



**KHANDWALA
SECURITIES
LIMITED**

Cairn India Limited

August 24, 2008

Company Update

CMP: INR 247

Target: INR 300

BUY

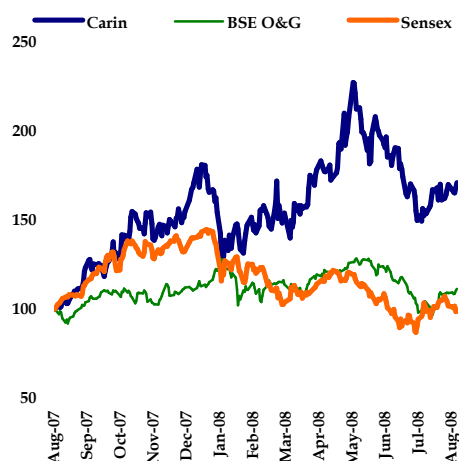
BSE Sensex	14,401
S&P Nifty	4,327
BSE Oil & Gas	9,942
Bloomberg Consensus	
(BUY/SELL/HOLD)	15/4/2
BSE Code	532792
NSE Code	CAIRN
Bloomberg Code	CAIN IN
Reuters	CAIN.BO
52 Wk High/Low (INR)	343/136
Equity (INR Mn)	18,944
Market Cap (INR Mn)	467,830

Shareholding Pattern (%)

Foreign	26.22
Institutions	5.25
Corporate	1.17
Promoters	64.76
Public & Others	2.60
Total	100.00

Returns (%)	Abs Perf	Relative to Sensex	Relative to BSE O&G
1 Month	12.12	15.74	0.48
3 Months	-19.42	-5.91	-6.24
1 Year	71.14	71.30	59.58

Relative Price Performance



Source: Comline Products

Analyst: Vinay Nair

Email: vinay.nair@kslindia.com

Investment Rationale

✓ MBA fields yet to be fully priced in

We have valued Mangalam, Bhagyam and Aishwarya (MBA) fields and current operating fields at INR 283/share with EV/BOE \$25 on 2P reserves. Currently the stock is trading at approx 13% discount to their valuation. The project is on schedule with expected gross production of 175,000 (Net 122,500) bpd beginning CY2010.

✓ Higher crude prices boost valuation

We have assumed long-term average crude oil price at \$75 per barrel from CY2012E. Currently crude prices are trading 60% higher than our average estimate, increasing the upside potential for the stock price. Our sensitivity analysis indicates valuation ranging from INR 272 to 357/share for \$65-\$95 per barrel long term crude price.

✓ Windfall Tax- Yet a blur picture

We are yet not certain regarding the imposition of the windfall tax on the private upstream players. We have analyzed two alternatives of (a) Imposition of Cess of INR 2500/tonne and (b) abolition of Sec 80 IB tax holiday. Both the alternatives reduce approximately 22 % of our valuation.

✓ Other fields in Rajasthan adding to the valuation

RJ Small Fields, Saraswati & Raageshwari Oil and other fields provide a valuation of INR 30/share with EV/BOE \$24 on 2P reserves of 60 mln barrels. We have not accounted for the contingent resources due to lack of visibility. However, it increases the upside risks to the valuation.

Financial Summary

(Rs Mn)	2007	2008E	2009E	2010E
Sales	10,123	13,205	12,114	114,023
EBITDA	1,457	5,227	4,135	99,976
PAT	(245)	3,071	1,681	70,498
EPS	(0.26)	1.64	0.90	37.53
P/E (INR)	-	150.45	274.82	6.55
P/BV	1.47	1.35	1.34	1.10
EV/EBITDA	310.08	89.13	115.90	2.31
ROCE (%)	0.42	1.37	1.01	18.26
ROE (%)	(0.15)	0.95	0.52	17.88

Khandwala Securities Limited

Vikas Building, Green Street, Fort, Mumbai 400 023.

