

BUY

TP: Rs 210 | ▲ 54%

ONGC

Oil & Gas

15 November 2019

Low costs drive profitability

ONGC's Q2FY20 earnings outperformed at Rs 62.6bn (-24% YoY). Key Q2 highlights: (a) production trends below estimates – oil at 5.8mmt (-2.7% YoY) / gas at 6.3bcm (-1.9% YoY), (b) operating costs at US\$ 7/bbl led to earnings beat (US\$ 8/bbl est.), and (c) oil price realisation at US\$ 60.3/bbl (-17% YoY) fell short of estimates, on higher discount to Brent. We trim FY20/FY21/FY22 earnings by 6%/6.5%/5% on lower oil/gas production assumptions. Our Sep'20 TP rises to Rs 210 (from Rs 200) on higher value estimated for HPCL.

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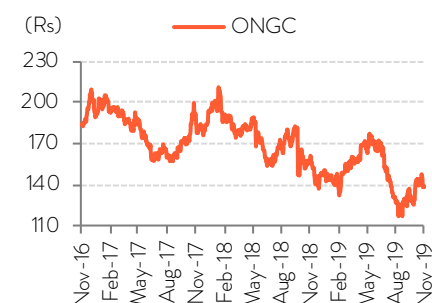
Drop in oil and gas production remains a concern: While the decline in oil output (-3.9% YoY in Q2FY20) was along expected lines, the fall in gas production was surprising (-1.6% YoY). Post the Q2 underperformance, we cut our gas production estimates for FY20-FY22 by 5-7%. ONGC's guidance for a ~20mmscmd increase in gas output over FY21-FY23 now looks increasingly unrealistic, as it continues to miss near-term guidance.

Ticker/Price	ONGC IN/Rs 136
Market cap	US\$ 23.8bn
Shares o/s	12,580mn
3M ADV	US\$ 22.5mn
52wk high/low	Rs 179/Rs 116
Promoter/FPI/DII	64%/8%/28%

Source: NSE

Low operating costs appear sustainable: Q2 operating cost at US\$ 7/bbl (almost at Q1 levels) was well below our estimates and led to above-expected standalone EBITDA of Rs 133bn (-16% YoY). Operating costs have been very volatile over the last few quarters and hence a stable cost outlook (at <US\$ 8/bbl levels) could have a positive impact on the earnings outlook for ONGC. We estimate costs at ~US\$ 9/bbl over FY20-FY22.

STOCK PERFORMANCE



Trading at distressed valuations: At 4.9x/4.2x FY21E/FY22E EPS, ONGC is trading at distressed valuations, implying oil prices at ~US\$ 53/bbl (vs. US\$ 63/bbl currently). With ~6% dividend yield (FY20E), an improved outlook from relatively stable oil prices and higher valuations for HPCL (on probable BPCL privatisation), we find the risk-reward favourable.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	3,622,462	4,534,606	4,158,474	4,939,293	5,522,471
EBITDA (Rs mn)	658,350	838,648	645,102	720,737	814,129
Adj. net profit (Rs mn)	234,323	348,309	296,505	352,961	406,087
Adj. EPS (Rs)	18.3	27.7	23.6	28.1	32.3
Adj. EPS growth (%)	(3.5)	51.6	(14.9)	19.0	15.1
Adj. ROAE (%)	11.8	16.4	12.9	14.3	15.2
Adj. P/E (x)	7.5	4.9	5.8	4.9	4.2
EV/EBITDA (x)	3.5	3.2	4.2	3.7	3.3

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)	H1FY20	H1FY19	YoY (%)
Net revenues	244,926	279,892	(12.5)	265,547	(7.8)	510,474	552,020	(7.5)
Employee costs	6,332	6,097	3.9	6,082	4.1	12,414	12,458	(0.4)
% of sales	2.6	2.2	-	2.3	-	2.4	2.3	-
Other expenditure	105,694	115,908	(8.8)	108,345	(2.4)	214,039	234,354	(8.7)
% of sales	43.2	41.4	-	40.8	-	41.9	42.5	-
EBITDA	132,900	157,887	(15.8)	151,120	(12.1)	284,020	305,208	(6.9)
EBITDA margin (%)	54.3	56.4	-	56.9	-	55.6	55.3	-
Depreciation and amortisation	62,553	48,488	29.0	61,563	1.6	124,115	98,754	25.7
Interest	6,818	6,291	8.4	6,460.80	5.5	13,278	13,777	(3.6)
Other income	26,853	23,942	12.2	7,475	259.2	34,328	30,441	12.8
Exceptional Item	-	-	-	-	-	-	-	-
PBT	90,383	127,050	(28.9)	90,572	(0.2)	180,955	223,118	(18.9)
Provision for tax	27,752	44,404	(37.5)	31,529	(12.0)	59,281	79,033	(25.0)
-Effective tax rate	30.70	34.95		34.81		32.76	35.42	
PAT (reported)	62,631	82,646	(24.2)	59,043	6.1	121,674	144,085	(15.6)
EPS (adjusted) (Rs/share)	5.0	6.4	(22.7)	4.7	6.1	9.7	11.2	(13.9)
Net realisation (US\$/bbl)	60.3	73.1	(17.4)	66.3	(9.0)	63.3	72.3	(12.5)

