

**BUY**

TP: Rs 175 | ▲ 39%

**ONGC**

| Oil &amp; Gas

| 11 September 2019

## Oil production targets ambitious

In a recent meeting, ONGC's management highlighted (a) its unchanged domestic gas production guidance at ~3mmscmd/year over FY20-FY25, and (b) expectations of sustained long-term growth in OVL production through added stake in the Vankor fields and start-up of the Mozambique project (by 2024-25). We maintain earnings estimates, factoring in oil prices at US\$ 65-75/bbl through to FY22. Our Sep'20 TP remains at Rs 175. Valuations appear to be pricing in the worst case (~US\$ 50/bbl oil price) and offer favourable risk-reward.

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**Oil targets ambitious; gas outlook buoyant:** Domestic oil production targets of 25.34mmt look challenging considering that ONGC has delivered a mere ~1% CAGR over the last five years. Management also hopes to raise gas production by ~30mmscmd (~10mmt) over 4-5 years, from development of fields in the KG basin and Mumbai High. We expect the rise in gas output witnessed in FY19 (+3.4mmscmd) to sustain until FY25 in the worst case. Management also anticipates an uptick in OVL's oil and gas production from additional buyouts in Vankor assets, start-up of oil production from South Sudan and development of the Mozambique project.

**Value from subsidiaries:** OPAL is guided to turn profitable in FY20 as utilisation improves to 100% (from ~68% YoY), with ~25% operating margins. OMPL's profitability is also expected to rise in FY20 led by better availability of naphtha and natural gas (once the Kochi-Mangalore pipeline commences).

**Trading at distressed valuations:** At 5.5x FY21E EPS, ONGC's valuation implies ~US\$ 45/bbl oil prices, an unjustifiably steep discount to prevailing Brent prices of US\$ 61/bbl. With ~6% dividend yield, risk-reward looks lucrative.

Ticker/Price	ONGC IN/Rs 126
Market cap	US\$ 22.1bn
Shares o/s	12,580mn
3M ADV	US\$ 23.1mn
52wk high/low	Rs 185/Rs 116
Promoter/FPI/DII	64%/8%/28%

Source: NSE

## STOCK PERFORMANCE



Source: NSE

## KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total Revenue (Rs mn)	3,622,462	4,534,606	4,636,467	5,498,962	6,068,100
EBITDA (Rs mn)	658,350	838,648	659,133	747,727	835,467
Adj. net profit (Rs mn)	234,323	348,309	241,255	294,220	337,747
Adj. EPS (Rs)	18.3	27.7	19.2	23.4	26.8
Adj. EPS growth (%)	(3.5)	51.6	(30.7)	22.0	14.8
Adj. ROAE (%)	11.8	16.4	10.6	12.2	13.2
Adj. P/E (x)	6.9	4.5	6.6	5.4	4.7
EV/EBITDA (x)	3.3	3.0	3.9	3.6	3.3

Source: Company, BOBCAPS Research

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Important disclosures, including any required research certifications, are provided at the end of this report.



## Excerpts from Annual Report

### Reserve replacement

**FIG 1 – RESERVE REPLACEMENT RATIO (RRR) ANALYSIS**

(mmtoe)	Ultimate reserve (2P) accretion O+OEG					Production (oil + gas)				RRR			
	ONGC (dom)	ONGC JV (dom)	Total (dom)	OVL share	Total (group)	ONGC	JV	OVL	Total	ONGC	JV	OVL	Total
<b>FY15</b>	61.06	(1.03)	60.03	20.03	80.06	44.28	5.18	8.87	58.33	1.38	(0.20)	2.26	1.37
<b>FY16</b>	65.58	0.8	66.38	(7.22)	59.16	43.54	4.92	8.92	57.38	1.51	0.16	(0.81)	1.03
<b>FY17</b>	64.32	0.22	64.54	120.28	184.82	44.34	4.47	12.8	61.61	1.45	0.05	9.40	3.00
<b>FY18</b>	67.83	1.02	68.85	21.56	90.41	45.78	4.43	14.16	64.37	1.48	0.23	1.52	1.40
<b>FY19</b>	63.02	11.45	74.47	(20.95)	53.52	45.85	4.18	14.84	64.87	1.37	2.74	(1.41)	0.83

Source: BOBCAPS Research, Company | Dom – Domestic

- High RRR but production remains a drag:** ONGC has maintained its domestic reserve replacement ratio (RRR) at ~1.4x levels over FY15-FY19. But production trends have been mixed – oil production has declined at 1.3% CAGR over five years, while gas has risen 3% over the same period. Management expects gas production to accelerate over FY20-FY23 to ~5% CAGR as new projects in the KG basin come onstream.

