kotak® Institutional Equities

Oil India (OINL)

Energy

BUY

October 01, 2009

INITIATING COVERAGE

Sector view: Attractive

Price (Rs): 1,141

Target price (Rs): 1,350

BSE-30: 17,127

East side story. We expect Oil India (OIL) to likely create significant value from its current large oil and gas reserves and solid exploration abilities. We initiate coverage with a BUY rating and 12-month target price of Rs1,350 based on 10X FY2011E EPS. Our positive view stems from OIL's production profile, attractive valuations and strong financials.

Attractive valuations—BUY rating with 12-month target price of Rs1,350

We initiate coverage on OIL with a BUY rating and 12-month target price of Rs1,350 based on 10X FY2011E EPS. We find OIL's valuations attractive at current levels with the stock trading at 8.5X FY2011E EPS and 6.1X FY2011E EV/DACF. Our reverse valuation analysis indicates that OIL stock is discounting US$60/bbl crude oil price in perpetuity, which seems low—factoring in the risks to earnings that emanate from an uncertain subsidy-sharing mechanism.

Upside potential—favorable subsidy-sharing, natural gas price increase and new discoveries

We highlight that subsidy-sharing mechanism will likely be the key to OIL's earnings and stock performance. We expect OIL to benefit significantly from a more favorable subsidy-sharing scheme versus the current uncertain one. We currently model upstream companies to bear 50% share of auto fuel subsidy in the absence of a clear policy. We see a potential EPS upside of Rs20/share from the increase of natural gas prices. Finally, the establishment of additional reserves in existing producing blocks or announcement of new discoveries will be a positive.

Strong cash flow generation, net income driven by volume growth, higher crude price

We expect OIL's EPS to increase to Rs123 in FY2010E and Rs134 in FY2011E versus Rs101 in FY2009 led by (1) higher crude price (net realized basis), (2) higher volumes and (3) more favorable subsidy-sharing scheme. We expect OIL to generate strong free cash flows of Rs62 bn over FY2010-12E. We model oil and gas production to increase to 112,350 boe/d in FY2012E compared to 97,950 boe/d in FY2009. We assume Dated Brent crude price at US$65/bbl in FY2010E and FY2011E and US$75/bbl on a normalized long-term basis.

Key risks—unfavorable subsidy-sharing scheme, lower-than-expected crude price, regulations

We see three key risks to OIL's revenues, earnings and valuation—(1) unfavorable subsidy-sharing scheme, which may result in higher-than-expected burden for upstream companies, (2) sharp decline in crude price, which would be negative for OIL's cash flows and earnings and (3) unfavorable developments in E&P regulations.

Company data and valuation summary

Company data	Stock data	High	Low	Price performance	1M	3M	12M
Rating: BUY	52-week range			Absolute (%)			
	Priced at close of:	September 30, 2009		Rel. to BSE-30 (%)			
Current price (Rs)	**Capitalisation**			**Forecasts/valuation**	**2009**	**2010E**	**2011E**
1,141	Market cap (Rs bn)		274	EPS (Rs)	101.2	123.1	133.5
	Net debt/(cash) (Rs bn)		(60)	P/E (X)	11.3	9.3	8.5
	Free float (%)		21.6	RoAE (%)	22.8	22.6	20.9
	Shares outstanding (mn)		240	EV/EBITDA (X)	6.5	4.6	4.1

Source: Company, Kotak Institutional Equities estimates

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The prices in this report are based on the market close of September 30, 2009.

VALUATIONS—ATTRACTIVE ON MULTIPLES AND NORMALIZED BASIS

Our 12-month target price for OIL is Rs1,350 (based on 10X FY2011E EPS), which implies a 18.3% potential upside from current levels. We find OIL's valuations attractive with the stock trading at 8.5X FY2011E EPS and 6.1X FY2011E EV/DACF. The stock also offers a good dividend yield of 4%. On a normalized crude price of US$65/bbl (adjusted for subsidy payment versus our otherwise normalized crude price of US$75/bbl), our fair valuation comes to Rs1,300. However, like all upstream stocks, OIL faces downside risk from a likely decline in crude oil prices.

Attractive valuations + healthy cash flows + good dividend yield = BUY

We initiate coverage on OIL with a BUY rating and 12-month target price of Rs1,350 based on 10X FY2011E EPS. We find OIL's valuations attractive on current and normalized cash flows and earnings.

- **Current valuations.** OIL stock trades at 8.5X FY2011E EPS and 6.1X FY2011E DACF based on US$65/bbl crude price, exchange rate of Rs47.8/US$ and subsidy amount of Rs2.75 bn. Our reverse valuation analysis indicates that OIL stock is discounting US$60/bbl crude oil price in perpetuity, which seems low and factors in a large subsidy burden on OIL in perpetuity.

