8.41bn, of which Rs2.52bn was its own share and Rs5.89bn was the share of Cairn India. ONGC's management has indicated that adjustment of royalty payment as per the new pact will take place in a few months and is likely to take effect either in 3QFY12 or 4QFY12 results. ONGC will continue to bear the entire royalty burden, but get more effective participating interest (currently at 30%) in lieu of Cairn India's royalty burden.

**Retain Buy on ONGC as it is trading below fair value:** We believe ONGC is trading below its fair value of Rs338, given the uncertainty regarding the subsidy sharing mechanism and elevated FY12 under-recoveries. Given the fact that fiscal deficit touched 71% of the budgeted sum for FY12 in the first-half itself, it makes us believe the government's finances are in dire straits and it requires big-ticket FPOs like that of ONGC to bridge the deficit. Therefore, we believe the government will take a calibrated stance on upstream subsidy quantum. We have made changes to our target price based on the following: 1) Increased our net realisation assumption to US$60/bbl for nomination blocks, compared to US$56/bbl earlier, on some inkling regarding another round of oil reforms. 2) Cut down volume growth assumption of subsidiary ONGC Videsh because of lower ramp-up at Imperial Energy.

Oil marketing companies hiking petrol price by 13% in 2011 gives us some conviction that the government may go for a hike in the prices of regulated fuels on 22 November 2011, although the hike will be cosmetic given that assembly polls are scheduled in Uttar Pradesh in May 2012 and also on headline inflation remaining high.

**Exhibit 2: Change in key assumptions**

| (Rsmn) | FY12E | FY13E | FY14E |
|---|---|---|---|
| **EPS** | | | |
| Earlier assumption | 31.76 | 34.5 | 38.6 |
| Revised assumption | 32.9 | 34.5 | 36.3 |
| *Change in EPS(%)* | *3.6* | *0.0* | *(6.0)* |
| **Realisation** | | | |
| Earlier realisation | 56 | 62 | 62 |
| Revised realisation | 60 | 63 | 63 |
| *Change (%)* | *7.1* | *1.6* | *1.6* |
| **OVL volume(mtoe)** | | | |
| Earlier assumption | 10.6 | 10.5 | 11.5 |
| Revised assumption | 9.1 | 10.1 | 10.7 |
| *Change (%)* | *(14.2)* | *(3.8)* | *(7.0)* |

*Source: Nirmal Bang Institution Equities Research*

**Exhibit 3: Subsidy impact on financials**

| (Rsmn) | 1QFY11 | 2QFY11 | 3QFY11 | 4QFY11 | 1QFY12 | 2QFY12 | *YoY (%)* | *QoQ (%)* |
|---|---|---|---|---|---|---|---|---|
| Revenue | 55,150 | 30,190 | 42,220 | 121,360 | 120,460 | 57,130 | *89.2* | *(52.6)* |
| PBT | 47,250 | 25,770 | 3,599 | 136,721 | 101,820 | 49,170 | *90.8* | *(51.7)* |
| PAT | 31,190 | 17,210 | 24,040 | 70,030 | 68,780 | 33,220 | *93.0* | *(51.7)* |

*Source: Nirmal Bang Institution Equities Research*

**Exhibit 4: Volume scenario**

| | 1QFY11 | 2QFY11 | 3QFY11 | 4QFY11 | 1QFY12 | 2QFY12 | *YoY (%)* | *QoQ (%)* |
|---|---|---|---|---|---|---|---|---|
| O+OEG(mmt) | 10.78 | 10.85 | 11.08 | 10.85 | 10.55 | 10.86 | *0.1* | *3.0* |
| O+OEG(mnboe) | 79.00 | 79.54 | 81.24 | 79.52 | 77.34 | 79.63 | *0.1* | *3.0* |
| VAP(mmt) | 0.77 | 0.75 | 0.78 | 0.83 | 0.72 | 0.80 | *6.3* | *10.7* |

*Source: Nirmal Bang Institution Equities Research*

**Exhibit 5: Realisation scenario**

| | 1QFY11 | 2QFY11 | 3QFY11 | 4QFY11 | 1QFY12 | 2QFY12 | *YoY (%)* | *QoQ (%)* |
|---|---|---|---|---|---|---|---|---|
| Crude oil(Rs/mt) | 16,820.49 | 22,076.56 | 22,379.04 | 15,728.80 | 19,523.06 | 29,704.16 | 34.6 | 52.2 |
| Avg. crude oil ($/bbl) | 50.25 | 64.77 | 68.07 | 47.41 | 59.54 | 88.56 | 36.7 | 48.7 |
| Avg. gas(Rs/mmsm) | 4,911 | 6,088 | 6,088 | 6,192 | 6,872 | 6,871 | 12.9 | (0.0) |
| Avg. gas($/mmBtu) | 2.71 | 3.30 | 3.42 | 3.45 | 3.87 | 3.78 | 14.7 | (2.3) |
| Avg. realisation($/boe) | 33.11 | 42.88 | 45.06 | 33.87 | 41.74 | 56.92 | 32.7 | 36.4 |

*Source: Nirmal Bang Institution Equities Research*

**Exhibit 6: Oil realisation & subsidy**

| | 1QFY11 | 2QFY11 | 3QFY11 | 4QFY11 | 1QFY12 | 2QFY12 | *YoY (%)* | *QoQ (%)* |
|---|---|---|---|---|---|---|---|---|
| Gross realisation($/bbl) | 80.8 | 79.21 | 89.13 | 108.9 | 121.29 | 116.94 | *47.6* | *(3.6)* |
| Net realisation($/bbl) | 48.04 | 62.75 | 64.79 | 38.75 | 48.76 | 83.70 | *33.4* | *71.7* |
| Subsidy ($/bbl) | 32.76 | 16.46 | 24.34 | 70.15 | 72.53 | 33.24 | *101.9* | *(54.2)* |
| Total subsidy burden(Rsmn) | 55,150 | 30,190 | 42,220 | 121,360 | 120,460 | 57,130 | *89.2* | *(52.6)* |
| Gross realisation (Rs/bbl) | 3,690 | 3,683 | 3,998 | 4,929 | 5,426 | 5,351 | *45.3* | *(1.4)* |
| Net realisation(Rs/bbl) | 2,194 | 2,918 | 2,906 | 1,754 | 2,181 | 3,830 | *31.3* | *75.6* |
| Upstream contribution(Rsmn) | 64,882 | 35,518 | 49,671 | 146,217 | 145,132 | 71,250 | *100.6* | *(50.9)* |
| Gross under-recoveries(Rsmn) | 196,613 | 107,629 | 150,517 | 376,848 | 439,795 | 219,260 | *(79.6)* | *(95.0)* |
| *Upstream contribution(%)* | *33.0* | *33.0* | *33.0* | *38.8* | *33.0* | *32.5* | *-* | *-* |

*Source: Nirmal Bang Institution Equities Research*

## Disclaimer

**Stock Ratings Absolute Returns**

BUY > 15%

HOLD 0-15%

SELL < 0%

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