



**INDIA**

**CAIR IN** Neutral

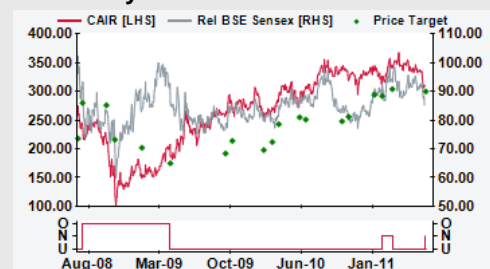
Price 27 Jun 11 Rs309.20

|                               |              |                |
|-------------------------------|--------------|----------------|
| <b>12-month target</b>        | <b>Rs</b>    | <b>300.00</b>  |
| <b>Upside/Downside</b>        | <b>%</b>     | <b>-3.0</b>    |
| <b>Valuation</b>              | <b>Rs</b>    | <b>300.00</b>  |
| - DCF                         |              |                |
| <b>GICS sector</b>            |              | <b>Energy</b>  |
| <b>Market cap</b>             | <b>Rsm</b>   | <b>588,163</b> |
| <b>30-day avg turnover</b>    | <b>US\$m</b> | <b>1.3</b>     |
| <b>Market cap</b>             | <b>US\$m</b> | <b>13,072</b>  |
| <b>Number shares on issue</b> | <b>m</b>     | <b>1,902</b>   |

**Investment fundamentals**

| Year end 31 Mar |    | 2011A | 2012E | 2013E | 2014E |
|-----------------|----|-------|-------|-------|-------|
| Revenue         | bn | 102.8 | 147.9 | 147.2 | 145.8 |
| EBITDA          | bn | 81.8  | 117.2 | 117.2 | 121.6 |
| EBITDA growth   | %  | 959.3 | 43.3  | 0.0   | 3.7   |
| Reported profit | bn | 62.7  | 80.7  | 81.4  | 81.3  |
| EPS rep         | Rs | 33.04 | 42.56 | 42.91 | 42.87 |
| EPS rep growth  | %  | 496.3 | 28.8  | 0.8   | -0.1  |
| PER rep         | x  | 9.4   | 7.3   | 7.2   | 7.2   |
| Total DPS       | Rs | 0.00  | 0.00  | 0.00  | 0.00  |
| Total div yield | %  | 0.0   | 0.0   | 0.0   | 0.0   |
| ROA             | %  | 16.3  | 19.9  | 17.3  | 14.9  |
| ROE             | %  | 16.9  | 18.3  | 15.5  | 13.4  |
| EV/EBITDA       | x  | 7.0   | 4.8   | 4.8   | 4.7   |
| Net debt/equity | %  | -4.5  | -1.7  | -2.7  | -1.3  |
| P/BV            | x  | 1.5   | 1.2   | 1.0   | 0.9   |

**CAIR IN rel BSE Sensex performance, & rec history**



Note: Recommendation timeline - if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.  
Source: FactSet, Macquarie Research, June 2011  
(all figures in INR unless noted)

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# Cairn India

## Sharp fall due to royalty overhang, crude decline

### Event

- **Upgrade to Neutral due to sharp fall, despite import duty cut being a negative:** Cairn India is one of the key companies that should be negatively affected by the EGoM's attempt to reduce under-recovery without raising prices substantially. We estimate that the 5% crude import duty cut will hurt Cairn India's earnings by 9% for the full year. We nevertheless are upgrading our recommendation to Neutral from Underperform given a sharp 13% MoM fall in the stock price.

### Impact

- **Decline in crude prices has pulled away bullishness in the stock:** Brent crude prices have fallen to ~US\$105/bbl from the US\$127/bbl levels two months ago. A major contributor to the fall was the recent IEA pledge to release 60mm barrels of oil, or 2 million barrels per day, from its strategic petroleum reserves (SPR). The US alone will provide 30mm barrels, while 20mm will come from Europe and the remainder from Asia. (The global SPR total surpasses 1.6B barrels). The agency cited lost Libyan supplies as the primary driver behind the action – just the third time the SPRs have been tapped in more than 30 years.
- **Royalty overhang a concern, as Vedanta deal continues to be in limbo:** Vedanta has already taken an 18.5% stake in Cairn India, of which 8.4% is through the open offer at Rs355/share and a 10.1% stake sale by Petronas at Rs331/share, and hence is significantly committed to acquire Cairn. The Group of Ministers (GoM) appointed by the government's Cabinet Committee of Economic Affairs (CCEA) recently recommended that royalty should be cost recoverable. Effectively, Cairn India would have to bear the hit. According to press reports it would be difficult for the CCEA to ignore the recommendation of GoM, which it appointed.

