

To gain even if some expert group proposals accepted

Potential gain even from part implementation; Neutral

The Expert Group to tackle subsidies has proposed auto fuel deregulation and steep LPG-kerosene price hike. It has proposed that the government, ONGC and Oil India (OIL) bear the balance LPG-kerosene subsidy. ONGC & OIL are to fund subsidy by way of a tax on oil. If all proposals are implemented OIL's FY11E EPS would be 47% higher than base case. Full implementation of proposals appears unlikely as steep price hikes are proposed. However, some subsidy cut and therefore higher oil realization net of subsidy is possible for OIL. Upside to FY11E EPS would be 9% if only petrol is deregulated and 25% if even diesel subsidy is cut by 50%. We remain Neutral on OIL until clarity on proposal implementation.

47% upside to FY11E EPS if all proposals implemented

The Expert group has proposed eliminating auto fuel subsidy and steep cut in LPG-kerosene subsidy. The remaining LPG-kerosene subsidy is proposed to be borne by the government, ONGC and OIL. The subsidy for upstream is to be in the form of a tax on oil price, which starts at 20% when oil is US\$60-70/bbl. It rises gradually to peak at 80% when oil is over US\$90/bbl. If all proposals are implemented OIL's FY11E subsidy would be 62% lower at US\$10.8/bbl (US\$28/bbl in base case) and upside to FY11E EPS would be 47%.

8-22% EPS upside if no subsidy on petrol & diesel cut 50%

Full implementation of all expert group proposals appears very unlikely given the prevailing high inflation and the very poor track record especially on LPG-kerosene price hikes. However, only one state election in the next 15 months gives hope that at least some proposals may be implemented to cut subsidy. Petrol price deregulation and cut in diesel subsidy is possible. Upside potential to OIL's FY11E EPS would be 9% if only gasoline price is deregulated and upside potential would be 25% if diesel subsidy is also halved.

Estimates (Mar)

(Rs)	2008A	2009A	2010E	2011E	2012E
Net Income (Adjusted - mn)	17,889	21,566	26,696	26,589	27,507
EPS	83.59	100.77	111.05	110.60	114.42
EPS Change (YoY)	NA	20.6%	10.2%	-0.4%	3.5%
Dividend / Share	27.50	30.50	45.00	45.00	46.00
Free Cash Flow / Share	80.28	82.70	(42.36)	(40.63)	(9.87)

Valuation (Mar)

	2008A	2009A	2010E	2011E	2012E
P/E	15.46x	12.82x	11.64x	11.68x	11.29x
Dividend Yield	2.13%	2.36%	3.48%	3.48%	3.56%
EV / EBITDA*	9.89x	7.90x	6.56x	6.47x	6.00x
Free Cash Flow Yield*	5.53%	5.70%	-3.28%	-3.14%	-0.764%

* For full definitions of *iQmethod*SM measures, see page 6.

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Stock Data

Price	Rs1,292
Price Objective	Rs1,411
Date Established	3-Dec-2009
Investment Opinion	C-2-7
Volatility Risk	HIGH
52-Week Range	Rs1,019-Rs1,375
Mrkt Val / Shares Out (mn)	US\$6,757 / 240.4
Average Daily Volume	97,499
BofAML Ticker / Exchange	XLCRF / NSI
Bloomberg / Reuters	OINL IN / OILI.NS
ROE (2010E)	23.3%
Net Dbt to Eqty (Mar-2009A)	-64.4%
Est. 5-Yr EPS / DPS Growth	NA / NA
Free Float	NA

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iQprofileSM Oil India Ltd

Key Income Statement Data (Mar)	2008A	2009A	2010E	2011E	2012E
(Rs Millions)					
Sales	61,040	72,364	82,827	86,411	91,784
Gross Profit	24,582	30,757	37,066	37,563	40,476
Sell General & Admin Expense	NA	NA	NA	NA	NA
Operating Profit	20,354	24,988	30,291	29,769	31,625
Net Interest & Other Income	6,792	8,877	10,157	10,517	10,052
Associates	NA	NA	NA	NA	NA
Pretax Income	27,145	33,865	40,448	40,286	41,677
Tax (expense) / Benefit	(9,245)	(12,253)	(13,752)	(13,697)	(14,170)
Net Income (Adjusted)	17,889	21,566	26,696	26,589	27,507
Average Fully Diluted Shares Outstanding	214	214	240	240	240

