Sharekhan by BNP PARIBAS

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Oil and Natural Gas Corporation Ltd

In-line Q3; Likely APM gas price cap a concern

Oil & Gas	Sharekhan code: ONGC
Reco/View: Hold ↔	CMP: **Rs. 156** / Price Target: **Rs. 165** ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Stock Update | Result Update

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 55.06

Updated Feb 08, 2023

Severe Risk

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

Source: Morningstar

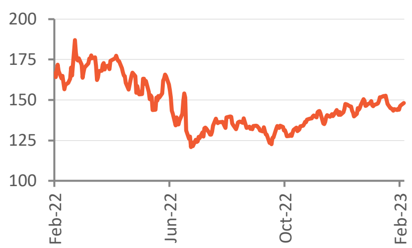
Company details

Market cap:	Rs. 1,96,064 cr
52-week high/low:	Rs. 195 / 120
NSE volume: (No of shares)	144.5 lakh
BSE code:	500312
NSE code:	ONGC
Free float: (No of shares)	517.2 cr

Shareholding (%)

Promoters	58.9
FII	8.4
DII	19.3
Others	13.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	5.6	9.1	11.4	-7.5
Relative to Sensex	3.5	10.1	8.9	-13.2

Sharekhan Research, Bloomberg

Summary

- Q3FY2023 operating profit of Rs. 20,411 crore (up 8.5% q-o-q) was largely in-line as lower oil and gas sales volume and higher cost were offset by lower statutory levies. PAT of Rs. 11,045 crore (down 14% q-o-q) missed estimates due to higher DD&A.
- Oil/gas sales declined by 7.9%/2.6% y-o-y to 4.7mmt/4.2bcm; net crude oil realisation increased 6% q-o-q to $76.7/bbl (gross realisation of $87.1/bbl minus SAED impact of $10.4/bbl). OVL posted PAT of Rs. 549 crore (versus loss of Rs. 440 crore in Q2FY2023), while MRPL reported net loss of Rs. 188 crore due to subdued GRM of $3.9/bbl.
- Management has guided for production growth of 1%/4-5% for FY2023E/FY2024E with KG 98/2 to witness peak production in FY2025. In our view, earnings of upstream PSUs would peak in FY2023 and decline going forward due to likely capping of domestic gas price and normalisation a crude oil price. Likely withdrawal of windfall tax is key to improve investor sentiments.
- We maintain our Hold rating on ONGC with a revised PT of Rs. 165. The stock trades at 4.8x/0.7x its FY2025E EPS/BV and offers high dividend yield of ~8%.

Oil and Natural Gas Corporation's (ONGC) Q3FY2023 standalone operating profit at Rs. 20,411 crore (up 27.8% y-o-y, up 8.5% q-o-q) was largely in-line with our estimate of Rs. 20,605 crore, as miss in oil and gas sales volume and higher cost (especially for raw-material cost, as it had to use expensive LNG due to lower APM gas allocation and higher RJ polymer injection cost) were offset by lower-than-expected statutory levies (down 24% q-o-q given decline in SAED). Oil/gas sales volume declined by 7.9%/2.6% y-o-y to 4.7mmt/4.2bcm. Gross crude oil realisation stood at $87.1/bbl (down 8.8% q-o-q) and SAED impact stood at $10.4/bbl. Thus, net crude oil realisation was at $76.7/bbl (up 6% q-o-q). Standalone PAT of Rs. 11,045 crore (up 26% y-o-y; down 13.9% q-o-q) was 8% below our estimate due to higher DD&A cost (up 22% q-o-q) and slightly lower other income.

Key positives

- Declared second interim dividend of Rs. 4/share, taking DPS to Rs. 10.75/share (implies 7% dividend yield) so far in FY2023.
- Net oil realisation increased by 6% q-o-q to $76.7/bbl in Q3FY2023.

Key negatives

- Miss of 3%/1% in oil/gas sales volume at 4.7 mmt/4.2 bcm, down 7.9%/2.6% % y-o-y.
- Sharp increase of 48% y-o-y/88% q-o-q in raw-material cost due to high LNG price and higher RJ polymer injection cost.