### Earnings and target price revision

- We are cutting our earnings forecasts by 4–5% for FY12/13 and target price by 1.4% to Rs300/share.

### Price catalyst

- 12-month price target: Rs300.00 based on a DCF methodology.
- Catalyst: Clarity on royalty issue.

### Action and recommendation

- Even after having declined sharply, the stock is quoting at >US\$45/bbl on an EV/1P reserve basis, due to low 1P reserve on account of limitations of permissions/leaseholds. With no clarity on the Vedanta deal having emerged as yet and the CAG (Comptroller and Auditor General, India's central auditor) accusing the petroleum ministry of having favoured Cairn India through not enforcing relinquishment of land as per the production sharing contract, we anticipate that the stock could remain stuck in 'no man's land' for a while. We recommend a switch to downstream companies Hindustan Petroleum (HPCL IN, Rs415.25, Outperform, TP: Rs507.00) and Bharat Petroleum (BPCL IN, Rs663.70, Outperform, TP: Rs794.00).

## Cairn India (CAIR IN, Neutral, Target Price: Rs300.00)

| Quarterly Results                 |        |         |         |        | Profit & Loss             |                                   |       |       |       |        |        |
|-----------------------------------|--------|---------|---------|--------|---------------------------|-----------------------------------|-------|-------|-------|--------|--------|
|                                   | 4Q/11A | 1Q/12E  | 2Q/12E  | 3Q/12E |                           | 2011A                             | 2012E | 2013E | 2014E |        |        |
| <b>Revenue</b>                    | bn     | 37.2    | 32.8    | 34.2   | 37.0                      | <b>Revenue</b>                    | bn    | 102.8 | 142.5 | 140.4  | 142.7  |
| <b>Gross Profit</b>               | bn     | 37.1    | 30.9    | 32.3   | 35.0                      | <b>Gross Profit</b>               | bn    | 102.4 | 134.5 | 130.8  | 133.0  |
| Cost of Goods Sold                | bn     | 0.1     | 1.8     | 1.9    | 2.1                       | Cost of Goods Sold                | bn    | 0.4   | 8.0   | 9.5    | 9.7    |
| <b>EBITDA</b>                     | bn     | 30.9    | 27.0    | 28.2   | 30.6                      | <b>EBITDA</b>                     | bn    | 81.8  | 117.6 | 116.4  | 120.1  |
| Depreciation                      | bn     | 4.6     | 3.8     | 4.0    | 4.3                       | Depreciation                      | bn    | 11.9  | 16.6  | 14.8   | 21.3   |
| Amortisation of Goodwill          | bn     | 0.0     | 0.0     | 0.0    | 0.0                       | Amortisation of Goodwill          | bn    | 0.0   | 0.0   | 0.0    | 0.0    |
| Other Amortisation                | bn     | 0.0     | 0.0     | 0.0    | 0.0                       | Other Amortisation                | bn    | 0.0   | 0.0   | 0.0    | 0.0    |
| <b>EBIT</b>                       | bn     | 26.2    | 23.2    | 24.2   | 26.2                      | <b>EBIT</b>                       | bn    | 69.9  | 100.9 | 101.6  | 98.8   |
| Net Interest Income               | bn     | -0.4    | -0.7    | -0.7   | -0.8                      | Net Interest Income               | bn    | -2.9  | -2.9  | -2.9   | -2.9   |
| Associates                        | bn     | 0.0     | 0.0     | 0.0    | 0.0                       | Associates                        | bn    | 0.0   | 0.0   | 0.0    | 0.0    |
| Exceptionals                      | bn     | 0.0     | 0.0     | 0.0    | 0.0                       | Exceptionals                      | bn    | 0.0   | 0.0   | 0.0    | 0.0    |
| Forex Gains / Losses              | bn     | 0.0     | 0.0     | 0.0    | 0.0                       | Forex Gains / Losses              | bn    | 0.0   | 0.0   | 0.0    | 0.0    |
| Other Pre-Tax Income              | bn     | 0.4     | 0.2     | 0.2    | 0.2                       | Other Pre-Tax Income              | bn    | 1.3   | 0.8   | 1.1    | 1.2    |
| <b>Pre-Tax Profit</b>             | bn     | 26.2    | 22.7    | 23.7   | 25.7                      | <b>Pre-Tax Profit</b>             | bn    | 68.2  | 98.8  | 99.8   | 97.2   |
| Tax Expense                       | bn     | -1.0    | -3.4    | -3.6   | -3.9                      | Tax Expense                       | bn    | -5.6  | -14.8 | -15.0  | -14.6  |
| <b>Net Profit</b>                 | bn     | 25.2    | 19.3    | 20.2   | 21.8                      | <b>Net Profit</b>                 | bn    | 62.7  | 84.0  | 84.8   | 82.6   |
| Minority Interests                | bn     | 0.0     | 0.0     | 0.0    | 0.0                       | Minority Interests                | bn    | 0.0   | 0.0   | 0.0    | 0.0    |
| <b>Reported Earnings</b>          | bn     | 25.2    | 19.3    | 20.2   | 21.8                      | <b>Reported Earnings</b>          | bn    | 62.7  | 84.0  | 84.8   | 82.6   |