Tel No. +91 22 4076 7373 Fax No. +91 22 4076 7377

Our Research Reports can be accessed on: www.bloomberg.net (KHDS<GO>), www.capitaliq.com, www.thomsonreuters.com, www.kslindia.com, www.moneycontrol.com, www.securities.com

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Please read the Important Disclosure at the end of this report.



Rajasthan MBA Fields

MBA Fields account for 94% of our valuation of the company.

CIL intends to execute Rajasthan block development with its first production from Mangala fields lined up from the beginning of 2010. Bhagyam and Aishwariya fields are expected to follow subsequently. Early implementation of EOR technique and high recovery ratio is expected to allow the fields to be operational until 2040. These fields account for 94% of our valuation of the company.

The GoI communication of 30th April 2008 accorded their consent to shift the delivery point from the outlet flange of the crude oil processing facility in Barmer to the Gujarat Coast thus allowing building the pipeline and claim cost recovery for the same. The proposed routing of the pipeline will allow access to an extensive existing pipeline. Infrastructure and refinery network, with a final coastal delivery point will enable access to the majority of India's refining capacity.

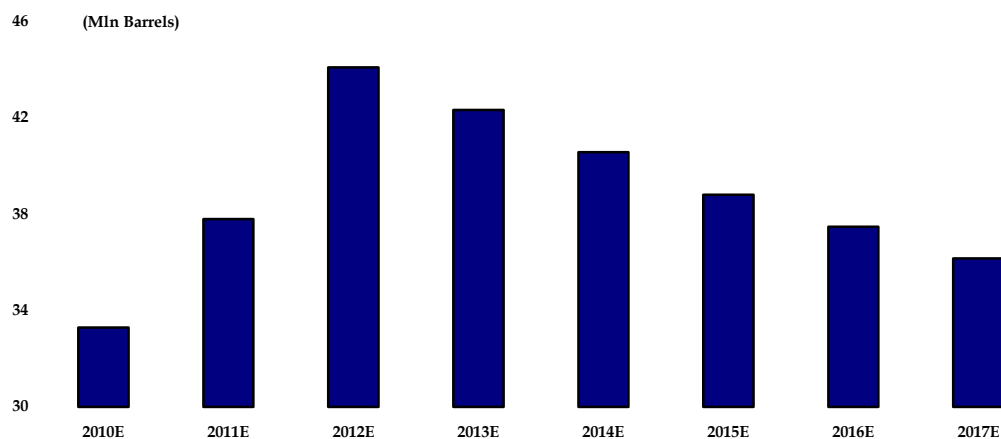
Reserves/Resources Detail

(MMBOE)	Gross		2P Gross		2P Net	
	STOIIP		Res/Resource		Reserves	
	Cairn	D&M	Cairn	D&M	Cairn	D&M
Rajasthan MBA fields	2,054	2,118	685	701	479	491
Rajasthan MBA EOR			308	308	216	216
RJ Small Fields:						
Saraswati & Raageshwari Oil	300	144	12	39	9	27
RJ Other Fields	1,397	1,216	72	54	51	38
Total	3,751	3,478	1,077	1,102	755	772

Source: Company

MBA Fields Production

Estimated annual production from MBA fields



Source: Khandwala Research



Asset Portfolio

Block	Location	Stage	Status	Stake
RJ-ON-90/1 (Upstream)	Rajasthan	Development	Operator	70.0%
RJ-ON-90/1 (Downstream)	Rajasthan	Development	Operator	70.0%
Kameshwari West 2,3,6	Rajasthan	Development	Operator	100.0%
SL 2007-01-001 (Mannar basin)	Sri Lanka	Exploration		
CB/OS-2 Lakshmi Guri and CBX	Western India	Operational	Operator	40.0%
CB-ONN-2002/1	Western India	Operational	Operator	30.0%
Ravva (KG Basin)	Eastern India	Operational	Operator	22.5%
KG-ONN-2003/1	Eastern India	Exploration	Operator	49.0%
KG-DWN-98/2	Eastern India	Appraisal	Nonoperator	10.0%
PR-OSN-2004/1	Eastern India	Exploration	Operator	35.0%
GV-ONN-2002/1 (Ganga Basin)	Northern India	Exploration	Operator	50.0%
GV-ONN-97/1	Northern India	Exploration	Nonoperator	15.0%
GV-ONN-2003/1	Northern India	Exploration	Operator	49.0%
VN-ONN-2003/1	Rest of India	Exploration	Operator	49.0%
KK-DWN-2004/1	Rest of India	Exploration	Nonoperator	40.0%

Source: Company

Windfall Tax Impact

Both the alternatives reduce approximately 22 % of our valuation.

