

## Company Flash

26 June 2007 | 6 pages

# Cairn India (CAIL.BO)

## Buy: No Mini-Refinery = Yes to Pipeline

- **ONGC says no to the mini-refinery** — ONGC has indicated that building a mini-refinery in Rajasthan (c.80kbpd) would not be economically feasible. This sends an important signal to the market, as the refinery proposal had also indicated the possibility of restricting Rajasthan crude production to 80kbpd from the intended (and approved) 150kbpd, in order to support the local refinery for a longer time frame.
- **Win-win for everyone** — Not only would the reduced plateau production rates have lowered Cairn India's NAV by 35-40%, it would also reduce the NAV of government share of profit petroleum by an estimated ~25%. In any case, a sub-economic sized refinery based on supplies from a single oil block would have been difficult to justify commercially.
- **Pipeline approval around the corner now?** — This also removes the uncertainty on production levels and raises hopes for the approval to the proposed pipeline for crude evacuation; capex of US\$800m to be included as part of the development capex. Also, as confirmed by ONGC, the crude evacuation issue will be settled without any delay to Cairn's start-up in 2H09.
- **Core valuation support, Buy (1M)** — At long-term crude of US\$55/bbl, the shares trade at an 11% discount to NAV. But potential bid interest raises the possibility that a higher oil price is used in the bid valuation. In this context, premium to NAV of 15% therefore corresponds to long-term oil assumption of US\$60/bbl.

<b>Buy/Medium Risk</b>	<b>1M</b>
Price (25 Jun 07)	Rs137.75
Target price	Rs185.00
Expected share price return	34.3%
Expected dividend yield	0.0%
<b>Expected total return</b>	<b>34.3%</b>
Market Cap	Rs243,172M
	US\$5,964M

### Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Dec	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2005A	na	na	na	na	na	na	na
2006A	na	na	na	na	na	na	na
2007E	1,725	0.98	na	140.9	0.8	na	0.0
2008E	1,570	0.89	-9.0	154.9	0.8	0.5	0.0
2009E	14,859	8.42	846.3	16.4	0.8	5.1	0.0

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

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Figure 1. Cairn India – SOTP Valuation

Field	NPV (end-07) US\$m	NPV p/s Rs	EV/boe (US\$)	CIR Comments
Ravva	123	2.8	13.6	
CB-OS/2	104	2.4	8.1	
<b>Producing Fields</b>	<b>227</b>	<b>5.2</b>		
Mangala, Bhagyam, Aishwariya (MBA)	5,197	119.2	15.7	Based on cash flow analysis
Rajasthan Pipeline Option	8	0.2		Based on incremental pipeline capex/opex
Early Oil	32	0.7	10.0	Discount to implied EV/boe of MBA fields
<b>Rajasthan 'Core'</b>	<b>5,237</b>	<b>120.1</b>		
<b>Production &amp; Development</b>	<b>5,463</b>	<b>125.3</b>		
Overheads	-40	-0.9		
Net Cash/(Debt)	247	5.7		Estimated Net Debt as on end-2007 incl. US\$600m of IPO proceeds
<b>Financial Items</b>	<b>207</b>	<b>4.8</b>		
<b>Core NAV</b>	<b>5,670</b>	<b>130.1</b>		
MBA Recovery Factor Upside	349	8.0	8.0	Incremental 9% EOR recovery. Discount to implied EV/boe of MBA
LPD Reported Resource	393	9.0	8.5	Disclosed 2P resource associated with LPD
LPD Appraisal Upside	92	2.1	8.0	Potential for upside to LPD resource
Exploration Upside	474	10.9	8.0	Potential for basin-wide exploration
Rajasthan Upside	1,308	30.0		
<b>Net Asset Value</b>	<b>6,978</b>	<b>160</b>		

Source: Company Reports and Citigroup Investment Research estimates

## Cairn India

### Company description

Cairn India was incorporated as a subsidiary of Cairn Energy PLC (UK) to own and operate all of Cairn Plc's Indian E&P assets. Cairn India has operating interests in producing fields in KG Basin and the Cambay Basin offshore. However, most of reserves accrue from the Rajasthan Block where production commences in 2009. Post-IPO, Cairn Plc holds 69.5% in Cairn India.