| <b>Adjusted Earnings</b>          | bn     | 25.2    | 19.3    | 20.2   | 21.8                      | <b>Adjusted Earnings</b>          | bn    | 62.7  | 84.0  | 84.8   | 82.6   |
| EPS (rep)                         |        | 13.31   | 10.18   | 10.63  | 11.51                     | EPS (rep)                         |       | 33.04 | 44.28 | 44.71  | 43.54  |
| EPS (adj)                         |        | 13.31   | 10.18   | 10.63  | 11.51                     | EPS (adj)                         |       | 33.04 | 44.28 | 44.71  | 43.54  |
| EPS Growth yoy (adj)              | %      | 789.6   | 1,210.1 | 27.1   | 8.6                       | EPS Growth (adj)                  | %     | 496.3 | 34.0  | 1.0    | -2.6   |
|                                   |        |         |         |        |                           | PE (rep)                          | x     | 9.4   | 7.0   | 6.9    | 7.1    |
|                                   |        |         |         |        |                           | PE (adj)                          | x     | 9.4   | 7.0   | 6.9    | 7.1    |
| EBITDA Margin                     | %      | 83.0    | 82.5    | 82.5   | 82.5                      | Total DPS                         |       | 0.00  | 0.00  | 0.00   | 0.00   |
| EBIT Margin                       | %      | 70.5    | 70.8    | 70.8   | 70.8                      | Total Div Yield                   | %     | 0.0   | 0.0   | 0.0    | 0.0    |
| Earnings Split                    | %      | 40.3    | 23.0    | 24.0   | 26.0                      | Weighted Average Shares           | m     | 1,897 | 1,897 | 1,897  | 1,897  |
| Revenue Growth                    | %      | 749.2   | 323.7   | 27.3   | 19.7                      | Period End Shares                 | m     | 1,897 | 1,897 | 1,897  | 1,897  |
| EBIT Growth                       | %      | 1,458.6 | 747.6   | 32.2   | 16.4                      |                                   |       |       |       |        |        |
| Profit and Loss Ratios            |        |         |         |        | Cashflow Analysis         |                                   |       |       |       |        |        |
|                                   | 2011A  | 2012E   | 2013E   | 2014E  |                           | 2011A                             | 2012E | 2013E | 2014E |        |        |
| Revenue Growth                    | %      | 533.3   | 38.6    | -1.5   | 1.6                       | <b>EBITDA</b>                     | bn    | 81.8  | 117.6 | 116.4  | 120.1  |
| EBITDA Growth                     | %      | 959.3   | 43.8    | -1.0   | 3.2                       | Tax Paid                          | bn    | -5.6  | -14.8 | -15.0  | -14.6  |
| EBIT Growth                       | %      | 1,020.3 | 44.5    | 0.7    | -2.7                      | Chgs in Working Cap               | bn    | 0.0   | 0.0   | 0.0    | 0.0    |
| Gross Profit Margin               | %      | 99.6    | 94.4    | 93.2   | 93.2                      | Net Interest Paid                 | bn    | -2.9  | -2.9  | -2.9   | -2.9   |
| EBITDA Margin                     | %      | 79.6    | 82.5    | 82.9   | 84.2                      | Other                             | bn    | 0.0   | 0.0   | 0.0    | 0.0    |
| EBIT Margin                       | %      | 68.0    | 70.8    | 72.4   | 69.3                      | <b>Operating Cashflow</b>         | bn    | 73.3  | 99.8  | 98.5   | 102.6  |
| Net Profit Margin                 | %      | 61.0    | 58.9    | 60.4   | 57.9                      | Acquisitions                      | bn    | 0.0   | 0.0   | 0.0    | 0.0    |
| Payout Ratio                      | %      | 0.0     | 0.0     | 0.0    | 0.0                       | Capex                             | bn    | -33.9 | -99.5 | -59.5  | -126.3 |
| EV/EBITDA                         | x      | 7.0     | 4.8     | 4.9    | 4.7                       | Asset Sales                       | bn    | 0.0   | 0.0   | 0.0    | 0.0    |
| EV/EBIT                           | x      | 8.2     | 5.6     | 5.6    | 5.8                       | Other                             | bn    | 0.0   | 0.0   | 0.0    | 0.0    |
| <b>Balance Sheet Ratios</b>       |        |         |         |        | <b>Investing Cashflow</b> | bn                                | -33.9 | -99.5 | -59.5 | -126.3 |        |
| ROE                               | %      | 16.9    | 18.9    | 16.0   | 13.5                      | Dividend (Ordinary)               | bn    | 0.0   | 0.0   | 0.0    | 0.0    |
| ROA                               | %      | 16.3    | 20.1    | 17.4   | 14.8                      | Equity Raised                     | bn    | 0.1   | 0.0   | 0.0    | 0.0    |
