

**ADD**

TP: Rs 92 | ▲ 14%

**ONGC**

Oil & Gas

01 July 2020

## Concerns abound – cut to ADD

**ONGC posted a surprising Q4 loss of Rs 31bn (Rs 66bn on consolidated basis) owing to impairment charges derived from low oil price expectations. Q4 highlights: (a) oil/gas production was in line at 5.8mmt/6.0bcm (-1.4%/-8% YoY), (b) operating costs stood at US\$ 10.7/bbl vs. US\$ 10/bbl estimated, and (c) oil price realisation was at US\$ 49/bbl (-21% YoY). We reduce FY21/FY22 earnings by 45%/36% to factor in higher operating costs and lower gas volumes. Downgrade to ADD (from BUY) with a revised Mar'21 TP of Rs 92 (vs. Rs 110).**

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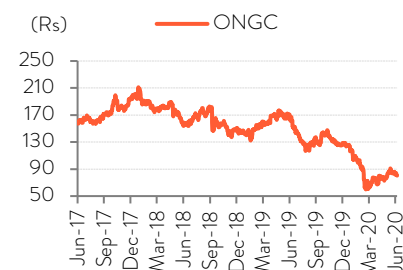
**Production remains a drag, costs rise:** Q4FY20 oil and gas production fell to 5.8mmt (-1.4% YoY) and 6bcm (-7.9%) respectively. Gas production reduced 10% in March as the lockdown disrupted demand, which has been restored to normal levels in June. Operating cost was above our estimate at US\$ 10.7/bbl.

Ticker/Price	ONGC IN/Rs 80
Market cap	US\$ 13.4bn
Shares o/s	12,580mn
3M ADV	US\$ 25.9mn
52wk high/low	Rs 169/Rs 50
Promoter/FPI/DII	60%/8%/32%

Source: NSE

**Low realisations, impairment charges drive losses:** Crude oil realisation fell to US\$ 49/bbl in Q4 (-21% YoY), causing revenues to drop 20% YoY to Rs 215bn. We expect crude prices to hover at around US\$ 35-40 and hence cut revenue estimates. Impairment expense of Rs 48bn (Rs 90bn at consolidated level) saw ONGC reporting a net loss of Rs 31bn. Though upstream companies may get some relief on cess and royalty payments, this will have transient benefits given sustained low oil prices. Low spot LNG prices (<US\$ 2.5/mmbtu) limit optimism if APM gas prices are freed – the outlook ultimately boils down to oil levels.

## STOCK PERFORMANCE



Source: NSE

**Trading at distressed valuations:** At 12.5x FY22E EPS, ONGC is trading at distressed valuations. We cut earnings estimates for FY21/FY22 by 45%/36% to bake in higher operating costs and a cut in production estimates (~5%). While the stock remains depressed, higher operating costs assuming oil prices at US\$ 35-40/bbl limit scope for earnings revival. Downgrade to ADD.

## KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
Total revenue (Rs mn)	3,622,462	4,534,606	4,250,014	3,084,240	3,820,726
EBITDA (Rs mn)	658,350	838,648	611,687	336,482	421,533
Adj. net profit (Rs mn)	234,323	348,309	168,256	19,559	80,654
Adj. EPS (Rs)	18.3	27.7	13.4	1.6	6.4
Adj. EPS growth (%)	(3.5)	51.6	(51.7)	(88.4)	312.4
Adj. ROAE (%)	11.8	16.4	7.9	0.9	3.8
Adj. P/E (x)	4.4	2.9	6.0	51.7	12.5
EV/EBITDA (x)	2.2	2.1	3.2	6.1	5.1

