Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update | Result Update

Oil and Natural Gas Corporation

Q4 marred by large tax provision on royalty

Oil & Gas	Sharekhan code: ONGC
Reco/View: Hold ↔	CMP: **Rs. 159**
	Price Target: **Rs. 170** ↑

↑ 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	55.06
Updated Mar 08, 2023	
Severe Risk	

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

Source: Morningstar

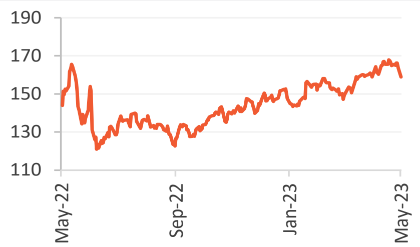
Company details

Market cap:	Rs. 1,99,901 cr
52-week high/low:	Rs. 169/120
NSE volume: (No of shares)	116.3 lakh
BSE code:	500312
NSE code:	ONGC
Free float: (No of shares)	517.2 cr

Shareholding (%)

Promoters	58.9
FII	8.0
DII	19.9
Others	13.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-0.0	4.5	12.6	10.4
Relative to Sensex	-2.9	-2.0	13.0	-2.0

Sharekhan Research, Bloomberg

Summary

- Q4FY23 results were weak with a reported net loss of Rs. 248 crore due to large one-time provision of Rs. 9,235 crore related to a disputed service tax & GST on royalty. Adjusted PAT of Rs. 6,178 crore (down 44.1% q-o-q) lagged our estimate by 42% due to higher opex and exploration cost write-off (up 2.8x q-o-q).
- Volume growth was subdued with a miss of 3%/5% in oil/gas sales volume at 4.7 mmt (flat q-o-q) and 4.1 bcm (down 2% q-o-q) respectively; net oil realisation post SAED of $76.5/bbl was in-line. OVL posted PBT loss of Rs. 1099 crore (versus positive PBT of Rs. 1,076 crore in Q3FY23) while MRPL reported PAT of Rs. 1,908 crore (versus Rs. 188 crore net loss in Q3FY23).
- New APM gas price formula provides visibility on improvement in gas price and 20% premium on APM gas price cap of $6.5/mmBtu for gas production from new wells provides upside risk to our gas realisation. Having said that, earnings of upstream PSUs peaked in FY23 and would decline in FY24 due to APM gas price and normalization of crude oil price.
- We maintain our Hold rating on ONGC with a revised PT of Rs. 170. Stock trades at 4.8x/0.7x its FY2025E EPS/BV and offers healthy dividend yield of ~8%.

Oil and Natural Gas Corporation's (ONGC) Q4FY23 standalone operating profit at Rs. 16,340 crore (down 12.1%% y-o-y; down 19.9% q-o-q) was 19% below our estimate of Rs. 20,192 crore due to a provision of Rs. 2,872 crore for disputed service tax & GST on royalty, lower-than-expected oil & gas sales volume and higher other expenses (up 97% q-o-q). Net oil realisation (post SAED) was in-line at $76.5/bbl while oil/gas sales volume missed our estimate by 3%/5% at 4.7 mmt (flat q-o-q) and 4.1 bcm (down 2% q-o-q) respectively. Reported net loss came in at Rs. 248 crore due to one-time exceptional provision of Rs. 9,235 crore for the disputed service tax & GST on royalty from April 1, 2016, to March 31, 2022. Adjusting for the same, PAT of Rs. 6,178 crore (down 30.3% q-o-q; down 44.1% q-o-q) was 42% below our estimate due to miss in operating profit and substantially higher exploration cost written off (up 2.8x q-o-q).

Key positives

- FY23 dividend per share of Rs. 11.25 implies dividend yield of 7% on CMP.

Key negatives

- Miss of 3%/5% in oil/gas sales volume at 4.7 mmt/4.1 bcm.
- Sharp rise of 97%/2.8x q-o-q in other expenses and exploration cost written off.
- Massive provision for service tax & GST on royalty at Rs. 12,107 crore in FY23.

Management Commentary

- Domestic gas prices are linked to crude oil. Gas production from new wells to fetch 20% premium to APM gas price cap of $6.5/mmBtu.
- Oil/gas production growth guidance of 4.6%/9.6% CAGR over FY23-26E and expected to reach 22.4 mmt/27.2bcm by FY26.
- The matter of service tax & GST on royalty is with Supreme Court now. ONGC view is that tax on royalty is double taxation and expects a favourable judgement from the SC.
- Target to become net zero for scope 1 & Scope 2 by 2038. Plan to have RE capacity of 10 GW by 2030 with capex of Rs. 1 lakh crore and 1 mmtpa of green ammonia capacity.
- FY24 Standalone capex guidance of Rs. 30,125 crore versus capex spending of Rs. 30,208 crore in FY23.

