

BUY

TP: Rs 170 | ▲ 65%

ONGC

Oil & Gas

14 February 2020

Earnings miss, pricing in the worst

ONGC's Q3FY20 earnings underperformed at Rs 41bn (-50% YoY). Key highlights: (a) production trends mixed – oil below estimates at 5.8mmt (-3.5% YoY) but gas volumes in line at 6.2bcm (-7.7% YoY); (b) operating cost at US\$ 8/bbl vs. US\$ 7.5/bbl estimated; and (c) oil price realisation in line at ~US\$ 60.3/bbl (-10% YoY). We reduce FY20/FY21/FY22 earnings estimates by 7%/14%/13% to build in lower oil prices (US\$ 65-70/bbl). On rollover, we arrive at a revised Mar'21 TP of Rs 170 (from Rs 210).

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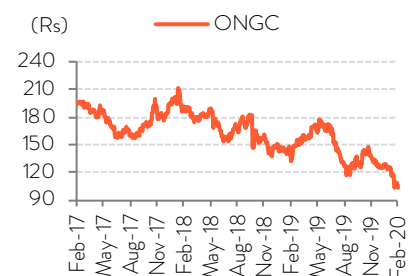
Oil production a drag, gas outlook remains upbeat: Oil and gas production continued to decline, by 3.5% and 7.7% YoY respectively in Q3, as ONGC struggles to maintain output. Gas production could recover from H2FY21 as new fields come into production.

Ticker/Price	ONGC IN/Rs 103
Market cap	US\$ 18.2bn
Shares o/s	12,580mn
3M ADV	US\$ 20.9mn
52wk high/low	Rs 179/Rs 102
Promoter/FPI/DII	63%/9%/29%

Source: NSE

Low spot prices put Mozambique project at risk: The government's recent notification of free pricing (US\$ 5-7/mmbtu as per current trends) for most of the incremental gas production augurs well for financial viability of the company's planned ~US\$ 10bn capex. But the decline in spot LNG prices puts viability of the Mozambique project (FID recently finalised) at risk. Funding would be at the Mozambique SPV level. As per management, breakeven gas price is ~US\$ 6-7/mmbtu given reduction in capex and operating cost estimates.

STOCK PERFORMANCE



Source: NSE

Valuations continue to build in massive discount: At 3.7x FY22E EPS (or 4.7x FY20E EPS), ONGC's valuations continue to build in the worst case, viz. <US\$ 40/bbl oil prices and cash allocation concerns. Rising dividend yields have crossed the logical threshold of 10% as the stock price continues to dive, implying this is one of the best opportunities to own the stock. With the dividend distribution tax exemption, we expect ONGC to increase its dividend payout.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	3,622,462	4,534,606	4,122,519	4,874,163	5,454,801
EBITDA (Rs mn)	658,350	838,648	618,371	657,821	750,160
Adj. net profit (Rs mn)	234,323	348,309	275,788	303,386	355,066
Adj. EPS (Rs)	18.3	27.7	21.9	24.1	28.2
Adj. EPS growth (%)	(3.5)	51.6	(20.8)	10.0	17.0
Adj. ROAE (%)	11.8	16.4	12.1	12.4	13.5
Adj. P/E (x)	5.7	3.7	4.7	4.3	3.7
EV/EBITDA (x)	2.6	2.5	3.7	3.5	3.1

