

BUY

TP: Rs 175 | ▲ 37%

ONGC

Oil & Gas

14 August 2019

Valuations pricing in the worst case

ONGC's Q1FY20 earnings outperformed at Rs 59bn (-4% YoY). Key Q1 highlights: (a) production trends lower than estimates – oil/gas at 5.9mmt/6.4bcm (-5.6%/+3.6% YoY), (b) operating costs at US\$ 7/bbl vs. US\$ 8.5/bbl estimated, and (c) oil price realisation above estimates at US\$ 66.3/bbl (-7% YoY) on lower discount to Brent. We cut FY20/FY21 earnings by 27%/21% on lower oil price (US\$ 65-70/bbl) and production (by ~5%) assumptions. Rolling forward to Sep'21 valuations, we have a revised TP of Rs 175 (from Rs 230).

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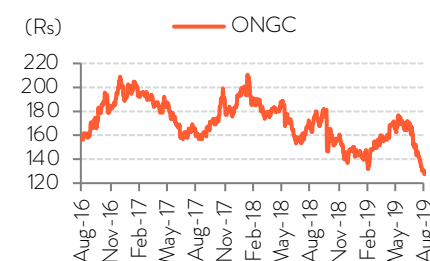
Oil production remains a drag; outlook on gas still buoyant: Oil production continues to decline (-5.6% YoY in Q1FY20), leading us to cut production estimates for FY20/FY21 to ~23.2mmt levels. Gas output too trended lower than expectations, falling far behind management's guidance of 4-5mmscmd a year. We reduce estimates for FY20/FY21 to 26.8bcm/28.3bcm (+4.5mmscmd over two years).

Ticker/Price	ONGC IN/Rs 128
Market cap	US\$ 22.6bn
Shares o/s	12,580mn
3M ADV	US\$ 23.8mn
52wk high/low	Rs 185/Rs 126
Promoter/FPI/DII	64%/8%/28%

Source: NSE

Focus on project execution: PNGRB's recent notification of free pricing for incremental gas production (US\$ 7-9/mmbtu as per current trends) augurs well for the financial viability of ONGC's planned ~US\$ 10bn capex. Mozambique project FID has been recently finalised as a sales contract for ~12.5mmtpa of the volumes have been signed. Funding for this project would be at the Mozambique SPV level. As per management, break-even gas price is US\$ 6-7/mmbtu (down from US\$ 9/mmbtu earlier), given reduction in capex and operating cost estimates.

STOCK PERFORMANCE



Source: NSE

Trading at distressed valuations: At 5.5x FY21E EPS, ONGC's valuations imply ~US\$ 45/bbl oil prices, an unjustifiably steep discount to the prevailing Brent oil price (US\$ 61/bbl). With ~6% dividend yields, risk-reward appears lucrative. Maintain BUY.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19P	FY20E	FY21E	FY22E
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)	7.0	4.6	6.7	5.5	4.8
EV/EBITDA (x)	3.4	3.1	3.9	3.6	3.4

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)
Net revenues	265,547	272,128	(2.4)	267,585	(0.8)
Employee costs	6,082	6,362	(4.4)	7,828	(22.3)
% of sales	2.3	2.3	-	2.9	-
Other expenditure	108,345	118,446	(8.5)	136,046	(20.4)
% of sales	40.8	43.5	-	50.8	-
EBITDA	151,120	147,321	2.6	123,710	22.2
EBITDA margin (%)	56.9	54.1	-	46.2	-
Depreciation/amortisation	61,563	50,266	22.5	85,084	(27.6)
Interest	6,461	7,486	(13.7)	5,336.80	21.1
Other income	7,475	6,499	15.0	22,503	(66.8)
Exceptional Item	-	-	-	-	-
PBT	90,572	96,068	(5.7)	55,792	62.3
Provision for tax	31,529	34,629	(9.0)	15,347	105.4
-effective tax rate	34.81	36.05	-	27.51	-
PAT (reported)	59,043	61,439	(3.9)	40,446	46.0
EPS (Rs/share)	4.6	4.8	(3.9)	3.2	46.0
Oil Realisation (US\$/bbl)	66.3	71.5	(7.2)	61.9	7.1

