Sharekhan by BNP PARIBAS

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Stock Update

Result Update

Oil and Natural Gas Corporation Ltd

Q1 shines on better realisation & lower opex

Oil & Gas	Sharekhan code: ONGC
Reco/View: Hold ↔	CMP: Rs. 178
	Price Target: Rs. 190 ↑

↑ 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 52.16

Updated Aug 08, 2023

Severe Risk

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

Source: Morningstar

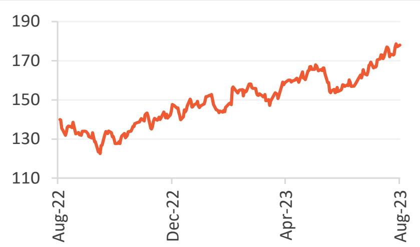
Company details

Market cap:	Rs. 2,23,929 cr
52-week high/low:	Rs. 180/122
NSE volume: (No of shares)	107.3 lakh
BSE code:	500312
NSE code:	ONGC
Free float: (No of shares)	517.2 cr

Shareholding (%)

Promoters	58.9
FII	8.1
DII	19.8
Others	13.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	7.0	7.5	20.7	27.2
Relative to Sensex	8.8	2.6	13.9	17.9

Sharekhan Research, Bloomberg

Summary

- Q1 performance was strong with an 8% beat in standalone PAT at Rs. 10,015 crore (up 62% q-o-q) led by better-than-expected oil & gas realisations, significantly lower operating cost and higher other income.
- Net oil/gas realisation of $74/bbl and $7.1/mmBtu was above estimate while employee/other expenses declined sharply by 7%/28% q-o-q. Volume performance was mixed with in-line oil sales volume of 4.7mmt (up 1% q-o-q) and 2% miss in gas sales volume at 4.1bcm (down 1.1% q-o-q). We increase our FY24/FY25 earnings estimate by 6%/9% to factor lower opex.
- The current pricing mechanism provides earnings visibility but capping of oil & gas realisation limits any earnings surprise over FY24-25 unless KG 98/2 block sees faster ramp-up. Any significant benefit from 20% premium on APM gas price cap of $6.5/mmBtu for gas production from new wells needs to be watched before building any likely improvement in gas price going forward.
- We maintain a Hold rating on ONGC with a revised PT of Rs. 190. Stock trades at 5x/0.7x its FY2025E EPS/BV and offers healthy dividend yield of ~8%.

Oil and Natural Gas Corporation's (ONGC) Q1FY24 standalone operating profit of Rs. 19,453 crore (down 25% y-o-y; up 19.1% q-o-q) was 9% above our estimate of Rs. 17,875 crore led by sharply lower operating cost (employee/other expenses declined by 7%/28% q-o-q) and higher-than-expected oil & gas realisation. We have excluded the provision of Rs. 641 crore/Rs. 2,872 in Q1FY24/Q4FY23 crore for disputed service tax & GST on royalty from other expenses to drive normalised expenses. Volume performance was mixed with in-line oil sales volume of 4.7 mmt (up 1% q-o-q) but gas sales volume of 4.1 bcm (down 1.1% q-o-q) was 2% below our estimate. Net oil realisation of $74/bbl (up 3.4% q-o-q) benefited from lower SAED of Rs. 731 crore (versus Rs. 1,561 crore in Q4FY23). Average gas realisation (domestic + JV) was higher at $7.1/mmbtu as compared to estimate of $6.7/mmbtu. The Standalone PAT of Rs. 10,015 crore (down 34% y-o-y; up 62% q-o-q) was 7.6% above our estimate of Rs. 9305 crore on back of beat in oil & gas realisation, lower cost, higher other income that was partially offset by rise in DD&A cost.

Key positives

- Better-than-expected net oil realisation of $74/bbl.

Key negatives

- Miss of 2% in gas sales volume at 4.1 bcm.

Revision in estimates: We have increased our FY24-25 earnings estimate to factor lower operating cost.