RRR for OVL remains volatile as reserve accretion seems to be driven by inorganic initiatives (Vankor, BC-10). OVL's reserves declined by 20mmt in FY19 as the company abandoned operations in South Sudan. Latest updates, however, indicate that these operations have resumed. OVL's production has increased at a reasonably good clip over the last five years (~14% CAGR), driven mostly by oil (16% CAGR).

**FIG 2 – PRODUCTION/VOLUME PROFILE**

Particulars	Production quantity			Sales quantity		Value (Rs mn)	
	FY19	FY18	Chg (%)	FY19	FY18	FY19	FY18
Crude Oil (mmt)	24.2	25.4	(4.7)	22.5	23.7	775,729	603,899
Natural Gas (bcm)	25.8	24.6	4.9	20.5	19.5	188,389	137,372
<b>Value Added Products (VAP) ('000 mt)</b>							
Liquefied Petroleum Gas	1,107	1,187	(6.7)	1,109	1,186	43,490	40,352
Naphtha	1,175	1,176	(0.1)	1,154	1,180	46,861	38,084
Ethane-Propane	414	356	16.3	414	356	10,063	7,502
Ethane	455	264	72.3	456	264	10,109	7,050
Propane	210	194	8.2	207	191	7,948	6,250
Butane	114	103	10.7	115	103	4,470	3,423
Superior Kerosene Oil	66	46	43.5	71	34	3,355	1,178
Others	99	61	62.3	58	28	2,585	692
Sub-total (VAP)	3,640	3,387	7.5	3,584	3,342	128,881	104,531
<b>Total</b>						<b>1,092,999</b>	<b>845,802</b>

Source: Company, BOBCAPS Research

- **High contingent resources highlight development challenges:** As per the recently adopted petroleum resource management system (PRMS), ONGC has disclosed contingent resources of 407mmtoe (2C) as at end-FY19, forming 35% of total domestic 2P reserves. These usually have a lower probability of production as compared to 2P and hence indicate a higher risk profile for ONGC's assets in terms of delivering on production growth (or imply a high level of pending appraisal activities across its discovered assets).

**FIG 3 – RESERVES**

(mmtoe)	Category	Domestic (Operated)	JV-Domestic (ONGC Share)	Total
Reserves	2P	748	23	770
	3P	818	23	840
Contingent Resources	2C	407		407
	3C	580		580
<b>Total reserves</b>	<b>2P+2C</b>	<b>1,155</b>	<b>23</b>	<b>1,178</b>
	<b>3P+3C</b>	<b>1,397</b>	<b>23</b>	<b>1,420</b>

Source: Company, BOBCAPS Research

- **Improvement in development drilling activity:** The company made 13 discoveries in FY19, 8 in onland blocks and 5 in offshore. Drilling activity improved during the year, especially for development drilling, which bolstered gas production. This is expected to sustain as ONGC strives to raise gas production across its assets in Mumbai High and the KG basin.

**FIG 4 – DRILLING ACTIVITY**

Type of well	Wells drilled (No.)	
	FY18	FY19
Exploratory (including shale)	119	105
Development	343	373
Side Tracks	41	38
<b>Total</b>	<b>503</b>	<b>516</b>

Source: Company, BOBCAPS Research

## Lifting costs

- **Current oil prices favourable as per cost structure:** ONGC's rolling three-year average finding cost for oil has been US\$ 3.02/boe and its lifting cost was ~US\$ 13.00/bbl – comparable to most international upstream companies. Oil prices in the range of US\$ 60-65/bbl thus represent a sweet spot for the company, as it allows for a healthy level of project activity without exerting undue sovereign financial stress on the import side.

**FIG 5 – SUBSIDIARY PERFORMANCE**

Entity	Net Assets		Share in profit or loss		Share in OCI		Share in total comprehensive income	
	As % of consolidated net assets	Amount	As % of consolidated net assets	Amount	As % of consolidated net assets	Amount	As % of consolidated net assets	Amount
ONGC Videsh (OVL)	5.37	126,797.8	0.84	2,855.1	(100.07)	8,971.7	3.58	11,826.8
Hindustan Petroleum Corp (HPCL)	10.10	238,707.4	17.47	59,216.0	7.27	(652.0)	17.75	58,564.0
Mangalore Refinery and Petrochemicals (MRPL)	3.93	92,839.2	0.93	3,163.5	0.43	(38.3)	0.95	3,125.2
ONGC Mangalore Petrochemicals (OMPL)	0.27	6,331.7	0.07	228.9	0.16	(14.1)	0.07	214.8
Petronet MHB (PMHBL)	0.34	7,963.0	0.33	1,117.7	0.01	(1.0)	0.34	1,116.7
Prize Petroleum Company	(0.10)	(2,392.1)	(0.04)	(138.4)	2.12	(190.1)	(0.10)	(328.5)
HPCL Biofuels	0.02	446.3	(0.20)	(675.5)	0.01	(1.1)	(0.21)	(676.6)
HPCL Middle East FZCO	0.00	29.7	0.00	(10.0)	0.01	(0.5)	0.00	(10.5)
OPAL	0.47	11,210.1	(1.84)	(6,232.3)	(0.04)	3.3	(1.89)	(6,229.0)