- **Normalized cash flows.** We use US$65/bbl (Dated Brent basis) normalized price to arrive at a fair valuation of Rs1,300 for OIL. Our assumed long-term price of US$65/bbl for crude oil factors in subsidy burden on OIL in perpetuity and is moderately higher than company's net realized price in 1QFY10 (US$60.3/bbl). Exhibit 1 gives the fair valuation of OIL on a normalized cash flows as well as range of valuation of OIL at various levels of normalized crude price. At our usual normalized price assumption of US$75/bbl, we compute OIL's fair valuation at Rs1,580.

Exhibit 1: We value OIL stock at Rs1,300 on US$65/bbl normalized crude price
Estimation of fair value of OIL stock based on normalized free cash flow (Rs mn)

	2010E	2011E	2012E
Normalized crude price assumption (US$/bbl)	65.0	65.0	65.0
Recurring operating cash flow			
Operating cash flow = EBIT X (1-t) + D	25,762	28,878	25,742
Add: OCF after normalizing natural gas price	4,698	5,060	4,337
Add: OCF after removing subsidies	3,466	1,815	4,951
Recurring OCF	33,926	35,752	35,030
Recurring capex			
Production per annum (mn bbls)	38	41	41
Replacement or F&D costs (US$/bbl)	8.0	8.0	8.0
Recurring capex	14,434	15,664	15,582
Free cash flow	**19,492**	**20,088**	**19,447**
Free cash flow multiple (X)	10	10	10
Enterprise value	194,918	200,882	194,473
(Net debt)/cash	89,436	97,106	106,833
Investments	10,625	10,625	10,625
Equity value	294,978	308,613	311,930
Total equity value per share (Rs/share)	**1,298**	**1,283**	**1,297**

	Equity value (Rs/share)	Change from base case (%)
Normalized crude prices		
US$85/bbl	1,875	46
US$80/bbl	1,727	35
US$75/bbl	1,579	23
US$70/bbl	1,431	12
US$65/bbl	**1,283**	
US$60/bbl	1,136	(12)
US$55/bbl	988	(23)
US$50/bbl	840	(35)
US$45/bbl	692	(46)

Source: Kotak Institutional Equities estimates

- **Strong dividend yield.** OIL stock also offers a decent dividend yield of 4% (FY2010E basis) at current levels. We model dividend of Rs46 for FY2010E and Rs52.8 for FY2011E compared to Rs30.5 in FY2009.

CRUDE—EXPECT NO NEAR-TERM SPIKE, LONG-TERM, NORMALIZED PRICE AT US$75/BBL

We expect crude prices to remain in the range of US$60-75/bbl over the next 12 months given that (1) large OPEC spare capacity, (2) high current global inventories, (3) likely lower compliance by OPEC members at higher prices, (4) potential regulations curbing speculative activity in commodities and (5) increased competitiveness of gas versus crude oil will offset likely recovery in global oil demand. We estimate long-term, normalized crude prices to be around US$70-80/bbl. We estimate US$50/bbl a likely floor for crude prices on cost of marginal crude production.

Likely stable crude prices in near term

We expect crude prices to be stable in the near term and expect (1) large OPEC spare capacity, (2) high level of global inventories, (3) possible slippage in OPEC compliance at higher crude prices, (4) potential regulations curbing speculative activity in commodities and (5) increased competitiveness of gas as an alternative to offset likely recovery in global oil demand. We discuss the same in detail below:

- **Likely recovery in global oil demand starting CY2010E on the back of global GDP growth.** The IEA projects global crude oil to recover by 1.3 mn b/d in CY2010E after collapsing 1.9 mn b/d in CY2009E. However, we expect large OPEC spare capacity of 7.3 mn b/d in CY2010E due to the start of new oil fields in Saudi Arabia (1.55 mn b/d across three new fields which started in June 2009) to likely act as an overhang on crude oil prices. Exhibit 2 gives our global supply-demand balance for crude oil.

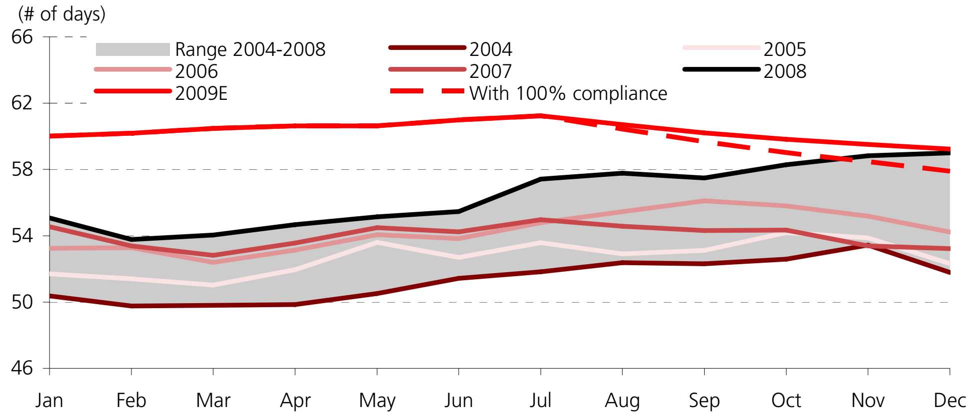
Exhibit 2: Large OPEC spare capacity to offset recovery in global demand over the next 12 months
Estimated global crude demand, supply and prices, Calendar year-ends, 2005-2014E