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q3FY20	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	9MFY20	9MFY19	YoY (%)
Net revenues	237,101	276,941	(14.4)	244,926	(3.2)	744,610	828,961	(10.2)
Employee costs	6,674	6,775	(1.5)	6,332	5.4	19,088	19,233	(0.8)
% of sales	2.8	2.4	-	2.6	-	2.6	2.3	-
Other expenditure	107,444	104,457	2.9	105,694	1.7	323,709	338,812	(4.5)
% of sales	45.3	37.7	-	43.2	-	43.5	40.9	-
EBITDA	122,983	165,708	(25.8)	132,900	(7.5)	401,813	470,916	(14.7)
EBITDA margin (%)	51.9	59.8	-	54.3	-	54.0	56.8	-
Depreciation and amortisation	70,759	61,517	15.0	62,553	13.1	194,874	160,271	21.6
Interest	6,264	5,807	7.9	6,817.60	(8.1)	19,542	19,585	(0.2)
Other income	14,025	22,246	(37.0)	26,853	(47.8)	48,353	52,687	(8.2)
Exceptional Item	-	-	-	-	-	-	-	-
PBT	59,986	120,630	(50.3)	90,383	(33.6)	235,750	343,748	(31.4)
Provision for tax	18,469	38,003	(51.4)	27,752	(33.4)	95,913	117,036	(18.0)
- Effective tax rate	30.79	31.50	-	30.70	-	40.68	34.05	-
PAT (reported)	41,516	82,627	(49.8)	62,631	(33.7)	139,837	226,712	(38.3)
EPS (adjusted) (Rs/share)	3.3	6.4	(48.7)	5.0	(33.7)	11.1	17.7	(37.1)
Net Realisation (US\$/bbl)	59.7	66.4	(10.0)	60.3	(1.0)	63.3	69.3	(8.7)

Source: Company, BOBCAPS Research

FIG 2 – QUARTERLY PRODUCTION

	Q3FY20	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	9MFY20	9MFY19	YoY (%)
Production								
Oil (mmt)	5.8	6.0	(3.5)	5.8	(0.3)	17.5	18.3	(4.3)
Gas (bcm)	6.2	6.7	(7.7)	6.3	(1.5)	18.9	19.3	(2.0)
Total (mmtoe)	12.0	12.7	(5.8)	12.1	(1.0)	36.4	37.6	(3.2)
Sales								
Oil (mmt)	5.2	5.4	(2.9)	5.4	(3.4)	15.9	16.6	(4.4)
Gas (bcm)	4.8	5.3	(9.4)	4.9	(1.9)	14.7	15.3	(3.4)
Total (mmtoe)	10.0	10.7	(6.1)	10.3	(2.7)	30.6	31.9	(4.0)

Source: Company, BOBCAPS Research

Valuation methodology

We reduce FY20/FY21/FY22 earnings estimates by 7%/14%/13% to build in lower oil prices (US\$ 65-70/bbl). On rollover, we arrive at a revised Mar'21 target price of Rs 170 (from Rs 210).

At 3.7x FY22E EPS (or 4.7x FY20E EPS), ONGC's valuations continue to build in the worst case, viz. <US\$ 40/bbl oil prices and cash allocation concerns. Rising dividend yields have crossed the logical threshold of 10% as the stock price continues to dive, implying this is one of the best opportunities to own the stock. With the dividend distribution tax exemption, we expect ONGC to increase its dividend payout. Maintain BUY.

FIG 3 – REVISED ESTIMATES

(Rs bn)	FY20E			FY21E			FY22E		
	Old	New	Var (%)	Old	New	Var (%)	Old	New	Var (%)
Revenue	4,158	4,123	(0.9)	4,939	4,874	(1.3)	5,522	5,522	-
EBITDA	645	618	(4.1)	721	658	(8.7)	814	814	-
EBITDA margin (%)	15.5	15.0	-	14.6	13.5	-	14.7	14.7	-
PAT	297	276	(7.0)	353	303	(14.0)	406	355	(12.6)
PAT margin (%)	7.1	6.7	-	7.1	6.2	-	7.4	6.4	-
EPS (Rs)	23.6	21.9	(7.0)	28.1	24.1	(14.0)	32.3	28.2	(12.6)

Source: BOBCAPS Research

Our SOTP valuation includes the following:

- core business valued at 3.5x FY22E consolidated cash earnings (from 4x earlier),
- value of holdings in HPCL (based on our SOTP value for HPCL net of cost of acquisition) and MRPL (6x FY22E EV/EBITDA), and
- investment value of holdings in other listed entities (GAIL, IOCL, etc.) at 20% discount to CMP.

