



Cairn India

STOCK INFO.	BLOOMBERG
BSE Sensex: 18,771	CAIR IN
S&P CNX: 5,569	REUTERS CODE
	CAIL.BO

25 October 2007

Buy

Previous Recommendation: Buy

Rs201

Equity Shares (m)	1,778.4
52-Week Range	217/111
1,6,12 Rel. Perf. (%)	-2/15/-
M.Cap. (Rs b)	357.7
M.Cap. (US\$ b)	9.0

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
12/07E	10,021	262	0.1	-	1,364.0	1.2	0.1	1.3	34.9	49.6
12/08E	10,849	1,449	0.8	452.4	246.9	1.2	0.5	1.2	33.4	47.4
12/09E	18,425	4,993	2.8	244.6	71.7	1.2	1.7	2.8	20.6	25.7

- ☞ Cairn India reported a net profit of Rs232m for 3QFY07 v/s our estimate of Rs572m. It had a loss of Rs714m in 2QCY07. PAT was lower than our estimate primarily due to higher depreciation and exploration write-offs (Rs1.2b v/s our est of Rs1b) and higher deferred tax (32.5% v/s 24% in 2QCY07).
- ☞ Revenue at Rs2.7b (our est Rs2.9b) was up 9% QoQ led by 16% higher realization of US\$58.4/boe (our est US\$60/boe) v/s US\$50.4/boe in 2QCY07. Cairn's WI production was lower by 5% at 18.9kbd v/s 19.8kbd in 2QCY08, primarily due to lower gas production of 39mmcf/d (v/s 55mmcf/d in 2QCY08) from Cambay block due to mechanical problems in two wells. Reported EBITDA was lower at Rs1.86b (our est Rs2.1b) due to lower revenue.
- ☞ **Rajasthan block update:** Approval from GoI on inclusion of pipeline in FDP is still awaited. Progress to secure access to land post ROU approval is on. FEED for pipeline has been completed and the company has commenced procurement process for long lead items. Cairn is preparing revised FDP for Mangala for increased oil in place and reserve estimates (Oct 2005 FDP targeted production of 96kbd). Has submitted declaration of commerciality (along with proposed development area) for three discoveries in Northern Appraisal Area. Addition of new area in development as well as revised FDP could result in reserve upside from current estimates.
- ☞ **Revising estimates, increasing target price, maintain Buy:** We have increased our long term Brent price assumption from US\$55/bbl to US\$65/bbl. We have also increased our FY10 and FY11 EPS estimates by 33% and 29% to Rs20.7 and Rs32 respectively. Our revised base SOTP is Rs198/share (up 21% from earlier Rs163). Our SOTP (including potential upside of Rs22/share) is Rs220. Stock trades at 9.7x FY10E and 6.3x FY11E. We maintain **Buy**.

QUARTERLY PERFORMANCE

Y/E DECEMBER	CY07				CY07E	CY08E
	(Rs Million)					
	1Q	2Q	3Q	4QE		
Net Sales	2,364	2,433	2,658	2,566	10,021	10,849
Inc/Dec in Stock	95	-157	0	0	-61	
Staff Cost	309	288	238	243	1,077	1,185
Operating Expenses	488	407	555	510	1,960	2,014
EBITDA	1,472	1,895	1,865	1,814	7,046	7,650
% of Net Sales	62.3	77.9	70.2	70.7	70.3	70.5
Depreciation & Exploration w rite-off	1,002	1,145	1,233	1,260	4,640	4,950
Interest	2	8	1	10	20	1,238
Other Income	362	351	343	350	1,406	1,021
Forex Fluctuations	-138	-1,406	-300	-120	-1,964	0
PBT	692	-312	674	774	1,828	2,483
Tax	317	402	442	405	1,565	1,035
Rate (%)	45.8	-128.6	65.5	52.3	85.7	41.7
PAT	376	-714	232	369	262	1,449

E: M0St Estimates

Operational glitches mar 3QCY07 performance

Cairn's 3QCY07 PAT at Rs232m was lower than our estimate of Rs572m. It had a loss of Rs714m in 2QCY07. Revenue increased 9% QoQ to Rs2.7b (our est Rs2.9b) led by higher 16% oil price realization of US\$58.4/boe (our est \$60/boe) v/s US\$50.4/boe in 2QCY07.

