Company

28 July 2010 | 9 pages

Oil India (OILI.BO)

Equity
Target price change
Estimate change

Hold: 1Q Impacted by Lower Production

- **1Q impacted by lower production** — OIL's 1Q PAT came in at Rs5bn (-32% YoY, +16% QoQ), impacted by lower crude sales (by c0.13 MMT) primarily due to a longer than expected shutdown at Numaligarh Refinery, though the partial (June onwards) impact of the APM gas price hike offset this to some extent. DD&A at Rs2bn was also higher than expected, on account of higher dry well write-offs.
- **Net realization at US$44/bbl** — OIL's subsidy burden came in at Rs7.3bn for the quarter, in line with the Govt's decision of making upstream bear 1/3 of total fuel under-recoveries. While this translates into a net realization of US$44.3/bbl (owing to higher under-recoveries in 1Q, and lower crude sales), we expect net realizations to improve going forward following the price hikes and petrol deregulation announced by the EGoM in end-June.
- **Basing earnings on 1/3 sharing** — Our new forecasts assume 1/3 upstream subsidy share (on diesel, LPG, kero), as recently announced by the Oil Secretary. We cut FY11E earnings by 3% as we now peg OIL's net realizations at US$57 (US$59 earlier) given muted 1Q and assuming Rs536bn of FY11E gross under-recoveries (based on US$75 crude). We, however, raise FY12E estimates by 8%, on the back of higher net realizations of US$62 (full impact of price hikes/petrol deregulation and 5% production growth). FY13E growth is driven by production from OIL's 3.5% stake in Venezuela's Carabobo oil field (0.4 MMT in FY13E).
- **Maintain Hold; highest upstream sensitivity to diesel deregulation** — Our revised TP of Rs1,370 (Rs1,290 earlier) is based on: (i) P/E of 9x core Sep-11E and (ii) cash of Rs384/sh as on Sep-10E. Given OIL's better production growth prospects, our target P/E is now based on 10% (15% earlier) discount to ONGC's target multiple of 10x. Also, OIL is most levered to diesel deregulation, with ~20% upside to FY12E estimates if diesel is fully deregulated. However, lack of clarity on timelines on deregulation and no immediate triggers lead us to maintain Hold.

Hold/Low Risk	2L
Price (28 Jul 10)	Rs1,335.00
Target price	Rs1,370.00
from Rs1,290.00	
Expected share price return	2.6%
Expected dividend yield	2.5%
Expected total return	**5.2%**
Market Cap	Rs321,007M
	US$6,880M

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 (%)
2009A	21,617	101.01	20.8	13.2	3.1	25.0	2.3
2010A	26,105	108.57	7.5	12.3	2.3	22.6	2.5
2011E	28,942	120.37	10.9	11.1	2.1	19.7	2.8
2012E	33,032	137.37	14.1	9.7	1.8	19.8	3.2
2013E	37,579	156.28	13.8	8.5	1.6	19.8	3.7