Source: Company, BOBCAPS Research

FIG 2 – QUARTERLY PRODUCTION

	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)
Production					
Oil (mmt)	5.9	6.2	(5.6)	5.9	(0.5)
Gas (bcm)	6.4	6.2	3.6	6.6	(2.2)
Total (mmtoe)	12.3	12.4	(1.0)	12.5	(1.4)
Sales					
Oil (mmt)	5.3	5.8	(8.9)	5.9	(9.8)
Gas (bcm)	5.0	4.9	2.1	5.2	(4.2)
Total (mmtoe)	10.3	10.7	(3.9)	11.1	(7.2)

Source: BOBCAPS Research, Company

Valuation methodology

We scale back FY20/FY21 earnings estimates by 27%/21% on lower oil price (US\$ 65-70/bbl) and production (cut ~5%) assumptions. Rolling forward to Sep'21 valuations, we have a revised target price of Rs 175 (from Rs 230). We also introduce FY22 estimates, factoring in oil price at US\$ 75/bbl and EPS of Rs 26.8 (+15% YoY).

FIG 3 – REVISED ESTIMATES

(Rs mn)	FY20E			FY21E			FY22E
	Old	New	Var (%)	Old	New	Var (%)	New
Revenue	4,782,047	4,636,467	(3.0)	5,696,337	5,498,962	(3.5)	6,068,100
EBITDA	787,389	659,133	(16.3)	851,833	747,727	(12.2)	835,467
EBITDA margin (%)	16.5	14.2	-	15.0	13.6	-	13.8
PAT	329,441	241,255	(26.8)	372,939	294,220	(21.1)	337,747
PAT margin (%)	6.9	5.2	-	6.5	5.4	-	5.6
EPS (Rs)	26.2	19.2	(26.8)	29.6	23.4	(21.0)	26.8

Source: BOBCAPS Research

At 5.5x FY21E EPS, ONGC is trading at distressed valuations, implying ~US\$ 45/bbl oil prices, an unjustifiably steep discount to the prevailing Brent oil price (US\$ 61/bbl). With ~6% dividend yields, risk-reward appears to be lucrative. Maintain BUY.

Our SOTP valuation includes the following:

- core business valued at 4x Sep'21E consolidated cash earnings (from 4.5x earlier),
- 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 4 – VALUATION SUMMARY

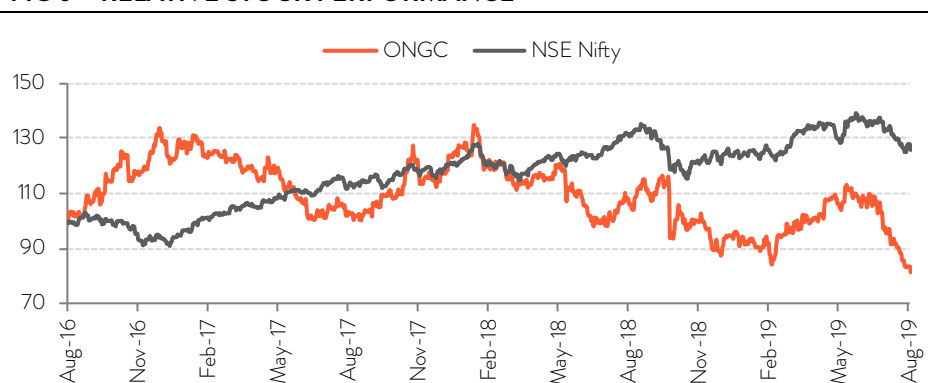
Particulars	Value (Rs bn)	Comments
ONGC/OVL value	2,112	4x Sep'21E consolidated cash earnings (excluding HPCL and MRPL)
HPCL and MRPL business value (net of costs)	(75)	As per our SOTP valuation for HPCL (net of costs); MRPL at 6x Sep'21E EV/EBITDA
Core equity value	2,037	
Core value (Rs/share)	162	~7x FY21E EPS
Value of holdings (Rs/share)	13	Listed companies @ 20% discount (other than MRPL, HPCL)
Value (Rs/share)	175	~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)	26.8	28.3	29.7
APM Gas price (US\$/mmbtu)	4.2	4.9	5.3
OVL			
Crude production (mmt)	10.1	10.1	10.1
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	FY19P	FY20E	FY21E	FY22E
Total revenue	3,622,462	4,534,606	4,636,467	5,498,962	6,068,100
EBITDA	658,350	838,648	659,133	747,727	835,467
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
Reported net profit	235,947	338,870	241,255	294,220	337,747
Adjusted net profit	234,323	348,309	241,255	294,220	337,747