Cairn's WI production was lower by 5% at 18.9kbd v/s 19.8kbd in 2QCY07, primarily due to lower gas production of 39mmcf (v/s 55mmcf in 2QCY07) from Cambay block due to mechanical problems in two wells. Cairn is currently drilling few wells at Cambay basin and expects to restore earlier production levels by 1QCY08.

Led by lower production at Cambay and flat production at its Ravva field, Cairn's working interest production was down 5% QoQ to 18,871boepd v/s 19,775 boepd in 2QCY07.

KEY OPERATIONAL PARAMETERS:

KEY METRICS	3QCY07	2QCY07	% CHG.
Ravva Production			
Oil (bpd)	51,725	51,577	0
Gas (mmscfd)	75	74	1
Total (boepd)	64,237	63,894	1
Cambay Production			
Oil (bpd)	4,557	4,261	7
Gas (mmscfd)	39	55	-29
Total (boepd)	11,043	13,498	-18
Total production (boepd)	75,280	77,392	-3
Cairn's WI (boepd)	18,871	19,775	-5
Realisation			
Oil (US\$/bbl)	77.20	71.11	9
Gas (US\$/mscf)	4.13	4.35	-5
Average realisation	58.38	50.45	16

Source: Company/Motilal Oswal Securities

Reported EBITDA was lower at Rs1.86b (our est Rs2.1b) due to lower topline. While PAT was lower than our estimate primarily due to:

- ✍ Higher depreciation and exploration write-offs (Rs1.2b v/s our est of Rs1.0b)
- ✍ Forex loss on its overseas deposits at Rs300m (our est Rs375m) and Rs1.4b in 2QCY07 and
- ✍ Higher deferred tax (32.5% v/s 24% in 2QCY07).

Pipeline FDP approval not yet in place

In August 2007, Cairn received 'Rights of Use' (RoU) approval permitting it to acquire land rights for laying the 585km pipeline from Barmer to Salaya. Rajasthan and Gujarat governments have recommended the competent authorities so that the process to secure access to the land where the pipeline will be built can commence.

With both Cairn and ONGC in alignment for inclusion of pipeline costs in FDP, we were expecting early approval from GoI on FDP issue. In our current estimates, we assume inclusion of pipeline costs of US\$750m (70:30 ratio for Cairn and ONGC) in FDP. Continued delay in approval of pipeline in FDP is a concern.

Work on pipeline continues – FEED report completed

While awaiting FDP approval for pipeline, Cairn is continuing initial work on pipeline projects. It has completed the Front End Engineering and Design (FEED) and also initiated the procurement process for long lead items.

The company has indicated that if FDP approval comes soon, the pipeline will be included in the revised FDP for Mangala currently under preparation.

Progress on Rajasthan Block Development:

Main contract for civil construction of Mangala processing facility has been awarded and work will commence soon. Several contracts for other equipment have been awarded or are in process. The company remains committed for first oil delivery in 2009. More definite guidance on date of commencement of production could come by end 2007.

Revised Mangala FDP under preparation: Cairn is preparing addendum for increased oil in place and reserve estimates (earlier FDP filed in October 2005 targeted production of 96kbpd). The revised FDP could include higher reserve estimates and higher production levels, in our view, providing upsides.

Cairn indicated that apart from increased reserve estimates, the addendum could also include:

1. EOR recovery (if designed pilot is successful) – Planning for Mangala EOR pilot to be implemented in 2009-10 is at an advanced stage and will be submitted for approval soon. The pilot, if successful, will enable booking of EOR reserves ahead of full scale EOR implementation in 2012-14.
2. Pipeline capex (if GOI approval on inclusion in FDP comes soon).

Northern Appraisal Area to be brought in development – Cairn has submitted the declaration of commerciality (along with proposed development area) for three discoveries. This was on expected lines as Cairn had reported two discoveries in this area last year and had got six month extension for further development in May 2007. Addition of new area in development is positive as this would lead to increased reserve accretion.

Producing Blocks – Effort continue to maintain plateau

At Cambay, Cairn has deployed “Offshore Courageous” rig for four infill oil and gas development wells and three work-over wells for further development of this field.