Our Call

Valuation – Maintain Hold on ONGC with a revised PT of Rs. 190: Although the current oil & gas pricing regime provides reasonable comfort in terms of predictability of earnings, but upstream PSUs have already seen peak earnings in FY23, and earnings would fall in FY24 with limited triggers for growth over next couple of years. 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. 190 (reflects upward revision in earnings estimate). Dividend yield of ~8% limits material downside risk for ONGC. Stock trades at reasonable valuation of 5x 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	1,35,447	1,34,860
OPM (%)	54.3	52.4	59.4	60.0
Adjusted PAT	30,710	48,064	44,972	45,169
% YoY growth	211.1	56.5	-6.4	0.4
Adjusted EPS (Rs.)	24.4	38.2	35.7	35.9
P/E (x)	7.3	4.7	5.0	5.0
P/B (x)	0.9	0.9	0.8	0.7
EV/EBITDA (x)	3.8	2.6	2.7	2.5
RoNW (%)	13.9	19.4	16.7	15.4
RoCE (%)	15.4	20.7	19.4	18.1

Source: Company; Sharekhan estimates

Strong Q1; earnings beat led by higher oil & gas realisation and lower opex

Q1FY24 standalone operating profit of Rs. 19,453 crore (down 25% y-o-y; up 19.1% q-o-q) was 9% above our estimate of Rs. 17,875 crore led by sharply lower operating cost (employee/other expenses declined by 7%/28% q-o-q) and higher-than-expected oil & gas realisation. We have excluded the provision of Rs. 641 crore/Rs. 2,872 in Q1FY24/Q4FY23 crore for disputed service tax & GST on royalty from other expenses to drive normalised expenses. Volume performance was mixed with in-line oil sales volume of 4.7 mmt (up 1% q-o-q) but gas sales volume of 4.1 bcm (down 1.1% q-o-q) was 2% below our estimate. Net oil realisation of $74/bbl (up 3.4% q-o-q) benefited from lower SAED of Rs. 731 crore (versus Rs. 1,561 crore in Q4FY23). Average gas realisation (domestic + JV) was higher at $7.1/mmbtu as compared to estimate of $6.7/mmbtu. The Standalone PAT of Rs. 10,015 crore (down 34% y-o-y; up 62% q-o-q) was 7.6% above our estimate of Rs. 9305 crore on back of beat in oil & gas realisation, lower cost, higher other income that was partially offset by rise in DD&A cost.

ONGC's subsidiary ONGC Videsh Limited (OVL) posted a PAT of Rs. 126 crore (versus Rs. 130 crore in Q1FY23 and adjusted loss of Rs. 327 crore in Q4FY23). Crude oil sales volume was marginally down by 1% q-o-q to 1.24 mmt, while gas sales volume recovered with an increase of 13% q-o-q to 0.59 bcm.

MRPL reported a PAT of Rs. 1,013 crore (versus Rs. 1,908 crore in Q4FY23). GRMs fell to $9.81/bbl as compared to $15.1/$24.5 per bbl in Q4FY23/Q1FY23. Refinery throughput was largely stable at 4.36 mmt as compared to 4.38 in Q4FY23.

Results (Standalone) Rs cr

Particulars	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)
Revenue	**33,814**	**42,321**	**-20.1**	**36,293**	**-6.8**
Total Expenditure	14,361	16,390	-12.4	19,953	-28.0
Operating profit	**19,453**	**25,930**	**-25.0**	**16,340**	**19.1**
Other Income	1,612	758	112.7	1,928	-16.4
Interest	1,008	636	58.6	708	42.4
Depreciation, depletion and amortisation	6,697	5,709	17.3	9,304	-28.0
Exceptional income/(expense)	0	0	NA	-9,235	NA
Reported PBT	13,361	20,343	-34.3	-979	NA
Adjusted PBT	13,361	20,343	-34.3	8,256	61.8
Tax	3,346	5,137	-34.9	-731	NA
Reported PAT	10,015	15,206	-34.1	-248	NA
Adjusted PAT	**10,015**	**15,206**	**-34.1**	**6,178**	**62.1**
Equity Cap (cr)	1,258	1,258		1,258	
Reported EPS (Rs.)	8.0	12.1	-34.1	-0.2	NA
Adjusted EPS (Rs.)	8.0	12.1	-34.1	4.9	62.1
Margins (%)			**BPS**		**BPS**
OPM	57.5	61.3	-374	45.0	1251
Effective tax rate	25.0	25.3	-21	NA	NA
NPM	29.6	35.9	-631	17.0	1260

Source: Company, Sharekhan Research

Standalone key operating metrics

Particulars	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)
Oil production (mmt)	5.3	5.5	-3.3	5.2	1.5
Oil sales (mmt)	4.7	5.0	-6.0	4.7	1.0
Gas Production (bcm)	5.2	5.4	-3.0	5.3	-0.8
Gas sales (bcm)	4.1	4.1	-1.6	4.1	-1.1
Gross oil realisation $/bbl	76.5	108.6	-29.5	77.1	-0.8
Subsidy $/bbl	2.5	0.0	NA	5.5	-54.7
Net oil realisation $/bbl	74.0	108.6	-31.8	71.6	3.4
Net oil realisation INR/bbl	6,082	8,385	-27.5	5,887	3.3
Rs. /USD rate	82.2	77.3	6.4	82.3	-0.1
Gas price ($/mmbtu)	6.7	6.1	10.0	8.6	-21.7

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 & 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.