All production-sharing contracts provide for in-built mechanism to pre-empt any windfall gains. Any so-called windfall profits from high oil prices accrue to government, either by way of higher share of profit or by increased royalty and taxes. Under most contracts over 75% of the incremental revenues above \$75/barrel are going to government. Profit petroleum plays a pivotal role in the production sharing contracts. Hence we don't see any abnormal returns being earned by the company on the assets on account of high crude oil prices. We have analyzed for two methods through which government could levy abnormal gains of the rise in crude price

Scenario	Value Per Share
Base case Valuation (INR)	300.0
Imposition of Cess (INR)	235.0
Reduction in Valuation	21.6%
Forfeit Sec 80 IB (INR)	232.0
Reduction in Valuation	22.6%

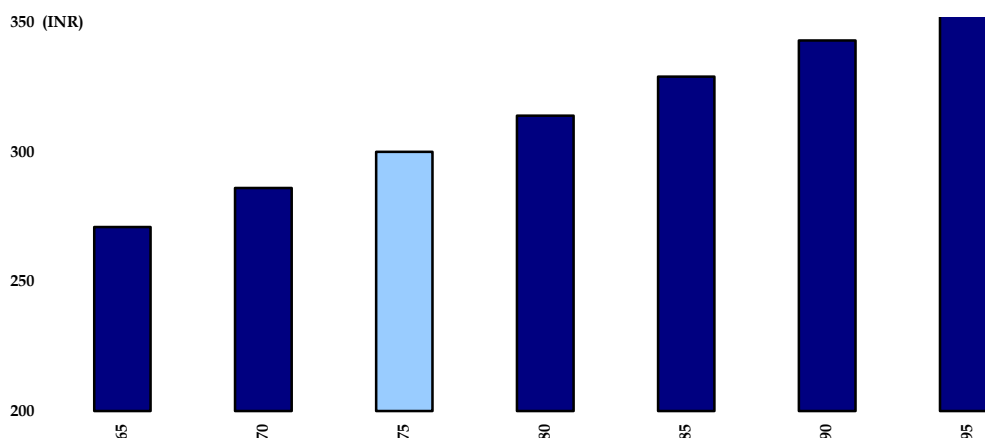


Crude Sensitivity

High crude oil prices provide more potential upside on account of higher realization. Depreciating rupee could add to the benefits. Currently exchange rate is trading approx. \$2 higher than our base case assumption of INR 42/\$. The current volatility in the crude oil prices and exchange rates are not sustainable. We expect them to stabilize at the levels of our assumptions in the long term.

