

BUY

TP: Rs 96 | ▲ 21%

ONGC

Oil & Gas

02 September 2020

Pricing in the worst – upgrade to BUY

ONGC's Q1FY21 earnings at Rs 5bn (–90% YoY) outperformed estimates on lower operating costs. Q1 highlights: (a) oil/gas production continued to decline (–3.5%/–13.6% YoY), (b) operating costs were lower at US\$ 6/bbl (vs. US\$ 8/bbl estimated), and (c) oil price realisation was at US\$ 28.7/bbl (–57% YoY). We raise FY21/FY22 earnings by 3x/1.6x to factor in higher oil price assumptions (by US\$ 5/bbl). Upgrade from ADD to BUY as we roll over to a new Sep'21 TP of Rs 96 (vs. Rs 92). The recent rise in oil prices provides valuation comfort.

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Production remains a drag: Q1 oil and gas production fell to 5.7mmt (–3.5% YoY) and 5.5bcm (–13.6%) respectively. Gas production was severely affected by lockdown-led demand disruptions, mostly in the CGD segment. Production could return to normal from Q3FY21, once lockdowns across major cities are lifted. ONGC has revised oil production guidance for FY21 down to 22.7mmt (from 23.3mmt). We accordingly trim our oil and gas production estimates for FY21/FY22 by ~5% each.

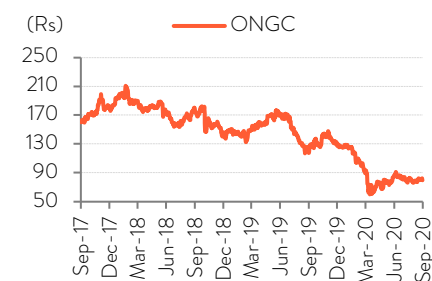
Low operating costs a positive: ONGC surprised with a 40% QoQ decline in operating cost to US\$ 6/bbl, as the company strived to reduce contractual rates for assets. Management believes these cost levels are sustainable, providing a necessary cushion against low oil prices.

Upgrade to BUY: The stock's underperformance despite the recent rise in oil prices provides valuation comfort, especially with the decline in operating costs. As oil prices remain robust, we find risk-reward favourable and upgrade earnings estimates. ONGC expects gas pricing across its assets to normalise to a tender-based system (from a pricing formula system). Low prices through the APM pricing formula seem unfair and impact economics for investment in development of new fields.

Ticker/Price	ONGC IN/Rs 79
Market cap	US\$ 13.7bn
Shares o/s	12,580mn
3M ADV	US\$ 22.8mn
52wk high/low	Rs 150/Rs 50
Promoter/FPI/DII	60%/8%/31%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20P	FY21E	FY22E	FY23E
Total revenue (Rs mn)	4,534,606	4,250,014	2,863,013	3,602,536	4,515,098
EBITDA (Rs mn)	838,648	611,687	381,476	478,782	602,425
Adj. net profit (Rs mn)	348,309	168,256	59,057	126,944	185,456
Adj. EPS (Rs)	27.7	13.4	4.7	10.1	14.7
Adj. EPS growth (%)	51.6	(51.7)	(64.9)	115.0	46.1
Adj. ROAE (%)	16.4	7.9	2.8	5.9	8.2
Adj. P/E (x)	2.9	5.9	16.9	7.9	5.4
EV/EBITDA (x)	2.1	3.2	5.3	4.2	3.4

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
Net revenues	130,113	265,547	(51.0)	214,562	(39.4)
Employee costs	4,985	6,082	(18.0)	6,115	(18.5)
% of sales	3.8	2.3	-	2.9	-
Other expenditure	66,051	108,345	(39.0)	122,568	(46.1)
% of sales	50.8	40.8	-	57.1	-
EBITDA	59,077	151,120	(60.9)	85,879	(31.2)
EBITDA margin (%)	45.4	56.9	-	40.0	-
DD&A	49,492	61,563	(19.6)	80,370	(38.4)
Interest	4,918	6,461	(23.9)	8,694.80	(43.4)
Other income	4,368	7,475	(41.6)	13,256	(67.0)
Exceptional Item	-	-	-	(48,991)	-
PBT	9,035	90,572	(90.0)	(38,920)	(123.2)
Provision for tax	4,075	31,529	(87.1)	(7,938)	(151.3)
effective tax rate	45.11	34.81	-	20.39	-
PAT (reported)	4,960	59,043	(91.6)	(30,983)	(116.0)
PAT (adjusted)	4,960	59,043	(91.6)	18,008	(72.5)
EPS (adjusted) (Rs/share)	0.4	4.6	(91.4)	1.4	(71.9)
Net Realisation (US\$/bbl)	28.7	66.3	(56.7)	49.0	(41.4)
Gas realisation (US\$/mmbtu)	3.4	4.2	(17.3)	3.45	0.0

