Sharekhan by BNP PARIBAS

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Stock Update

Result Update

Oil and Natural Gas Corporation

Q1 misses mark; earnings environment uncertain

Oil & Gas	Sharekhan code: ONGC

Reco/View: Hold	↔	CMP: **Rs. 140**	Price Target: **Rs. 148**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX	+	=	-
Right Sector (RS)		✓	
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING 54.93

Updated July 08, 2022

Severe Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 175,998 cr
52-week high/low:	Rs. 195/109
NSE volume: (No of shares)	296.3 lakh
BSE code:	500312
NSE code:	ONGC
Free float: (No of shares)	517.2 cr

Shareholding (%)

Promoters	58.9
FII	10.0
DII	17.8
Others	13.3

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	10.6	-14.2	-18.5	22.9
Relative to Sensex	-0.7	-24.4	-21.9	15.6

Sharekhan Research, Bloomberg

Summary

- Q1FY23 standalone PAT grew strongly by 72% q-o-q to Rs. 15,206 crore but missed our estimate by 4.5% due to lower-than-expected oil & gas volumes and net oil realisation that was partially offset by higher other income.
- Oil/gas sales volume stood at 5 mmt/4.1 bcm, down 2% q-o-q/up 1.5% q-o-q missed our estimate by 2%/4%; net oil realization grew by 14% q-o-q to $108.5/bbl (slightly below estimate) while gas realisations were up 94% q-o-q to $6.5/mmBtu.
- OVL's earnings were hit by lower oil & gas production given sanctions on Russia and impairments. MRPL benefited from sharply higher GRM of $24.5/bbl ($5/bbl in Q1FY22) and a 40% y-o-y rise in throughput to 4.3 mmt.
- We maintain our Hold rating on ONGC with a revised PT of Rs. 148 as ad-hoc tax policy changes create earnings uncertainty and concern on valuation. Dividend yield of ~8% limits meaningful downside from current level.

Oil and Natural Gas Corporation's (ONGC) Q1FY23 standalone operating profit grew strongly by 113%/40% y-o-y/q-o-q to Rs. 25,930 crore was 4.6% below our estimate of Rs. 27,180 crore due to 2%/4% miss in oil/gas sales volume at 5 mmt/4.1bcm, down 2.1% and up 1.5% q-o-q respectively and oil realization of $108.5/bbl (up 14% q-o-q but slightly below our estimate of $110/bbl). Gas realisations surged by 94% q-o-q to $6.5/mmBtu led by 110% hike in domestic gas price for H1FY23. Standalone PAT of Rs. 15,206 crore (up 72% q-o-q) was 4.5% below our estimates due to a miss in operating profit. However, this was partially offset by higher other income (up 42% y-o-y). Performance of subsidiary ONGC Videsh ltd (OVL) was muted with PAT of Rs. 1,30 crore (versus Rs. 915 crore in Q1FY22) due sharply lower oil/gas production, down 26%/6% y-o-y given sanctions on Russia and an impairment provision of Rs. 674 crore.

Key positives

- Sharp 94% q-o-q rise in gas realization to $6.5/mmBtu.

Key negatives

- Miss of 2%/4% in oil/gas sales volume at 5 mmt/4.1 bcm; down 2.1% q-o-q and up 1.5% q-o-q respectively.

Revision in estimates – We have fine-tuned our FY23-24 earnings estimates.

Our Call

Valuation – Maintain Hold on ONGC with a revised PT of Rs. 148: The ad-hoc cess rate has created earnings uncertainty and valuation concern for upstream PSUs and lack of policy clarity would remain a key overhang on ONGC until the windfall taxes are removed. Hence, we maintain our Hold rating on ONGC with a revised PT of Rs. 148. Dividend yield of ~8% limits material downside risk for ONGC. Stock trades at 4.7x/ 5.8x its FY2023E/FY2024E EPS.

