28 May 2010 | 9 pages

Oil India (OILI.BO)

Equity

4Q FY10 Impacted by One-offs

- **4Q below estimates** — OIL's 4Q PAT came in at Rs4.3bn (-40% qoq) and was below estimates primarily due to: 1) higher DD&A expenses owing to dry-well write-offs which got bunched up in the quarter and 2) higher other expenses. Crude oil sales at 0.86 MMT were a tad lower than 3Q, though full-year sales of 3.57 MMT were in line with estimates.

- **Post-subsidy realization of US$53.3/bbl** — OIL's 4Q subsidy burden came in at Rs6.7bn, resulting in a net realization of US$53.3/bbl. The company hopes that the EGoM meeting scheduled for June 7 will result in announcements on fuel price deregulation (albeit partial) as well as introduction of a transparent, crude linked subsidy sharing mechanism for upstream companies, in line with recommendations of the Kirit Parikh Committee.

- **Cash continues to provide support** — OIL currently has ~Rs85bn of cash (~Rs355/share), which continues to support valuations. The company is on the look-out to acquire producing assets, the nature and the prudence of this will therefore be a key determinant of shareholder value.

- **Production growth to support performance** — Management reiterated its oil production target of 3.7 MMT in FY11 (3.57 in FY10), growing up to 4.0 MMT over the next two years. Besides, its 3.5% stake in Project Carabobo in Venezuela could add an additional 0.7 MMT in next 2-3 years. OIL provides significantly more promise on the production growth count, compared to ONGC, where production is likely to remain flat over the next 2 years. On a relative basis, we prefer OIL to ONGC given its lower valuations, moderate production growth and downside support from cash.

Hold/Low Risk	2L
Price (28 May 10)	Rs1,258.50
Target price	Rs1,290.00
Expected share price return	2.5%
Expected dividend yield	3.2%
Expected total return	**5.7%**
Market Cap	Rs302,612M
	US$6,474M

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

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2008A	17,889	83.59	9.1	15.1	3.4	24.2	2.2
2009A	21,617	101.01	20.8	12.5	2.9	25.0	2.4
2010E	28,381	118.03	16.8	10.7	2.2	24.5	3.2
2011E	29,720	123.60	4.7	10.2	1.9	20.2	3.3
2012E	30,518	126.92	2.7	9.9	1.7	18.4	3.4

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	15.1	12.5	10.7	10.2	9.9
EV/EBITDA adjusted (x)	9.4	7.0	5.0	4.4	4.2
P/BV (x)	3.4	2.9	2.2	1.9	1.7
Dividend yield (%)	2.2	2.4	3.2	3.3	3.4
Per Share Data (Rs)					
EPS adjusted	83.59	101.01	118.03	123.60	126.92
EPS reported	83.59	101.01	118.03	123.60	126.92
BVPS	370.69	436.02	575.49	650.81	728.15
DPS	27.50	30.50	40.13	42.02	43.15
Profit & Loss (RsM)					
Net sales	62,372	73,842	90,185	95,326	98,028
Operating expenses	-40,466	-47,375	-54,733	-58,873	-60,860
EBIT	**21,907**	**26,467**	**35,453**	**36,453**	**37,169**
Net interest expense	-344	-87	-100	-100	-100
Non-operating/exceptionals	5,582	7,537	7,649	8,677	9,171
Pre-tax profit	**27,145**	**33,916**	**43,002**	**45,030**	**46,240**
Tax	-9,245	-12,253	-14,621	-15,310	-15,721
Extraord./Min.Int./Pref.div.	-11	-46	0	0	0
Reported net income	**17,889**	**21,617**	**28,381**	**29,720**	**30,518**
Adjusted earnings	17,889	21,617	28,381	29,720	30,518
Adjusted EBITDA	28,849	36,944	47,679	50,069	50,117
Growth Rates (%)					
Sales	12.6	18.4	22.1	5.7	2.8
EBIT adjusted	7.9	20.8	34.0	2.8	2.0
EBITDA adjusted	7.3	28.1	29.1	5.0	0.1
EPS adjusted	9.1	20.8	16.8	4.7	2.7
Cash Flow (RsM)					
Operating cash flow	**35,445**	**41,571**	**40,254**	**42,941**	**43,260**
Depreciation/amortization	6,942	10,477	12,226	13,616	12,949
Net working capital	10,613	9,477	-353	-395	-207
Investing cash flow	**-8,485**	**-8,999**	**-16,900**	**-17,387**	**-16,000**
Capital expenditure	-7,673	-8,999	-16,900	-17,387	-16,000
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**-12,530**	**-8,337**	**16,672**	**-11,609**	**-11,920**
Borrowings	-6,391	-1,184	0	0	0
Dividends paid	-6,761	-7,498	-11,086	-11,609	-11,920
Change in cash	**14,431**	**24,236**	**40,026**	**13,946**	**15,340**
Balance Sheet (RsM)					
Total assets	**107,286**	**133,801**	**179,607**	**197,956**	**216,678**
Cash & cash equivalent	42,808	60,700	93,025	98,360	106,200
Accounts receivable	6,110	4,047	4,943	5,225	5,373
Net fixed assets	40,633	45,361	57,736	70,118	80,669
Total liabilities	**27,956**	**40,491**	**41,230**	**41,467**	**41,591**
Accounts payable	2,518	3,403	4,157	4,394	4,518
Total Debt	1,749	565	565	565	565
Shareholders' funds	**79,330**	**93,310**	**138,378**	**156,489**	**175,087**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	46.3	50.0	52.9	52.5	51.1
ROE adjusted	24.2	25.0	24.5	20.2	18.4
ROIC adjusted	25.6	27.8	34.8	29.1	25.4
Net debt to equity	-51.8	-64.4	-66.8	-62.5	-60.3
Total debt to capital	2.2	0.6	0.4	0.4	0.3

