The Economics Times
24th Sep. 2024
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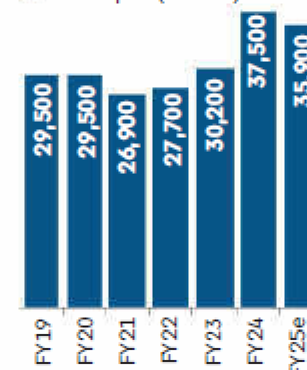
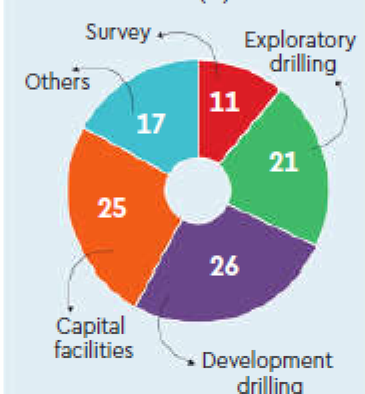
ONGC faces risks without oil price floor

Declining prices to hurt earnings, IRRs and oil recovery projects

FALLING OIL PRICE reveals downside risks for ONGC as earnings largely depend on production, not oil price. Government policies effectively cap price realisation at $75/bbl for oil and $6.50/mmbtu for gas. If oil prices drop below $75 per barrel, ONGC faces significant risks, since there is no established floor for oil prices, and the gas price floor corresponds to an oil price equivalent of $45 per barrel. Falling oil prices could adversely affect earnings and internal rate of returns (IRRs), jeopardising the viability of greenfield and enhanced oil recovery projects. Our view on oil prices is consistent with Kim Fustier's 'Hard to be bullish' report from September 4.





Track record of production growth also uninspiring

ONGC has struggled with declining production volumes from its aging fields. Multiple interventions in the form of enhanced oil recovery have reduced the pace of decline but it's down, nonetheless. Western High oilfields, the largest production contributor, were discovered in 1970s and continue to decline. ONGC missed forward-year production guidance. The most promising new field (KG-DWN-98/2) has also had delays and lower output guidance.

Capex intensity to increase

ONGC started its green journey by acquiring PTC's renewable assets in 2024. The company is also one of the final two contenders to acquire Ayana Renewable Power. It has committed ₹97,000 crore by 2030 to set up 5GW of renewable power. ONGC enjoys an ROE of 15% from its core business.

Weaker performance of subsidiaries can impact dividend

HPCL and MRPL have been meaningful contributors to ONGC's earnings, which typically get distributed as dividends to make it more tax efficient. Softer earnings from these units due to weak refining margins could impact FY25 dividend distribution potential, in our view.

Our FY25-26 cut in earnings estimates by 4-5% due to anticipated lower production volumes. Our valuation of ONGC utilises a dividend discount model, reflecting that government actions significantly influence cash flow and that dividends are a proper value gauge. Given ONGC's serious commitment to a green energy transition, we believe it justifies a higher terminal growth assumption compared to its previous status as solely an oil explorer, supporting our target price increase to ₹230. With disappointment on production, oil prices and increased capex as potential estimate-cut drivers, we downgrade our rating to Reduce from Hold. Conversely, any new oil or gas discoveries that enhance production growth present an upside risk.

We expect ONGC's capex intensity to go up as it embarks on a path towards green energy. Initiatives to build a green portfolio seem serious. The company incorporated a wholly owned subsidiary in February. A decarbonisation strategy to achieve net zero operational emissions by 2038 has been firmed up. ONGC aims to invest ₹1 trillion to establish renewable energy capacity of 10GW by 2030.

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