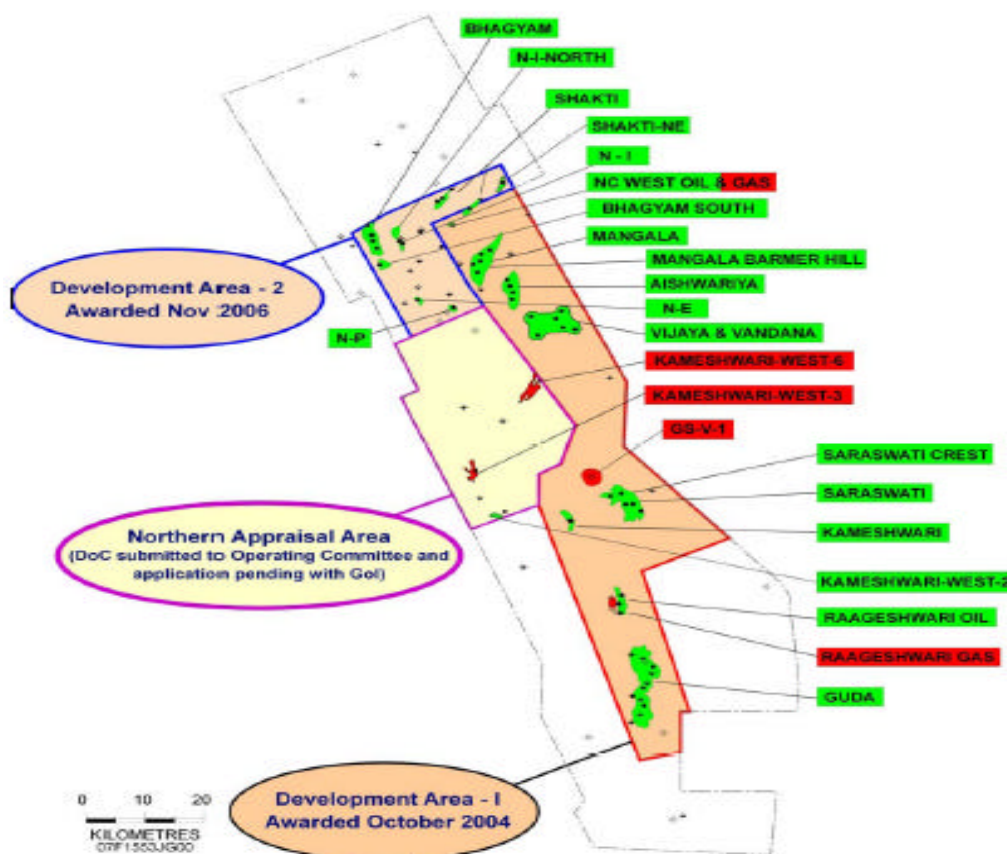
At Ravva, extensive infill development and exploration drilling programme that commenced in October 2006 is nearing completion. Production has commenced from three new infill wells and one appraisal wells. Further, three work over wells are planned to maintain production.

Cairn had reported oil & gas discovery in RX-8 well recently encountering 50 meter net in four pay zones.

Other Exploration Acreage

Cairn has guided for ~US\$200-250m exploration expenditure over 2007-2009. It has reported exploration capex of Rs1.9b (US\$48m) for first nine months in CY07.

RJ-ON-90/1 OCTOBER 2007 UPDATE



Source: Company

UPDATE ON EXPLORATION BLOCKS

BLOCKS	INTEREST (%)	3QCY07 UPDATE
RAJASTHAN BASIN		
RJ-ONN-2003/1 (ENI operator)	30	Completed acquisition and processing of 622sq km 3D seismic Planning underway for drilling in 2008
CAMBAY BASIN		
CB-ONN-2001/1 (ONGC Operator)	30	Final commitment well drilled and abandoned in April 2007 Will relinquish its equity in this licence shortly
CB-ONN-2002/1 (ONGC Operator)	30	3 exploration wells scheduled to be drilled during 4QCY07 and early 2008
GS-OSN-2003/1 (ONGC Operator)	49	Acquired and processed a 3D seismic of 510 sqkm. Data Interpretation in progress
KRISHNA-GODAVARI BASIN		
KG-DWN-98/2 (ONGC Operator)	10	Agreed to enter third exploration phase Review of discoveries to date nearing completion
KG-ONN-2003/1**	49	Plans to acquire 2D and 3D seismic in late 2007 / early 2008.
PR-OSN-2004/1	35	2D seismic planned in early 2008
KK-DWN-2004/1 (ONGC Operator)	40	2D seismic planned in early 2008
HIMALAYAN FORELAND BASIN		
GV-ONN-2002/1	50	Data processing for 500 km 2D seismic completed One exploration well planned in 2008
GV-ONN-97/1	15	Final commitment well expected to be drilled in late 2007 / early 2008
GV-ONN-2003/1**	24	550 km 2D seismic to commence in early 2008
VN-ONN-2003/1**	24	2D seismic acquisition to be planned for 2008

