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ONGC –Justice to ONGC on the Rajasthan field

ONGC is set to get permission from the Centre to pay only a 30% of its total royalty obligation to the Rajasthan Govt. on the revenues earned from the oil blocks owned by Cairn India. This will save the state owned oil explorer ~Rs 1575 cr /year and Govt. of India will compensate Rajasthan Govt. for remaining amount. As per a 1993 government regulation, PSU companies were meant to undertake the entire royalty burden to boost up private company's investment in India's oil blocks. Presently ONGC is bearing 100% royalty on Rajasthan block.

Royalty Statistics for Rajasthan (RJ) Block

Presently ONGC is bearing 100% royalty on the revenue earned crude oil sold from a RJ block. ONGC's royalty obligation from this block alone has shot up to Rs 2250 cr/ year, it will climb up again because of expected ramp up in production to touch 2,10,000 bbl/day from Current production level of 1,25,000 bbl/day. We expect global crude prices to hover around $65 to $80/bbl and average selling price of RJ crude is ~ 10% discounted to global crude prices. The cost of production from oil from RJ field is ~$18/bbl and royalty burden ONGC has to pay $40/bbl, so very miniscule amount of return ~$2/bbl and Company is unhappy with its huge royalty outgo.

Analysis

This is a positive development with ONGC that Govt. has agreed to restrict company's royalty share to 30% of total. At the current market price of Rs.1346, the stock trades at a P/E of 17x for FY10. On the basis of EV/EBDITA, the stock trades at 5.7x for FY10.

Tax Structure for Upstream Oil Companies