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Figure 1. OIL — 4Q FY10 Results (Rs m)

	4Q FY09	3Q FY10	4Q FY10
Net sales	**13,671**	**20,413**	**18,321**
Other operating income	335	431	385
Total income	14,006	20,844	18,706
Expenses			
(Increase)/decrease in stock	(7)	(10)	76
Consumption of raw materials	253	285	265
Employee cost	2,555	2,303	2,038
Statutory levies	4,601	5,969	5,602
Other expenditure	1,174	1,237	3,683
Total expenditure	8,577	9,784	11,664
EBITDA	**5,429**	**11,061**	**7,043**
EBITDA Margin	*40%*	*54%*	*38%*
Depreciation, depletion, & amortization	3,052	1,754	3,235
Interest	35	8	10
Other income	2,087	1,797	2,084
Profit before tax	4,429	11,095	5,881
Current tax	4,239	3,747	1510.5
Deferred tax	(517)	175	61.1
Tax rate	*84.0%*	*35.4%*	*26.7%*
Profit after tax	**707**	**7,173**	**4,310**
Sales (Quantity)			
Crude oil (mmbbl)	6.0	6.42	6.31
Natural Gas (mmscm)	402	486	446
Realizations (US$/bbl)			
Gross realization	44.6	73.9	75.7
Subsidy	3.1	15.1	22.4
Net realization	41.6	58.8	53.3

Source: Company and Citi Investment Research and Analysis

Oil India

Company description

OIL is a public-sector E&P company engaged in exploration and production of crude oil and natural gas. Even though the company has most of its assets concentrated in Northeastern India, it is looking to diversify its business by concentrating on its NELP blocks, as well as acreages abroad. Post-IPO, the government (including HPCL, BPCL and IOC) holds 87.3% of the company.

Investment strategy

We rate OIL shares Hold / Low Risk (2L), with an Rs1,290 target price. OIL has established reserves on Onshore Assam Basin with adequate reserve life and reasonable production growth, which generates strong and stable cash flows, adding on to the already strong balance sheet. Despite the new subsidy mechanism of the upstream companies sharing losses on only petrol/diesel, we believe that OIL's leverage to crude beyond US$65/bbl is going to be limited. OIL, which has predominantly focused on North-east Indian onshore blocks, has gradually gained exposure to domestic offshore through NELP blocks as well as abroad. Though the strategic shift to reinvest cash flows from the pre-NELP blocks is in the right direction, it will take time to show results, especially given lack of prior experience.

Valuation

Our target price of Rs1,290 comprises (i) Business valued at PER of 8.5x Sep-11E core EPS, and (ii) cash at Rs398/share (Sep-10E). The core PER is at a 15% discount to ONGC's current multiple of 10.0x. We believe a lower multiple vs. ONGC is warranted on account of (i) OIL's smaller size, (ii) still-to-be-tested track record outside the North East, and (iii) risk pertaining to use of OIL's significant cash balance, in addition to ONGC's relatively higher leverage to crude prices (thru OVL) and natural gas deregulation. Further re-rating from here would be dependent on higher net crude realizations i.e. significant price reforms in auto fuels, revision in gas prices, and any positive news flow from new exploration programs.

Risks

We rate Oil India shares Low Risk given the stable earnings profile and cash-rich balance sheet. Drop in crude prices and sharp rupee appreciation remains the key downside risks to earnings. Uncertainty on government policy on subsidy sharing remains a key risk, in our opinion, although deregulation (especially of auto fuels) and/or any clarity on this front would have a positive impact.

The government also determines the gas price realization for OIL to a large extent. Any delay in implementation or reduction in the proposed APM gas price hike would have negative impact on profitability and valuations. On the other hand a complete de-regulation of gas price to the market determined levels would have a positive impact on earnings and valuation.

Given the significant increase in exploratory activity likely to be initiated in the NELP blocks, there are risks of failures and hence material dry well write-offs which could impact earnings and cash flows in the short-term. However, OIL's ability to drive exploration success in the new blocks and/or undertake a successful acquisition will be value accretive esp. given its lower reserve base relative to ONGC.

