



COMPANY UPDATE  
**Cairn India Ltd. (CAIL.BO)**

Buy

Looking at headwinds that could impede near-term performance

**What's changed**

We believe there could be some negative headwinds in the run-up to commencement of oil production from Cairn's Rajasthan block that could impact the stock price in the near term. These, in our view, are likely to be: 1) higher discount for Rajasthan Oil (about 15%) to Brent oil owing to a high pour point vs. market expectation of about 10%; 2) higher oil cess of Rs 2,575/ton for Cairn until arbitration likely ends in 2010E; 3) ONGC delaying future capex until govt reimburses part of royalty paid, and 4) possible delay in signing oil offtake agreement by refiners. Moreover, we believe there could be a near-term pullback in spot oil prices leading to weakness in the stock.

**Implications**

We believe short-term weakness on the above-mentioned potential negative headwinds could offer a more attractive entry level for investors over the next couple of months after it is priced in. We would watch for oil pricing and offtake agreements as we move towards first oil, which we believe could be in June rather than the market expectation of this month, based on our analysis. Nonetheless, we believe Cairn's attractive bottom-up growth story remains intact and reiterate our Buy rating. Currently the stock is implying long-term Brent of US\$75/bbl vs. our forecast of US\$85/bbl.

**Valuation**

We reduce our NAV-based 12-m TP to Rs220/sh (from Rs 232), with normalized Brent of US\$85/bbl from 2013E, implying 7% upside. Specifically, we cut Cairn's 2009E-11E EPS by 7%-25%, as we build in 1) a 15% discount to Brent (vs. 10% earlier), and 2) higher cess of Rs2,575/ton until the likely end of arbitration proceedings by end-2010E. The impact on our target price is muted owing to 1) the gov't sharing 50% of the impact of lower oil realization and 2) cost recovery on oil cess.

**Key risks**

1) Oil price decline, 2) project delays and 3) potential need to fund future capex by equity.

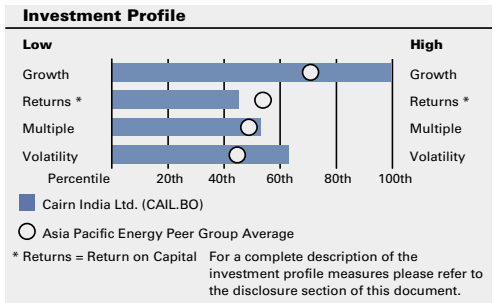
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Asia Pacific Buy List

**Coverage View: Neutral**

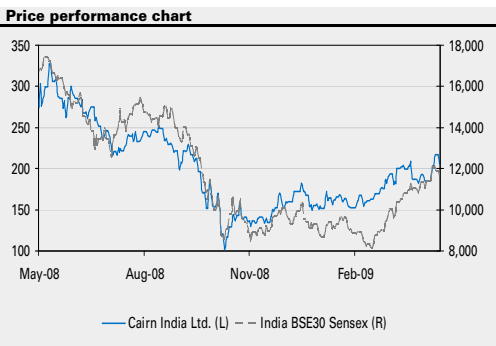
India:  
Oil

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Key data	Current
Price (Rs)	205.95
12 month price target (Rs)	220.00
Market cap (Rs mn / US\$ mn)	389,533.7 / 7,904.5
Foreign ownership (%)	12.0

	12/08	12/09E	12/10E	12/11E
<b>EPS (Rs) New</b>	<b>2.65</b>	<b>2.10</b>	<b>17.15</b>	<b>42.88</b>
EPS revision (%)	0.0	(24.5)	(21.0)	(7.2)
EPS growth (%)	161.6	(20.9)	716.8	150.0
<b>EPS (dil) (Rs) New</b>	<b>2.65</b>	<b>2.10</b>	<b>17.15</b>	<b>42.88</b>
P/E (X)	77.6	98.1	12.0	4.8
P/B (X)	1.2	1.2	1.1	0.9
EV/EBITDA (X)	48.4	39.6	7.4	2.9
Dividend yield (%)	--	--	--	--
ROE (%)	2.5	1.2	9.4	20.3



Share price performance (%)	3 month	6 month	12 month
Absolute	27.1	42.9	(24.8)
Rel. to India BSE30 Sensex	4.7	20.4	7.7

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 5/11/2009 close.