FIG 4 – VALUATION SUMMARY

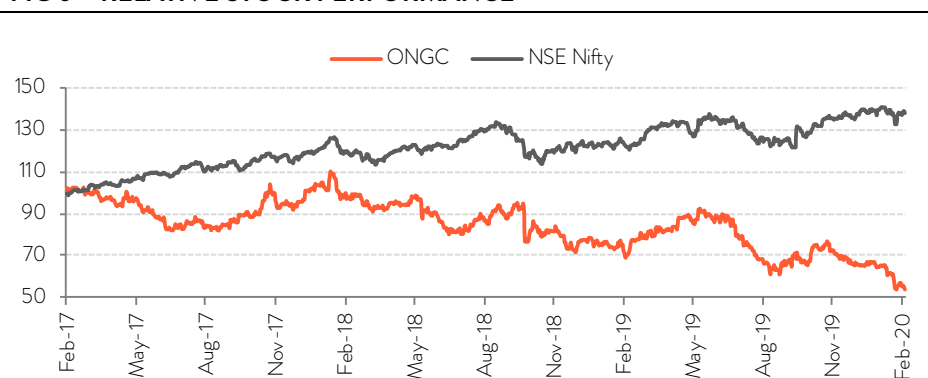
Particulars	Value (Rs bn)	Comments
ONGC/OVL value	1,978	3.5x FY22E consolidated cash earnings (excluding HPCL and MRPL)
HPCL and MRPL business value (net of costs)	(37)	As per our SOTP valuation for HPCL (net of costs); MRPL at 6x FY22E EV/EBITDA
Core equity value	2,015	
Core value (Rs/share)	160	7x FY22E EPS
Value of holdings (Rs/share)	10	Listed companies (@ 20% discount to their CMP (other than MRPL, HPCL)
Value (Rs/share)	170	~6.8x FY22E EPS

Source: BOBCAPS Research

FIG 5 – KEY ASSUMPTIONS

	FY20E	FY21E	FY22E
Brent oil price (US\$/bbl)	62	65	70
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 downside 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	4,122,519	4,874,163	5,454,801
EBITDA	658,350	838,648	618,371	657,821	750,160
Depreciation	(305,506)	(332,469)	(338,346)	(352,020)	(361,485)
EBIT	352,844	506,179	280,026	305,802	388,675
Net interest income/(expenses)	(49,990)	(58,367)	(54,102)	(62,662)	(70,938)
Other income/(expenses)	74,682	81,488	132,474	163,222	160,757
Exceptional items	2,481	(15,910)	0	0	0
EBT	377,535	529,299	358,397	406,361	478,494
Income taxes	(131,395)	(208,802)	(116,892)	(137,257)	(157,711)
Min. int./Inc. from associates	(12,675)	34,283	34,283	34,283	34,283
Reported net profit	235,947	338,870	275,788	303,386	355,066
Adjusted net profit	234,323	348,309	275,788	303,386	355,066

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	265,507	312,560	316,803	341,674	402,752
Other current liabilities	417,632	416,528	440,929	447,637	473,880
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	477,327	502,834	532,017
Equity capital	64,166	62,901	62,901	62,901	62,901
Reserves & surplus	1,976,023	2,141,319	2,302,844	2,461,612	2,655,028
Shareholders' fund	2,040,189	2,204,221	2,365,745	2,524,513	2,717,929
Total liabilities and equities	4,602,349	4,741,338	5,108,079	5,504,093	5,877,651
Cash and cash eq.	50,784	41,059	204,599	312,539	272,135
Accounts receivables	155,556	174,533	181,334	205,171	226,504
Inventories	305,630	351,807	471,830	547,637	606,142
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	5,108,079	5,504,093	5,877,651

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	450,999	703,032	591,030	720,180	774,855
Changes in working capital	(376,807)	400,915	(40,324)	(148,311)	(56,390)
Other operating cash flows	(29,733)	(24,280)	(111,504)	(137,715)	(131,574)
Cash flow from operations	44,459	1,079,667	439,202	434,155	586,891
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	132,474	163,222	160,757
Cash flow from investing	(255,421)	(757,981)	(308,544)	(359,649)	(528,573)
Debt raised/repaid	268,463	14,256	147,145	178,053	62,927
Dividends paid	(102,486)	(103,033)	(114,263)	(144,618)	(161,649)
Other financing cash flows	(36,357)	(242,634)	0	0	0
Cash flow from financing	129,619	(331,411)	32,882	33,435	(98,722)
Changes in cash and cash eq.	(81,343)	(9,725)	163,540	107,941	(40,405)
Closing cash and cash eq.	50,784	41,058	204,599	312,539	272,135