Revision in estimates: We have fine-tuned our FY24-25 earnings estimate earnings estimate to factor FY23 P&L and balance sheet numbers.

Our Call

Valuation – Maintain Hold on ONGC with a revised PT of Rs. 170: We believe that upstream PSUs' earnings peaked out in FY23 and expected to decline sharply going ahead due to a cap on domestic gas prices. Although now there is a reasonable comfort in terms of predictability of oil & gas realisations, but the same is likely to remain capped in FY24. The withdrawal of windfall tax and policy clarity remain key to remove overhang for upstream PSUs. Hence, we maintain a Hold rating on ONGC with a revised PT of Rs. 170. Dividend yield of ~8% limits material downside risk for ONGC. Stock trades at 4.8x its FY2025E EPS and 0.7x its FY2025E P/BV.

Key Risks

A surge in crude oil & gas prices, removal of windfall tax and policy clarity on various duties is a key upside risk, while continuation of ad-hoc cess rate and a sharp fall in crude oil prices are downside risks.

Valuation (Standalone) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Revenue	1,10,345	1,55,517	1,30,320	1,29,787
OPM (%)	54.3	52.4	58.5	58.5
Adjusted PAT	30,710	48,064	42,356	41,475
% YoY growth	211.1	56.5	-11.9	-2.1
Adjusted EPS (Rs.)	24.4	38.2	33.7	33.0
P/E (x)	6.5	4.2	4.7	4.8
P/B (x)	0.8	0.8	0.7	0.7
EV/EBITDA (x)	3.4	2.3	2.6	2.4
RoNW (%)	13.9	19.4	15.8	14.3
RoCE (%)	15.4	20.7	18.3	16.8

Source: Company; Sharekhan estimates

Q4 earnings marred by one-offs, higher cost and rise in exploration cost written off

Q4FY23 standalone operating profit at Rs. 16,340 crore (down 12.1%% y-o-y; down 19.9% q-o-q) was 19% below our estimate of Rs. 20,192 crore due to a provision of Rs. 2,872 crore for disputed service tax & GST on royalty, lower-than-expected oil & gas sales volume and higher other expenses (up 97% q-o-q). Net oil realisation (post SAED) was in-line at \$76.5/bbl while oil/gas sales volume missed our estimate by 3%/5% at 4.7 mmt (flat q-o-q) and 4.1 bcm (down 2% q-o-q) respectively. Reported net loss came in at Rs. 248 crore due to one-time exceptional provision of Rs. 9,235 crore for the disputed service tax & GST on royalty from April 1, 2016, to March 31, 2022. Adjusting for the same, PAT of Rs. 6,178 crore (down 30.3% q-o-q; down 44.1% q-o-q) was 42% below our estimate due to miss in operating profit and substantially higher exploration cost written off (up 2.8x q-o-q).

Subsidiary ONGC Videsh Limited (OVL) posted a PBT loss of Rs. 1,099 crore (versus positive PBT of Rs. 1076 crore in Q3FY23). Crude oil sales volume remained weak at 1.3 mmt (down 28% y-o-y; up 1% q-o-q) while gas sales volume stood at 0.52 bcm (down 34% y-o-y; down 9% q-o-q).

MRPL reported a PAT of Rs. 1908 crore (versus Rs. 188 crore net loss in Q3FY23). GRM was strong at \$15.1/bbl (versus \$3.9/bbl in Q3FY23 and \$15.3/bbl in Q4FY22). Refinery throughput was largely stable at 4.38 mmt as compared to 4.35 mmt in Q3FY23 and 4.41 mmt in Q4FY22.