Source: Company, BOBCAPS Research

**BOB Capital Markets Ltd is a wholly owned subsidiary of Bank of Baroda**

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



**FIG 1 – QUARTERLY PERFORMANCE**

(Rs mn)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	FY20	FY19	YoY (%)
<b>Net revenues</b>	<b>214,562</b>	<b>267,585</b>	<b>(19.8)</b>	<b>237,101</b>	<b>(9.5)</b>	<b>962,136</b>	<b>1,096,546</b>	<b>(12.3)</b>
Employee costs	6,115	7,828	(21.9)	6,674	(8.4)	25,203	27,061	(6.9)
% of sales	2.9	2.9	-	2.8	-	2.6	2.5	-
Other expenditure	122,568	136,014	(9.9)	107,455	14.1	444,063	474,795	(6.5)
% of sales	57.1	50.8	-	45.3	-	46.2	43.3	-
<b>EBITDA</b>	<b>85,879</b>	<b>123,742</b>	<b>(30.6)</b>	<b>122,971</b>	<b>(30.2)</b>	<b>492,869</b>	<b>594,689</b>	<b>(17.1)</b>
<b>EBITDA margin (%)</b>	<b>40.0</b>	<b>46.2</b>	<b>-</b>	<b>51.9</b>	<b>-</b>	<b>51.2</b>	<b>54.2</b>	<b>-</b>
Depreciation and amortisation	80,370	84,710	(5.1)	70,196	14.5	273,005	242,130	12.8
Interest	8,695	5,337	62.9	6,263.60	38.8	28,237	24,921	13.3
Other income	13,256	23,923	(44.6)	14,025	(5.5)	61,050	72,653	(16.0)
Exceptional Item	(48,991)	-	-	-	-	(48,991)	-	-
<b>PBT</b>	<b>(38,920)</b>	<b>57,618</b>	<b>(167.5)</b>	<b>60,537</b>	<b>(164.3)</b>	<b>203,687</b>	<b>400,291</b>	<b>(49.1)</b>
Provision for tax	(7,938)	15,223	(152.1)	18,273	(143.4)	69,242	132,645	(47.8)
-Effective tax rate	20.39	26.42	-	30.18	-	33.99	33.14	-
<b>PAT (reported)</b>	<b>(30,983)</b>	<b>42,395</b>	<b>(173.1)</b>	<b>42,264</b>	<b>(173.3)</b>	<b>134,445</b>	<b>267,646</b>	<b>(49.8)</b>
<b>PAT (adjusted)</b>	<b>18,008</b>	<b>42,395</b>	<b>(57.5)</b>	<b>42,264</b>	<b>(57.4)</b>	<b>183,436</b>	<b>267,646</b>	<b>(31.5)</b>
<b>EPS (adjusted) (Rs/share)</b>	<b>1.4</b>	<b>3.3</b>	<b>(56.7)</b>	<b>3.3</b>	<b>(56.5)</b>	<b>14.6</b>	<b>20.9</b>	<b>(30.1)</b>
<b>Net Realisation (US\$/bbl)</b>	<b>49.0</b>	<b>61.9</b>	<b>(20.9)</b>	<b>59.7</b>	<b>(17.9)</b>	<b>58.1</b>	<b>68.2</b>	<b>(14.8)</b>

Source: Company, BOBCAPS Research

**FIG 2 – QUARTERLY PRODUCTION**

	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	FY20	FY19	YoY (%)
<b>Production</b>								
Oil (mmt)	5.8	5.9	(1.4)	5.8	(0.1)	23.4	24.2	(3.6)
Gas (bcm)	6.0	6.6	(7.9)	6.2	(2.2)	24.9	25.8	(3.5)
<b>Total (mmtoe)</b>	<b>11.9</b>	<b>12.5</b>	<b>(4.8)</b>	<b>12.0</b>	<b>(1.1)</b>	<b>48.3</b>	<b>50.0</b>	<b>(3.6)</b>
<b>Sales</b>								
Oil (mmt)	5.4	5.9	(7.3)	5.2	4.2	21.3	22.5	(5.2)
Gas (bcm)	4.7	5.2	(10.6)	4.8	(3.4)	19.4	20.5	(5.3)
<b>Total (mmtoe)</b>	<b>10.1</b>	<b>11.1</b>	<b>(8.8)</b>	<b>10.0</b>	<b>0.6</b>	<b>40.7</b>	<b>43.0</b>	<b>(5.2)</b>

Source: Company, BOBCAPS Research

## Valuation methodology

At 12.5x FY22E EPS, ONGC is trading at distressed valuations. We reduce FY21/FY22 earnings estimates by 45%/36% to bake in higher operating costs and a cut in production estimates (~5%). While the stock remains depressed, an increase in operating costs assuming oil prices at US\$ 35-40/bbl limits scope for earnings revival. Downgrade to ADD (from BUY) with a revised Mar'21 SOTP-based target price of Rs 92 (from Rs 110).