Key Risks

A sharp rise in crude oil & gas prices, removal of windfall tax and policy clarity on various duties are key upside risks, while continuation of ad-hoc cess rate, a sharp decline in oil price and likely capping of domestic gas price are downside risks.

Valuation (Standalone) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenue	68,141	1,10,345	1,58,915	1,35,230
OPM (%)	48.2	54.3	43.7	43.7
Adjusted PAT	9,871	30,710	37,653	30,203
% y-o-y growth	-46.2	211.1	22.6	-19.8
Adjusted EPS (Rs.)	7.8	24.4	29.9	24.0
P/E (x)	17.8	5.7	4.7	5.8
P/B (x)	0.9	0.7	0.7	0.7
EV/EBITDA (x)	5.8	3.0	2.5	2.9
RoNW (%)	4.9	13.9	15.4	11.7
RoCE (%)	6.5	15.4	17.8	13.8

Source: Company; Sharekhan estimates

Standalone PAT misses mark; Russian sanctions hit OVL, while MRPL benefits from higher GRM

Q1FY23 standalone operating profit at Rs. 25,930 crore (up 113% y-o-y; up 39.5% q-o-q) was 4.6% below our estimate of Rs. 27,180 crore due to lower-than-expected oil/gas sales volume and oil realisations. Oil/gas sales volume stood at 5 mmt/4.1 bcm, down 2.1% and up 1.5% q-o-q was 2%/4% below our estimates, while net oil realisations at $108.5/bbl (up 14.3% q-o-q) missed our estimate of $110/bbl. PAT of Rs. 15,206 crore (up 72% q-o-q) was 4.5% below our estimate due to miss in operating profit that was partially offset by higher other income (up 42% y-o-y).

Performance of subsidiary ONGC Videsh (OVL) was muted with a PAT of Rs. 1,30 crore (versus Rs. 915 crore in Q1FY22) due sharply lower oil/gas production, down 26%/6% y-o-y given sanctions on Russia and an impairment provision of Rs. 674 crore.

MRPL reported strong performance with PAT of Rs. 2708 crore (versus net loss of Rs. 230 crore in Q1FY22) supported by a surge in GRM to $24.5/bbl as compared to $4.9/$15.3 per bbl in Q1FY22/Q4FY22. The refinery throughput also increased by 40% y-o-y to 4.3 mmt.

Results (Standalone) Rs cr

Particulars	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)
Revenue	**42,321**	**23,022**	**83.8**	**34,497**	**22.7**
Total Expenditure	16,390	10,869	50.8	15,907	3.0
Operating profit	**25,930**	**12,153**	**113.4**	**18,590**	**39.5**
Other Income	758	534	42.0	1,344	-43.6
Interest	636	620	2.6	580	9.6
Depreciation, depletion and amortisation	5,709	5,317	7.4	7,640	-25.3
PBT	20,343	6,750	201.4	11,714	73.7
Tax	5,137	2,415	112.7	2,855	79.9
Reported PAT	**15,206**	**4,335**	**250.8**	**8,860**	**71.6**
Equity Cap (cr)	1,258	1,258		1,258	
Reported EPS (Rs.)	12.1	3.4	250.8	7.0	71.6
Margins (%)			**BPS**		**BPS**
OPM	61.3	52.8	848	53.9	738
Tax rate	25.3	35.8	-1053	24.4	88
NPM	35.9	18.8	1710	25.7	1025

Source: Company, Sharekhan Research

Standalone key operating metrics

Particulars	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)
Oil production (mmt)	5.5	5.4	1.9	5.4	1.9
Oil sales (mmt)	5.0	5.1	-1.2	5.1	-2.1
Gas Production (bcm)	5.4	5.3	1.4	5.3	0.8
Gas sales (bcm)	4.1	4.1	1.4	4.1	1.5
Net oil realisation ($/bbl)	108.5	65.6	65.5	95.0	14.3
Net oil realisation (Rs./bbl)	8,384	4,836	73.4	7,147	17.3
Rs. /USD rate	77.3	73.7	4.8	75.3	2.7