### Investment thesis

We rate Cairn India Buy/ Medium Risk with a target price of Rs185, based on a 15% premium to NAV of cash flows and recovery & exploration upsides. Cairn India's ownership of valuable oil reserves in Rajasthan (OIP of 3.6bn boe) should generate steady cash flows from 2009, besides having potential to generate further upside from EOR and exploration. Cairn India's valuations are among the most highly leveraged to crude amongst global E&P peers, offsetting inherent operational risks. While recent bid speculation may prove ephemeral, we believe there exists potential upside from a prospective bidder willing to pay US\$60/bbl.

## Valuation

Our target price of Rs185 is based on a 15% premium to NAVs of under-development and producing assets and incorporating recovery & exploration upsides. We prefer NAV to value Cairn's assets as it has long-term visible cash flows from its existing resource base, the value of which cannot be captured using traditional near-term earnings multiples. The key assumptions for our NAV analysis are: long-term crude price (Brent) of US\$55/bbl; first oil from Rajasthan in 2H09; crude realization at a 7% discount to Brent; cess at Rs918/MT; plateau production at 155-160kbpd; development capex of US\$2.3bn; and the impact of pipeline option. Our target price is more leveraged to crude prices and less sensitive to operating parameters and/or reserve upside. We add a 15% premium to NAV to reflect the potential upside for an acquirer willing to pay c.US\$60/bbl. The traditional valuation multiples (EV/DACF) will become more relevant as Rajasthan approaches first oil, but contingent on the extent of exploration success.

## Risks

Our quantitative risk rating system assigns a default Speculative Risk rating to Cairn India as the stock has traded for less than 12 months. However, we believe a Medium Risk rating is more appropriate despite it being in the project stage due to tangible oil reserves which can be monetized, strong track record of the parent, and favorable demand-supply for domestic crude. Key risks include: (1) Delays and cost overruns; though cost recoverable, this could impact NAVs; (2) Unfavorable ruling on the cess liability being higher than our base case of Rs918/tonne; and (3) Potential conflict of interest arising out of Cairn PLC's majority ownership in Cairn India, especially in the context of the new exploration assets in India.

## Appendix A-1

### Analyst Certification

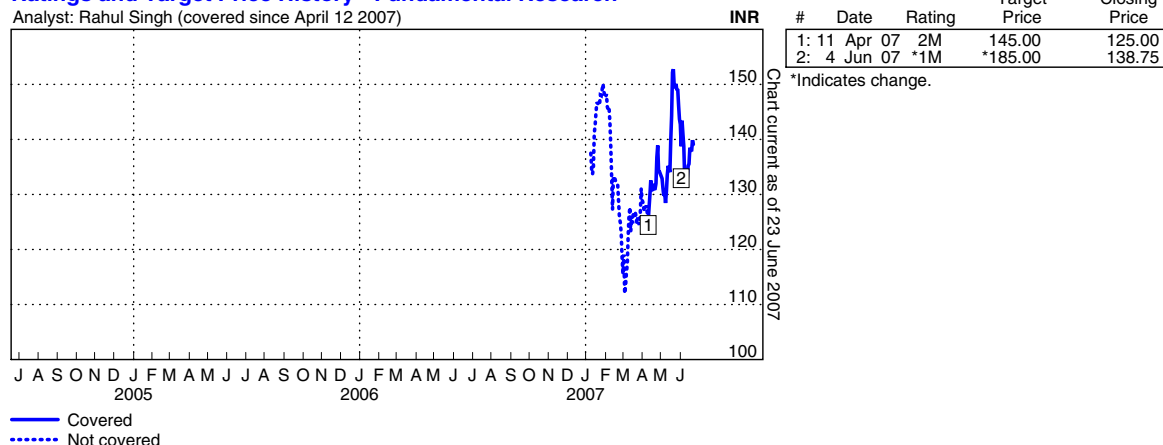
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##### Ratings and Target Price History - Fundamental Research

Analyst: Rahul Singh (covered since April 12 2007)



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