Analyst meet key takeaways

- **Gas pricing** - Domestic gas pricing formula linked to crude oil and gas from new wells would fetch 20% premium to APM gas price cap of \$6.5/mmBtu. ONGC's gas production decline rate is ~8% given old fields and the entire gas replaced from new wells would get gas price of \$9/mmBtu.
- **Service tax & GST on royalty update** - Service tax & GST on royalty would be shown as an exceptional item in P&L as shown in Q4FY23 results. The matter is with the Supreme Court now and if the judgement is in favour of ONGC then the money will flow to shareholders. ONGC view is that tax on royalty is double taxation and expects favourable judgement from the SC.
- **Production guidance** - Oil/gas production growth guidance of 4.6%/9.6% CAGR over FY23-26E and expected to reach 22.4 mmt/27.2bcm by FY26. Oil production guidance of 21.3 mmt/21.5 mmt/22.4 mmt and gas production guidance of 23.6bcm/26.1bcm/27.2bcm for FY24/FY25/FY26.
- **KG DWN 98/2** - ONGC guided for first oil production from KG basin by August 2023 and gas production by end-FY24.
- **Capex guidance** - FY24 Standalone capex guidance of Rs. 30,125 crore versus capex spending of Rs. 30,208 crore in FY23.
- **Green energy** - Target to become net zero for scope 1 & Scope 2 by 2038. Plan to have RE capacity of 10 GW by 2030 (versus only 189 MW currently) with capex of Rs. 1 lakh crore and 1 mmtpa of green ammonia capacity.
- **OVL – 1) Sakhalin:** OVL received back rights for Sakhalin and production is at plateau level of 190-200kbpd 2) Mozambique LNG project: Situation has improved in Mozambique and expects gas production to start from 2026-27.

Results (Standalone) **Rs cr**

Particulars	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)
Revenue	**36,293**	**34,497**	**5.2**	**38,583**	**-5.9**
Total Expenditure	19,953	15,907	25.4	18,172	9.8
Operating profit	**16,340**	**18,590**	**-12.1**	**20,411**	**-19.9**
Other Income	1,928	1,344	43.5	1,411	36.6
Interest	708	580	22.1	690	2.6
Depreciation, depletion and amortisation	9,304	7,640	21.8	6,461	44.0
Exceptional income/(expense)	-9,235	0	NA	0	NA
Reported PBT	**-979**	**11,714**	**NA**	**14,672**	**NA**
Adjusted PBT	**8,256**	**11,714**	**-29.5**	**14,672**	**-43.7**
Tax	-731	2,855	NA	3,627	NA
Reported PAT	**-248**	**8,860**	**NA**	**11,045**	**NA**
Adjusted PAT	**6,178**	**8,860**	**-30.3**	**11,045**	**-44.1**
Equity Cap (cr)	1,258	1,258		1,258	
Reported EPS (Rs.)	-0.2	7.0	NA	8.8	NA
Adjusted EPS	4.9	7.0	-30.3	8.8	-44.1
Margins (%)			**BPS**		**BPS**
OPM	45.0	53.9	-887	52.9	-788
Effective tax rate	NA	24.4	NA	24.7	NA
Adjusted NPM	17.0	25.7	-866	28.6	-1160

Source: Company, Sharekhan Research

Standalone key operating metrics

Particulars	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)
Oil production (mmt)	5.2	5.4	-2.9	5.4	-3.0
Oil sales (mmt)	4.7	5.1	-8.9	4.7	0.0
Gas Production (bcm)	5.3	5.3	-1.5	5.4	-1.8
Gas sales (bcm)	4.1	4.1	1.0	4.2	-2.0
Gross oil realisation $/bbl	77.1	95.0	-18.8	87.1	-11.5
Subsidy $/bbl	0.6	0	NA	10.4	-94.7
Net oil realisation $/bbl	76.5	95.0	-19.4	76.7	-0.2
Net oil realisation INR/bbl	6,344	7,147	-11.2	6,986	-9.2
Rs. /USD rate	82.3	75.3	9.3	82.2	0.1
Gas price ($/mmBtu)	8.6	2.9	195.5	8.6	0.0

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 has raised concerns over the earnings outlook for 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 fixed cess rate, which is in addition to current ad valorem effective cess rate of 16.67% on realised oil price for upstream PSUs. Additionally, capping of domestic gas prices at $6.5/mmBtu would further limit earnings growth for upstream PSUs.