| ROIC                              | %      | 17.7    | 22.3    | 18.0   | 16.0                      | Debt Movements                    | bn    | -7.2  | 0.0   | 0.0    | 0.0    |
| Net Debt/Equity                   | %      | -4.5    | -1.4    | -8.1   | -3.4                      | Other                             | bn    | 0.0   | 0.0   | 0.0    | 0.0    |
| Interest Cover                    | x      | 24.0    | 34.7    | 34.9   | 34.0                      | <b>Financing Cashflow</b>         | bn    | -7.1  | 0.0   | 0.0    | 0.0    |
| Price/Book                        | x      | 1.5     | 1.2     | 1.0    | 0.9                       | <b>Net Chg in Cash/Debt</b>       | bn    | 29.4  | -11.3 | 39.5   | -24.2  |
| Book Value per Share              |        | 211.9   | 256.2   | 300.9  | 344.5                     | <b>Free Cashflow</b>              | bn    | 39.4  | 0.3   | 38.9   | -23.7  |
|                                   |        |         |         |        |                           |                                   |       |       |       |        |        |
|                                   |        |         |         |        | Balance Sheet             |                                   |       |       |       |        |        |
|                                   | 2011A  | 2012E   | 2013E   | 2014E  |                           | 2011A                             | 2012E | 2013E | 2014E |        |        |
| Cash                              | bn     | 44.8    | 33.6    | 73.1   | 48.8                      | Cash                              | bn    | 44.8  | 33.6  | 73.1   | 48.8   |
| Receivables                       | bn     | 14.8    | 20.6    | 20.3   | 20.6                      | Receivables                       | bn    | 14.8  | 20.6  | 20.3   | 20.6   |
| Inventories                       | bn     | 3.3     | 4.5     | 4.5    | 4.5                       | Inventories                       | bn    | 3.3   | 4.5   | 4.5    | 4.5    |
| Investments                       | bn     | 10.9    | 10.9    | 10.9   | 10.9                      | Investments                       | bn    | 10.9  | 10.9  | 10.9   | 10.9   |
| Fixed Assets                      | bn     | 119.9   | 202.8   | 247.6  | 352.6                     | Fixed Assets                      | bn    | 119.9 | 202.8 | 247.6  | 352.6  |
| Intangibles                       | bn     | 253.2   | 253.2   | 253.2  | 253.2                     | Intangibles                       | bn    | 253.2 | 253.2 | 253.2  | 253.2  |
| Other Assets                      | bn     | 16.7    | 16.7    | 16.7   | 16.7                      | Other Assets                      | bn    | 16.7  | 16.7  | 16.7   | 16.7   |
| <b>Total Assets</b>               | bn     | 463.6   | 542.3   | 626.2  | 707.4                     | <b>Total Assets</b>               | bn    | 463.6 | 542.3 | 626.2  | 707.4  |
| Payables                          | bn     | 8.0     | 2.6     | 1.8    | 0.4                       | Payables                          | bn    | 8.0   | 2.6   | 1.8    | 0.4    |
| Short Term Debt                   | bn     | 13.5    | 13.5    | 13.5   | 13.5                      | Short Term Debt                   | bn    | 13.5  | 13.5  | 13.5   | 13.5   |
| Long Term Debt                    | bn     | 13.3    | 13.3    | 13.3   | 13.3                      | Long Term Debt                    | bn    | 13.3  | 13.3  | 13.3   | 13.3   |
| Provisions                        | bn     | 16.6    | 16.6    | 16.6   | 16.6                      | Provisions                        | bn    | 16.6  | 16.6  | 16.6   | 16.6   |
| Other Liabilities                 | bn     | 10.2    | 10.2    | 10.2   | 10.2                      | Other Liabilities                 | bn    | 10.2  | 10.2  | 10.2   | 10.2   |
| <b>Total Liabilities</b>          | bn     | 61.7    | 56.3    | 55.4   | 54.0                      | <b>Total Liabilities</b>          | bn    | 61.7  | 56.3  | 55.4   | 54.0   |
| Shareholders' Funds               | bn     | 402.0   | 486.0   | 570.8  | 653.3                     | Shareholders' Funds               | bn    | 402.0 | 486.0 | 570.8  | 653.3  |
| Minority Interests                | bn     | 0.0     | 0.0     | 0.0    | 0.0                       | Minority Interests                | bn    | 0.0   | 0.0   | 0.0    | 0.0    |
| Other                             | bn     | 0.0     | 0.0     | 0.0    | 0.0                       | Other                             | bn    | 0.0   | 0.0   | 0.0    | 0.0    |
| <b>Total S/H Equity</b>           | bn     | 402.0   | 486.0   | 570.8  | 653.3                     | <b>Total S/H Equity</b>           | bn    | 402.0 | 486.0 | 570.8  | 653.3  |
| <b>Total Liab &amp; S/H Funds</b> | bn     | 463.6   | 542.3   | 626.2  | 707.4                     | <b>Total Liab &amp; S/H Funds</b> | bn    | 463.6 | 542.3 | 626.2  | 707.4  |