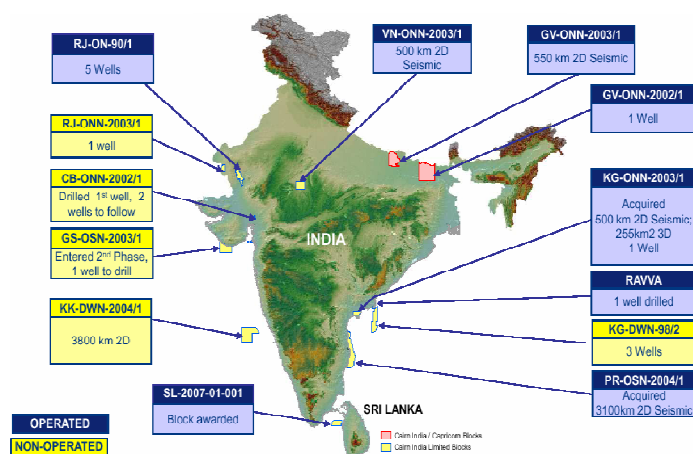
Valuation vis-à-vis crude price

Long-term average crude oil price at \$75 per barrel



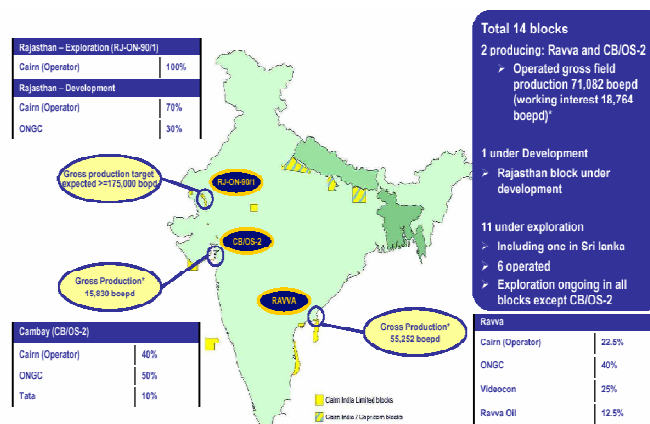
Source: Khandwala Research

2008 Exploration Programme



Source: Company

Overview of Assets



Note : '02'08 figures

Source: Company



Valuations

Mangalam Bhagyam and Aishwarya fields and current operating fields are yet to be fully priced in. Currently crude prices are trading 60% higher than our average estimate increasing the upside potential for the stock price. The contingent resource increases the prospects even better. The uncertainty regarding the windfall tax has pressurized the performance of the stock in the recent past. The reduction in the crude oil price will help investors overcome this concern. Currently it is cheaply priced at P/E 6.5x on CY2010 earnings in relation to global peer set. **We recommend a BUY rating on the stock with a target price of INR 300/share.**

Existing and MBA Fields (DCF)	283
RJ other fields (On basis of the MBA Fields)	30
Total	313
Less: Debt	27
Add: Cash	14
Value Per Share (INR)	300

Upsides

- ✓ Crude price stabilizes higher than our assumption.
- ✓ Potential resources in Rajasthan fields
- ✓ Increase in volumes from marginal fields
- ✓ Rupee depreciating further

Downsides

- ✓ Crude price slides
- ✓ Delay in production from Rajasthan Fields
- ✓ Appreciation of rupee
- ✓ Imposition of windfall tax.



Financial Statements

Profit & Loss Statement

Descriptions (INR Mn)	CY2006 Dec-06	CY2007 Dec-07	CY2008E Dec-08	CY2009E Dec-09	CY2010E Dec-10
Total Income	421	11,559	13,205	12,114	114,023
Expenditure	541	10,101	7,978	7,978	14,047
EBITDA	(121)	1,457	5,227	4,135	99,976
Depreciation	7	171	327	405	17,956
EBIT	(127)	1,287	4,900	3,731	82,019
Net Interest	3	27	422	1,279	1,720
EBT	(130)	1,260	4,478	2,452	80,300
Tax	56	1,505	1,407	770	9,802
PAT	(186)	(245)	3,071	1,681	70,498
EPS (INR)	(0.11)	(0.26)	1.64	0.90	37.53

Balance Sheet

Descriptions (INR Mn)	CY2006 Dec-06	CY2007 Dec-07	CY2008E Dec-08	CY2009E Dec-09	CY2010E Dec-10
Shareholders funds	293,016	294,815	322,154	323,836	394,333
Loan funds	5,179	3,124	30,000	40,000	50,000
Deferred tax liability	4,152	4,916	4,916	4,916	4,916
Total	302,345	302,856	357,070	368,752	449,250
Net Fixed Assets	273,786	282,739	326,789	342,884	407,959
Investment	105	7,129	7,129	7,129	7,129
Current Assets	5,942	7,215	5,190	5,059	17,288
Cash	61,348	13,318	26,187	22,775	26,979
Current :Liability	39,554	8,372	8,224	9,095	10,105
Miscellaneous	718	827	-	-	-
Total	302,345	302,856	357,070	368,752	449,250