Source: BOBCAPS Research, Company

## Strategy 2040

- Scale up production:** ONGC aims to increase oil and gas production growth to 2% and 5% CAGR respectively in domestic and international (OVL) operations respectively. We find the domestic targets challenging given that ONGC has delivered a mere ~1% CAGR over the last five years. Management also hopes to raise gas production by ~30mmscmd (~10mnt) over 4-5 years, from development of fields in the KG basin and Mumbai High. The target for OVL looks realistic considering the 13.7% CAGR in production achieved in the last five years (albeit mostly driven by inorganic initiatives). Start-up of the Mozambique integrated LNG project (by 2024-25) could be a key factor in organically ratcheting up OVL's production growth trajectory. The Mozambique consortium has finalised gas sale purchase agreements (GSPA) for >9.5mmtpa of LNG volumes to date.
- Enlarge downstream business:** ONGC's downstream subsidiaries (HPCL and MRPL) plan to triple their total refining capacity, from 35mmtpa to 90-100mmtpa. ONGC will work to derive operational synergies with HPCL through integrated crude sourcing, centralised trading, capability and infrastructure sharing. Expansion in petrochemicals would be based on the robust demand outlook of 8-9% CAGR for the country, as well as ONGC's significant presence in the market through OMPL, OPAL and HPCL's petchem investments.

## Valuation methodology

We maintain our Sep'20 target price of Rs 175 for ONGC. At 5.5x FY21E EPS, the stock is trading at distressed valuations that imply ~US\$ 45/bbl oil prices, an unjustifiably steep discount to the prevailing Brent price of US\$ 61/bbl. With ~6% dividend yield, risk-reward looks lucrative.

Our SOTP valuation includes the following:

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

**FIG 6 – VALUATION SUMMARY**

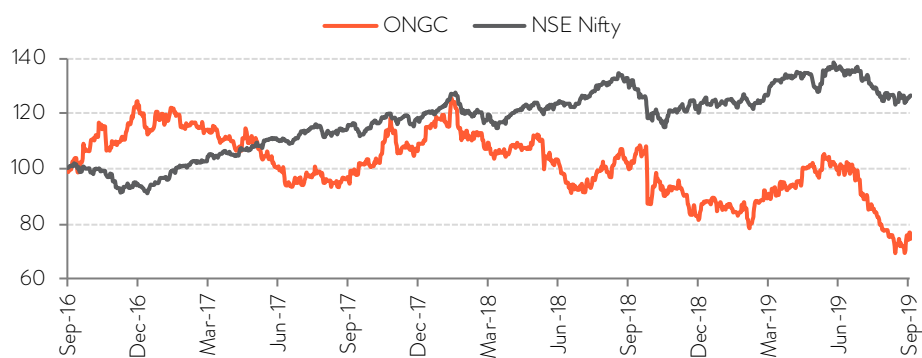
Particulars	Value (Rs bn)	Comments
ONGC/OVL value	2,112	4x Sep'21E consolidated cash earnings (excluding HPCL and MRPL)
HPCL and MRPL business value (net of costs)	(75)	As per our SOTP valuation for HPCL (net of costs); MRPL at 6x Sep'21E EV/EBITDA
<b>Core equity value</b>	<b>2,037</b>	
<b>Core value (Rs/share)</b>	<b>162</b>	<b>7x FY20E/FY21E EPS</b>
Value of holdings (Rs/share)	13	Listed companies (@ 20% discount (other than MRPL, HPCL))
<b>Value (Rs/share)</b>	<b>175</b>	<b>~7.5x FY21E EPS</b>