Source: Company, BOBCAPS Research

FIG 2 – QUARTERLY PRODUCTION

	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)	H1FY20	H1FY19	YoY (%)
Production								
Oil (mmt)	5.84	6.08	(3.88)	5.9	(0.5)	11.7	12.3	(4.7)
Gas (bcm)	6.27	6.37	(1.55)	6.4	(2.3)	12.7	12.6	1.0
Total (mmtoe)	12.11	12.45	(2.7)	12.3	(1.4)	24.4	24.9	(1.8)
Sales								
Oil (mmt)	5.4	5.5	(1.2)	5.3	2.2	10.7	11.3	(5.2)
Gas (bcm)	4.9	5.0	(2.6)	5.0	(1.6)	9.9	9.9	(0.3)
Total (mmtoe)	10.3	10.5	(1.9)	10.3	0.4	20.6	21.2	(2.9)

Source: Company, BOBCAPS Research

Valuation methodology

We trim FY20/FY21/FY22 earnings by 6%/6.5%/5% on lower oil and gas production assumptions. Our Sep'20 target price rises to Rs 210 (from Rs 200) on higher value estimated for HPCL.

At 4.9x/4.2x FY21E/FY22E EPS, ONGC is trading at distressed valuations, implying oil prices at ~US\$ 53/bbl (vs. US\$ 63/bbl currently). With ~6% dividend yield (FY20E), an improved outlook from relatively stable oil prices and higher valuations for HPCL (on probable BPCL privatisation), we find the risk-reward favourable. Maintain BUY.

Our SOTP valuation includes the following:

- core business valued at 4x Sep'21E consolidated cash earnings
- increase in value of holdings in HPCL (based on our higher SOTP value for HPCL net of ONGC's cost of acquisition) and value of MRPL (6x Sep'21E EV/EBITDA), and
- investment value of holdings in other listed entities (GAIL, IOCL, etc.) at 20% discount to CMP.

FIG 3 – REVISED ESTIMATES

(Rs bn)	FY20E			FY21E			FY22E		
	Old	New	Var (%)	Old	New	Var (%)	New	New	Var (%)
Revenue	4,185	4,158	(0.6)	4,975	4,939	(0.7)	5,561	5,522	(0.7)
EBITDA	670	645	(3.7)	755	721	(4.5)	851	814	(4.3)
EBITDA margin (%)	14.2	15.5	-	13.6	14.6	-	15.3	14.7	-
PAT	313	297	(5.3)	377	353	(6.4)	432	406	(6.0)
PAT margin (%)	5.2	7.1	-	5.4	7.1	-	7.8	7.4	-
EPS (Rs)	25.0	23.6	(5.7)	30.0	28.1	(6.5)	34.0	32.3	(5.1)

Source: BOBCAPS Research

FIG 4 – VALUATION SUMMARY

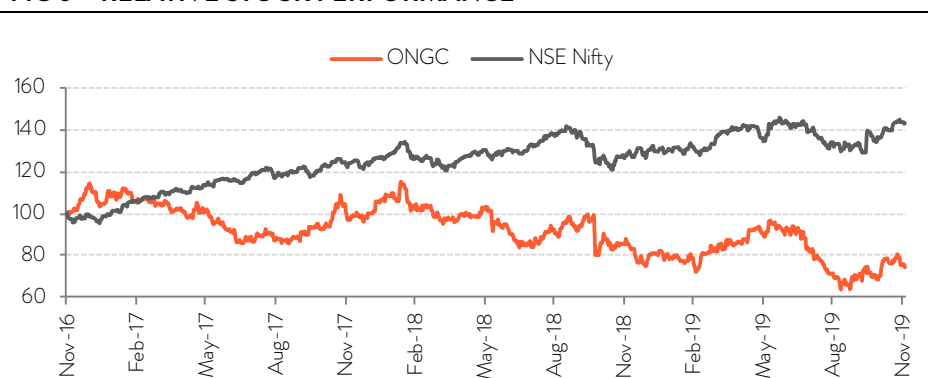
Particulars	Value (Rs bn)	Comments
ONGC/OVL value	2,509	4x Sep'21E consolidated cash earnings (excluding HPCL and MRPL)
HPCL and MRPL business value (net of costs)	(37)	As per our SOTP valuation for HPCL (net of costs); MRPL at 6x Sep'21E EV/EBITDA
Core equity value	2,472	
Core value (Rs/share)	197	
Value of holdings (Rs/share)	13	Listed companies @ 20% discount to their CMP (other than MRPL, HPCL)
Value (Rs/share)	210	7.5x FY21E EPS