	2005	2006	2007	2008	2009E	2010E	2011E	2012E	2013E	2014E
Demand (mb/d)										
Total demand	84.1	85.2	86.5	86.3	84.4	85.7	87.0	88.1	89.3	90.4
Yoy growth	1.6	1.1	1.3	(0.2)	**(1.9)**	**1.3**	**1.3**	1.2	1.1	1.1
Supply (mb/d)										
Non-OPEC	49.8	50.4	50.8	50.6	**51.0**	**51.5**	**52.0**	51.6	51.3	51.1
Yoy growth	1.0	0.6	0.4	(0.2)	0.4	0.5	0.5	(0.4)	(0.3)	(0.2)
OPEC										
Crude	30.4	30.5	30.5	31.2	28.2	28.2	28.4	29.7	30.9	32.0
NGLs	4.3	4.4	4.5	4.7	**5.2**	**6.1**	**6.6**	6.9	7.1	7.3
Total OPEC	**34.7**	**34.9**	**35.0**	**35.9**	**33.4**	**34.3**	**35.0**	**36.6**	**38.0**	**39.3**
Total supply	**84.7**	**85.6**	**85.7**	**86.5**	**84.4**	**85.7**	**87.0**	**88.1**	**89.3**	**90.4**
Total stock change	0.7	0.3	(0.8)	0.2						
OPEC crude capacity			**34.4**	**34.2**	**34.7**	**35.5**	**35.0**	**34.8**	**35.5**	**35.8**
Implied OPEC spare capacity			**3.9**	**2.9**	**6.5**	**7.3**	**6.6**	**5.2**	**4.6**	**3.9**
Demand growth (yoy, %)	**1.9**	**1.3**	**1.5**	**(0.2)**	**(2.2)**	**1.5**	**1.5**	**1.3**	**1.3**	**1.2**
Supply growth (yoy, %)										
Non-OPEC	**2.0**	**1.2**	**0.8**	**(0.3)**	**0.7**	**0.9**	**1.0**	**(0.8)**	**(0.6)**	**(0.4)**
OPEC	**3.0**	**0.6**	**0.3**	**2.6**	**(6.9)**	**2.5**	**2.2**	**4.5**	**3.9**	**3.3**
Total	**1.6**	**1.1**	**0.1**	**1.0**	**(2.4)**	**1.5**	**1.5**	**1.3**	**1.3**	**1.2**
Dated Brent (US$/bbl)	**54.4**	**65.8**	**72.7**	**102.0**	**65.0**	**65.0**	**70.0**	**75.0**	**75.0**	**75.0**

Source: IEA, Kotak Institutional Equities estimates

- **High inventory levels.** Exhibit 3 shows that OECD inventory levels of products and crude have increased to nearly 62 days of forward cover, the highest in a decade.

Exhibit 3: Expect inventory levels to come down sharply if OPEC supply cuts reach 100% compliance
Global demand-supply balance for crude (mn b/d)



Note: Days of forward cover based on average demand over the next 4 quarters

Source: IEA, Kotak Institutional Equities estimates

- **Possible slippage in OPEC compliance**. We see possible slippage in OPEC compliance to production cuts at higher crude oil prices to keep a lid on crude prices in the near term. OPEC-11's August production was 26.25 mn b/d resulting in 67% compliance with its production target of 24.85 mn b/d. This is significantly lower than the high compliance of 83% in March 2009 (see Exhibit 4).

Exhibit 4: OPEC's compliance with the announced production cuts has declined over the last few months
OPEC crude production and sustainable capacity (mn b/d)

