

## Company

16 August 2010 | 10 pages

# Cairn India (CAIL.BO)

Equity

## Offer Price Limits Upside; Reiterate Hold

- Transaction summary** — Cairn Plc announced that it would be selling a 40-51% stake in Cairn India to Vedanta Resources (VED.L; £21.28; 1M) for US\$6.65-8.48bn (Rs405/sh). The stake sold would depend on the uptake of the open offer (for 20%) which Vedanta group would make to minorities. The transaction is expected to be completed by end-FY11, after which Vedanta group would hold 51-60% in Cairn India, while Cairn Plc would continue to hold 11-22%.
- Open offer price close to NAV** — The open offer price has been fixed at Rs355/sh, in line with our Cairn NAV (Rs343-349/sh; TP at 5% premium), with Cairn Plc getting additional Rs50/sh as non-compete fee, wherein it would not compete with Cairn India in certain geographies (India, Sri Lanka, Bhutan, and Pakistan).
- Limited upsides; maintain Hold** — Our recent downgrade to Hold was premised on further reserve upgrades/exploratory newsflow largely being 2011 events, with limited near-term stock drivers. While Petronas's stance could determine acceptance ratio of the 20% open offer (free float of 23/38% excl./incl. Petronas), we see limited upside to both our NAV for Cairn (Rs343-349/sh) and the open offer price (Rs355/sh), and accordingly maintain Hold.
- Regulatory approvals; mgmt confident** — Mgmt indicated that since this was a corporate transaction and not an asset sale, they were not overly concerned about regulatory approvals or specific PSC provisions. While gov't endorsement of the deal would be required, they did not envisage any significant hurdles. Further, mgmt also stated that neither ONGC (30% partner in Rajasthan) nor Petronas (14.9% shareholder) had pre-emptive rights. Lastly, mgmt believes the transaction would not affect the royalty position in Raj. at all, as this is governed by the PSC.
- Vedanta to gain mgmt control** — On the transaction completion, Vedanta would gain mgmt control of Cairn India, though Cairn Plc might continue to have board representation. Vedanta stated its intention to fully support existing Cairn mgmt.

<b>Hold/Low Risk</b>	<b>2L</b>
Price (16 Aug 10)	Rs332.85
Target price	Rs363.00
Expected share price return	9.1%
Expected dividend yield	0.0%
<b>Expected total return</b>	<b>9.1%</b>
Market Cap	Rs631,532M US\$13,545M

### Price Performance (RIC: CAIL.BO, BB: CAIR IN)



### Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2009A	na	na	na	na	na	na	na
2010A	10,511	5.43	na	61.3	1.9	3.1	0.0
2011E	53,686	27.74	410.8	12.0	1.6	14.7	0.0
2012E	90,769	46.90	69.1	7.1	1.3	20.7	0.0
2013E	89,348	46.16	-1.6	7.2	1.1	16.9	0.0