Key Cash Flow Statement Data

Net Income	17,901	21,612	26,696	26,589	27,507
Depreciation & Amortization	4,228	5,768	6,775	7,794	8,851
Change in Working Capital	11,235	9,823	(4,679)	(4,796)	1,214
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	(7,135)	(9,011)	(10,200)	(10,560)	(10,095)
Cash Flow from Operations	26,229	28,193	18,592	19,027	27,477
Capital Expenditure	(9,049)	(10,496)	(28,775)	(28,794)	(29,851)
(Acquisition) / Disposal of Investments	NA	NA	NA	NA	NA
Other Cash Inflow / (Outflow)	(811)	0	0	0	0
Cash Flow from Investing	(9,860)	(10,496)	(28,775)	(28,794)	(29,851)
Shares Issue / (Repurchase)	0	0	27,720	0	0
Cost of Dividends Paid	(6,885)	(7,636)	(12,232)	(12,232)	(12,504)
Cash Flow from Financing	(6,141)	144	25,688	(1,672)	(2,409)
Free Cash Flow	17,180	17,698	(10,183)	(9,767)	(2,374)
Net Debt	(41,059)	(60,136)	(75,641)	(64,202)	(59,419)
Change in Net Debt	(16,619)	(19,025)	(15,505)	11,439	4,783

Key Balance Sheet Data

Property, Plant & Equipment	40,633	45,361	67,361	88,361	109,361
Other Non-Current Assets	4,887	4,887	4,887	4,887	4,887
Trade Receivables	12,165	14,319	15,035	16,573	16,850
Cash & Equivalents	42,808	60,700	76,205	64,766	59,984
Other Current Assets	6,793	8,535	8,961	10,383	10,220
Total Assets	107,286	133,801	172,449	184,970	201,301
Long-Term Debt	1,749	565	565	565	565
Other Non-Current Liabilities	8,667	9,013	8,000	8,000	8,000
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	17,541	30,914	28,390	26,554	27,882
Total Liabilities	27,956	40,491	36,955	35,119	36,446
Total Equity	79,330	93,310	135,494	149,851	164,855
Total Equity & Liabilities	107,286	133,801	172,449	184,970	201,301

iQmethodSM - Bus Performance*

Return On Capital Employed	15.4%	16.6%	16.2%	13.0%	12.6%
Return On Equity	24.2%	25.0%	23.3%	18.6%	17.5%
Operating Margin	33.3%	34.5%	36.6%	34.5%	34.5%
EBITDA Margin	40.3%	42.5%	44.8%	43.5%	44.1%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	1.5x	1.3x	0.7x	0.7x	1.0x
Asset Replacement Ratio	2.1x	1.8x	4.2x	3.7x	3.4x
Tax Rate (Reported)	34.1%	36.2%	34.0%	34.0%	34.0%
Net Debt-to-Equity Ratio	-51.8%	-64.4%	-55.8%	-42.8%	-36.0%
Interest Cover	NM	NM	NM	NM	NM

Key Metrics

* For full definitions of iQmethodSM measures, see page 6.

Company Description

Oil India is state-owned (78.4% stake) E&P company with mainly onshore production and exploration in North-east India. This region accounts for its entire crude oil and most of its gas production and reserves. It now has NELP exploration acreage in other areas including eastern offshore region. It also has 17 E&P assets outside India. OIL also has crude, gas and product pipelines in North-east India and has a small LPG production capacity.

Investment Thesis

Large subsidy on petroleum products has ensured that OIL does not benefit from rising oil prices and has hurt its earnings growth. Subsidized gas prices have also hit OIL. Reforms that substantially reduce or eliminate subsidy would improve earnings outlook and lead to re-rating. Gas price hike or deregulation will also help. OIL is aggressively acquiring highly prospective acreage in India and overseas but large reserve accretion is likely to take some time.

Stock Data

Price to Book Value

2.3x

Potential upsides

Implementation of expert group proposal

Subsidy for upstream in the form of tax on oil

Tax at 20% if oil US\$60-70/bbl; Tax of 80% at peak if oil over US\$90/bbl

The expert group has proposed that upstream players ONGC and OIL should fund subsidy by way of a tax on oil price. The tax is proposed to start at 20% if oil price is US\$60-70/bbl and peak at 80% if oil is over US\$90/bbl.

Table 1: Rate of tax on oil proposed by the expert group

Price range (US\$/bbl)	Rate of tax (% of the incremental price)
60-70	20%
70-80	40%
80-90	60%
Above 90	80%

Source: MOPNG

47% upside to FY11E EPS if all proposals implemented

If all proposals are implemented, in FY11E OIL's subsidy would be US\$10.8/bbl at our Brent price forecast of US\$88/bbl. This is 62% lower than subsidy of US\$28/bbl which we are assuming in the base case. Thus if all proposals are implemented, upside to OIL's EPS would be 47%.

Table 2: Upside to OIL's FY11E EPS if expert group proposal implemented

Rs/share	
FY11E EPS	
If expert group proposal fully implemented	162.0
Base case	110.6
Potential upside	47%

Source: BofA Merrill Lynch Global Research

Only 9% upside to FY11E EPS if only petrol deregulated

If only petrol prices are deregulated, OIL's FY11E subsidy would be US\$25/bbl vis-à-vis US\$28/bbl in the base case. Thus the upside to OIL's FY11E EPS would be 9% in this scenario.