	Production (mn b/d)							Spare capacity	Cut in production (a)	Compliance
	Sep-08	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09	(mn b/d)	(mn b/d)	(%)
Algeria	1.40	1.22	1.25	1.25	1.25	1.22	1.22	0.18	0.18	90
Angola	1.76	1.64	1.67	1.75	1.72	1.76	1.78	0.32	(0.02)	—
Ecuador	0.50	0.46	0.48	0.48	0.48	0.47	0.47	0.03	0.03	43
Iran	3.90	3.65	3.75	3.72	3.80	3.82	3.80	0.20	0.10	18
Kuwait	2.60	2.25	2.25	2.25	2.24	2.24	2.24	0.41	0.36	95
Libya	1.72	1.52	1.52	1.54	1.54	1.54	1.55	0.22	0.17	68
Nigeria	1.99	1.78	1.78	1.80	1.72	1.68	1.74	0.86	0.25	78
Qatar	0.85	0.74	0.78	0.76	0.78	0.77	0.77	0.13	0.08	67
Saudi Arabia	9.37	8.35	8.00	8.20	8.35	8.24	8.20	3.40	1.17	89
United Arab Emirates	2.60	2.25	2.25	2.25	2.25	2.27	2.27	0.58	0.33	87
Venezuela	2.35	2.10	2.12	2.12	2.12	2.16	2.21	0.19	0.14	39
OPEC-11 production	**29.05**	**25.95**	**25.85**	**26.12**	**26.25**	**26.16**	**26.25**	**6.52**	**2.80**	**67**
Indonesia	0.86									
Iraq	2.19	2.38	2.37	2.49	2.50	2.59	2.56	0.04		
Total OPEC	**31.24**	**28.33**	**28.22**	**28.61**	**28.75**	**28.75**	**28.81**	**6.56**		

Note:
(a) Cut in production in August 2009 versus September 2008.

Source: IEA, Kotak Institutional Equities

Long-term view—crude prices at US$70-80/bbl

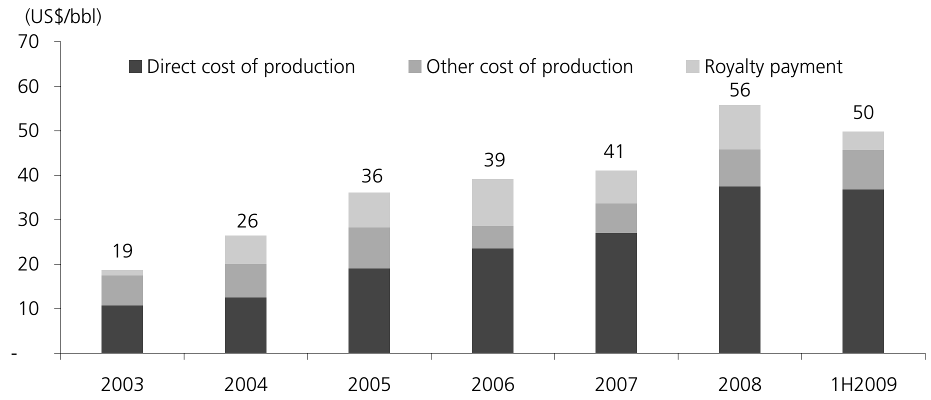
We continue to be positive on the long-term crude oil prices and expect rebound in crude prices. Our constructive view on crude prices stems from an eventual decline in OECD inventories leading to higher prices in CY2011E. We estimate our normalized long-term crude price of US$75/bbl on the economics of Canadian oil sands producers, which we treat as marginal-cost producers.

Floor for crude price at around US$50/bbl

We do not expect crude prices to remain below US$50/bbl on a sustainable basis given that (1) the cost of production of crude for marginal-cost producers is around US$50/bbl and (2) OPEC will likely cut production sharply to shore up prices.

- **Cost of production of least-efficient producers to set the floor for crude prices** Exhibit 5 shows the cost of production of crude oil for Suncor, a large Canadian oil sands producer. We highlight that the cost of production would have risen further on a pro forma basis, led by a higher royalty rate arising from a new royalty regime from January 1, 2009. However, lower gas prices have resulted into declining cost of production in 1HCY09. We note that Canadian oil sands production at 1.2 mn b/d is relatively large and also highlight that the economics of marginal oil production typically determines the price of crude oil unlike in the case of other commodities.

Exhibit 5: Oil production cost of least-efficient producers to set crude price floor around US$50/bbl
Cost of crude oil production from Suncor oil sands, calendar year-ends, 2003-2009YTD (US$/bbl)

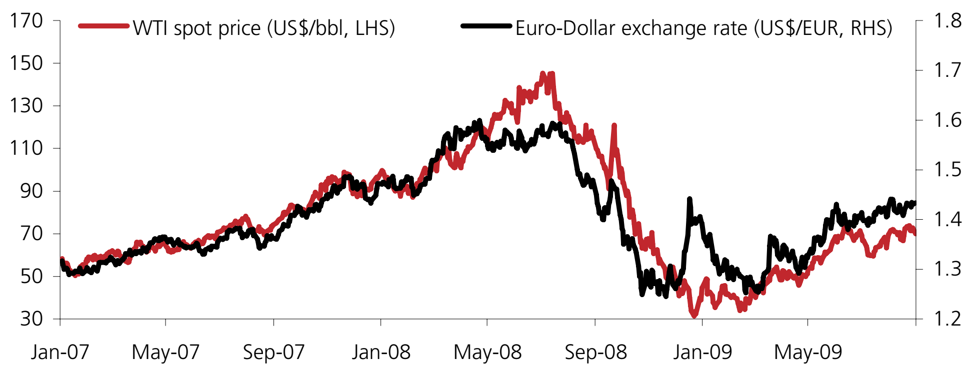


Source: Company, Kotak Institutional Equities

- **OPEC can cut production to shore up prices.** We expect OPEC to cut production to shore up prices if crude prices declined sharply below US$50/bbl. We note that OPEC had announced production cut of 4.2 mn b/d in CY2008 when crude prices declined sharply.