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2009	2010	2011E	2012E	2013E
<b>Valuation Ratios</b>					
P/E adjusted (x)	na	61.3	12.0	7.1	7.2
EV/EBITDA adjusted (x)	na	65.0	7.5	4.2	3.7
P/BV (x)	na	1.9	1.6	1.3	1.1
Dividend yield (%)	na	0.0	0.0	0.0	0.0
<b>Per Share Data (Rs)</b>					
EPS adjusted	na	5.43	27.74	46.90	46.16
EPS reported	na	5.43	27.74	46.90	46.16
BVPS	na	174.90	202.64	249.53	295.70
DPS	na	0.00	0.00	0.00	0.00
<b>Profit &amp; Loss (RsM)</b>					
Net sales	na	16,596	91,324	143,649	139,726
Operating expenses	na	-10,362	-27,396	-39,660	-39,604
<b>EBIT</b>	<b>na</b>	<b>6,235</b>	<b>63,928</b>	<b>103,989</b>	<b>100,123</b>
Net interest expense	na	-295	-3,220	-3,150	-3,080
Non-operating/exceptionals	na	4,224	2,233	9,870	14,201
<b>Pre-tax profit</b>	<b>na</b>	<b>10,163</b>	<b>62,942</b>	<b>110,709</b>	<b>111,243</b>
Tax	na	348	-9,255	-19,940	-21,895
Extraord./Min.Int./Pref.div.	na	0	0	0	0
<b>Reported net income</b>	<b>na</b>	<b>10,511</b>	<b>53,686</b>	<b>90,769</b>	<b>89,348</b>
Adjusted earnings	na	10,511	53,686	90,769	89,348
Adjusted EBITDA	na	9,805	81,516	128,102	121,444
<b>Growth Rates (%)</b>					
Sales	na	na	450.3	57.3	-2.7
EBIT adjusted	na	na	925.4	62.7	-3.7
EBITDA adjusted	na	na	731.4	57.1	-5.2
EPS adjusted	na	na	410.8	69.1	-1.6
<b>Cash Flow (RsM)</b>					
<b>Operating cash flow</b>	<b>na</b>	<b>14,820</b>	<b>71,246</b>	<b>114,782</b>	<b>110,575</b>
Depreciation/amortization	na	3,571	17,588	24,113	21,322
Net working capital	na	738	-28	-100	-95
<b>Investing cash flow</b>	<b>na</b>	<b>-46,080</b>	<b>-37,720</b>	<b>-30,600</b>	<b>-28,380</b>
Capital expenditure	na	-46,080	-37,720	-30,600	-28,380
Acquisitions/disposals	na	0	0	0	0
<b>Financing cash flow</b>	<b>na</b>	<b>-5,164</b>	<b>5,300</b>	<b>10,300</b>	<b>-1,200</b>
Borrowings	na	-5,164	5,300	10,300	-1,200
Dividends paid	na	0	0	0	0
<b>Change in cash</b>	<b>na</b>	<b>-36,424</b>	<b>38,826</b>	<b>94,482</b>	<b>80,995</b>
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>na</b>	<b>399,441</b>	<b>462,777</b>	<b>570,645</b>	<b>666,276</b>
Cash & cash equivalent	na	32,760	87,288	191,906	285,717
Accounts receivable	na	8,994	10,287	10,540	10,819
Net fixed assets	na	104,494	112,010	115,007	116,547
<b>Total liabilities</b>	<b>na</b>	<b>60,907</b>	<b>70,557</b>	<b>87,656</b>	<b>93,938</b>
Accounts payable	na	18,456	19,720	19,873	20,057
Total Debt	na	38,400	43,700	54,000	52,800
<b>Shareholders' funds</b>	<b>na</b>	<b>338,534</b>	<b>392,220</b>	<b>482,989</b>	<b>572,338</b>
<b>Profitability/Solvency Ratios (%)</b>					
EBITDA margin adjusted	na	59.1	89.3	89.2	86.9
ROE adjusted	na	3.1	14.7	20.7	16.9
ROIC adjusted	na	1.9	15.5	23.5	21.7
Net debt to equity	na	1.7	-11.1	-28.6	-40.7
Total debt to capital	na	10.2	10.0	10.1	8.4

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**Figure 1. Open-Offer Calculations**

No. of shares	(m)	Comments
Cairn Plc (1)	1,183	62.36% stake pre-transaction
Petronas (2)	283	14.94% stake
LIC (3)	49	2.57% stake
Others (4)	382	20.12% stake
Total share count	1,897	
<b>Calculations related to open offer</b>		
Open offer	379	For 20% of share capital
No. of shares eligible to be tendered	714	Total non-promoter shares incl. Petronas: (2)+(3)+(4)
Acceptance Ratio	53%	Assuming all eligible shares are tendered
<b>Calculations related to Break-even Price</b>		
Current Price	333	
Open offer Price	355	
Break-even price	<b>308</b>	For shares not accepted in the open offer (price after the open offer)

Source: Citi Investment Research and Analysis

**Figure 2. Sensitivity Analysis of Stock Returns Based on Where the Share Price Settles Post the Open Offer (Rs/share)**

Current price	333								
Selling price for shares post open offer	250	275	300	325	333	350	400	450	500
Average selling price (if tendered in open offer)	306	318	329	341	345	353	376	400	423
Overall Return (%)	-8%	-5%	-1%	2%	4%	6%	13%	20%	27%

Source: Citi Investment Research and Analysis

Figure 3. Cairn India – SOTP Valuation (NAV calculation as of Dec-10)