Management Commentary

- Overall production growth guidance of 1% for FY2023 and 4-5% (including oil production from KG 98/2) for FY2024.
- KG 98/2 is expected to start oil production from May/June 2023 with incremental oil production volume of 1.9 mmt in FY2024. Management has guided for peak oil/gas production of 45,000 bdp/12 mmscmd by FY2025. ONGC Videsh Limited's (OVL) FY2024 oil and gas production is expected at 9.7mtoe.
- Standalone capex guidance of Rs. 30,000 crore annually (spent Rs. 19,153 crore in 9MFY2023). OVL's capex is expected to be at Rs. 3,000 crore p.a.
- ONGC got premium of $1.8/bbl over Brent crude oil price for crude oil bidding conducted in October 2022.

Revision in estimates – We have fine-tuned our FY2023/FY2024/FY2025 earnings estimate.

Our Call

Valuation – Maintain Hold on ONGC with a revised PT of Rs. 165: We believe earnings for upstream PSUs would peak in FY2023 and are expected to decline sharply going ahead due to likely capping of domestic gas price. Although now there is a reasonable comfort in terms of predictability of oil and gas realisation, but the same is likely to remain capped. Thus, we see limited scope of earnings surprise. Withdrawal of windfall tax and policy clarity remain key for removing the overhang for upstream PSUs. Hence, we maintain our Hold rating on ONGC with a revised price target (PT) of Rs. 165. Dividend yield of ~8% limits the material downside risk for ONGC. The stock trades at 4.8x its FY2025E EPS and 0.7x its FY2025E P/BV.

Key Risks

A sharp rise in crude oil and gas prices, removal of windfall tax, and policy clarity on various duties are key upside risk, 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	FY22	FY23E	FY24E	FY25E
Revenue	1,10,345	1,57,659	1,29,172	1,28,743
OPM (%)	54.3	53.4	57.5	57.6
Adjusted PAT	30,710	48,877	41,616	40,884
% YoY growth	211.1	59.2	-14.9	-1.8
Adjusted EPS (Rs.)	24.4	38.9	33.1	32.5
P/E (x)	6.4	4.0	4.7	4.8
P/B (x)	0.8	0.8	0.7	0.7
EV/EBITDA (x)	3.4	2.3	2.5	2.3
RoNW (%)	13.9	19.8	15.6	14.2
RoCE (%)	15.4	22.7	18.1	16.7

Source: Company; Sharekhan estimates

In-line Q3 operating profit

Q3FY2023 standalone operating profit at Rs. 20,411 crore (up 27.8% y-o-y; up 8.5% q-o-q) was in-line with our estimate of Rs. 20,605 crore, as miss in oil and gas sales volume and higher cost (especially for raw-material cost, the company had to use expensive LNG due to lower APM gas allocation and higher RJ polymer injection cost) were offset by lower-than-expected statutory levies (down 24% q-o-q given decline in SAED). Oil/gas sales declined by 7.9%/2.6% y-o-y to 4.7mmt/4.2bcm. Gross crude oil realisation stood at $87.1/bbl (down 8.8% q-o-q) and estimated SAED impact stood at $10.4/bbl. Thus, net crude oil realisation was at $76.7/bbl (up 6% q-o-q). Standalone PAT of Rs. 11,045 crore (up 26% y-o-y; down 13.9% q-o-q) was 8% below our estimate due to higher DD&A cost (up 22% q-o-q) and slightly lower other income.

Subsidiary OVL posted PAT of Rs. 549 crore as compared to net loss of Rs. 440 crore in Q2FY2023. Crude oil sales volume remained weak at 1.2mmt (versus 1.3mmt/1.9mmt in Q2FY2023/Q3FY2022), while gas sales volume stood at 0.57 bcm as compared to 0.71 bcm/0.91 bcm in Q2FY2023/Q3FY2022.