Key Financial Ratios

Descriptions (INR Mn)	CY2006 Dec-06	CY2007 Dec-07	CY2008E Dec-08	CY2009E Dec-09	CY2010E Dec-10
Current Ratio	1.70	2.45	3.82	3.06	4.38
Debt Equity Ratio	0.02	0.01	0.09	0.12	0.13
Gross Profit Margin (%)	(31.15)	14.40	39.58	34.14	87.68
Net Profit Margin (%)	(48.09)	(4.51)	23.26	13.88	61.83
Return On Net Worth (%)	(0.06)	(0.15)	0.95	0.52	17.88
Return On Capital Employed (%)	(0.04)	0.42	1.37	1.01	18.26
EPS (INR)	(0.11)	(0.26)	1.64	0.90	37.53
CEPS (INR)	(0.10)	(0.16)	1.81	1.11	47.09
CMP (INR)	246.00	246.00	246.00	246.00	246.00
P/E	-	-	150.45	274.82	6.55
P/BV	1.48	1.47	1.35	1.34	1.10
EV/EBITDA	-	310.08	89.13	115.90	2.31
Inventory Turnover	0.43	8.31	8.63	9.41	1.76
Debtor Turnover Ratio	0.20	7.51	20.00	20.00	20.00
Asset Turnover	0.29	9.27	6.31	4.67	0.99



INDIA

EQUITY RESEARCH

TEL. NO. +91 22 4076 7373

FAX +91 22 4076 7378

Name	Designation	Sectors	E-mail
Ashok Jainani	VP, Head Research	Market Strategy	ashokjainani@kslindia.com
Dipesh Mehta	Research Analyst	IT, Telecom	dipesh@kslindia.com
Hatim K Broachwala	Research Analyst	BFSI	hatim@kslindia.com
Vinay Nair	Research Analyst	Energy	vinay.nair@kslindia.com
Giriraj Daga	Research Analyst	Metals, Cement	giriraj@kslindia.com
Vivek Patil	Research Analyst	FMCG, Retail	vivek.patil@kslindia.com
Harshul Verma	Research Associate	Automobiles, Capital Goods	harshul.verma@kslindia.com
Sandeep Bhatkhande	Research Associate	Publishing	sandeep@kslindia.com
Lydia Rodrigues	Research Executive	Data Mining	lydia@kslindia.com

INSTITUTIONAL DEALING

TEL NO. +91 22 4076 7342-47/56

FAX NO. +91 22 4076 73 77-78

Biranchi Sahu	Head	Institutional Equity	bsahu@kslindia.com
Gopi Doshi	Senior Dealer	Institutional Equity	gopi.doshi@kslindia.com
Mayank Patwardhan	Dealer	Institutional Equity	mayank.patwardhan@kslindia.com

PRIVATE CLIENT GROUP

TEL No. +91 22 4076 7317-21

FAX NO. +91 22 4076 73 77

Sanjay K Thakur	President	Sales & Marketing	thakursk@kslindia.com
Subroto Duttaroy	General Manager	Equity & Portfolio Mgmt. Service	subroto@kslindia.com
Jagdish R Modi	Manager	Equity & Portfolio Mgmt. Service	jrmodi@kslindia.com

BRANCH OFFICE (PUNE)

TEL NO. +91 20 2567 1404/06

FAX NO. +91 20 2567 1405

Ajay G Laddha	Vice President	ajay@kslindia.com
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Corporate Office:

Vikas Building, Ground Floor,
Green Street, Fort,
MUMBAI 400 023.

Tel. No. (91) (22) 4076 7373

Fax No. (91) (22) 4076 7377/78

E-mail: research@kslindia.comWeb site: www.kslindia.com

Branch Office:

C8/9, Dr. Herekar Park,
Off. Bhandarkar Road,
PUNE 411 004

Tel. No. (91) (20) 2567 1404/06

Fax. No. (91) (20) 2567 1405

Email: pune@kslindia.com

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