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	18.4	26.9	21.9	24.1	28.2
Adjusted EPS	18.3	27.7	21.9	24.1	28.2
Dividend per share	6.6	7.0	7.8	9.8	11.0
Book value per share	159.0	175.2	188.1	200.7	216.0

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	0.5	0.5	0.6	0.5	0.4
EV/EBITDA	2.6	2.5	3.7	3.5	3.1
Adjusted P/E	5.7	3.7	4.7	4.3	3.7
P/BV	0.6	0.6	0.5	0.5	0.5

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	61.7	67.8	77.0	74.7	74.2
Interest burden (PBT/EBIT)	107.7	101.4	128.0	132.9	123.1
EBIT margin (EBIT/Revenue)	9.7	11.2	6.8	6.3	7.1
Asset turnover (Revenue/Avg TA)	80.0	97.1	83.7	91.9	95.9
Leverage (Avg TA/Avg Equity)	2.3	2.2	2.2	2.2	2.2
Adjusted ROAE	11.8	16.4	12.1	12.4	13.5

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	(9.1)	18.2	11.9
EBITDA	12.8	27.4	(26.3)	6.4	14.0
Adjusted EPS	(3.5)	51.6	(20.8)	10.0	17.0
Profitability & Return ratios (%)					
EBITDA margin	18.2	18.5	15.0	13.5	13.8
EBIT margin	9.7	11.2	6.8	6.3	7.1
Adjusted profit margin	6.5	7.7	6.7	6.2	6.5
Adjusted ROAE	11.8	16.4	12.1	12.4	13.5
ROCE	7.7	9.3	5.6	5.5	6.5
Working capital days (days)					
Receivables	15	13	16	14	14
Inventory	56	45	55	54	55
Payables	31	29	33	29	29
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	5.2	4.9	5.5
Adjusted debt/equity	0.5	0.4	0.4	0.4	0.4

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

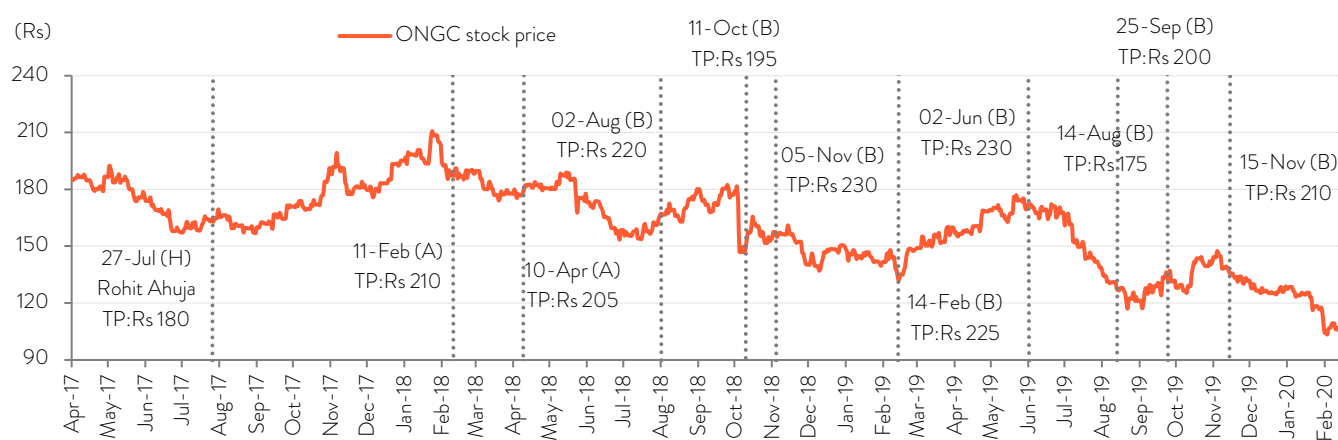
ADD – Expected return from >+5% to +15%

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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