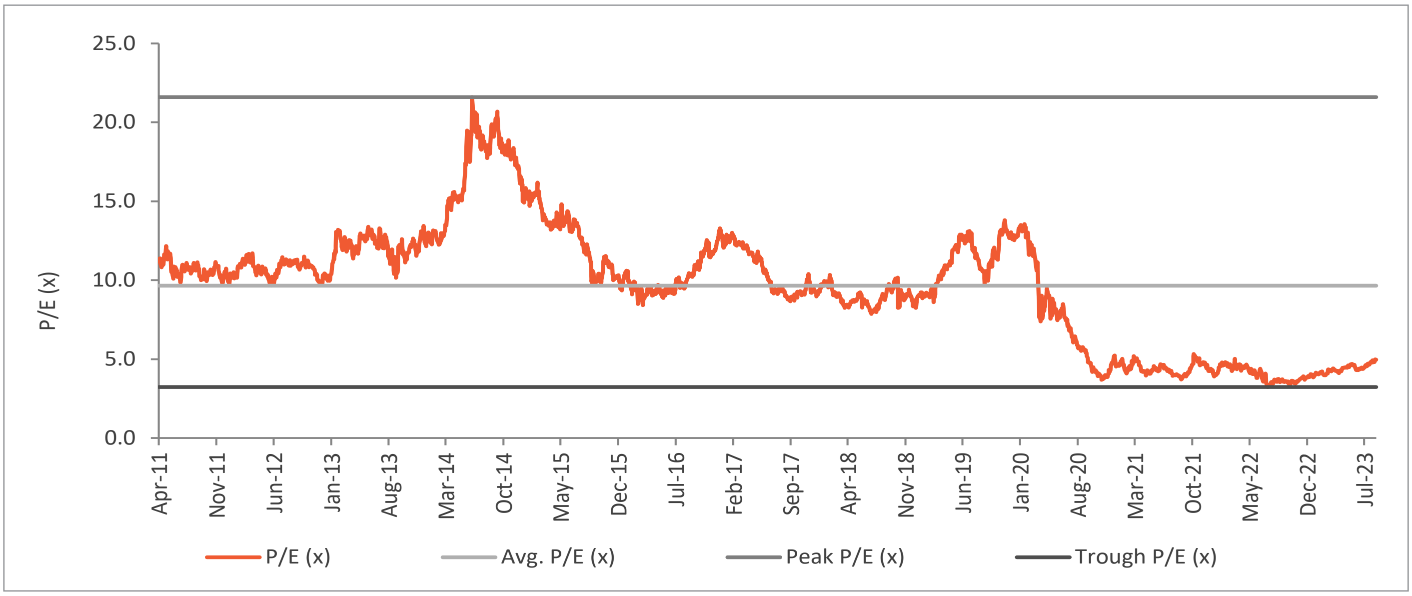
■ Company outlook - Expect earnings to be capped under current oil & gas pricing mechanism

ONGC's earnings outlook has been hit by a windfall tax (in form of a higher cess) 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. We thus expect earnings of upstream PSUs to remain capped over FY24-25.

■ Valuation - Maintain Hold on ONGC with a revised PT of Rs. 190

Although the current oil & gas pricing regime provides reasonable comfort in terms of predictability of earnings, but upstream PSUs have already seen peak earnings in FY23, and earnings would fall in FY24 with limited triggers for growth over next couple of years. 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. 190 (reflects upward revision in earnings estimate). Dividend yield of ~8% limits material downside risk for ONGC. Stock trades at reasonable valuation of 5x 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

Arun Kumar Singh	Chairman & CEO
Pomila Jaspal	Director (Finance)
Sushma Rawat	Director (Exploration)
Pankaj Kumar	Director (Production)

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	3.7
4	GAIL India Ltd	2.45
5	Nippon Life India Asset Management	2.25
6	FMR LLC	1.12
7	Vanguard Group Inc/The	1.02
8	SBI Funds Management Ltd	1.01
9	HDFC Asset Management Co Ltd	0.99
10	BlackRock Inc	0.76

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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