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19P	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
Total liabilities and equities	4,602,349	4,741,338	5,138,286	5,530,680	5,857,918
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
Total assets	4,602,349	4,741,338	5,138,286	5,530,680	5,857,918

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19P	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)
Cash flow from operations	44,459	1,079,667	304,862	415,236	647,575
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
Cash flow from investing	(255,421)	(757,981)	(309,340)	(360,623)	(530,576)
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
Cash flow from financing	129,619	(331,411)	37,410	30,056	(135,472)
Changes in cash and cash eq.	(81,343)	(9,725)	32,931	84,669	(18,473)
Closing cash and cash eq.	50,784	41,058	73,990	158,659	140,186

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19P	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	FY19P	FY20E	FY21E	FY22E
EV/Sales	0.6	0.6	0.6	0.5	0.5
EV/EBITDA	3.4	3.1	3.9	3.6	3.4
Adjusted P/E	7.0	4.6	6.7	5.5	4.8
P/BV	0.8	0.7	0.7	0.6	0.6

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19P	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	FY19P	FY20E	FY21E	FY22E
YoY growth (%)					
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
Profitability & Return ratios (%)					
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
Working capital days (days)					
Receivables	15	13	15	14	14
Inventory	56	45	50	53	54
Payables	31	29	31	29	30
Ratios (x)					
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%

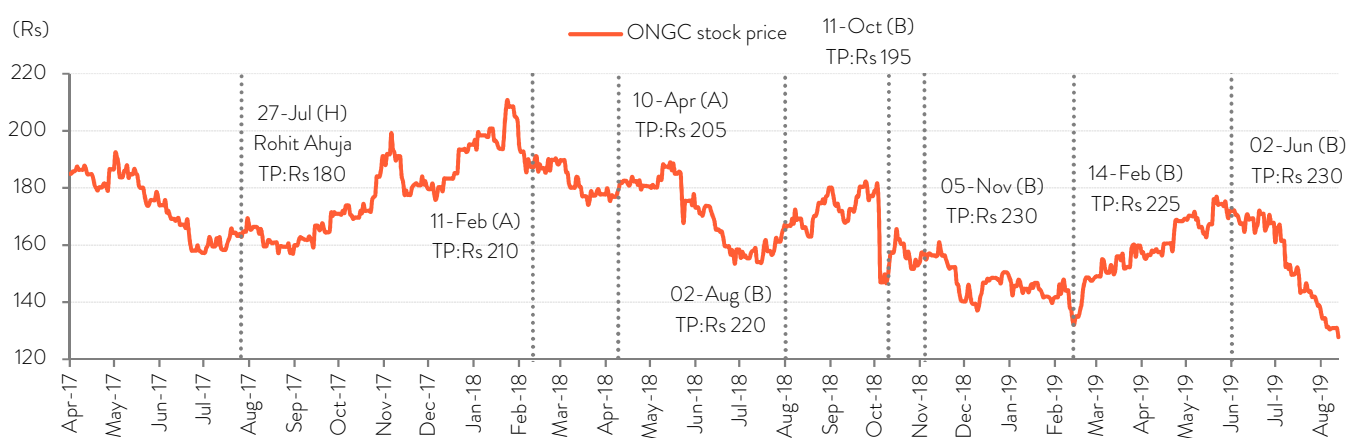
ADD – Expected return from >+5% to +15%

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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