MRPL reported net loss of Rs. 188 crore (versus net loss of Rs. 1,789 crore in Q2FY2023 and PAT of Rs. 586 crore in Q3FY2022). GRM was weak at $3.9/bbl (versus negative $4.5/bbl in Q2FY2023 and positive $9/bbl in Q3FY2023). The refinery throughput improved marginally to 4.48mmt in Q3FY2023 as compared to 4.35mmt in Q3FY2022.

Results (Standalone) Rs cr

Particulars	Q3FY23	Q3FY22	Y-o-Y %	Q2FY23	Q-o-Q %
Revenue	**38,583**	**28,473**	**35.5**	**38,321**	**0.7**
Total Expenditure	18,172	12,504	45.3	19,509	-6.9
Operating profit	**20,411**	**15,969**	**27.8**	**18,812**	**8.5**
Other Income	1,411	1,492	-5.4	3,529	-60.0
Interest	690	582	18.6	667	3.4
Depreciation, depletion and amortisation	6,461	5,456	18.4	5,315	21.6
PBT	14,672	11,423	28.4	16,359	-10.3
Tax	3,627	2,659	36.4	3,534	2.7
Reported PAT	**11,045**	**8,764**	**26.0**	**12,826**	**-13.9**
Equity Cap (cr)	1,258	1,258		1,258	
EPS (Rs.)	8.8	7.0	26.0	10.2	-13.9
Margins (%)			**BPS**		**BPS**
OPM	52.9	56.1	-318	49.1	381
Effective tax rate	24.7	23.3	144	21.6	312
NPM	28.6	30.8	-215	33.5	-484

Source: Company; Sharekhan Research

Standalone key operating metrics

Particulars	Q3FY23	Q3FY22	Y-o-Y %	Q2FY23	Q-o-Q %
Oil production (mmt)	5.4	5.5	-1.0	5.4	0.7
Oil sales (mmt)	4.7	5.1	-7.9	4.8	-1.9
Gas Production (bcm)	5.4	5.6	-3.8	5.4	0.1
Gas sales (bcm)	4.2	4.3	-2.6	4.2	0.9
Gross oil realisation $/bbl	87.1	75.7	15.1	95.5	-8.8
Subsidy $/bbl	10.4	0	NA	23.1	-54.9
Net oil realisation $/bbl	76.7	75.7	1.3	72.4	6.0
Rs./USD rate	82.2	75.0	9.7	79.8	3.0
Gas price ($/mmbtu)	8.6	2.9	195.5	6.1	40.5

Source: Company; Sharekhan Research

Outlook and Valuation

■ **Sector View – Ad-hoc policy changes to impact earnings of upstream PSUs**

The government's ad-hoc tax policy changes for the oil and gas sector in the volatile oil price environment have raised concerns over the earnings outlook of upstream PSUs and its divergence from government's earlier intent of doing away with the oil subsidy mechanism. The government has introduced a windfall tax in the form of fixed cess rate, which is in addition to the current ad valorem effective cess rate of 16.67% on realised oil price 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 FY2024E-FY2025E earnings. Additionally, a likely capping of the domestic gas price would further limit earnings growth for upstream PSUs.