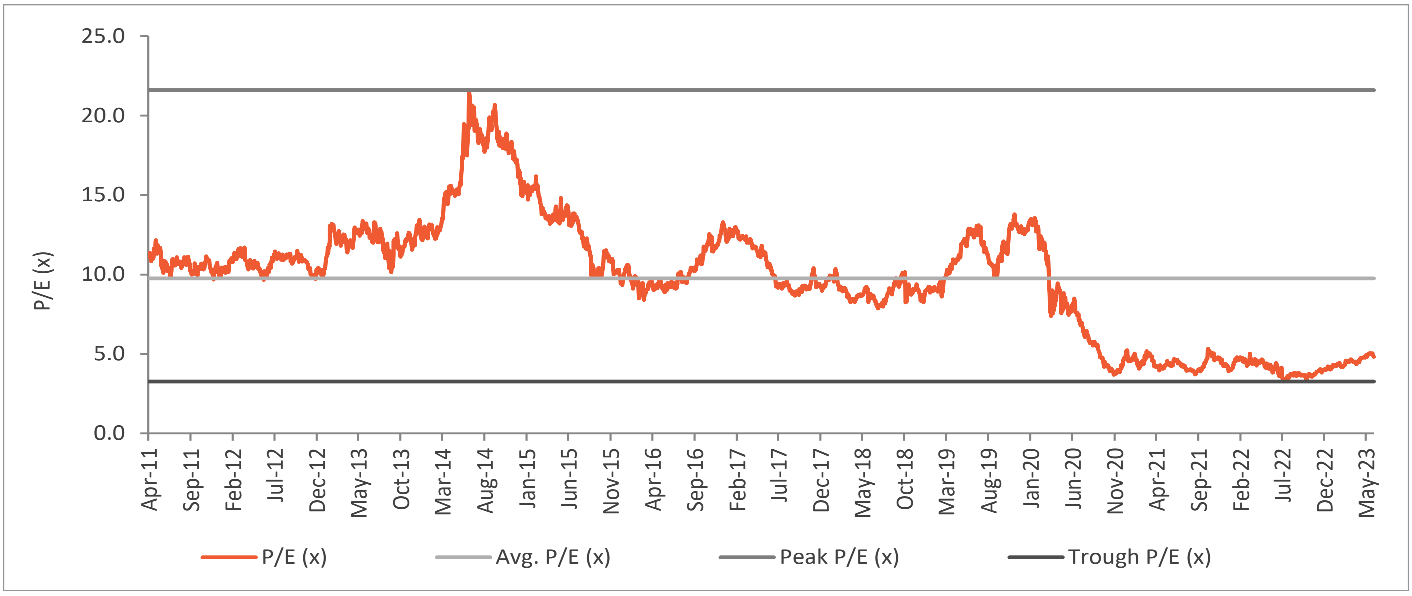
■ Company outlook - Muted earnings outlook

ONGC's earnings outlook has been hit by a windfall tax (in form of higher cess rate) imposed by the government and capping of APM gas price at $6.5/mmBtu. The management has guided for 4.6%/9.6% oil & gas production CAGR over FY23-26E and KG-DWN-98/2 to be the key volume growth driver.

■ Valuation - Maintain Hold on ONGC with a revised PT of Rs. 170

We believe that upstream PSUs' earnings peaked out in FY23 and expected to decline sharply going ahead due to a cap on domestic gas prices. Although now there is a reasonable comfort in terms of predictability of oil & gas realisations, but the same is likely to remain capped in FY24. The withdrawal of windfall tax and policy clarity remain key to remove overhang for upstream PSUs. Hence, we maintain a Hold rating on ONGC with a revised PT of Rs. 170. Dividend yield of ~8% limits material downside risk for ONGC. 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 53 mmtoe in FY2023. The ONGC group held 2P reserves (oil &and gas) of 1221 million tonne of oil equivalent as on March 31, 2023. ONGC also holds interest in oil refining and marketing business through its subsidiaries (HPCL and MRPL).

Investment theme

The recent cap of $6.5/mmBtu on domestic gas price and normalization of international crude oil price would impact earnings of upstream PSUs (including ONGC) in FY24. However, ONGC's valuation is reasonable and the stock offers healthy dividend yield of 8% which 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 is key upside risk and continued ad-hoc cess rate are sharp decline in oil 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 Corp of India	9.9
2	Indian Oil Corp Ltd	7.84
3	ICICI Prudential Asset Management	3.45
4	GAIL India Ltd	2.45
5	Nippon Life India Asset Management	2.18
6	FMR LLC	1.57
7	Vanguard Group Inc/The	1.13
8	SBI Funds Management Ltd	0.99
9	HDFC Asset Management Co Ltd	0.9
10	BlackRock Inc	0.64

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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Registration and Contact Details: Name of Research Analyst - Sharekhan Limited, Research Analyst Regn No.: INH000006183. (CIN): - U99999MH1995PLC087498. Registered Office: The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA. Tel: 022-6115000.

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Compliance Officer: Ms. Binkle Oza; Tel: 022-61169602; email id: complianceofficer@sharekhan.com

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