Field	Based on CIRA crude forecasts			Based on Future's Curve			Comments
	NPV US\$m	NPV (Rs/share)	EV/boe (US\$)	NPV US\$m	NPV (Rs/share)	EV/boe (US\$)	
Ravva	207	5	12.8	208	5	12.9	
CB-OS/2	77	2	11.2	77	2	11.2	
Producing Fields	<b>284</b>	<b>7</b>		<b>285</b>	<b>7</b>		
Rajasthan 'Core' (MBA)	<b>10,074</b>	<b>239</b>	<b>14.2</b>	<b>10,432</b>	<b>248</b>	<b>14.7</b>	Based on cash flow analysis Incremental 3-9% EOR recovery. Discount to implied EV/boe of MBA fields Based on 2.5 bn boe of exploration upside (250 mmboe risked recoverable resources)
MBA Recovery Factor Upside	728	17	9.7	728	17	9.7	
Exploration Upside	1,698	40	9.7	1,698	40	9.7	
Production & Development	<b>12,784</b>	<b>304</b>		<b>13,143</b>	<b>312</b>		
Overheads	-476	-11		-476	-11		
Net Cash/(Debt)	681	16		584	14		
Core NAV	<b>12,989</b>	<b>309</b>		<b>13,251</b>	<b>315</b>		
LPD Reported Resource (a)	951	23	9.7	951	23	9.7	Based on disclosed 2P resource associated with LPD of 1.9 bn boe (recoverable reserves of 140 mmboe). Discount to implied EV/boe of MBA fields 25% upside to LPD in-place resource assumed
LPD Appraisal Upside (b)	323	8	9.7	323	8	9.7	
<b>Rajasthan Upside (a+b)</b>	<b>1,273</b>	<b>30</b>		<b>1,273</b>	<b>30</b>		
KG-DWN-98/2	159	4	4.5	159	4	4.5	
<b>Net Asset Value</b>	<b>14,421</b>	<b>343</b>		<b>14,683</b>	<b>349</b>		
<b>Average NAV</b>		<b>346</b>					
Premium to NAV		1.05					
<b>Target Price</b>		<b>363</b>					

Source: Citi Investment Research and Analysis 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 reserves accrue from the Rajasthan Block where production commenced in 2009. Cairn Plc now holds 62.4% in Cairn India.

### Investment strategy

We rate Cairn India shares Hold / Low Risk (2L) with a Rs363 target price. Cairn India's ownership of valuable oil reserves in Rajasthan has started generating steady cash flows from FY10E, with potential to generate further upside from EOR and exploration. However, with limited success in KG-ONN and other exploratory drilling scheduled for 1HCY11, we believe most newsflow on the exploratory front, key for a re-look at our NAV approach, will be back-ended. Further, any newsflow on LPD resource upgrades is also likely to be a 2011 event with the Barmer pilot set to commence by end-FY11E. Not

withstanding its excellent track record in exploration and project execution, we believe the stock lacks near-term triggers necessary for further outperformance from current levels.

In addition, Cairn Plc recently announced that it would be selling a 40-51% stake in Cairn India to Vedanta Resources for US\$6.65-8.48bn (Rs405/sh). While Petronas's stance could determine acceptance ratio of the 20% open offer (free float of 23/38% excl./incl. Petronas), we see limited upside to both our NAV for Cairn (Rs343-349/sh) and the open offer price (Rs355/sh), and accordingly maintain Hold.

## Valuation

Our Rs363 target price is based on estimated NAVs of under-development and producing assets and incorporating recovery upside. 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. Given Cairn's leverage to crude, our target of Rs363 is based on an average NAV value of Rs346 derived using two different crude scenarios: 1) CIRA global crude price forecasts yielding a base NAV of Rs343, and 2) Crude futures curve yielding an NAV of Rs349. In addition, we ascribe a 5% premium to the blended NAV to build in exploration potential in other blocks and to factor in the potential for a positive surprise in project development targets in the Rajasthan Block. We believe that the stock would partially factor in a combination of longer-term fundamentals and near-term momentum in underlying crude prices, till it can establish a track record of success outside Rajasthan. Key assumptions for our NAV analysis are: crude realization at a 12% discount to Brent; cess at Rs2,550/MT; plateau production at 210kbpd in 2H12; and total life-of-field development capex (including pipeline) of US\$4.35bn. Our target price is more leveraged to crude prices and less sensitive to operating parameters and/or reserve upside. The traditional valuation multiples (PER, EV/DACF) will become relevant depending on the extent of exploration success.

## Risks

Despite Cairn being in the project stage due to tangible oil reserves, which can be monetized, we have faith in the parent's strong track record and favorable demand-supply for domestic crude. Its track record in project execution and getting required approvals (esp. on pipeline) reduce risk significantly. In addition, Cairn has been able to negotiate the pricing terms for its crude at more or less expected levels. We therefore ascribe a Low Risk rating to Cairn India. Key downside risks include: 1) Delays, slow ramp-up, and cost overruns; though cost-recoverable, these could impact NAVs; 2) Potential conflict of interest arising out of Cairn PLC's majority ownership in Cairn India, especially in the context of new exploration assets in India; 3) Difficulty in absorbing the crude quantities due to its viscosity and various refinery's readiness, and 4) Sharp correction in crude prices. Key upside risks include: 1) Positive results from exploratory drilling in other blocks; 2) Upgrades in reported LPD resource base; 3) Sharp uptick in crude prices; and 4) Favorable ruling in the cess arbitration.