All figures in INR unless noted.

Source: Company data, Macquarie Research, June 2011

## Important disclosures:

## Recommendation definitions

**Macquarie - Australia/New Zealand**

Outperform – return >3% in excess of benchmark return  
Neutral – return within 3% of benchmark return  
Underperform – return >3% below benchmark return

Benchmark return is determined by long term nominal GDP growth plus 12 month forward market dividend yield

**Macquarie – Asia/Europe**

Outperform – expected return >+10%  
Neutral – expected return from -10% to +10%  
Underperform – expected return <-10%

**Macquarie First South - South Africa**

Outperform – expected return >+10%  
Neutral – expected return from -10% to +10%  
Underperform – expected return <-10%

**Macquarie - Canada**

Outperform – return >5% in excess of benchmark return  
Neutral – return within 5% of benchmark return  
Underperform – return >5% below benchmark return

**Macquarie - USA**

Outperform (Buy) – return >5% in excess of Russell 3000 index return  
Neutral (Hold) – return within 5% of Russell 3000 index return  
Underperform (Sell) – return >5% below Russell 3000 index return

## Volatility index definition\*

This is calculated from the volatility of historical price movements.

**Very high-highest risk** – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

**High** – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

**Medium** – stock should be expected to move up or down at least 30–40% in a year.

**Low-medium** – stock should be expected to move up or down at least 25–30% in a year.

**Low** – stock should be expected to move up or down at least 15–25% in a year.

\* Applicable to Australian/NZ/Canada stocks only

**Recommendations** – 12 months

**Note:** Quant recommendations may differ from Fundamental Analyst recommendations

## Financial definitions

All "Adjusted" data items have had the following adjustments made:

Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense  
Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

**EPS** = adjusted net profit / epowa\*

**ROA** = adjusted ebit / average total assets

**ROA Banks/Insurance** = adjusted net profit / average total assets

**ROE** = adjusted net profit / average shareholders funds

**Gross cashflow** = adjusted net profit + depreciation

\*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

## Recommendation proportions – For quarter ending 31 March 2011

|              | AU/NZ  | Asia   | RSA    | USA    | CA     | EUR    |   |
|--------------|--------|--------|--------|--------|--------|--------|---|
| Outperform   | 45.65% | 65.72% | 59.70% | 43.02% | 68.91% | 51.16% | (for US coverage by MCUSA, 14.36% of stocks covered are investment banking clients) |
| Neutral      | 39.49% | 19.00% | 29.85% | 53.09% | 26.43% | 35.73% | (for US coverage by MCUSA, 17.55% of stocks covered are investment banking clients) |
| Underperform | 14.86% | 15.28% | 10.45% | 3.89%  | 4.66%  | 13.11% | (for US coverage by MCUSA, 0.00% of stocks covered are investment banking clients)  |

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