**ONGC operator for development and production phase

Source: Company/Motilal Oswal Securities

Exploration efforts in terms of seismic and drilling continue in most of these blocks. A summary table of progress in different blocks is given above.

Revising oil price assumption and earnings estimate

The oil prices have continued to scale new highs in recent months. With demand remaining robust, and enough incremental oil production capacity not coming online, the oil production spare capacity remains low. OPEC controls bulk of spare capacity and continues to test higher oil price levels by not increasing supplies.

We believe that oil prices are going to remain high in medium to long term and have revised our long term Brent price assumption from earlier rather conservative US\$55/bbl to

US\$65/bbl. For Rajasthan oil, we assume 10% discount to Brent. The revised earning estimates based on increased price assumption are given in table below:

REVISED EARNING ESTIMATES (RS M)

	2010E			2011E		
	REV.	PREV.	CHG. (%)	REV.	PREV.	CHG. (%)
Net Sales	65,114	54,608	19.2	89,267	74,470	19.9
EBITDA	57,628	46,881	22.9	79,767	64,677	23.3
Net Profit	36,791	27,741	32.6	56,919	44,172	28.9
EPS (Rs)	20.7	15.6	32.6	32.0	24.8	28.9

Source: Motilal Oswal Securities

Increasing base target price to Rs 198/share; Maintain Buy

We value Cairn on Sum of Parts basis. Our revised base SOTP is Rs198/share (up 21% from earlier Rs163) as shown in valuations summary table.

VALUATIONS SUMMARY

	US\$M	(RS B)	RS/SH.	IMPLIED US\$/BOE	REMARKS
Rajasthan Block - Base	6,548	262	147	14.8	DCF Based
Rajasthan Block - EOR	1,145	46	26	8.3	DCF Based
Ravva	492	20	11	9.4	DCF Based
Cambay	236	9	5	11.2	DCF Based
KG-DWN-98/2	375	15	8	6.0	2P gas reserves of 3.7tcf @ US\$6/boe
Base Target Value	8,796	352	198	12.3	
Potential Upsides					
Rajasthan Block					
Upside from current development area	0	0	0		Exploration continues in current dev area
Addition of new area in development	0	0	0		Most likely addition is North. Appr Area
Contingent Resource from smaller fields	980	39	22		1.4 b boe valued at US\$1/boe
Other Exploration Assets	0	0	0		
Value with potential upside	9,776	391	220		

Source: Motilal Oswal Securities

Rajasthan block (incl. EOR) with a value of Rs173/share (earlier Rs142) accounts for 87% of our current base target price for Cairn.

Significant upside potential remains; our current value Rs22/share

As we had mentioned in our August 2007 detailed report “Raring to Go”, there remains large potential upside for Cairn. These could accrue from:

☞ **Upside from current Rajasthan area under development:** Significant exploration effort continues, which could result in higher than current estimate of 632mmbbls of 2P reserves. We do not ascribe any value to this upside. We believe that Cairn will make next public disclosure of its reserves in annual report for CY07 (in early 2008).

☞ **Adding new development area into development phase:** The most likely candidate for this is Northern Appraisal Area, adjacent to current area in development. Cairn has recently submitted the declaration of commerciality (along with proposed development area) for three discoveries. Currently, we do not ascribe any value to this.

☞ **Development of smaller fields in Rajasthan Block:** These smaller fields contain 1.4bboe of contingent

STOIPP. We believe these fields will be included in the development plan once production commences from six fields currently planned for development.

☞ **Other Exploration Assets:** Cairn has large exploration acreage in 11 other blocks (excluding 2 producing blocks, Rajasthan Block and KG-98/2). In five of these, Cairn is the operator. The exploration continues in these blocks in various stages. Once the cash flow from Rajasthan block starts accruing in 2009, we would expect stepped up exploration efforts in these blocks leading to potential upside. At present, we ascribe no value to these blocks.