- **Reversal in US Dollar rate versus other currencies may result in higher crude oil prices.** We highlight the high inverse correlation between crude oil prices and US Dollar exchange rate (with other global currencies) as can be seen in Exhibit 6.

Exhibit 6: Crude oil prices and US Dollar have shown high inverse correlation
Movement in crude oil price and US Dollar-Euro exchange rate



Source: Bloomberg, Kotak Institutional Equities

POTENTIAL TRIGGERS: DEREGUALTION OF AUTO FUELS, INCREASE IN NATURAL GAS PRICES AND NEW DISCOVERIES

We see potential upside to our earning estimates and fair valuation of OIL from (1) lower-than-expected subsidy burden from auto fuel deregulation, (2) increase in natural gas prices and (3) announcement of new discoveries. The government has constituted a task force to review pricing of auto fuels and the ministry of petroleum and natural gas has recommended an increase in price of 'APM' natural gas to Rs4.7/cu m by end-FY2010E from the current Rs3.2/cu m. Finally, establishment of additional reserves in existing producing blocks or announcement of new discoveries will boost our valuation for OIL stock.

- **Lower-than-expected subsidy burden.** We expect OIL to benefit from lower-than-expected subsidy burden due to any potential deregulation of pricing of auto fuels. We highlight that the government has already agreed to bear the entire subsidy burden on cooking fuels for FY2010E through issue of oil bonds to the downstream companies. We expect OIL's FY2010E and FY2011E EPS to jump to Rs136 (from Rs123) and Rs140 (from Rs134), respectively, if it did not have to bear any subsidy. Our fair valuation of OIL would also jump by Rs50/share under a scenario of full deregulation of auto fuels pricing.

- **Increase in natural gas prices from nomination blocks.** We expect OIL to be a big beneficiary of increase in natural gas prices. As per media reports, the government is planning to increase the price of natural gas produced by OIL from its nomination fields to Rs4.7/cu m from Rs3.2/cu m currently. The ministry of petroleum has prepared a draft cabinet note for the same. An increase in natural gas price will be significantly positive for OIL's earnings and sentiment.

  More importantly, we believe this would set in motion the process of full gas price deregulation. We compute a positive impact of Rs20/share on OIL's EPS (see Exhibit 7) under our assumption of a long-term delivered price of gas price of US$5/mn BTU versus average realization of US$2/mn BTU for FY2009.

Exhibit 7: OIL should be a big beneficiary of gas price increase in India
Impact of gas price increase on OIL's earnings (%)

Gas sales in FY2009 (bcm)	1.7
Average gas price in FY2009 (Rs/cu meter)	3.4
Average gas price in FY2009 (US$/mn BTU)	2.0
Long-term delivered price of gas (US$/mn BTU)	5.0
Pipeline tariff and royalty (US$/mn BTU)	0.8
Average long-term wellhead price (US$/mn BTU)	4.2
Increase in gas price (US$/mn BTU)	**2.2**
Increase in pretax profits (Rs bn)	7
Pretax profits in FY2009 (Rs bn)	34
% increase in pretax profits (%)	**19**
Increase in post-tax profits (Rs bn)	4
Increase in EPS (Rs)	**20**