Source: Company, BOBCAPS Research

FIG 2 – QUARTERLY PRODUCTION

	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
Production					
Oil (mmt)	5.7	5.9	(3.5)	5.8	(2.6)
Gas (bcm)	5.5	6.4	(13.6)	6.0	(8.2)
Total (mmtoe)	11.2	12.3	(8.8)	11.9	(5.5)
Sales					
Oil (mmt)	5.2	5.3	(2.6)	5.4	(5.2)
Gas (bcm)	4.2	5.0	(15.2)	4.7	(9.2)
Total (mmtoe)	9.4	10.3	(8.7)	10.1	(7.0)

Source: Company, BOBCAPS Research

Valuation methodology

The stock's underperformance despite the recent rise in oil prices provides valuation comfort, especially with the decline in operating costs. As oil prices remain robust, risk-reward appears favourable. ONGC expects gas pricing across its assets to normalise to a tender-based system (from a pricing formula system). Low prices through the APM pricing formula seem unfair and impact economics for investment in development of new fields.

We raise FY21/FY22 earnings estimates by 3x/1.6x to factor in higher oil price assumptions (by US\$ 5/bbl). Upgrade from ADD to BUY as we roll over to a revised SOTP-based Sep'21 target price of Rs 96 (vs. Rs 92). The recent rise in oil prices provides valuation comfort.

FIG 3 – REVISED ESTIMATES

(Rs bn)	FY21E			FY22E			FY23E
	Old	New	Var (%)	Old	New	Var (%)	New
Revenue	3,084	2,863	(7.2)	3,820	3,603	(5.7)	4,515
EBITDA	336	381	13.4	426	479	12.4	602
EBITDA margin (%)	10.9	13.3	-	14.7	13.3	-	13.3
PAT	19.6	59	201.9	80.7	127	57.4	185
PAT margin (%)	0.6	2.1	-	2.1	3.5	-	4.1
EPS (Rs)	1.6	4.7	201.9	6.4	10.1	57.4	14.7

Source: Company, BOBCAPS Research

Our SOTP valuation includes the following:

- core business valued at 3x Sep'22E consolidated cash earnings (from 3.5x earlier),
- value of holdings in HPCL (based on our SOTP value for HPCL net of cost of acquisition) and MRPL (unchanged at 6x Sep'22E EV/EBITDA), and
- investment value of holdings in other listed entities (GAIL, IOCL, etc.) at 20% discount to CMP.

FIG 4 – VALUATION SUMMARY

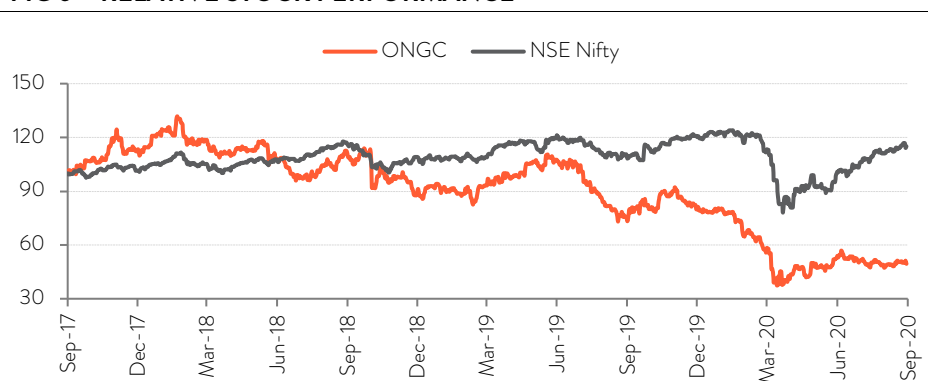
Particulars	Value (Rs bn)	Comments
ONGC/OVL value	1,144	3x Sep'22E consolidated cash earnings (excluding HPCL and MRPL)
HPCL and MRPL business value (net of costs)	(32)	As per our SOTP valuation for HPCL (net of costs); MRPL at 6x Sep'22E EV/EBITDA
Core equity value	1,112	
Core value (Rs/share)	89	8.8x FY22E EPS
Value of holdings (Rs/share)	7	Listed companies @ 20% discount to their CMP (other than MRPL, HPCL)
Value (Rs/share)	96	9.5x FY22E EPS