Source: BOBCAPS Research

**FIG 7 – KEY ASSUMPTIONS**

	FY20E	FY21E	FY22E
<b>Brent oil price (US\$/bbl)</b>	<b>65</b>	<b>70</b>	<b>75</b>
<b>USDINR</b>	<b>72</b>	<b>74</b>	<b>74</b>
<b>ONGC &amp; JV</b>			
Crude production (mmt)	23.2	23.2	23.7
Gas production (bcm)	26.8	28.3	29.7
APM gas price (US\$/mmbtu)	4.2	4.9	5.3
<b>OVL</b>			
Crude production (mmt)	10.1	10.1	10.1
Gas production (bcm)	5.3	5.3	5.3
<b>MRPL</b>			
Refining throughput (mmtpa)	16.0	16.5	16.5
GRM (US\$/bbl)	6.0	6.0	6.0

Source: BOBCAPS Research

**FIG 8 – 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
<b>Total revenue</b>	<b>3,622,462</b>	<b>4,534,606</b>	<b>4,636,467</b>	<b>5,498,962</b>	<b>6,068,100</b>
EBITDA	658,350	838,648	659,133	747,727	835,467
Depreciation	(305,506)	(332,469)	(350,837)	(364,342)	(373,807)
EBIT	352,844	506,179	308,296	383,385	461,660
Net interest income/(expenses)	(49,990)	(58,367)	(53,784)	(62,254)	(69,545)
Other income/(expenses)	74,682	81,488	131,679	162,250	158,755
Exceptional items	2,481	(15,910)	0	0	0
EBT	377,535	529,299	386,191	483,381	550,870
Income taxes	(131,395)	(208,802)	(179,219)	(223,444)	(247,405)
Min. int./Inc. from associates	(12,675)	34,283	34,283	34,283	34,283
<b>Reported net profit</b>	<b>235,947</b>	<b>338,870</b>	<b>241,255</b>	<b>294,220</b>	<b>337,747</b>
<b>Adjusted net profit</b>	<b>234,323</b>	<b>348,309</b>	<b>241,255</b>	<b>294,220</b>	<b>337,747</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	265,507	312,560	364,010	393,551	459,471
Other current liabilities	417,632	416,528	460,344	469,348	497,330
Provisions	295,441	324,957	324,824	326,256	326,121
Debt funds	1,012,460	1,026,716	1,178,222	1,360,615	1,393,527
Other liabilities	415,059	456,357	479,507	507,647	538,842
Equity capital	64,166	62,901	62,901	62,901	62,901
Reserves & surplus	1,976,023	2,141,319	2,268,479	2,410,361	2,579,725
Shareholders' fund	2,040,189	2,204,221	2,331,380	2,473,263	2,642,626
<b>Total liabilities and equities</b>	<b>4,602,349</b>	<b>4,741,338</b>	<b>5,138,286</b>	<b>5,530,680</b>	<b>5,857,918</b>
Cash and cash eq.	50,784	41,059	73,990	158,659	140,186
Accounts receivables	155,556	174,533	196,472	225,744	248,529
Inventories	305,630	351,807	527,711	612,606	678,312
Other current assets	541,338	150,733	203,621	303,423	303,423
Investments	673,346	669,112	709,228	749,420	794,671
Net fixed assets	2,519,857	2,522,648	2,626,568	2,613,785	2,733,054
CWIP	213,813	690,563	659,813	726,160	818,860
Intangible assets	142,025	140,884	140,884	140,884	140,884
<b>Total assets</b>	<b>4,602,349</b>	<b>4,741,338</b>	<b>5,138,286</b>	<b>5,530,680</b>	<b>5,857,918</b>

Source: Company, BOBCAPS Research

### Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	450,999	703,032	568,989	723,336	769,858
Changes in working capital	(376,807)	400,915	(155,597)	(173,991)	5,276
Other operating cash flows	(29,733)	(24,280)	(108,530)	(134,110)	(127,559)
<b>Cash flow from operations</b>	<b>44,459</b>	<b>1,079,667</b>	<b>304,862</b>	<b>415,236</b>	<b>647,575</b>
Capital expenditures	(364,214)	(843,703)	(400,904)	(482,680)	(644,080)
Change in investments	34,111	4,234	(40,116)	(40,192)	(45,250)
Other investing cash flows	74,682	81,488	131,679	162,250	158,755
<b>Cash flow from investing</b>	<b>(255,421)</b>	<b>(757,981)</b>	<b>(309,340)</b>	<b>(360,623)</b>	<b>(530,576)</b>
Debt raised/repaid	268,463	14,256	151,505	182,394	32,912
Dividends paid	(102,486)	(103,033)	(114,095)	(152,338)	(168,383)
Other financing cash flows	(36,357)	(242,634)	0	0	0
<b>Cash flow from financing</b>	<b>129,619</b>	<b>(331,411)</b>	<b>37,410</b>	<b>30,056</b>	<b>(135,472)</b>
<b>Changes in cash and cash eq.</b>	<b>(81,343)</b>	<b>(9,725)</b>	<b>32,931</b>	<b>84,669</b>	<b>(18,473)</b>
<b>Closing cash and cash eq.</b>	<b>50,784</b>	<b>41,058</b>	<b>73,990</b>	<b>158,659</b>	<b>140,186</b>

### Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	18.4	26.9	19.2	23.4	26.8
Adjusted EPS	18.3	27.7	19.2	23.4	26.8
Dividend per share	6.6	7.0	7.8	10.3	11.4
Book value per share	159.0	175.2	185.3	196.6	210.1

### 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	3.3	3.0	3.9	3.6	3.3
Adjusted P/E	6.9	4.5	6.6	5.4	4.7
P/BV	0.8	0.7	0.7	0.6	0.6

### DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	61.7	67.8	62.5	60.9	61.3
Interest burden (PBT/EBIT)	107.7	101.4	125.3	126.1	119.3
EBIT margin (EBIT/Revenue)	9.7	11.2	6.6	7.0	7.6
Asset turnover (Revenue/Avg TA)	80.0	97.1	93.9	103.1	106.6
Leverage (Avg TA/Avg Equity)	2.3	2.2	2.2	2.2	2.2
Adjusted ROAE	11.8	16.4	10.6	12.2	13.2

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



**Ratio Analysis**

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
<b>YoY growth (%)</b>					
Revenue	11.2	25.2	2.2	18.6	10.3
EBITDA	12.8	27.4	(21.4)	13.4	11.7
Adjusted EPS	(3.5)	51.6	(30.7)	22.0	14.8
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	18.2	18.5	14.2	13.6	13.8
EBIT margin	9.7	11.2	6.6	7.0	7.6
Adjusted profit margin	6.5	7.7	5.2	5.4	5.6
Adjusted ROAE	11.8	16.4	10.6	12.2	13.2
ROCE	7.7	9.3	4.9	5.6	6.5
<b>Working capital days (days)</b>					
Receivables	15	13	15	14	14
Inventory	56	45	50	53	54
Payables	31	29	31	29	30
<b>Ratios (x)</b>					
Gross asset turnover	0.7	0.9	0.9	1.0	1.0
Current ratio	0.7	0.5	0.6	0.7	0.7
Net interest coverage ratio	7.1	8.7	5.7	6.2	6.6
Adjusted debt/equity	0.5	0.4	0.5	0.5	0.5

Source: Company, BOBCAPS Research

## Disclaimer

### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

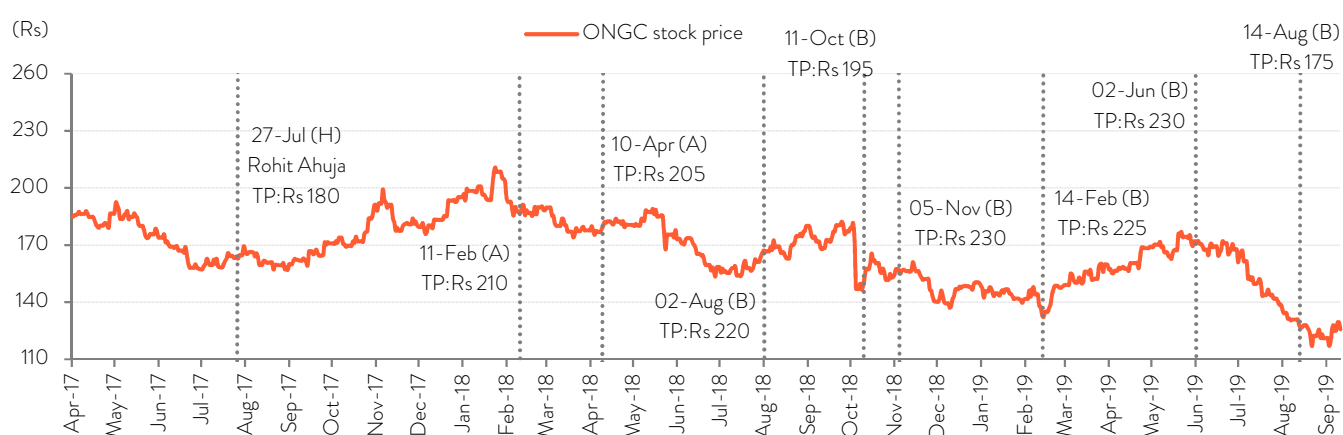
**ADD** – Expected return from >+5% to +15%

**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)

### HISTORICAL RATINGS AND TARGET PRICE: ONGC (ONGC IN)



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

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