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# Cairn India Ltd.: Summary financials

Profit model (Rs mn)	12/08	12/09E	12/10E	12/11E	Balance sheet (Rs mn)	12/08	12/09E	12/10E	12/11E
<b>Total revenue</b>	<b>11,682.5</b>	<b>17,258.1</b>	<b>80,366.6</b>	<b>138,697.7</b>	Cash & equivalents	43,707.4	28,221.9	31,760.8	71,361.3
Cost of goods sold	(2,279.2)	(5,675.5)	(23,691.0)	(19,661.6)	Accounts receivable	811.3	1,198.5	5,581.0	9,631.8
SG&A	(1,218.2)	(1,379.5)	(2,450.7)	(2,698.3)	Inventory	2,056.3	2,694.4	5,483.3	5,040.3
R&D	--	--	--	--	Other current assets	4,650.3	4,650.3	4,650.3	4,650.3
Other operating profit/(expense)	0.0	0.0	0.0	0.0	<b>Total current assets</b>	<b>51,225.2</b>	<b>36,765.0</b>	<b>47,475.3</b>	<b>90,683.6</b>
<b>EBITDA</b>	<b>8,185.0</b>	<b>10,203.1</b>	<b>54,225.0</b>	<b>116,337.8</b>	Net PP&E	54,811.0	92,461.0	118,667.6	138,198.6
Depreciation & amortization	(3,266.6)	(4,949.9)	(14,259.2)	(20,415.2)	Net intangibles	253,192.7	253,192.1	253,192.7	253,192.1
<b>EBIT</b>	<b>4,918.4</b>	<b>5,253.3</b>	<b>39,965.8</b>	<b>95,922.6</b>	Total investments	7,128.9	7,128.9	7,128.9	7,128.9
Interest income	--	--	--	--	Other long-term assets	0.0	0.0	0.0	0.0
Interest expense	(43.3)	(1,017.1)	(1,659.5)	(1,799.7)	<b>Total assets</b>	<b>366,357.9</b>	<b>389,547.0</b>	<b>426,464.5</b>	<b>489,203.2</b>
Income/(loss) from uncons. subs.	0.0	0.0	0.0	0.0	Accounts payable	4,525.7	6,788.5	8,146.2	14,058.8
Others	2,868.0	1,000.0	1,250.0	2,000.0	Short-term debt	0.0	0.0	0.0	0.0
<b>Pretax profits</b>	<b>7,743.2</b>	<b>5,236.2</b>	<b>39,556.3</b>	<b>96,122.9</b>	Other current liabilities	3,998.2	4,111.1	4,228.6	4,350.7
Income tax	(2,702.0)	(1,247.2)	(6,974.6)	(14,668.4)	<b>Total current liabilities</b>	<b>8,523.9</b>	<b>10,899.7</b>	<b>12,374.8</b>	<b>18,409.6</b>
Minorities	0.0	0.0	0.0	0.0	Long-term debt	26,424.4	43,049.4	45,659.4	20,659.4
<b>Net income pre-preferred dividends</b>	<b>5,041.2</b>	<b>3,988.9</b>	<b>32,581.7</b>	<b>81,454.5</b>	Other long-term liabilities	6,664.3	6,864.3	7,114.3	7,364.3
Preferred dividends	0.0	0.0	0.0	0.0	Total long-term liabilities	33,088.7	49,913.7	52,773.7	28,023.7
<b>Net income (pre-exceptionals)</b>	<b>5,041.2</b>	<b>3,988.9</b>	<b>32,581.7</b>	<b>81,454.5</b>	<b>Total liabilities</b>	<b>41,612.6</b>	<b>60,813.4</b>	<b>65,148.5</b>	<b>46,433.3</b>
Post-tax exceptionals	2,807.0	0.0	0.0	0.0	<b>Preferred shares</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Net income</b>	<b>7,848.2</b>	<b>3,988.9</b>	<b>32,581.7</b>	<b>81,454.5</b>	<b>Total common equity</b>	<b>324,745.3</b>	<b>328,733.6</b>	<b>361,316.0</b>	<b>442,769.9</b>