## Vedanta Resources Plc

## Valuation

Our £33.80 target price is based on a blend of NPV and EV/EBITDA levels. We allocate a 60% weighting to the NPV outcome and a 40% weighting to the EV/EBITDA outcome. We derive an NPV of £26.67 for Vedanta, using a discount rate of 9%, and we apply a 10% premium to that NPV, in line with diversified peers. We apply a 5.0 x EV/EBITDA ratio to VED's EBITDA for the year to March 2011, in line with emerging market mining peers.

## Risks

We rate Vedanta as Medium Risk. The risk rating on the stock is derived after consideration of a number of factors. These include an assessment of industry-specific risk, financial risk and management risk. Key risks to our projected earnings, cash flow and target price are focused on the inherent volatility in commodity prices but also relate to product risk as VED wants to increase its Aluminium capacity to 2.5 mtpa by 2013 and specific geographic risk with respect to its Zambian copper assets, which have very high operating costs. The group has an active project pipeline which makes it vulnerable to project-startup delays. Upside risks to our target price include ongoing strength in base metal prices and success in buying out minority stakes.

# Appendix A-1

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### Cairn India (CAIL.BO) Ratings and Target Price History Fundamental Research

Analyst: Saurabh Handa  
Covered since June 18 2010



Chart current as of 14 August 2010

	Date	Rating	Target Price	Closing Price
1	14-Oct-07	1M	*221.00	183.10
2	20-Dec-07	1M	*262.00	223.35
3	31-Mar-08	1M	*275.00	224.20
4	9-Jun-08	1M	*355.00	300.10
5	26-Sep-08	1M	*302.00	217.25

	Date	Rating	Target Price	Closing Price
6	12-Nov-08	1M	*230.00	138.45
7	10-Mar-09	1M	*195.00	162.55
8	28-Jun-09	*2L	*237.00	234.00
9	27-Aug-09	2L	*268.00	252.80
10	13-Jan-10	*1L	*337.00	294.05

	Date	Rating	Target Price	Closing Price
11	28-Jan-10	1L	*323.00	270.45
12	14-Apr-10	1L	*351.00	302.95
13	28-Jul-10	*2L	*363.00	328.90

\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

### Vedanta Resources Plc (VED.L) Ratings and Target Price History Fundamental Research

Analyst: Anindya Mohinta  
Covered since June 22 2010

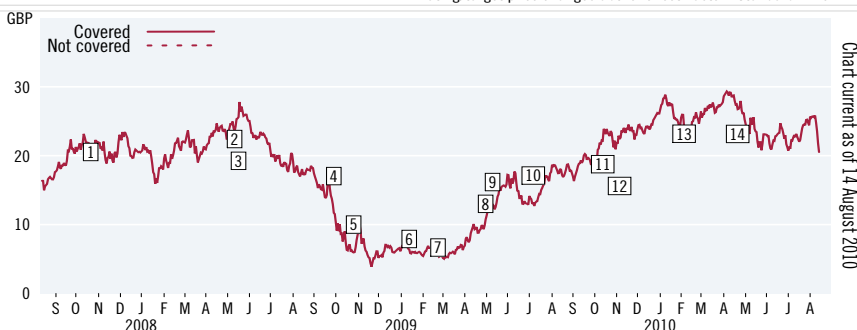


Chart current as of 14 August 2010

	Date	Rating	Target Price	Closing Price
1	22-Oct-07	*2H	23.50	20.54
2	12-May-08	2H	*27.50	23.50
3	16-May-08	*1H	*30.61	25.61
4	28-Sep-08	1H	*23.00	12.96
5	27-Oct-08	*1M	*9.40	5.95

	Date	Rating	Target Price	Closing Price
6	13-Jan-09	1M	*7.90	6.39
7	23-Feb-09	1M	*7.25	5.55
8	30-Apr-09	1M	*12.30	10.74
9	10-May-09	*3M	*11.00	13.01
10	7-Jul-09	*2M	*14.60	13.22

	Date	Rating	Target Price	Closing Price
11	13-Oct-09	2M	*23.00	22.18
12	5-Nov-09	2M	*23.50	22.42
13	4-Feb-10	2M	*26.85	24.15
14	21-Apr-10	*1M	*33.80	26.74

\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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