Oil India

Risk-reward favourable

Visit Update

January 12, 2012

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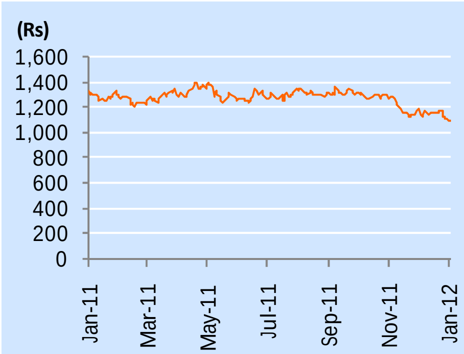
Rating	**Accumulate**
Price	Rs1,104
Target Price	Rs1,525
Implied Upside	38.1%
Sensex	16,176
Nifty	4,861

(Prices as on January 11, 2012)

Trading data			
Market Cap. (Rs bn)			266.9
Shares o/s (m)			240.5
3M Avg. Daily value (Rs m)			102
Major shareholders			
Promoters			78.43%
Foreign			2.27%
Domestic Inst.			5.28%
Public & Other			14.02%
Stock Performance			
(%)	**1M**	**6M**	**12M**
Absolute	(7.2)	(13.1)	(17.2)
Relative	(7.0)	0.5	(1.5)
How we differ from Consensus			
EPS (Rs)	**PL**	**Cons.**	***% Diff.***
2012	139.1	138.4	*0.5*
2013	152.5	146.3	*4.2*

Price Performance (RIC: OILI.BO, BB: OINL IN)



Source: Bloomberg

We hosted investor meetings with the OIL India (OIL) management – Mr. T.K Ananth Kumar, Director (Finance). Following are the key takeaways on key issues:

- **Utilisation of cash flows and acquisition:** OIL is in advance talks for potential overseas acquisition of producing property in the African region. The company is likely to give a non-binding agreement for the same in the next 2-3 months. The reserve is around 200m barrels and the potential acquisition cost is around Rs50-60bn, translating into EV/boe of US$4.8-5.8/boe. The same compares favourably to the opportunity cost (F&D cost of US$5.45/bbl in FY11).

- **Possible options for divestment of government stake:** Management believes the preferred option for the divestment of government stake is likely to be block-trade, wherein the government offloads its stake to the institutional investor.

- **Subsidy sharing mechanism:** OIL expects government to provide minimum net realisation of around US$60/bbls for the current fiscal. The company has asked the government to take average of the last five years for calculating the proportionate share of upstream companies against the current practice of last three year's average.

- **Outlook:** OIL has been delivering impressive performance on the core operating parameters such as production growth, coupled with efficient operations, resulting in low finding, development and lifting cost. Key catalysts affecting the stock price continues to be subsidy sharing and outlook with regards to deployment of significant cash balance. The stock is currently trading at attractive 7.3x FY2013E EPS. We continue to maintain '**Accumulate'** on the stock, with a target price of Rs1,525/share (a multiple of 10x FY2013E EPS).

Key financials (Y/e March)	**2010**	**2011**	**2012E**	**2013E**
Revenues (Rs m)	79,226	83,641	101,061	106,482
Growth (%)	*10.0*	*5.6*	*20.8*	*5.4*
EBITDA (Rs m)	34,438	36,174	43,573	46,917
PAT (Rs m)	26,106	28,877	33,435	36,664
EPS (Rs)	108.6	120.1	139.1	152.5
Growth (%)	*7.2*	*10.6*	*15.8*	*9.7*
Net DPS (Rs)	34.0	39.0	42.0	42.0

Profitability & Valuation	**2010**	**2011**	**2012E**	**2013E**
EBITDA margin (%)	*43.5*	*43.2*	*43.1*	*44.1*
RoE (%)	*22.6*	*19.6*	*19.9*	*19.1*
RoCE (%)	*22.5*	*18.9*	*19.6*	*19.5*
EV / sales (x)	2.3	1.9	1.6	1.3
EV / EBITDA (x)	5.2	4.4	3.6	3.0
PE (x)	10.2	9.2	7.9	7.2
P / BV (x)	1.9	1.7	1.5	1.3
Net dividend yield (%)	*3.1*	*3.5*	*3.8*	*3.8*

Source: Company Data; PL Research

Key takeaway of the interactions with OIL India management

Utilisation of cash flows and acquisition

With regards to utilisation of the significant cash balance available with the company, OIL is in advance talks for potential overseas acquisition of producing property in the African region. The company is likely to give a non-binding agreement for the same in the next 2-3 months. The reserve of the potential target is around 200m barrels and the potential acquisition cost is around Rs50-60bn. The same translates into EV/boe of US$ 4.8-5.8/boe. The same compares favourably to the opportunity cost (F&D cost of US$5.45/bbl in FY11).