EPS (basic, pre-exception) (Rs)	2.67	2.11	17.23	43.07	Minority interest	0.0	0.0	0.0	0.0
EPS (basic, post-exception) (Rs)	2.67	2.11	17.23	43.07	<b>Total liabilities &amp; equity</b>	<b>366,357.9</b>	<b>389,547.0</b>	<b>426,464.5</b>	<b>489,203.2</b>
EPS (diluted, post-exception) (Rs)	2.65	2.10	17.15	42.88	<b>BVPS (Rs)</b>	<b>171.70</b>	<b>173.80</b>	<b>191.03</b>	<b>234.10</b>
DPS (Rs)	0.00	0.00	0.00	0.00					
Dividend payout ratio (%)	0.0	0.0	0.0	0.0					
Free cash flow yield (%)	(4.4)	(8.4)	(0.1)	16.2					
<b>Growth &amp; margins (%)</b>	<b>12/08</b>	<b>12/09E</b>	<b>12/10E</b>	<b>12/11E</b>	<b>Ratios</b>	<b>12/08</b>	<b>12/09E</b>	<b>12/10E</b>	<b>12/11E</b>
Sales growth	15.4	47.7	365.7	72.6	ROE (%)	2.5	1.2	9.4	20.3
EBITDA growth	23.8	24.7	431.5	114.5	ROA (%)	2.3	1.1	8.0	17.8
EBIT growth	143.5	6.8	660.8	140.0	ROACE (%)	1.7	1.5	9.4	21.6
Net income growth	NM	(49.2)	716.8	150.0	Inventory days	262.0	152.8	63.0	97.7
EPS growth	161.6	(20.9)	716.8	150.0	Receivables days	33.7	21.3	15.4	20.0
Gross margin	80.5	67.1	70.5	85.8	Payable days	676.4	363.8	115.0	206.1
EBITDA margin	70.1	59.1	67.5	83.9	Net debt/equity (%)	(5.3)	4.5	3.8	(11.5)
EBIT margin	42.1	30.4	49.7	69.2	Interest cover - EBIT (X)	113.7	5.2	24.1	53.3
<b>Cash flow statement (Rs mn)</b>	<b>12/08</b>	<b>12/09E</b>	<b>12/10E</b>	<b>12/11E</b>	<b>Valuation</b>	<b>12/08</b>	<b>12/09E</b>	<b>12/10E</b>	<b>12/11E</b>
Net income pre-preferred dividends	5,041.2	3,988.9	32,581.7	81,454.5	P/E (analyst) (X)	77.6	98.1	12.0	4.8
D&A add-back	1,743.6	3,474.9	12,606.7	18,995.2	P/B (X)	1.2	1.2	1.1	0.9
Minorities interests add-back	0.0	0.0	0.0	0.0	EV/EBITDA (X)	48.4	39.6	7.4	2.9
Net (inc)/dec working capital	(152.1)	1,350.6	(5,696.3)	2,427.0	Dividend yield (%)	--	--	--	--
Other operating cash flow	2,119.0	200.0	250.0	250.0					
<b>Cash flow from operations</b>	<b>8,751.7</b>	<b>9,014.4</b>	<b>39,742.1</b>	<b>103,126.7</b>					
Capital expenditures	(27,008.4)	(41,124.9)	(38,813.3)	(38,526.2)					
Acquisitions	0.0	0.0	0.0	0.0					
Divestitures	0.0	0.0	0.0	0.0					
Others	0.0	0.0	0.0	0.0					
<b>Cash flow from investments</b>	<b>(27,008.4)</b>	<b>(41,124.9)</b>	<b>(38,813.3)</b>	<b>(38,526.2)</b>					
Dividends paid (common & pref)	0.0	0.0	0.0	0.0					
Inc/(dec) in debt	23,300.0	16,625.0	2,610.0	(25,000.0)					
Common stock issuance (repurchase)	25,345.9	0.0	0.0	0.0					
Other financing cash flows	0.0	0.0	0.0	0.0					
<b>Cash flow from financing</b>	<b>48,645.9</b>	<b>16,625.0</b>	<b>2,610.0</b>	<b>(25,000.0)</b>					
<b>Total cash flow</b>	<b>30,389.2</b>	<b>(15,485.5)</b>	<b>3,538.9</b>	<b>39,600.5</b>					