Source: BOBCAPS Research

FIG 5 – KEY ASSUMPTIONS

	FY20E	FY21E	FY22E
Brent oil price (US\$/bbl)	65	70	75
USDINR	72	74	74
ONGC & JV			
Crude production (mmt)	23.2	23.2	23.7
Gas production (bcm)	26.0	27.5	28.9
APM gas price (US\$/mmbtu)	4.2	4.9	5.3
OVL			
Crude production (mmt)	9.9	9.9	9.9
Gas production (bcm)	5.3	5.3	5.3
MRPL			
Refining throughput (mmtpa)	16.0	16.5	16.5
GRM (US\$/bbl)	6.0	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)	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue	3,622,462	4,534,606	4,158,474	4,939,293	5,522,471
EBITDA	658,350	838,648	645,102	720,737	814,129
Depreciation	(305,506)	(332,469)	(338,346)	(352,020)	(361,485)
EBIT	352,844	506,179	306,757	368,717	452,644
Net interest income/(expenses)	(49,990)	(58,367)	(54,102)	(62,662)	(70,938)
Other income/(expenses)	74,682	81,488	134,329	168,108	166,525
Exceptional items	2,481	(15,910)	0	0	0
EBT	377,535	529,299	386,983	474,163	548,231
Income taxes	(131,395)	(208,802)	(124,761)	(155,485)	(176,426)
Min. int./Inc. from associates	(12,675)	34,283	34,283	34,283	34,283
Reported net profit	235,947	338,870	296,505	352,961	406,087
Adjusted net profit	234,323	348,309	296,505	352,961	406,087

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	265,507	312,560	336,714	362,016	424,071
Other current liabilities	417,632	416,528	451,004	458,610	485,300
Provisions	295,441	324,957	333,413	335,520	336,232
Debt funds	1,012,460	1,026,716	1,173,861	1,351,914	1,414,841
Other liabilities	415,059	456,357	478,460	506,887	539,091
Equity capital	64,166	62,901	62,901	62,901	62,901
Reserves & surplus	1,976,023	2,141,319	2,315,932	2,504,617	2,728,720
Shareholders' fund	2,040,189	2,204,221	2,378,833	2,567,518	2,791,621
Total liabilities and equities	4,602,349	4,741,338	5,152,286	5,582,466	5,991,156
Cash and cash eq.	50,784	41,059	239,715	374,659	368,948
Accounts receivables	155,556	174,533	186,381	214,060	235,622
Inventories	305,630	351,807	475,873	555,002	613,715
Other current assets	541,338	150,733	101,335	183,687	248,272
Investments	673,346	669,112	709,227	749,418	794,669
Net fixed assets	2,519,857	2,522,648	2,639,058	2,638,596	2,770,187
CWIP	213,813	690,563	659,813	726,160	818,860
Intangible assets	142,025	140,884	140,884	140,884	140,884
Total assets	4,602,349	4,741,338	5,152,285	5,582,465	5,991,156

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	450,999	703,032	611,747	769,755	825,877
Changes in working capital	(376,807)	400,915	(19,429)	(154,145)	(55,404)
Other operating cash flows	(29,733)	(24,280)	(112,227)	(139,681)	(134,321)
Cash flow from operations	44,459	1,079,667	480,092	475,929	636,152
Capital expenditures	(364,214)	(843,703)	(400,902)	(482,679)	(644,080)
Change in investments	34,111	4,234	(40,115)	(40,191)	(45,250)
Other investing cash flows	74,682	81,488	134,329	168,108	166,525
Cash flow from investing	(255,421)	(757,981)	(306,688)	(354,763)	(522,806)
Debt raised/repaid	268,463	14,256	147,145	178,053	62,927
Dividends paid	(102,486)	(103,033)	(121,892)	(164,275)	(181,984)
Other financing cash flows	(36,357)	(242,634)	0	0	0
Cash flow from financing	129,619	(331,411)	25,253	13,777	(119,057)
Changes in cash and cash eq.	(81,343)	(9,725)	198,656	134,944	(5,711)
Closing cash and cash eq.	50,784	41,058	239,715	374,659	368,948