The likely production from the asset under discussion is likely to be around 15,000bpd to 20,000bpd (around 25% of the current production). Thus, acquisition of the producing asset is likely to lead to reduction in concentration risk for OIL (largely operating in North East). The likely valuation associated with acquisition is likely to have material implication on the stock price.

Management believes that the acquisition is likely to be value-accretive as the company works with minimum IRR of 14.0% while examining the acquisition prospects vis-à-vis interest yield of around 10.5% earned on the cash with the company.

While the management refrained from providing the acquisition target, we believe the *Maurel & Prom's* oil assets in Gabon has similar data point as disclosed by the management for the potential target. Even the OIL's interest in the same has been in news for some time. As per the news reports, OIL has done the due-diligence and is likely to approach E-GoM for the approval of the deal shortly. Given the smaller size of the asset under contention the competition from the bigger Chinese players is also not significant.

Apart from the conventional Oil & Gas segment, OIL is also for the acquisition in the non-conventional hydrocarbon segment, such as shale gas, for strategic benefits.

Possible options for divestment of government stake

Management highlights those potential options likely for the government disinvestment in OIL is contingent on couple of factors - successful ONGC issue and market conditions.

OIL management believes the preferred option for the divestment of the government stake is likely to be block-trade in which government will offload its stake to institutional investor. Talking about the prospects of cross-holding, management said that large part of the current cash balance is likely to be spent on overseas acquisition of the producing property. Company is currently working on couple of acquisitions, with ticket size of around Rs50-60bn each. Management believes that its recent interaction with the government has also acknowledged the fact that company's cash needs to be utilised for the inorganic growth prospects of the company rather than for the purpose of cross-holdings.

Subsidy sharing

OIL's management acknowledged that the subsidy-sharing continues to be an overhang with regards to the upstream companies. However, it expects government to provided minimum net realisation of around US$60/bbls for the current fiscal. Management estimates a capex outlay of around Rs160-180bn over the period of next five years and to fund the same, it requires government support in the form of limited subsidy burden.

With regards to sharing of the subsidy burden amongst the upstream companies, OIL highlighted that it has asked the government to take average of the last five years for calculating the proportionate share of upstream companies against the current practice of last three year's average.

Last year, the subsidy-sharing formula for upstream companies was changed, with companies requiring to share subsidy based on last three years average profit ratio rather than last one year's profit ratio. The same was done to incentivise the efficient player. The move has resulted into OIL benefitting to the tune of around Rs4.5bn for FY11.

Exploration portfolio update

On the exploratory front, OIL believes it has an exciting portfolio, wherein key prospects are *Assam Arakan* basin (Mizoram Block) followed by KG onshore field on the domestic front, while on the overseas front, it believes Gabon offers good prospects.

Despite being one of the oldest discovered hydrocarbon basins, Assam-Arakan basin has lots of hydrocarbon yet to be discovered. However, the key challenges for the same remains to be logistical issues with regards to exploration at the difficult geographical locations.

With exploratory drilling likely to happen in the current year in these key blocks, the blocks are likely to be keenly watched for the upsides to the reserve estimates.

Crude Oil Production, operating cost and capex update

Management believes the average production during the year is likely to be around 3.9MMT, resulting into a growth of around 5-6% adjusted for the lower NRL offtake for FY2011. Crude oil production for FY2013E is estimated to be around 4.1MMT, resulting into a growth of around 5.0% over FY2012 from the domestic fields. The increase in the production is likely to occur due to various EOR/IOR activities undertaken by the company and incremental production from horizontal wells.

On the operating cost front, management expects the cost of production to remain in the range of around US$5.25-5.5/bbls. The same is in line with historical averages. RRR is expected to continue to remain over one, going forward.

With regards to capex, OIL is likely to step on the gas with capex during the current year and is likely to increase significantly to Rs31.8bn as compared to capex of Rs20bn. The significant increase in capex is largely on account of increase in planned outlay for the 3D seismic and exploratory drilling for FY2012E. Management estimates a capex outlay of around Rs160-180bn over the period of next five years.

Management highlighted that despite spending around Rs1.7bn against the budget expenditure of around Rs31.8bn, it is likely to meet the capex plan. In a recent meeting called by PMO to look at the progress of growth, OIL has maintained its guidance of capex of around Rs31.8bn for the year.

Outlook and Valuation

OIL has underperformed the benchmark indices over the last one year owing to headwinds in the form of lack of subsidy-sharing mechanism. Recent concerns over the diversion of the cash towards cross-holding as a means to fund the government disinvestment programme could be traced to stock price decline over last couple of months.