Table 3: Upside to OIL's FY11E EPS if only petrol deregulated (zero subsidy)

Rs/share	
FY11E EPS	
If only petrol deregulated	120.5
Base case	110.6
Potential upside	9%

Source: BofA Merrill Lynch Global Research

25% upside to FY11E EPS if even diesel subsidy halved

If petrol prices are deregulated and diesel subsidy is also cut by 50%, OIL's FY11E subsidy would be US\$19/bbl vis-à-vis US\$28/bbl in the base case. Thus the upside to OIL's FY11E EPS would be 25% in this scenario.

Table 4: Upside to OIL's FY11E EPS if petrol deregulated (zero subsidy) and diesel subsidy halved

Rs/share	
FY11E EPS	
If petrol deregulated and diesel subsidy halved	138.4
Base case	110.6
Potential upside	25%

Source: BofA Merrill Lynch Global Research

Summary of potential EPS upside FY11E earnings outlook in three scenarios

Table 5 gives downsides to OIL's FY11E subsidy and upside to FY11E EPS in three potential scenarios of subsidy reduction. Thus, at least some upside to earnings seems likely.

Table 5: Downside to OIL's FY11E subsidy and upside to EPS in various scenarios

Scenario	OIL's FY11E	
	Subsidy US\$/bbl	EPS Rs/share
If all expert group proposal implemented	10.8	162.0
If only petrol deregulated	25.0	120.5
If petrol deregulated and diesel subsidy halved	19.0	138.4
Base case	28.0	110.6
Change vis-à-vis base case if		
All expert group proposal implemented	-61%	47%
Only petrol deregulated	-11%	9%
Petrol deregulated and diesel subsidy halved	-32%	25%

Source: BofA Merrill Lynch Global Research

Price objective basis & risk

Oil India Ltd (XLCRF)

Our sum of parts PO of Rs1,411 includes the DCF value of its 2P reserves (Rs971), best case resources (Rs18) and exploration upside (Rs58). It also includes net cash (Rs315), value of product pipeline on EV/EBITDA basis (Rs28) and investments at cost (Rs20). We have used WACC of 13.6pct to calculate DCF value. DCF value is based on long-term Brent price forecast of US\$80/bbl. However, given our subsidy assumptions the PO is effectively based on oil price realization net of subsidy of US\$56/bbl. We think that DCF is the most appropriate measure to value E&P assets. Downside risks are (1) Standard oil and gas industry operating risks which include exploration, development and production risks, oil price fluctuations, currency risk and reserve estimation, (2) lower-than-expected gas price rise which may adversely hit our valuation of OIL, and (3) sovereign risks, which include changes in the government and/or policies (eg, withdrawal of the tax holiday) which may have a direct impact on the business, cash flow and profit. (4) OIL's subsidy hit being higher than assumed by us (5) terrorist attacks in North East India causing significant damage to OIL's installations and facilities. Upside risks are: (1) Reforms that permanently reduce or eliminate OIL's subsidy hit (2) Large oil or gas discovery leading to significant reserve and value accretion

Analyst Certification

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	CNOOC	CEOHF	883 HK	Thomas Wong
	CNOOC	CEO	CEO US	Thomas Wong
	CNPC (Hong Kong)	CNPXF	135 HK	Vitus Leung
	COSL	CHOLF	2883 HK	Vitus Leung
	LG Chem	LGCLF	051910 KS	Kenneth Whee
	ONGC	ONGCF	ONGC IN	Vidyadhar Ginde
	Sinopec	SNPMF	386 HK	Thomas Wong
	Sinopec - A	SNP	SNP US	Thomas Wong
	SK Energy	XVERF	096770 KS	Kenneth Whee
NEUTRAL				
	Oil India Ltd	XLCRF	OINL IN	Vidyadhar Ginde
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	PetroChina - A	PTR	PTR US	Thomas Wong
UNDERPERFORM				
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	Formosa Petrochemical	FPTCF	6505 TT	Kenneth Whee
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	Reliance Inds -G	RLNIY	RIGD LI	Vidyadhar Ginde
	S-Oil	SOOCF	010950 KS	Kenneth Whee

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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*Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of December 31, 2009 or such later date as indicated.

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Buy	131	55.04%	Buy	84	71.19%
Neutral	58	24.37%	Neutral	29	69.05%
Sell	49	20.59%	Sell	20	44.44%

Investment Rating Distribution: Global Group (as of 01 Jan 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1699	50.78%	Buy	904	58.82%
Neutral	841	25.13%	Neutral	491	65.03%
Sell	806	24.09%	Sell	368	49.80%

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