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Fiscal year end 31-Mar	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	13.2	12.3	11.1	9.7	8.5
EV/EBITDA adjusted (x)	7.5	6.6	4.9	4.3	3.8
P/BV (x)	3.1	2.3	2.1	1.8	1.6
Dividend yield (%)	2.3	2.5	2.8	3.2	3.7
Per Share Data (Rs)					
EPS adjusted	101.01	108.57	120.37	137.37	156.28
EPS reported	101.01	108.57	120.37	137.37	156.28
BVPS	436.02	572.41	649.47	737.42	837.47
DPS	30.50	34.00	37.70	43.02	48.94
Profit & Loss (RsM)					
Net sales	73,842	80,728	92,061	103,837	120,660
Operating expenses	-47,375	-49,610	-57,210	-63,178	-72,755
EBIT	**26,467**	**31,118**	**34,851**	**40,659**	**47,905**
Net interest expense	-87	-37	-100	-100	-100
Non-operating/exceptionals	7,537	7,869	8,433	8,727	8,266
Pre-tax profit	**33,916**	**38,951**	**43,184**	**49,286**	**56,071**
Tax	-12,253	-12,846	-14,242	-16,254	-18,492
Extraord./Min.Int./Pref.div.	-46	0	0	0	0
Reported net income	**21,617**	**26,105**	**28,942**	**33,032**	**37,579**
Adjusted earnings	21,617	26,105	28,942	33,032	37,579
Adjusted EBITDA	36,944	38,756	48,121	55,034	63,669
Growth Rates (%)					
Sales	18.4	9.3	14.0	12.8	16.2
EBIT adjusted	20.8	17.6	12.0	16.7	17.8
EBITDA adjusted	28.1	4.9	24.2	14.4	15.7
EPS adjusted	20.8	7.5	10.9	14.1	13.8
Cash Flow (RsM)					
Operating cash flow	**41,571**	**21,109**	**53,177**	**46,505**	**52,055**
Depreciation/amortization	10,477	7,638	13,270	14,375	15,764
Net working capital	9,477	-12,634	10,965	-902	-1,288
Investing cash flow	**-8,999**	**-12,289**	**-20,792**	**-32,000**	**-35,200**
Capital expenditure	-8,999	-8,581	-24,499	-32,000	-35,200
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**-8,337**	**19,222**	**-10,058**	**-11,884**	**-13,520**
Borrowings	-1,184	-190	190	0	0
Dividends paid	-7,498	-9,392	-10,413	-11,884	-13,520
Change in cash	**24,236**	**28,042**	**22,327**	**2,621**	**3,335**
Balance Sheet (RsM)					
Total assets	**133,801**	**180,934**	**197,065**	**218,755**	**243,589**
Cash & cash equivalent	60,700	85,429	99,444	93,265	87,150
Accounts receivable	4,047	6,597	5,046	5,691	6,613
Net fixed assets	45,361	49,460	69,001	95,426	124,312
Total liabilities	**40,491**	**43,485**	**40,897**	**41,440**	**42,216**
Accounts payable	3,403	3,721	4,243	4,786	5,561
Total Debt	565	565	565	565	565
Shareholders' funds	**93,310**	**137,638**	**156,167**	**177,315**	**201,374**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	50.0	48.0	52.3	53.0	52.8
ROE adjusted	25.0	22.6	19.7	19.8	19.8
ROIC adjusted	27.8	29.8	28.2	26.8	24.6
Net debt to equity	-64.4	-61.7	-63.3	-52.3	-43.0
Total debt to capital	0.6	0.4	0.4	0.3	0.3

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OIL – 1QFY11 Result Overview

Figure 1. OIL – 1QFY11 Results

	1QFY10	4QFY10	1QFY11	% yoy	Comments
Revenues	**19,746**	**18,706**	**15,742**	**-20%**	Impacted owing to: 1) lower crude sales, 2) lower net realizations due to higher subsidy payout
Expenses					
(Increase)/decrease in stock	(146)	76	-118.2	-19%	
Consumption of raw materials	228	265	217	-5%	
Employee cost	2,477	2,038	2,499	1%	
Statutory levies	5,823	5,602	4,786	-18%	
Other expenditure	1,128	3,683	1,463	30%	
Total expenditure	9,510	11,664	8,847	-7%	
EBITDA	**10,236**	**7,043**	**6,895**	**-33%**	
EBITDA margin (%)	*53%*	*38%*	*45%*		
DD&A	1,218	3,235	1,979	63%	Higher dry well expenses
Interest	9	10	6	-29%	
Other income	1,635	2,084	2,424	48%	
Profit before tax	10,645	5,881	7,333	-31%	
Tax	3,248	1,572	2,322	-28%	
Tax rate	*30.5%*	*26.7%*	*31.7%*		
Profit after tax	**7,397**	**4,310**	**5,011**	**-32%**	
Operational Parameters					
Production (Quantity)					
Crude oil (MMT)	0.88	0.88	0.80		
Crude oil (mmbbl)	6.5	5.8	5.3		
Natural Gas (mmscm)	604	583	553		
Sales (Quantity)					
Crude oil (MMT)	0.84	0.86	0.78		Impact of c0.13 MMT due to NRL shutdown
Natural Gas (mmscm)	471	446	423		
Realizations					
Gross realization (US$/bbl)	57.5	75.7	78.1		OIL's crude benchmark is ~US$2.5-3 lower than Bonny Light
Net realization (US$/bbl)	55.7	53.3	44.3		Lower on account of: 1) higher subsidy burden and 2) lower crude sales
Gas (Rs/scm)	3.5	3.5	4.6		Partial (June onwards) impact of the APM gas price hike
Subsidy					
Rs m	576	6,700	7,297		Upstream shared 1/3 of total subsidy in 1Q, as opposed to bearing only the auto-fuel losses in FY10
$/bbl	1.8	22.4	33.8		