Note: Last actual year may include reported and estimated data.  
Source: Company data, Goldman Sachs Research estimates.

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## Looking at near-term headwinds on Cairn as we approach first oil

We believe there could be some negative headwinds for Cairn India in the run-up to commencement of oil production from its Rajasthan block that could have negative impact on the stock in near term.

The negative headwinds, in our view, are likely to be:

- 1) Higher discount (about 15%) to Brent for Rajasthan oil vs. market expectation of c. 10% discount to Brent;
- 2) Higher oil cess of Rs 2,575/ton for Cairn until arbitration likely ends 2010E, as the company expects;
- 3) ONGC delaying future capex until the government reimburses part of royalty paid; and
- 4) Delay in signing oil offtake agreement by refiners.

Moreover, we believe that there could be a near-term pullback in spot oil prices following the recent rally, leading to weakness in Cairn stock.

### Rajasthan crude likely to sell at nearly 15% discount to Brent

While crudes similar to Rajasthan's in terms of API and sulphur content have globally traded at 8%-14% discount to Brent over time, we believe that Cairn's crude could sell at a steeper discount of around 15% owing to a high pour point of 40°-45°C. Specifically, a high pour point is an issue in transporting and storing the crude, necessitating some changes in the internal infrastructure of the off-taking refineries in order to handle it properly. **Our channel checks indicate that recent negotiations are moving more towards a 15% discount than 10%, as we estimated earlier.**

#### Exhibit 1: While similar crudes have traded at a 10%-14% discount to Brent over the last year, we now think Cairn's Rajasthan crude could sell at about 15% discount owing to high pour point of 40°-45°C

Summary of various benchmark crudes

Particulars	Discount %						
	Spot	1 yr	3 yr	5 yr	10 yr		
<b>Differential to Brent: API Gravity Sulphur %</b>							
Duri-Widuri (55:45)	27	0.15%	4%	10%	9%	10%	8%
Maya	22	3.30%	12%	14%	17%	19%	19%
Arab Heavy	27	2.87%	3%	10%	11%	13%	12%
Ratawi	24.6	3.90%	12%	12%	12%	NA	NA
Oriente	24	1.51%	13%	13%	10%	14%	13%
Soudie	24	3.90%	14%	14%	11%	15%	14%
<b>Differential to Dubai</b>							
Duri-Widuri (55:45)	27	0.15%	4%	6%	5%	4%	2%
Maya	22	3.30%	14%	11%	13%	13%	13%
Arab Heavy	27	2.87%	3%	7%	7%	7%	6%
Ratawi	24.6	3.90%	8%	8%	8%	NA	NA
Oriente	24	1.51%	10%	10%	9%	10%	9%
Soudie	24	3.90%	11%	11%	10%	11%	10%

Source: Bloomberg, Goldman Sachs Research

**Exhibit 2: We estimate Cairn's NAV varies between Rs202 to Rs230 for 20%-10% discount to Brent for Rajasthan oil**

Sensitivity of Cairn India's NAV under various discounts to Brent for Rajasthan oil

Discount to Brent	Value (Rs/share)	% impact on base case
10%	230	5%
12%	226	3%
15% - Base case	220	0%
18%	209	-5%
20%	202	-8%

Source: Goldman Sachs Research estimates

**Cairn will have to pay Rs 2,575/ton cess until arbitration likely ends in 2010E**

While we continue to believe that ONGC, as the licensee of Rajasthan block, has the liability of paying oil cess for the entire production, the issue is likely to be settled only by arbitration proceedings, which the company expects could last until the end of 2010E. Meanwhile, Cairn would have to pay oil cess for its share of production "under protest" at the current rate of Rs 2,575/ton although it has a fiscal stability clause in the production-sharing contract (PSC) for Rajasthan.

After the arbitration proceedings are over, the fiscal stability clause would likely come into effect and the cess would likely come down to Rs927/ton, which was the prevailing rate at the time of signing the PSC.