**FIG 3 – REVISED ESTIMATES**

(Rs bn)	FY21E			FY22E		
	Old	New	Var (%)	Old	New	Var (%)
Revenue	3,300	3,084	(6.5)	5,853	5,522	(5.7)
EBITDA	505	336	(33.3)	1,180	814	(31.0)
EBITDA margin (%)	15.3	10.9	-	20.2	14.7	-
PAT	35.2	20	(44.5)	125.8	81	(35.9)
PAT margin (%)	1.1	0.6	-	2.1	1.5	-
EPS (Rs)	2.8	1.6	(44.5)	10.0	6.4	(35.9)

Source: Company, BOBCAPS Research

Our SOTP valuation includes the following:

- core business valued at 3.5x FY22E consolidated cash earnings (unchanged),
- value of holdings in HPCL (based on our SOTP value for HPCL net of cost of acquisition) and MRPL (unchanged at 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**

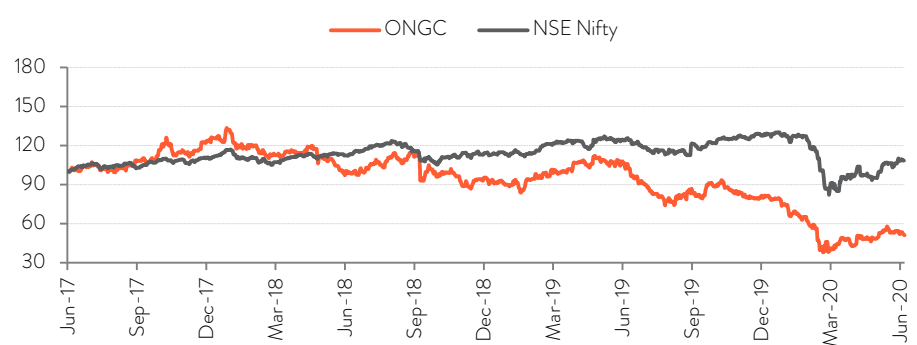
Particulars	Value (Rs bn)	Comments
ONGC/OVL value	1,117	3.5x FY22E consolidated cash earnings (excluding HPCL and MRPL)
HPCL and MRPL business value (net of costs)	(47)	As per our SOTP valuation for HPCL (net of costs); MRPL at 6x FY22E EV/EBITDA
<b>Core equity value</b>	<b>1,070</b>	
<b>Core value (Rs/share)</b>	<b>85</b>	<b>12x FY22E EPS</b>
Value of holdings (Rs/share)	7	Listed companies @ 20% discount to their CMP (other than MRPL, HPCL)
<b>Value (Rs/share)</b>	<b>92</b>	<b>14x FY22E EPS</b>

Source: BOBCAPS Research

**FIG 5 – KEY ASSUMPTIONS**

	FY21E	FY22E
<b>Brent oil price (US\$/bbl)</b>	<b>35</b>	<b>40</b>
<b>USDINR</b>	<b>76</b>	<b>78</b>
<b>ONGC &amp; JV</b>		
Crude production (mmt)	23.2	23.6
Gas production (bcm)	24.7	26.2
APM Gas price (US\$/mmbtu)	2.4	2.6
<b>OVL</b>		
Crude production (mmt)	10.1	10.1
Gas production (bcm)	5.3	5.3
<b>MRPL</b>		
Refining throughput (mmtpa)	16.5	16.5
GRM (US\$/bbl)	5.0	5.0