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	18.4	26.9	23.6	28.1	32.3
Adjusted EPS	18.3	27.7	23.6	28.1	32.3
Dividend per share	6.6	7.0	8.3	11.2	12.4
Book value per share	159.0	175.2	189.1	204.1	221.9

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	0.6	0.6	0.6	0.5	0.5
EV/EBITDA	3.5	3.2	4.2	3.7	3.3
Adjusted P/E	7.5	4.9	5.8	4.9	4.2
P/BV	0.9	0.8	0.7	0.7	0.6

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	61.7	67.8	76.6	74.4	74.1
Interest burden (PBT/EBIT)	107.7	101.4	126.2	128.6	121.1
EBIT margin (EBIT/Revenue)	9.7	11.2	7.4	7.5	8.2
Asset turnover (Revenue/Avg TA)	80.0	97.1	84.1	92.0	95.4
Leverage (Avg TA/Avg Equity)	2.3	2.2	2.2	2.2	2.2
Adjusted ROAE	11.8	16.4	12.9	14.3	15.2

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

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Revenue	11.2	25.2	(8.3)	18.8	11.8
EBITDA	12.8	27.4	(23.1)	11.7	13.0
Adjusted EPS	(3.5)	51.6	(14.9)	19.0	15.1
Profitability & Return ratios (%)					
EBITDA margin	18.2	18.5	15.5	14.6	14.7
EBIT margin	9.7	11.2	7.4	7.5	8.2
Adjusted profit margin	6.5	7.7	7.1	7.1	7.4
Adjusted ROAE	11.8	16.4	12.9	14.3	15.2
ROCE	7.7	9.3	6.1	6.6	7.6
Working capital days (days)					
Receivables	15	13	16	15	15
Inventory	56	45	56	56	56
Payables	31	29	34	30	30
Ratios (x)					
Gross asset turnover	0.7	0.9	0.8	0.9	0.9
Current ratio	0.7	0.5	0.6	0.7	0.7
Net interest coverage ratio	7.1	8.7	5.7	5.9	6.4
Adjusted debt/equity	0.5	0.4	0.4	0.4	0.4

Source: Company, BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

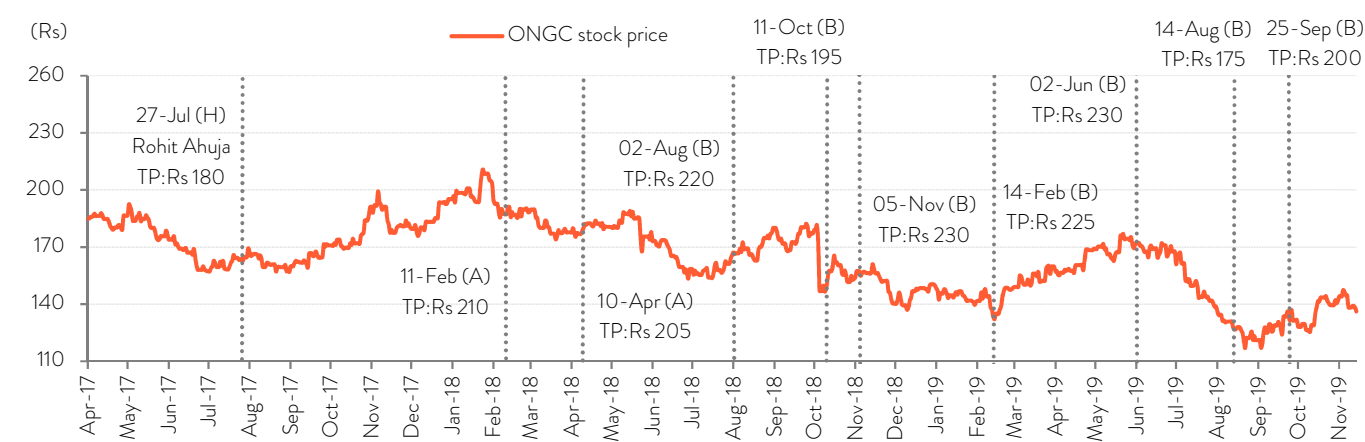
ADD – Expected return from >+5% to +15%

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)

HISTORICAL RATINGS AND TARGET PRICE: ONGC (ONGC IN)



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

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