Fair value highly leveraged to crude prices assumption

Cairn’s fair value is highly leveraged to oil prices. The table below gives our estimate of base fair value at different long-term oil prices.

SENSITIVITY TO CRUDE PRICE (US\$/BBL)

CRUDE PRICE	FAIR VALUE (RS/SH)	
55	165	
60	180	
65	198	Our current target price
70	213	
75	230	

Source: Motilal Oswal Securities

Cairn India: an investment profile

Company description

Cairn India, an E&P company, was listed in January 2007 through an IPO after it spun off from its parent Cairn Energy Plc (current stake - 69%). Cairn has working interest in 15 E&P blocks. Ravva & Cambay blocks currently produce about 50kboed (Cairn ~20kbpd). Rajasthan block, currently under development to start production in 2009, is key asset accounting for 80% of reserves.

Key investment arguments

- ✍ Rajasthan block is a world-class asset. There remains upside from current development area and additional area to be developed.
- ✍ Large exploration acreage in 12 blocks provides upside. Currently the most promising is ONGC-operated (Cairn 10%) deep-water block KG-DWN-98/2.

Key investment risks

- ✍ Cess issue is not yet resolved. We build in cess outgo of Rs927/MT (Govt demanding Rs2,675/MT).
- ✍ We assume pipeline costs to be included in FDP. Further delay in FDP approval/ or non-approval will be negative.

Recent developments

- ✍ Received ROU approval from GoI for its 585km pipeline from its Rajasthan block to Gujarat coast
- ✍ FEED study for pipeline has been completed
- ✍ Submitted declaration of commerciality (along with proposed development area) for three discoveries in Northern Appraisal Area in Rajasthan block

Valuation and view

- ✍ We value Cairn on SOTP at Rs198 per share. Our target including upside is Rs220.
- ✍ The stock currently trades at 9.7x on FY10E and 6.3x on FY11E. We maintain **Buy**.

Sector view

- ✍ Higher oil price will boost the bottom line of standalone E&P players like Cairn. We expect oil prices to remain high driven by robust oil products demand and limited incremental capacity coming online. OPEC which controls bulk of current low spare production capacity seems to be testing ever higher oil prices, which the global economy can absorb without significant demand slowdown.

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
201	-	-	Buy

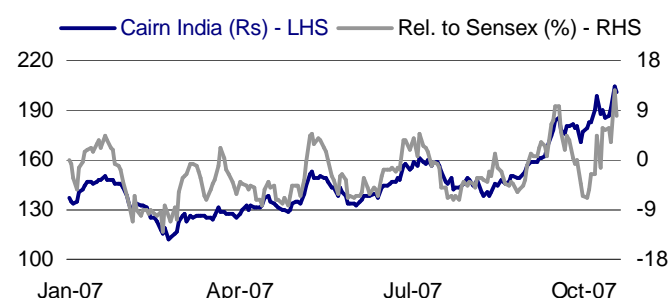
SHAREHOLDING PATTERN (%)

	SEP-07	JUN-07	SEP-06
Promoter	69.0	69.0	N.A.
Domestic Inst	5.0	4.7	N.A.
Foreign	21.9	21.5	N.A.
Others	4.1	4.8	N.A.

EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	0.8	1.4	-42.9
FY09	2.8	8.8	-68.2

STOCK PERFORMANCE (FROM 9 JANUARY 2007)