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	FY20P	FY21E	FY22E
<b>Total revenue</b>	<b>3,622,462</b>	<b>4,534,606</b>	<b>4,250,014</b>	<b>3,084,240</b>	<b>3,820,726</b>
EBITDA	658,350	838,648	611,687	336,482	421,533
Depreciation	(305,506)	(332,469)	(356,583)	(350,207)	(363,155)
EBIT	352,844	506,179	255,104	(13,725)	58,378
Net interest income/(expenses)	(49,990)	(58,367)	(69,998)	(60,863)	(65,535)
Other income/(expenses)	74,682	81,488	85,316	91,401	107,617
Exceptional items	2,481	(15,910)	(90,285)	0	0
EBT	377,535	529,299	270,422	16,814	100,460
Income taxes	(131,395)	(208,802)	(75,080)	(7,799)	(30,350)
Min. int./Inc. from associates	(12,675)	34,283	10,544	10,544	10,544
<b>Reported net profit</b>	<b>235,947</b>	<b>338,870</b>	<b>115,601</b>	<b>19,559</b>	<b>80,654</b>
<b>Adjusted net profit</b>	<b>234,323</b>	<b>348,309</b>	<b>168,256</b>	<b>19,559</b>	<b>80,654</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Accounts payables	265,507	305,575	229,679	136,266	209,493
Other current liabilities	417,632	452,175	589,312	543,930	574,788
Provisions	295,441	322,323	372,878	374,985	375,697
Debt funds	1,012,460	1,026,716	1,137,925	1,231,621	1,474,548
Other liabilities	415,059	456,357	434,725	438,641	446,713
Equity capital	64,166	62,901	62,901	62,901	62,901
Reserves & surplus	1,976,023	2,142,314	2,006,634	2,032,339	2,096,338
Shareholders' fund	2,040,189	2,205,216	2,069,536	2,095,240	2,159,239
<b>Total liabilities and equities</b>	<b>4,602,349</b>	<b>4,949,424</b>	<b>5,012,183</b>	<b>4,998,812</b>	<b>5,418,606</b>
Cash and cash eq.	50,784	41,059	57,041	21,093	6,704
Accounts receivables	155,556	174,533	115,475	74,573	99,128
Inventories	305,630	351,807	330,512	300,683	377,855
Other current assets	541,338	358,820	395,072	477,425	542,009
Investments	673,346	669,112	506,403	546,594	591,845
Net fixed assets	2,519,857	2,522,648	2,626,989	2,678,340	2,858,261
CWIP	213,813	690,563	838,324	757,738	800,438
Intangible assets	142,025	140,884	142,367	142,367	142,367
<b>Total assets</b>	<b>4,602,349</b>	<b>4,949,424</b>	<b>5,012,183</b>	<b>4,998,812</b>	<b>5,418,606</b>

Source: Company, BOBCAPS Research

### Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Net income + Depreciation	450,999	703,032	435,921	434,541	502,113
Changes in working capital	(376,807)	218,857	155,896	(148,309)	(61,516)
Other operating cash flows	(29,733)	(24,280)	(16,663)	(87,485)	(99,546)
<b>Cash flow from operations</b>	<b>44,459</b>	<b>897,609</b>	<b>575,154</b>	<b>198,747</b>	<b>341,052</b>
Capital expenditures	(364,214)	(843,703)	(572,421)	(385,746)	(644,080)
Change in investments	34,111	4,234	162,709	(40,191)	(45,250)
Other investing cash flows	74,682	81,488	85,316	91,401	107,617
<b>Cash flow from investing</b>	<b>(255,421)</b>	<b>(757,981)</b>	<b>(324,397)</b>	<b>(334,536)</b>	<b>(581,713)</b>
Debt raised/repaid	268,463	14,256	111,209	93,696	242,927
Dividends paid	(102,486)	(103,033)	(113,934)	6,145	(16,655)
Other financing cash flows	(36,357)	(60,576)	(232,050)	0	0
<b>Cash flow from financing</b>	<b>129,619</b>	<b>(149,353)</b>	<b>(234,775)</b>	<b>99,841</b>	<b>226,272</b>
<b>Changes in cash and cash eq.</b>	<b>(81,343)</b>	<b>(9,725)</b>	<b>15,982</b>	<b>(35,948)</b>	<b>(14,389)</b>
<b>Closing cash and cash eq.</b>	<b>50,784</b>	<b>41,059</b>	<b>57,041</b>	<b>21,093</b>	<b>6,704</b>

### Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20P	FY21E	FY22E
Reported EPS	18.4	26.9	9.2	1.6	6.4
Adjusted EPS	18.3	27.7	13.4	1.6	6.4
Dividend per share	6.6	7.0	7.7	(0.4)	1.1
Book value per share	159.0	175.3	164.5	166.5	171.6

### Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20P	FY21E	FY22E
EV/Sales	0.4	0.4	0.5	0.7	0.6
EV/EBITDA	2.2	2.1	3.2	6.1	5.1
Adjusted P/E	4.4	2.9	6.0	51.7	12.5
P/BV	0.5	0.5	0.5	0.5	0.5

### DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20P	FY21E	FY22E
Tax burden (Net profit/PBT)	61.7	67.8	93.4	116.3	80.3
Interest burden (PBT/EBIT)	107.7	101.4	70.6	(122.5)	172.1
EBIT margin (EBIT/Revenue)	9.7	11.2	6.0	(0.4)	1.5
Asset turnover (Revenue/Avg TA)	80.0	94.9	85.3	61.6	73.4
Leverage (Avg TA/Avg Equity)	2.3	2.2	2.3	2.4	2.4
Adjusted ROAE	11.8	16.4	7.9	0.9	3.8

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

### Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
<b>YoY growth (%)</b>					
Revenue	11.2	25.2	(6.3)	(27.4)	23.9
EBITDA	12.8	27.4	(27.1)	(45.0)	25.3
Adjusted EPS	(3.5)	51.6	(51.7)	(88.4)	312.4
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	18.2	18.5	14.4	10.9	11.0
EBIT margin	9.7	11.2	6.0	(0.4)	1.5
Adjusted profit margin	6.5	7.7	4.0	0.6	2.1
Adjusted ROAE	11.8	16.4	7.9	0.9	3.8
ROCE	7.7	9.1	4.4	(0.2)	1.1
<b>Working capital days (days)</b>					
Receivables	15	13	12	11	8
Inventory	56	45	47	56	47
Payables	31	28	27	24	19
<b>Ratios (x)</b>					
Gross asset turnover	0.7	0.9	0.8	0.5	0.6
Current ratio	0.7	0.6	0.6	0.6	0.5
Net interest coverage ratio	7.1	8.7	3.6	0.0	0.9
Adjusted debt/equity	0.5	0.4	0.5	0.6	0.7

Source: Company, BOBCAPS Research

## Disclaimer

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

**BUY** – Expected return >+15%

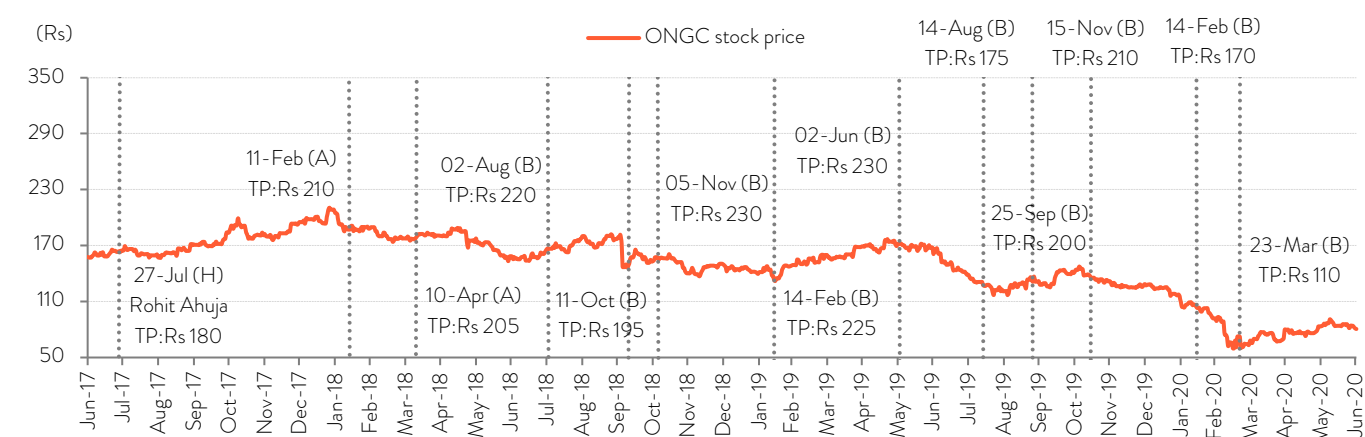
**ADD** – Expected return from >+5% to +15%

**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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