Post the duty cuts in June 2011; we had highlighted the fact that government is likely to add back the duty cuts in order to determine the subsidy burden for the upstream companies. The same was largely due to significant likely increase in net realisation of upstream oil producers in absence of the move. Government, thereafter, had also advocated for introduction of a step-ladder subsidy-sharing mechanism in order to restrict net realisation of the upstream companies in the band of US$55-65/bbls.

Despite the duty cuts, the under-recoveries for the current fiscal has remained at elevated levels on account of significant depreciation of the rupee, coupled with higher crude oil prices. The same results into check on the higher net realisation of the PSU upstream oil producing companies. Thus, we assume a 40% upstream sharing for FY12E and FY13E against the implied 45% in case of foregone duty add backs for the current year.

Exhibit 1: FY12 EPS sensitivity to Upstream subsidy and Crude oil prices

	102.5	105.0	107.5	110.0	112.5	115.0
35%	128	136	143	150	158	165
40%	110	117	124	132	139	146
45%	91	99	106	113	121	128
50%	73	80	87	95	102	109
55%	54	62	69	76	83	91

Source: Company Data, PL Research

Exhibit 2: FY13 EPS sensitivity to Upstream subsidy and Crude oil prices

	100.0	105.0	110.0	115.0	120.0	125.0
35%	156	172	188	204	220	235
40%	137	152	168	184	200	216
45%	117	133	149	165	181	197
50%	98	114	130	146	162	178
55%	79	95	111	127	143	159

Source: Company Data, PL Research

On the cash deployment front, we believe post the acquisition of the producing property in Africa, coupled with production from Carabobo-1, overseas volumes would form around 40% of OIL India's current volumes. Markets in general have accorded a premium valuation to ONGC vis-à-vis OIL due to its overseas presence (ONGC Videsh) and better balance sheet composition due to lower proportion of the cash on the book. Thus, the value accretive overseas acquisition is likely to improve the business model.

On the operating front, OIL has been delivering impressive performance on the core operating parameters such as production growth, coupled with efficient operations, resulting in low finding, development and lifting cost. High proportion of the developed 1P reserves continues to act as a comforting factor for the production growth. We believe this, coupled with healthy and consistent reserve replacement ratios and strong reserve base, holds company in good state.

On the valuation front, the stock is currently trading at attractive 7.3x FY2013E EPS and 1.3x FY2013E Book Value. On EV/boe of US$5.3/bbl (1P) and US$2.8/bbl (2P), the stock incorporates the risk of lower realisations due to higher subsidy and offers a favour risk-reward equation at the current juncture. We value OIL at 10x FY2013E EPS, arriving at a fair value estimates of Rs1,525/share. We continue to maintain '**Accumulate**' rating on the stock.

Income Statement (Rs m)

Y/e March	2010	2011	2012E	2013E
Net Revenue	**79,226**	**83,641**	**101,061**	**106,482**
Raw Material Expenses	106	(76)	(202)	—
Gross Profit	79,120	83,718	101,263	106,482
Employee Cost	12,059	9,978	11,475	12,048
Other Expenses	32,624	37,566	46,215	47,517
EBITDA	**34,438**	**36,174**	**43,573**	**46,917**
Depr. & Amortization	4,811	4,781	4,942	5,506
Net Interest	37	139	950	950
Other Income	9,420	11,837	12,597	14,673
Profit before Tax	**39,010**	**43,091**	**50,279**	**55,134**
Total Tax	12,845	14,255	16,843	18,470
Profit after Tax	**26,165**	**28,836**	**33,435**	**36,664**
Ex-Od items / Min. Int.	(59)	41	—	—
Adj. PAT	**26,106**	**28,877**	**33,435**	**36,664**
Avg. Shares O/S (m)	**240.5**	**240.5**	**240.5**	**240.5**
EPS (Rs.)	**108.6**	**120.1**	**139.1**	**152.5**

Balance Sheet Abstract (Rs m)

Y/e March	2010	2011	2012E	2013E
Shareholder's Funds	137,657	157,664	179,081	203,930
Total Debt	375	10,268	—	—
Other Liabilities	11,409	11,491	11,491	11,491
Total Liabilities	**149,440**	**179,422**	**190,572**	**215,420**
Net Fixed Assets	49,460	55,723	69,243	74,750
Goodwill	—	—	—	—
Investments	8,594	8,904	8,904	8,904
Net Current Assets	90,002	114,794	112,425	131,766
Cash & Equivalents	*85,429*	*117,693*	*107,548*	*126,977*
Other Current Assets	*37,266*	*30,317*	*30,260*	*31,176*
Current Liabilities	*32,693*	*33,215*	*25,384*	*26,386*
Other Assets	1,384	—	—	—
Total Assets	**149,440**	**179,422**	**190,572**	**215,420**

Cash Flow Abstract (Rs m)