We, therefore, have now built in oil cess at current rate of Rs 2,575/ton for Cairn until end of 2010E. **While we note that the impact on Cairn's NAV from this would likely be muted because of cost recovery on cess, we believe the impact on 2009E-10E EPS would be higher, which we now factor into our estimates.**

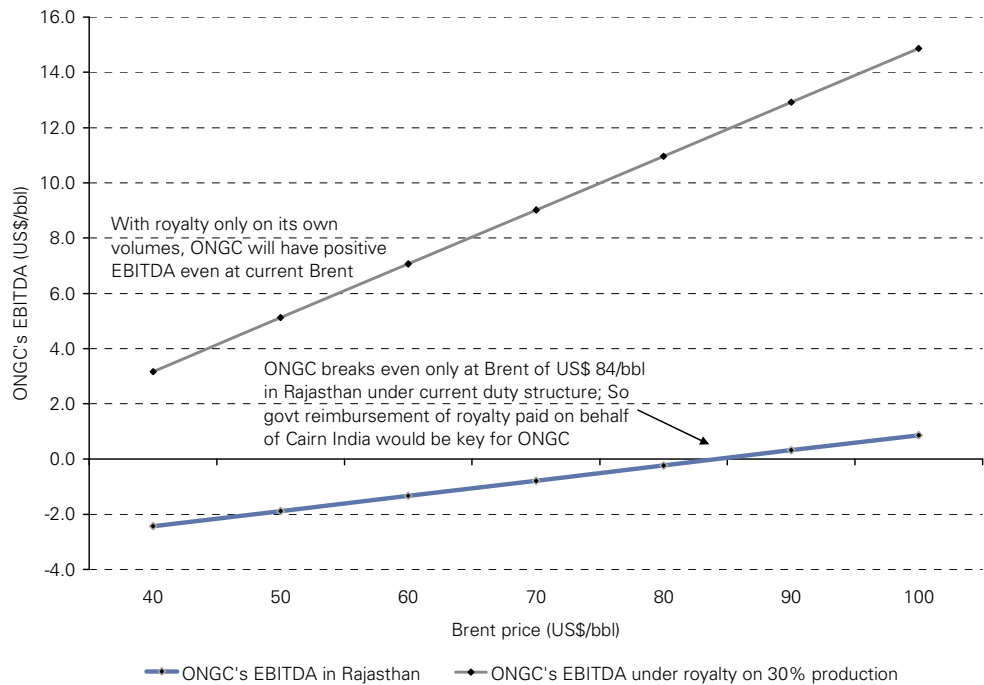
**ONGC could delay future capex in Rajasthan until the government reimburses part of royalty paid**

Our analysis indicates that the commencement of crude production in Rajasthan will not necessarily be beneficial for ONGC. **If ONGC is required to pay both the royalty of 20% and oil cess for the entire production, we calculate that it would only break even at EBITDA level in Rajasthan at Brent oil of US\$84/bbl.** Based on our analysis, the NPV of the Rajasthan project could also turn out to be negative for ONGC under our current crude oil price forecasts.

Hence, according to Business Standard, ONGC's board is hesitant to approve any future capex in Rajasthan until the company renegotiates the terms with the government. We believe this could delay production ramp-up in Rajasthan or put cash flow stress on Cairn to spend the entire capex from its own books until the issue is resolved.

Also reports by media sources (including Business Standard) indicate that ONGC is trying to work out a solution with the government, **in which ONGC would pay full cess to the government, but would be reimbursed by the government for royalty from the latter's share of profit petroleum.**

**Exhibit 3: ONGC would break even at EBITDA level in Rajasthan at Brent of US\$84/bbl, if it pays royalty and cess for the entire production**  
 ONGC's EBITDA/bbl from Rajasthan under various Brent price scenarios



Source: Goldman Sachs Research estimates.

**Exhibit 4: NPV of ONGC's share in Rajasthan project would be negative under our current oil assumptions unless government reimburses part of royalty**  
 Scenario analysis for ONGC's Rajasthan NPV

NPV (US\$ mn)	Royalty		
	0%	10%	20%
Cess (Rs/ton)			
0	3,825	2,390	589
927	3,389	1,747	-329
1854	2,699	984	-1,358
2575	2,163	324	-2,307

Source: Goldman Sachs Research estimates

**There could be a delay in signing oil offtake agreement by refiners**

The initial indications are that the state-owned oil marketing companies (OMCs), nominated by the government, are unlikely to lift the entire volume of Rajasthan crude production. HPCL, MRPL and IOC have together agreed to off-take only 30%-40% of the Rajasthan production for FY10E and FY11E.

While the petroleum ministry is in the process of figuring out the maximum crude volume that can be taken by OMCs, it is likely that Cairn would have to search for buyers among the private refiners like Essar and Reliance Industries (RIL).