Source: Company, Sharekhan Research

OVL – key financials and operating metrics Rs cr

Particulars	Q1FY23	Q1FY22	y-o-y (%)	Q4FY22	q-o-q (%)
Gross Revenue	4,169	4,075	2.3%	4,964	-16.0%
EBITDA	2,295	2,685	-14.5%	3,131	-26.7%
PAT	130	915	-85.8%	-1,232	NA
Production					
Oil (mmt)	1.5	2.1	-25.5%	1.9	-18.2%
Gas (bcm)	1.0	1.1	-6.0%	1.1	-6.3%
Total	**2.5**	**3.1**	**-18.9%**	**3.0**	**-13.9%**
Sale volume					
Oil (mmt)	1.4	1.9	-24.4%	1.7	-17.6%
Gas (bcm)	0.8	0.8	8.3%	0.8	4.6%
Total	**2.2**	**2.6**	**-15.0%**	**2.5**	**-10.6%**

Source: Company, Sharekhan Research

MRPL key financial and operating metrics Rs cr

Particulars	Q1FY23	Q1FY22	y-o-y (%)	Q4FY22	q-o-q (%)
Revenue	35,952	15,083	138.4%	28,266	27.2%
EBITDA	4714	285	1554.0%	2941	60.3%
PAT	2708	-230	NA	3008	-10.0%
Refining throughput (mmt)	4.29	3.07	39.7%	4.38	-2.1%
GRM ($/bbl)	24.45	4.94	394.9%	15.28	60.0%

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Adhoc policy changes to impact earnings of upstream PSUs

The government's ad-hoc tax policy changes for the oil & gas sector in the environment of high oil prices has again raised concerns over the earnings outlook of upstream PSUs and is divergence from government's earlier intent of doing away with oil subsidy mechanism. The government has introduced a windfall tax in the form of a fixed cess rate of Rs. 17,750/tonne currently versus current ad valorem effective cess rate of 16.67% on realised oil prices for upstream PSUs. A higher cess would be more detrimental to earnings of upstream PSUs in case of the falling crude oil price environment and pose risk to FY2023E-FY2024E earnings. Additionally, a likely capping of domestic gas price would further limit earnings growth for upstream PSUs.

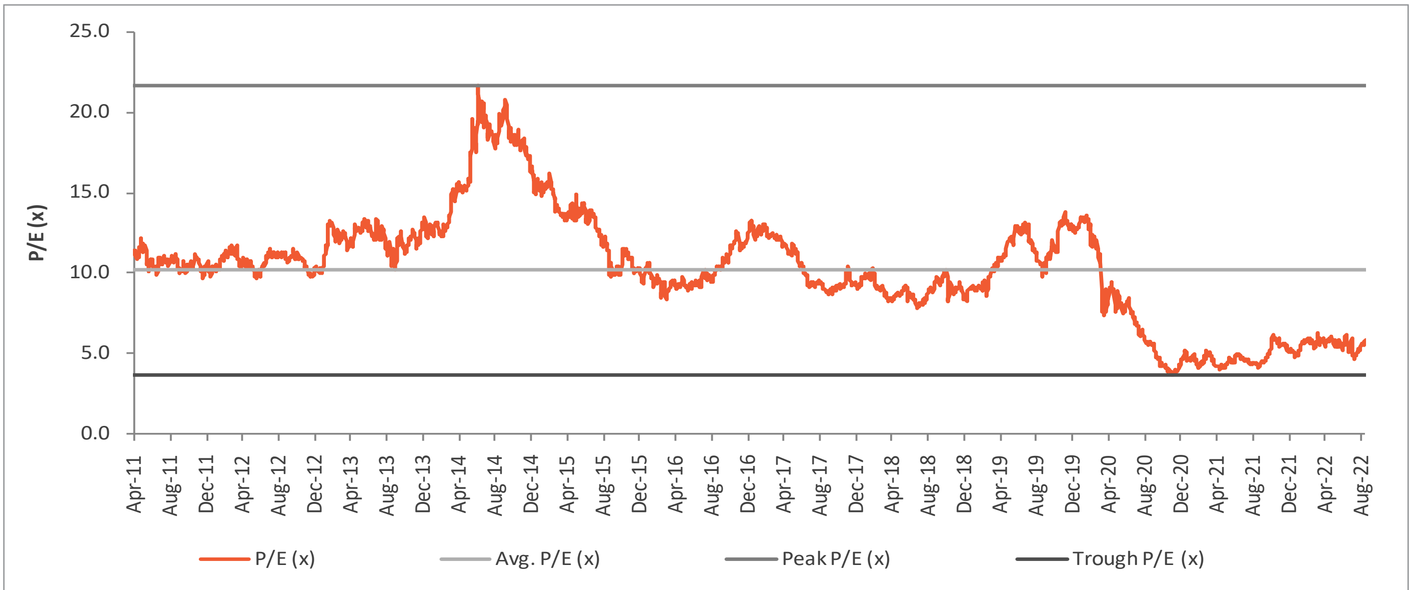
■ Company outlook - Muted earnings outlook