INCOME STATEMENT					RATIOS				
(Rs Million)									
Y/E DECEMBER	2007E	2008E	2009E	2010E	Y/E DECEMBER	2007E	2008E	2009E	2010E
Net Sales	10,021	10,849	18,425	65,114	Basic (Rs)				
Change (%)		8.3	69.8	253.4	EPS	0.1	0.8	2.8	20.7
Total Income	10,021	10,849	18,425	65,114	Cash EPS	12	2.0	4.8	25.6
Employee Costs	1,077	1,185	1,303	1,433	Book Value	165	166	168	177
Other Expenditure	187	262	288	317	DPS	0.0	0.0	0.3	10.3
Operating expenses	1,772	1,752	2,060	5,735	Payout (incl. Div. Tax.)	0.0	0.0	11.4	57.2
EBITDA	7,046	7,650	14,773	57,628	Valuation (x)				
% of Net Sales	70.3	70.5	80.2	88.5	P/E	1364.0	246.9	71.7	9.7
Depreciation & Exploration write-off	4,640	4,950	6,272	10,808	Cash P/E	1614	99.4	42.3	7.8
Interest	20	1,238	3,066	3,296	EV / EBITDA	49.6	47.4	25.7	6.3
Other Income	1,406	1,021	1,021	500	EV / Sales	34.9	33.4	20.6	5.5
Forex Fluctuations	-1,964				Price / Book Value	12	12	12	11
PBT	1,828	2,483	6,456	44,024	Dividend Yield (%)	0.0	0.0	0.1	5.1
Tax	1,565	1,035	1,463	7,233	Profitability Ratios (%)				
Rate (%)	85.7	41.7	22.7	16.4	RoE	0.1	0.5	1.7	12.0
PAT	262	1,449	4,993	36,791	RoCE	13	12	2.8	13.5
Adjusted PAT	262	1,449	4,993	36,791	Turnover Ratios				
Change (%)		452.4	244.6	636.9	Debtors (No. of Days)	35	35	35	35
BALANCE SHEET	(Rs Million)				Fixed Asset Turnover (x)	7.8	8.4	15	2.9
Y/E DECEMBER	2007E	2008E	2009E	2010E	Leverage Ratio				
Share Capital	17,784	17,784	17,784	17,784	Net Debt / Equity (x)	0.0	0.0	0.1	0.0
Reserves	275,279	276,728	281,149	296,892	CASH FLOW STATEMENT	(Rs Million)			
Net Worth	293,063	294,512	298,933	314,676	Y/E DECEMBER	2007E	2008E	2009E	2010E
Total Loans	5,920	21,587	46,557	26,693	Profit / (Loss) before Tax	1828	2,483	6,456	44,024
Deferred Tax	4,652	5,248	5,570	6,125	Depreciation	1954	2,150	3,472	8,808
Capital Employed	303,635	321,347	351,060	347,494	Direct Taxes Paid	-478	-439	-1,140	-6,678
Gross Fixed Assets	1,292	1,292	22,817	22,817	(Inc)/Dec in Wkg. Capital	-2,371	-57	-519	-3,198
Less: Depreciation	936	968	997	2,961	CF from Op. Activity	933	4,138	8,269	42,956
Net Fixed Assets	356	324	21,820	19,856	(Inc)/Dec in FA & CWIP	-12,841	-16,676	-24,535	-2,387
Capital WIP	23,684	39,287	11,917	11,917	(Pur)/Sale of Investments	0	0	0	0
Producing Properties (net of depletio	3,504	2,460	29,396	24,939	Other In activities	0	0	0	0
Goodwill	256,460	256,460	256,460	256,460	CF from Inv. Activity	-12,841	-16,676	-24,535	-2,387
Investments	4	4	4	4	Change in Equity	131	0	0	0
Curr. Assets, L & Adv.					Inc / (Dec) in Debt	1956	15,667	24,970	-19,864
Inventory	549	594	1,010	3,568	Dividends Paid	0	0	-571	-21,048
Debtors	961	1,040	1,767	6,244	CF from Fin. Activity	2,087	15,667	24,399	-40,912
Cash & Bank Balance	18,547	21,676	29,809	29,466	Change in Equity	131	0	0	0
Loans & Adv. and Other CA	2,501	2,501	2,501	2,501	Inc / (Dec) in Debt	1956	15,667	24,970	-19,864
Current Liab. & Prov.					Dividends Paid	0	0	-571	-21,048
Liabilities	824	892	1,514	5,352	CF from Fin. Activity	2,087	15,667	24,399	-40,912
Other Liabilities	2,108	2,108	2,108	2,108	Inc / (Dec) in Cash	-9,821	3,129	8,132	-343
Net Current Assets	19,627	22,812	31,463	34,319	Add: Opening Balance	28,368	18,547	21,676	29,809
Application of Funds	303,635	321,347	351,060	347,494	Closing Balance	18,547	21,676	29,809	29,466

E: MOS Estimates



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Cairn India

- | | |
|---|----|
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| 2. Group/Directors ownership of the stock | No |
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