For FY07-09, the MoPNG allowed OIL full recovery, on a net basis, of transportation tariffs and sales tax for crude oil that it produced and transported to all public sector refineries. Any reversal of the government decision on transportation tariff and sales tax recovery would be a key negative for OIL.

Any of these risk factors could cause the shares to deviate from our target price.

Oil & Natural Gas

(ONGC.BO; Rs1,134.00; 2L)

Valuation

Our target price of Rs1,170 is based on: (i) P/E of 10x core Sep-11E and (ii) cash of Rs173/sh as on Sep-10E. With structural concerns on ONGC's production growth persisting, we expect the stock to continue trading in its historical median P/E band of 6-11x, and accordingly accord it a 10x target multiple. We continue to value ONGC on traditional valuation parameters as against NAV/SOTP approach due to it being a going concern. Given that its existing fields face declining or mature production profiles, it will be incorrect to value the new discoveries (say KG gas) separately in an SOTP since the new fields would anyway be required to compensate for the decline in mature fields. In terms of asset valuation, ONGC's current EV/boe of ~US$5 (on 2P reserves) is unlikely to get further re-rated given (i) limited benefit from higher crude (ii) subsidized gas prices and (iii) higher F&D costs of incremental production going forward.

Risks

We assign a Low Risk rating in line with our quantitative risk rating system. Upside risks to our estimates are: 1) Value accretive overseas acquisitions. 2) Rupee depreciation which benefits ONGC through higher domestic realisations. 3) Positive policy announcements entailing deregulation of petroleum product pricing and/or introduction of a transparent, slab-based subsidy sharing mechanism. Downside risks to our estimates are: 1) Higher than expected production growth. 2) Continued Gov't interference, esp. if ONGC is made to bear the cost of further populist measures. 3) More overseas acquisitions increase ONGC's geopolitical risks.

Appendix A-1

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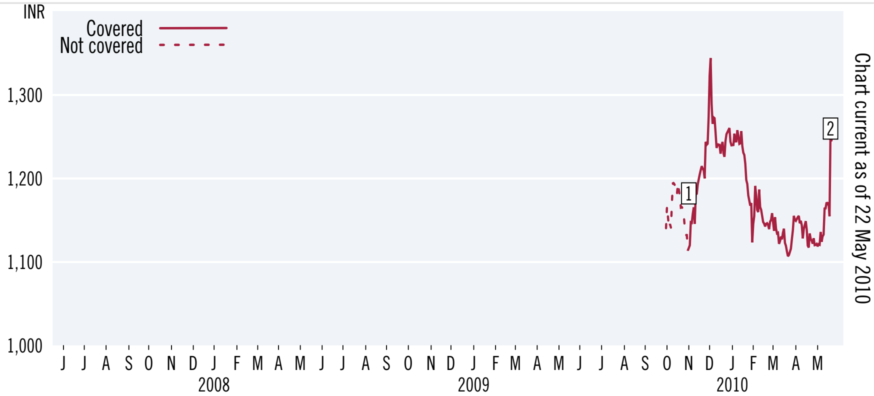
Ratings and Target Price History
Fundamental Research

Analyst: Rahul Singh
Covered since November 2 2009



Date	Rating	Target Price	Closing Price
1 2-Nov-09	*2L	*1,165.00	1,113.70
2 20-May-10	2L	*1,290.00	1,259.80

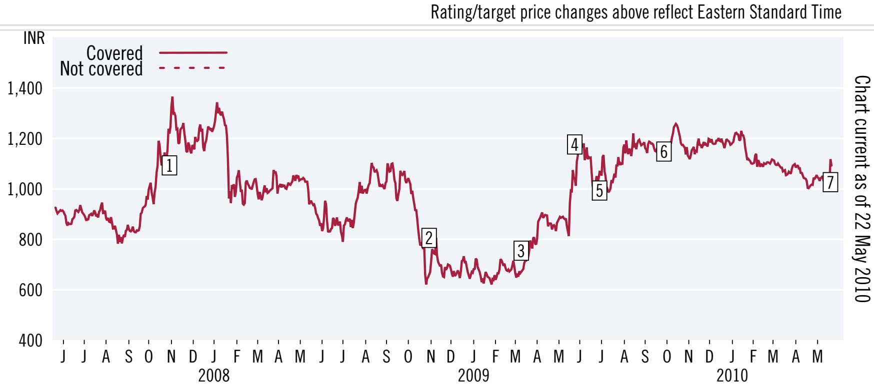
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Oil & Natural Gas (ONGC.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Rahul Singh



Date	Rating	Target Price	Closing Price
1 30-Oct-07	*1L	*1,400.00	1,219.55
2 30-Oct-08	*1M	*850.00	650.05
3 10-Mar-09	*3M	*587.00	665.75
4 24-May-09	3M	*820.00	1,045.30
5 28-Jun-09	3M	*910.00	1,040.90
6 27-Sep-09	3M	*1,130.00	1,157.30
7 20-May-10	*2L	*1,170.00	1,118.20

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