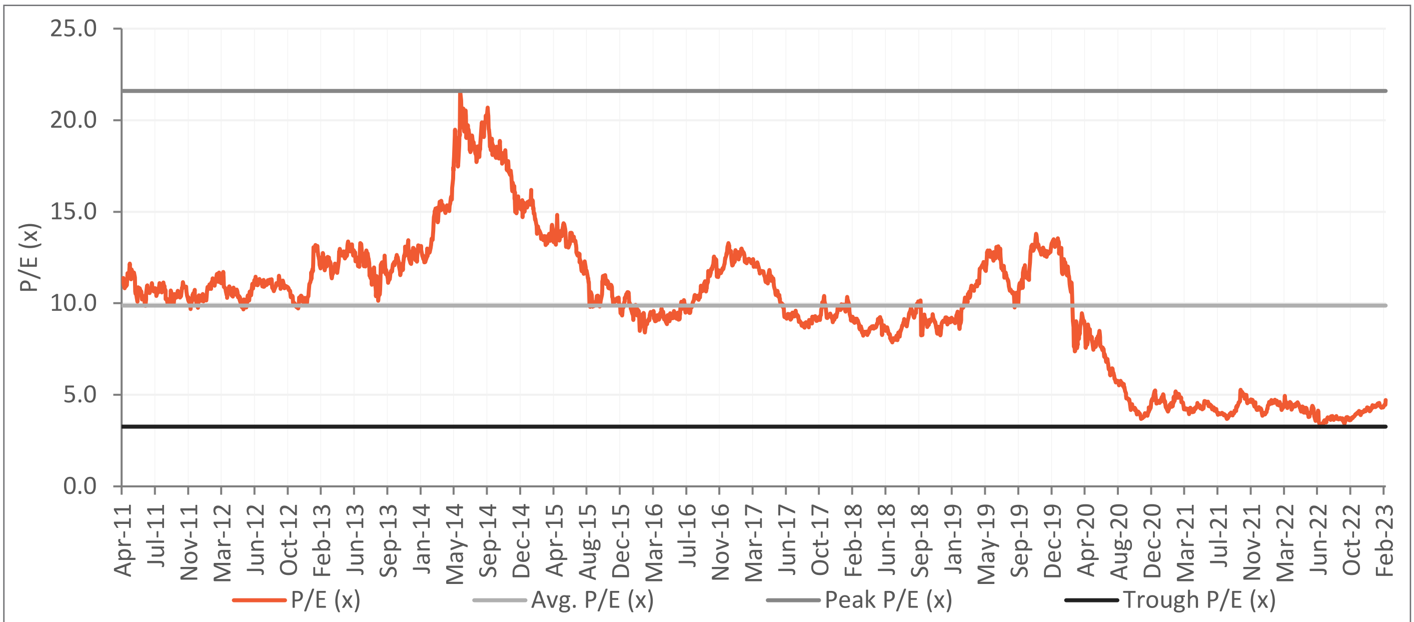
■ **Company Outlook – Muted earnings outlook**

ONGC's earnings outlook has been impacted due to windfall tax (in form of a higher cess rate) imposed by the government and the likely capping of APM gas price at $6.5/mmbtu. Management has guided for 4-5% production growth for FY2024 and KG-DWN-98/2 to be the key drivers of volume growth with peak oil/gas production potential of 45kbpd/12mmscmd in FY2024.

■ **Valuation – Maintain Hold on ONGC with a revised PT of Rs. 165**

We believe earnings for upstream PSUs would peak in FY2023 and are expected to decline sharply going ahead due to likely capping of domestic gas price. Although now there is a reasonable comfort in terms of predictability of oil and gas realisation, but the same is likely to remain capped. Thus, we see limited scope of earnings surprise. Withdrawal of windfall tax and policy clarity remain key for removing the overhang for upstream PSUs. Hence, we maintain our Hold rating on ONGC with a revised PT of Rs. 165. Dividend yield of ~8% limits the material downside risk for ONGC. The stock trades at 4.8x its FY2025E EPS and 0.7x its FY2025E P/BV.

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 1,221 million tonne of oil equivalent as on March 31, 2022. ONGC also holds an interest in the oil refining and marketing business through its subsidiaries (HPCL and MRPL).

Investment theme

The recent imposition of the windfall tax on upstream PSUs and likely cap on domestic gas price have severely dented the earnings outlook for upstream PSUs (including OIL). Windfall tax if not removed would be detrimental to the earnings of upstream PSUs in case of the falling crude oil price environment. However, a high dividend yield of 8% limits downside risk for ONGC.

Key Risks

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

Additional Data

Key management personnel

Arun Kumar Singh	Chairman
Pomila Jaspal	Director (Finance)
Anurag Sharma	Director (Onshore)
Pankaj Kumar	Director (Offshore)

Source: Company Website

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

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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