Source: Company, Kotak Institutional Equities estimates

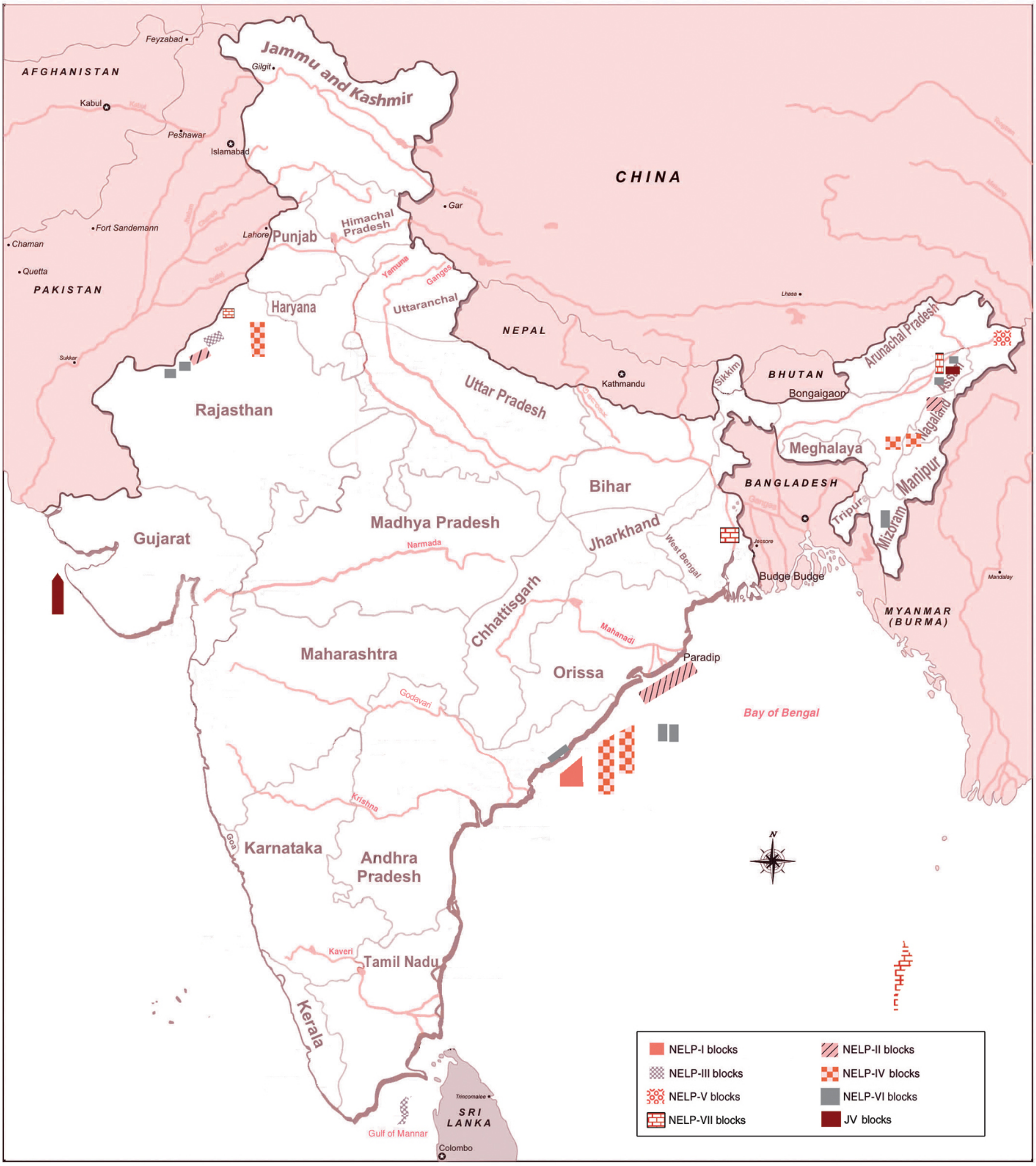
- **Announcement of new discoveries.** We believe OIL can create potential value from exploration. It has a portfolio of 26 exploration blocks in India and 17 overseas blocks. We believe India is an under-explored country with about 78% of its sedimentary basins relatively unexplored. In Exhibit 8, we present the level of exploration activity in India. Exhibit 9 shows the domestic exploration blocks where OIL holds a stake. Apart from the extant blocks, OIL also has the opportunity to participate in future exploration and licensing rounds including the ongoing NELP (New Exploration and Licensing Policy) VIII round.

Exhibit 8: India is still relatively unexplored
Breakdown of area by level of exploration, March fiscal year-ends (mn sq. km.)

	1996	1999	2003	2005	2006	2007	2008
Moderately/well explored	0.50	0.50	0.54	0.60	0.63	0.64	0.69
Poorly explored	0.53	0.53	0.59	0.69	0.66	0.66	0.63
Exploration inititated	0.56	0.84	1.00	1.16	1.38	1.38	1.37
Unexplored	1.57	1.28	1.02	0.70	0.47	0.47	0.45
Total	3.15	3.14	3.14	3.14	3.14	3.14	3.14

Source: DGH, Kotak Institutional Equities

Exhibit 9: OIL's domestic assets



Source: Company, Kotak Institutional Equities

KEY RISKS: UNFAVORABLE SUBSIDY-SHARING SCHEME, CRUDE PRICES

In our view, key risk to OIL's earnings and valuations stems from higher-than-expected subsidy burden due to unfavorable changes in the subsidy-sharing scheme. We currently assume that government-owned upstream companies will bear 50% of the auto fuel subsidy burden. However, we do not rule out upstream companies bearing a higher burden if the overall under-recoveries increase significantly due to rise in crude prices. Also, we see downside risks emanating from (1) lower-than-expected volume growth, (2) unfavorable regulatory developments and (3) non-extension of Petroleum Exploratory Licenses (PELs) for 15 blocks.