Source: BOBCAPS Research

FIG 5 – KEY ASSUMPTIONS

	FY21E	FY22E	FY23E
Brent oil price (US\$/bbl)	40	45	50
USDINR	76	78	80
ONGC & JV			
Crude production (mmt)	22.6	22.6	22.6
Gas production (bcm)	24.34	25.8	25.8
APM Gas price (US\$/mmbtu)	2.8	2.9	3.3
OVL			
Crude production (mmt)	10.1	10.1	10.1
Gas production (bcm)	5.0	5.3	5.3
MRPL			
Refining throughput (mmtpa)	16.5	16.5	16.5
GRM (US\$/bbl)	5.0	6.0	6.0

Source: BOBCAPS Research

FIG 6 – RELATIVE STOCK PERFORMANCE

Source: NSE

Key risks

Key risks to our estimates are:

- lower-than-expected oil and gas prices,
- delay or abandonment of Mozambique development (ONGC has invested >US\$ 6bn in Mozambique Area 1 fields for a 16% stake),
- revival of any upstream oil subsidy mechanism by the government, and
- forced M&A with any other public sector company.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20P	FY21E	FY22E	FY23E
Total revenue	4,534,606	4,250,014	2,863,013	3,602,536	4,515,098
EBITDA	838,648	611,687	381,476	478,782	602,425
Depreciation	(332,469)	(356,583)	(347,488)	(359,036)	(381,094)
EBIT	506,179	255,104	33,988	119,745	221,331
Net interest income/(expenses)	(58,367)	(69,998)	(60,863)	(65,535)	(77,269)
Other income/(expenses)	81,488	85,316	94,890	109,559	103,310
Exceptional items	(15,910)	(90,285)	0	0	0
EBT	529,299	270,422	68,015	163,769	247,372
Income taxes	(208,802)	(75,080)	(19,502)	(47,369)	(72,460)
Min. int./Inc. from associates	34,283	10,544	10,544	10,544	10,544
Reported net profit	338,870	115,601	59,057	126,944	185,456
Adjusted net profit	348,309	168,256	59,057	126,944	185,456

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20P	FY21E	FY22E	FY23E
Accounts payables	305,575	229,679	147,707	218,816	304,266
Other current liabilities	452,175	589,312	550,884	580,820	612,363
Provisions	322,323	372,878	375,832	376,544	377,246
Debt funds	1,026,716	1,137,925	1,223,550	1,481,071	1,747,189
Other liabilities	456,357	434,725	441,493	456,289	473,240
Equity capital	62,901	62,901	62,901	62,901	62,901
Reserves & surplus	2,142,314	2,006,634	2,052,638	2,144,744	2,273,444
Shareholders' fund	2,205,216	2,069,536	2,115,539	2,207,646	2,336,346
Total liabilities and equities	4,949,424	5,012,183	5,033,134	5,499,313	6,028,779
Cash and cash eq.	41,059	57,041	289,338	305,981	390,722
Accounts receivables	174,533	115,475	82,260	106,497	131,794
Inventories	351,807	330,512	306,934	383,330	480,365
Other current assets	358,820	395,072	226,849	303,770	374,402
Investments	669,112	506,403	546,592	591,845	637,139
Net fixed assets	2,522,648	2,626,989	2,681,057	2,865,098	3,043,190
CWIP	690,563	838,324	757,738	800,427	828,800
Intangible assets	140,884	142,367	142,367	142,367	142,367
Total assets	4,949,424	5,012,183	5,033,134	5,499,313	6,028,779

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20P	FY21E	FY22E	FY23E
Net income + Depreciation	703,032	435,921	471,320	544,285	608,315
Changes in working capital	218,857	155,896	107,571	(75,797)	(75,268)
Other operating cash flows	(24,280)	(16,663)	(88,122)	(94,763)	(86,358)
Cash flow from operations	897,609	575,154	490,769	373,725	446,689
Capital expenditures	(843,703)	(572,421)	(385,744)	(644,071)	(629,324)
Change in investments	4,234	162,709	(40,189)	(45,252)	(45,295)
Other investing cash flows	81,488	85,316	94,890	109,559	103,310
Cash flow from investing	(757,981)	(324,397)	(331,044)	(579,765)	(571,309)
Debt raised/repaid	14,256	111,209	85,625	257,521	266,118
Dividends paid	(103,033)	(113,934)	(13,054)	(34,838)	(56,756)
Other financing cash flows	(60,576)	(232,050)	0	0	0
Cash flow from financing	(149,353)	(234,775)	72,572	222,683	209,362
Changes in cash and cash eq.	(9,725)	15,982	232,297	16,643	84,742
Closing cash and cash eq.	41,059	57,041	289,338	305,981	390,722