ONGC's earnings outlook has been affected by the windfall tax (in form of higher cess rate) imposed by the government and expect ONGC's PAT to decline by 1% CAGR over FY22-24E despite assumption of further hike in domestic gas price from October 2022. ONGC has earmarked an exploration capex of $4 billion to augment production and has guided for impressive 4%/8% CAGR in oil/gas production over FY22-FY25E. KG-DWN-98/2 to be the key driver of volume growth with peak oil/gas production potential of 45kbpd/12mmscmd in CY2024.

■ Valuation - Maintain Hold on ONGC with a revised PT of Rs. 148

The ad-hoc cess rate has created earnings uncertainty and valuation concern for upstream PSUs and lack of policy clarity would remain a key overhang on ONGC until the windfall taxes are removed. Hence, we maintain our Hold rating on ONGC with a revised PT of Rs. 148. Dividend yield of 8% limits material downside risk for ONGC. Stock trades at 4.7x/ 5.8x its FY2023E/FY2024E EPS.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

ONGC is India's largest exploration and production company with a consolidated crude oil and gas production of 55.7 mmtoe in FY2022. The ONGC group held 2P reserves (oil &and gas) of 1221 million tonne of oil equivalent as on March 31, 2022. ONGC also holds interest in oil refining and marketing business through its subsidiaries (HPCL and MRPL).

Investment theme

The recent imposition of windfall tax on upstream PSUs and likely LPG subsidy burden has severely dented earnings outlook for upstream PSUs (including ONGC). Higher cess rate would be more detrimental to the earnings of upstream PSUs in case of the falling crude oil price environment. However, high dividend yield of 8% limits downside risk for ONGC.

Key Risks

A sharp rise in crude oil & gas price, removal of windfall tax and policy clarity on various duties are key upside risks and continued ad-hoc cess rate, sharp decline in oil price and likely capping of domestic gas price are downside risk.

Additional Data

Key management personnel

Dr. Alka Mittal	Chairperson & Managing Director
Pomila Jaspal	Director (Finance)
R.K. Srivastava	Director (Exploration)
Pankaj Kumar	Director (Offshore)

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corporation of India	9.73
2	Indian Oil Corporation Ltd	7.84
3	ICICI Prudential Asset Management Co Ltd	3.48
4	FMR LLC	2.86
5	GAIL India Ltd	2.45
6	Nippon Life India Asset Management Ltd	1.80
7	NSE Clearing Ltd	1.18
8	Vanguard Group Inc	0.95
9	SBI Funds Management Ltd	0.65
10	Blackrock Inc	0.62

Source: Bloomberg (old data)

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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Compliance Officer: Ms. Priya Sonavane; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

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Registered Office: Sharekhan Limited, The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA, Tel: 022 - 67502000/ Fax: 022 - 24327343. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183.