- **Unfavorable subsidy-sharing scheme.** In our view, the key downside risk to OIL 's earnings and valuation stems from higher-than-expected subsidy burden. We currently assume that (1) the government will bear the entire subsidy on cooking fuels by issuing oil bonds to downstream companies and (2) upstream companies will bear 50% of the auto fuel subsidy. However, we do not rule out changes in the subsidy-sharing scheme.

  Exhibit 10 shows that the valuation of OIL will not vary significantly under different scenarios of subsidy sharing as long as the government takes up the entire burden of subsidies on cooking fuels. We have assumed the following scenarios—(1) base-case scenario of government-owned upstream companies bearing 50% of auto fuel subsidy, (2) upstream companies bearing the entire subsidy on auto fuels and (3) upstream companies bearing 33.3% of the total subsidy burden.

Exhibit 10: OIL's valuation remain attractive under different subsidy-sharing arrangements
OIL's P/E under different subsidy-sharing arrangements, March fiscal year-end, 2011E

Base case: Upstream to bear 50% of auto fuel subsidy	
EPS (Rs)	134
Price/earnings (X)	8.5
Scenario 1: Upstream to bear entire auto fuel subsidy	
EPS (Rs)	127
Price/earnings (X)	8.9
Scenario 2: Upstream to bear 33.3% share of total subsidy	
EPS (Rs)	115
Price/earnings (X)	9.9

Source: Kotak Institutional Equities estimates

However, we expect the government to bear a substantial portion of the subsidy burden and do not see upstream companies being unduly burdened with a disproportionately higher subsidy burden. We highlight that the subsidy burden of upstream companies was restricted to Rs320 bn in FY2009 when overall under-recoveries ballooned to Rs1.03 tn. The government bore 70% of the overall industry under-recoveries of Rs1.03 tn in FY2009.

We highlight that the government burden in the form of oil bonds will be significantly lower at Rs380 bn for FY2010E versus Rs713 bn borne in FY2009 even if the government was to bear the entire subsidy burden on cooking and 50% of the auto fuel subsidy (see Exhibit 11). These figures exclude about Rs30 bn of annual subsidy payment made directly from the budget by the government to the downstream oil companies.

Exhibit 11: FY2010E subsidy burden on the government will likely be meaningfully lower yoy
Share of various participants of under-recoveries, March fiscal year-ends, 2006-2010E (Rs bn)

	2006	2007	2008	2009	2010E
Dated Brent crude oil price (US$/bbl)	57	65	82	85	65
Subsidy loss	**400**	**494**	**771**	**1,032**	**440**
Payment by government (oil bonds)	**115**	**241**	**353**	**713**	**380**
Share of BPCL	22	53	86	162	—
Share of HPCL	23	49	77	147	—
Share of IOCL	70	138	190	404	—
Net under-recovery of oil companies	**285**	**253**	**418**	**319**	**60**
Share of refining companies	27	—	—	—	—
Share of upstream companies	**140**	**205**	**257**	**329**	**60**
Share of ONGC	120	170	220	282	48
Share of GAIL	11	15	14	18	7
Share of Oil India	10	20	23	29	5
Net under-recovery of R&M companies (BPCL, HPCL, IOCL)	**118**	**48**	**161**	**(10)**	**—**
Pre-tax profits of R&M companies	**74**	**96**	**153**	**50**	

Note:
(a) We assume government will bear entire subsidy burden on cooking fuels and 50% subsidy on auto fuels for FY2010E.

Source: Company, Kotak Institutional Equities estimates

- **Lower-than-expected crude prices.** A sharp decline in crude price would be negative for OIL's earnings. OIL's earnings are highly leveraged to crude oil prices, as we show in Exhibit 12. However, we note that the impact of decline in crude prices would be mitigated to some extent by lower subsidy burden.

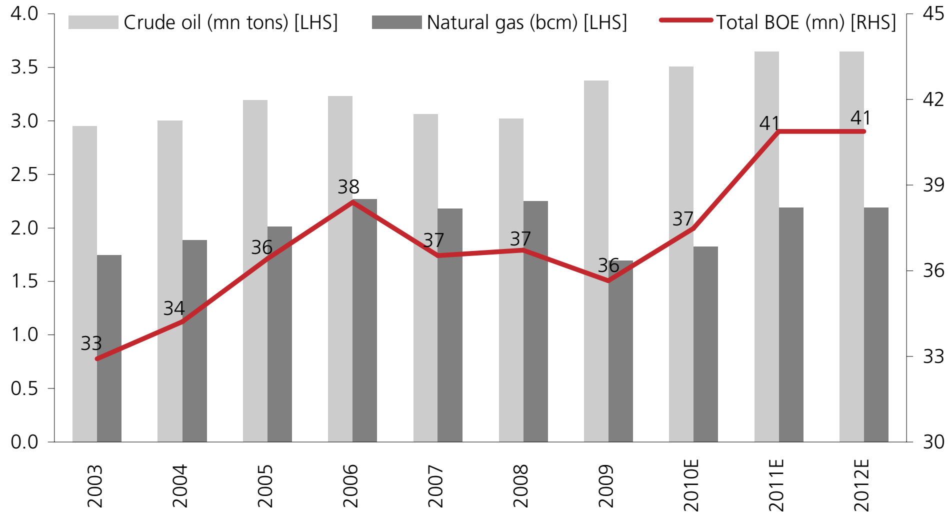
Exhibit 12: OIL's earnings are highly sensitive to crude price and exchange rate assumptions
Earnings sensitivity of OIL to key variables