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20P	FY21E	FY22E	FY23E
Reported EPS	26.9	9.2	4.7	10.1	14.7
Adjusted EPS	27.7	13.4	4.7	10.1	14.7
Dividend per share	7.0	7.7	0.9	2.4	3.9
Book value per share	175.3	164.5	168.2	175.5	185.7

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20P	FY21E	FY22E	FY23E
EV/Sales	0.4	0.5	0.7	0.6	0.5
EV/EBITDA	2.1	3.2	5.3	4.2	3.4
Adjusted P/E	2.9	5.9	16.9	7.9	5.4
P/BV	0.5	0.5	0.5	0.5	0.4

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20P	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	67.8	93.4	86.8	77.5	75.0
Interest burden (PBT/EBIT)	101.4	70.6	200.1	136.8	111.8
EBIT margin (EBIT/Revenue)	11.2	6.0	1.2	3.3	4.9
Asset turnover (Revenue/Avg TA)	94.9	85.3	57.0	68.4	78.3
Leverage (Avg TA/Avg Equity)	2.2	2.3	2.4	2.4	2.5
Adjusted ROAE	16.4	7.9	2.8	5.9	8.2

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY19A	FY20P	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	25.2	(6.3)	(32.6)	25.8	25.3
EBITDA	27.4	(27.1)	(37.6)	25.5	25.8
Adjusted EPS	51.6	(51.7)	(64.9)	115.0	46.1
Profitability & Return ratios (%)					
EBITDA margin	18.5	14.4	13.3	13.3	13.3
EBIT margin	11.2	6.0	1.2	3.3	4.9
Adjusted profit margin	7.7	4.0	2.1	3.5	4.1
Adjusted ROAE	16.4	7.9	2.8	5.9	8.2
ROCE	9.1	4.4	0.7	2.3	3.9
Working capital days (days)					
Receivables	13	12	13	10	10
Inventory	45	47	66	54	51
Payables	28	27	28	21	24
Ratios (x)					
Gross asset turnover	0.9	0.8	0.5	0.6	0.7
Current ratio	0.6	0.6	0.6	0.6	0.6
Net interest coverage ratio	8.7	3.6	0.6	1.8	2.9
Adjusted debt/equity	0.4	0.5	0.4	0.5	0.6

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

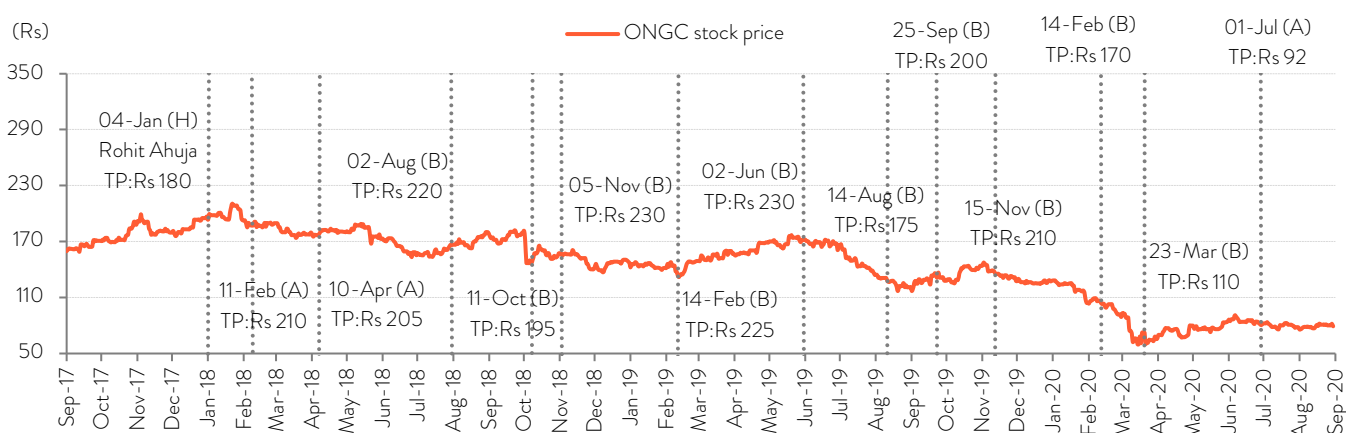
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

RATINGS AND TARGET PRICE (3-YEAR HISTORY): ONGC (ONGC IN)



B – Buy, A – Add, R – Reduce, S – Sell, H – Hold

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