Source: Company Reports, Citi Investment Research and Analysis

Revising target price to Rs1,370

Figure 2. OIL – Target Price of Rs1,370

	Rs/sh	Comments
OIL Sep-11E core-EPS	109	Excl. other income
Target core P/E (x)	9.0	At a 10% discount to ONGC's core target multiple of 10x
Implied core equity value	982	
Cash per share	384	As of Sep-10E
Target Price	**1,370**	

Source: Citi Investment Research and Analysis estimates

Figure 3. OIL – Changes in key assumptions

Old	Units	FY11E	FY12E	FY13E
EPS	Rs/share	123.6	126.9	-
Crude	US$/bbl	82.0	88.0	-
Net realization (domestic)	US$/bbl	59.2	59.7	-
OIL's subsidy burden	Rsbn	26	33	-
Oil sales	MMT	3.7	3.9	-
Gas sales	bcm	2.0	2.1	-
INR/US$	Rs/$	46	45	-
New	**Units**	**FY11E**	**FY12E**	**FY13E**
EPS	Rs/share	120.4	137.4	156.3
% change in EPS		*-2.6%*	*8.2%*	-
Crude	US$/bbl	75.0	80.0	80.0
Net realization (domestic)	US$/bbl	57.1	62.1	62.7
OIL's subsidy burden	Rsbn	18.9	19.5	19.5
Oil sales	MMT	3.7	3.8	4.3
Gas sales	bcm	2.1	2.5	3.1
INR/US$	Rs/$	46	45	45

Source: Citi Investment Research and Analysis estimates

Figure 4. Oil India – Earnings Revision

Year to	Net Profit (Rs Mils.)		Diluted EPS (Rs)			Dividend Per Share (Rs)	
31-Mar	Old	New	Old	New	% Chg	Old	New
2011E	29,720	28,942	123.60	120.37	-2.6%	42.0	37.7
2012E	30,518	33,032	126.92	137.37	8.2%	43.2	43.0
2013E	-	37,579	-	156.28	-	-	48.9

Source: Citi Investment Research and Analysis estimates

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 Rs1,370 target price. OIL has established reserves in Onshore Assam Basin with adequate reserve life and reasonable production growth, which generates strong and stable cash flows, adding to the already-strong balance sheet. Given the subsidy mechanism of the upstream companies sharing 1/3 losses on all fuels and no clear timelines on future deregulation, we believe that OIL's leverage to crude beyond US$70/bbl is going to be limited. On the E&P front, while in the past OIL has predominantly focused on North-east Indian onshore blocks, it is now gradually gaining 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 Rs1,370 comprises: (i) Business valued at P/E of 9x Sep-11E core EPS and (ii) cash at Rs384/share (Sep-10E). The core P/E is at a 10% 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). Further re-rating from here would be dependent on higher net crude realizations, i.e. significant price reforms esp. in diesel (full deregulation), 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. Government policy on subsidy sharing remains a key risk, in our opinion, although further deregulation (especially of diesel) and/or any clarity on this front would have a positive impact.

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 FY07-10, 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.

Appendix A-1

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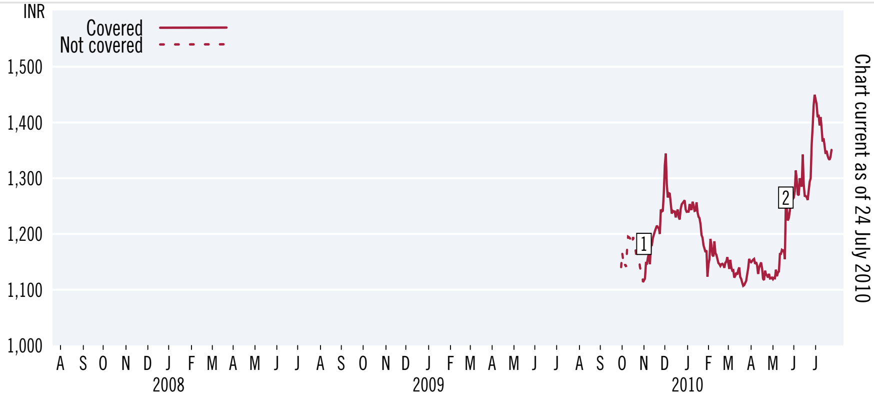
Oil India (OILI.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Saurabh Handa
Covered since June 18 2010



	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

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