Y/e March	2010	2011	2012E	2013E
C/F from Operations	10,111	30,714	18,955	28,534
C/F from Investing	(3,198)	483	(5,864)	3,660
C/F from Financing	17,816	1,067	(23,235)	(12,765)
Inc. / Dec. in Cash	24,729	32,264	(10,145)	19,429
Opening Cash	60,700	85,429	117,693	107,548
Closing Cash	85,429	117,693	107,548	126,977
FCFF	11,310	34,117	12,141	31,244
FCFE	11,120	44,010	1,873	31,244

Quarterly Financials (Rs m)

Y/e March	Q4FY11	Q1FY12	Q2FY12	Q3FY12E
Net Revenue	**20,189**	**22,878**	**32,703**	**33,098**
EBITDA	**8,595**	**11,629**	**16,202**	**16,584**
% of revenue	*42.6*	*50.8*	*49.5*	*50.1*
Depr. & Amortization	3,413	2,784	5,901	5,901
Net Interest	112	88	5	5
Other Income	3,298	3,809	6,823	6,200
Profit before Tax	**8,368**	**12,566**	**17,119**	**16,879**
Total Tax	2,742	4,070	5,734	5,570
Profit after Tax	**5,626**	**8,496**	**11,385**	**11,309**
Adj. PAT	**5,626**	**8,496**	**11,385**	**11,309**

Key Financial Metrics

Y/e March	2010	2011	2012E	2013E
Growth				
Revenue (%)	10.0	5.6	20.8	5.4
EBITDA (%)	21.5	5.0	20.5	7.7
PAT (%)	20.4	10.6	15.8	9.7
EPS (%)	7.2	10.6	15.8	9.7
Profitability				
EBITDA Margin (%)	43.5	43.2	43.1	44.1
PAT Margin (%)	33.0	34.5	33.1	34.4
RoCE (%)	22.5	18.9	19.6	19.5
RoE (%)	22.6	19.6	19.9	19.1
Balance Sheet				
Net Debt : Equity	(0.6)	(0.7)	(0.6)	(0.6)
Net Wrkng Cap. (days)	—	—	—	—
Valuation				
PER (x)	10.2	9.2	7.9	7.2
P / B (x)	1.9	1.7	1.5	1.3
EV / EBITDA (x)	5.2	4.4	3.6	3.0
EV / Sales (x)	2.3	1.9	1.6	1.3
Earnings Quality				
Eff. Tax Rate	32.9	33.1	33.5	33.5
Other Inc / PBT	24.1	27.5	25.1	26.6
Eff. Depr. Rate (%)	7.1	6.4	5.3	5.3
FCFE / PAT	42.6	152.4	5.6	85.2

Source: Company Data, PL Research.

Key Operating Metrics

Y/e March	2010	2011	2012E	2013E
Oil production (mn barrels)	26.3	26.4	27.0	28.2
Gas sales (mcm)	2,410	2,480	2,670	3,070
Sales of LPG(TMT)	47.6	45.0	44.9	44.9
Gross realisations (US$/bbls)	69	86	113	105
Net realisations (US$/bbls)	56.2	58.5	60.4	55.9
Subsidy burden (Rs m)	15,488	32,931	65,500	67,600
Subsidy burden (% of total)	3.4	4.2	5.0	5.2
Natural gas realisation (Rs/scm)	3.6	6.8	7.3	7.7

Source: Company Data, PL Research.

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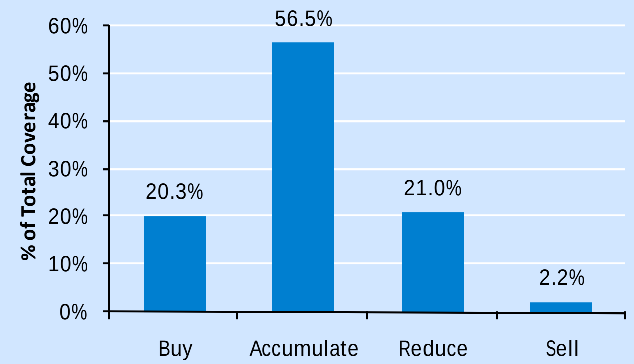
Rating Distribution of Research Coverage



PL's Recommendation Nomenclature

BUY	:	Over 15% Outperformance to Sensex over 12-months	**Accumulate**	:	Outperformance to Sensex over 12-months
Reduce	:	Underperformance to Sensex over 12-months	**Sell**	:	Over 15% underperformance to Sensex over 12-months
Trading Buy	:	Over 10% absolute upside in 1-month	**Trading Sell**	:	Over 10% absolute decline in 1-month
Not Rated (NR)	:	No specific call on the stock	**Under Review (UR)**	:	Rating likely to change shortly