This suggests that there could be delays in finalizing the list of off-takers for Cairn crude. **The decision regarding allowing Cairn to export oil would likely be made by the new**

**central government to be elected by ongoing general elections in the country by mid-June and hence uncertain at this time.**

## Retain Buy with new TP of Rs 220, implying 7% upside; EPS cut

We reduce our NAV-based 12-month target price of Rs220 (Rs 232 earlier), with normalized Brent of US\$85/bbl from 2013E, implying 7% upside.

We cut our 2009E-11E EPS estimates for Cairn by 7%-24%, as we build in 1) 15% discount to Brent (vs. 10% earlier), and 2) higher cess of Rs2,575/ton until likely resolution of arbitration proceedings by end-2010E.

Impact on our target price is muted, owing to 1) the government sharing 50% impact of lower oil realization and 2) cost recovery on oil cess.

We retain our Buy rating, as we believe Cairn's attractive bottom-up growth story remains intact.

### Exhibit 5: Our new NAV-based target price for Cairn India falls to Rs220 from Rs 232 NAV valuation of Cairn India

Asset	Value (US\$ mn)	Per share (Rs/share)	Methodology
Rajasthan	6,852	171	DCF-based
Rajasthan - EOR	1,330	33	DCF-based
Ravva	654	16	DCF-based
Cambay	300	8	DCF-based
KG Basin	0	0	at EV/boe of US\$2.0
<b>Total EV</b>	<b>9,136</b>	<b>228</b>	
Net debt (cash)	318	8	
<b>Equity value</b>	<b>8,818</b>	<b>220</b>	

Source: Goldman Sachs Research estimates

### Exhibit 6: We cut our EPS estimates by 7%-24% primarily owing to 1) lower oil realization and 2) higher oil cess until 2010E

Summary of EPS changes for Cairn India

Period	EPS (Rs)		% Change	Comments
	Old	New		
2009E	2.78	2.10	-24%	15% discount to Brent for Rajasthan oil (10% earlier); Higher cess of Rs2,575/ton
2010E	21.72	17.15	-21%	15% discount to Brent for Rajasthan oil (10% earlier); Higher cess of Rs2,575/ton
2011E	46.20	42.88	-7%	15% discount to Brent for Rajasthan oil (10% earlier)

Source: Goldman Sachs Research estimates

## Reg AC

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The precise calculation of each metric may vary depending on the fiscal year, industry and region but the standard approach is as follows:

**Growth** is a composite of next year's estimate over current year's estimate, e.g. EPS, EBITDA, Revenue. **Return** is a year one prospective aggregate of various return on capital measures, e.g. CROCI, ROACE, and ROE. **Multiple** is a composite of one-year forward valuation ratios, e.g. P/E, dividend yield, EV/FCF, EV/EBITDA, EV/DACF, Price/Book. **Volatility** is measured as trailing twelve-month volatility adjusted for dividends.

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Nilesh Banerjee: Asia Pacific Energy.

Asia Pacific Energy: Bharat Petroleum, Cairn India Ltd., China Petroleum & Chemical (A), China Petroleum and Chemical (ADS), China Petroleum and Chemical (H), CNOOC, CNOOC (ADR), Gas Authority of India, GS Holdings, Gujarat State Petronet, Hindustan Petroleum, Indian Oil Corp., Mangalore Refinery & Petrochemicals, Oil & Natural Gas Corp., PetroChina (A), PetroChina (ADR), PetroChina (H), Petronet LNG, PTT Public Company, PTTEP, Reliance Industries, Reliance Industries (GDR), S-Oil Corp., Singapore Petroleum, SK Energy, Thai Oil.

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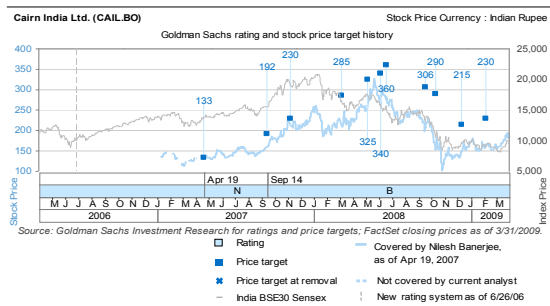
Goldman Sachs Investment Research global coverage universe

	Rating Distribution			Investment Banking Relationships		
	Buy	Hold	Sell	Buy	Hold	Sell
Global	25%	53%	22%	54%	51%	43%

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## Price target and rating history chart(s)



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