	2010E			2011E			2012E		
	Downside	Base case	Upside	Downside	Base case	Upside	Downside	Base case	Upside
Exchange rate									
Rs/US$	47.0	48.0	49.0	46.8	47.8	48.8	46.5	47.5	48.5
Net profits (Rs mn)	27,033	27,963	28,894	31,129	32,107	33,086	32,182	33,235	34,288
Earnings per share (Rs)	119.0	123.1	127.2	129.5	133.5	137.6	133.8	138.2	142.6
% upside/(downside)	**(3.3)**		**3.3**	**(3.0)**		**3.0**	**(3.2)**		**3.2**
Average crude prices									
Crude price (US$/bbl)	63.0	65.0	67.0	63.0	65.0	67.0	68.0	70.0	72.0
Net profits (Rs mn)	26,603	27,963	29,324	30,684	32,107	33,530	31,820	33,235	34,651
Earnings per share (Rs)	117.1	123.1	129.1	127.6	133.5	139.4	132.3	138.2	144.1
% upside/(downside)	**(4.9)**		**4.9**	**(4.4)**		**4.4**	**(4.3)**		**4.3**
Cess									
Cess on domestic crude (Rs/ton)	3,090	2,575	2,060	3,090	2,575	2,060	3,090	2,575	2,060
Net profits (Rs mn)	26,780	27,963	29,146	30,877	32,107	33,338	32,005	33,235	34,465
Earnings per share (Rs)	117.9	123.1	128.3	128.4	133.5	138.6	133.1	138.2	143.3
% upside/(downside)	**(4.2)**		**4.2**	**(3.8)**		**3.8**	**(3.7)**		**3.7**
Natural gas prices									
Natural gas price ceiling (Rs/'000 cum)	3,100	3,600	4,100	3,500	4,000	4,500	4,000	4,500	5,000
Net profits (Rs mn)	27,421	27,963	28,505	31,457	32,107	32,758	32,585	33,235	33,886
Earnings per share (Rs)	120.7	123.1	125.4	130.8	133.5	136.2	135.5	138.2	140.9
% upside/(downside)	**(1.9)**		**1.9**	**(2.0)**		**2.0**	**(2.0)**		**2.0**

Source: Kotak Institutional Equities estimates

- **Lower-than-expected volumes.** We see downside risk to earnings of OIL from a slower-than-expected ramp-up in volumes. Exhibit 13 shows our volume assumptions for OIL. We highlight that the majority of OIL's producing fields (10 out of 15) are in a declining phase. However, we expect the company to enhance production through implementation of enhanced recovery techniques.

Exhibit 13: We expect production volumes to ramp up through FY2011E
Production of crude oil (mn tons) and natural gas (bcm) for OIL, March fiscal year-ends, 2003-2012E



Source: Company, Kotak Institutional Equities estimates

- **Unfavorable regulatory developments in India.** Unfavorable changes to the current regulatory regime (fiscal terms, pricing and taxation) may be negative for OIL's earnings. OIL pays royalty of 20% and cess of Rs2,575/ton for crude oil produced from its onshore blocks. The government had increased the cess to Rs2,500/ton (base rate without education tax of 3%) from Rs1,800/ton on March 1, 2006.

  It is possible that the government may impose windfall tax on crude oil produced by the government-owned companies as part of a revised subsidy-sharing system. The B K Chaturvedi Committee had recommended in August 2008 a ceiling of US$75/bbl for crude oil produced from non-NELP (New Exploration and Licensing Policy) blocks with incremental revenues above US$75/bbl going to the government as 'Special Oil Tax' for payment of subsidy. The government has constituted a five-member committee in September 2009 headed by Kirit Parikh, a former member of the Planning Commission of India, to examine the current pricing policy of diesel, gasoline, kerosene and LPG and "advise on viable and sustainable system of pricing of petroleum products."

  We note that the current fiscal regime under the NELP is very attractive with low royalty (5%-20%) on crude oil and gas, a seven-year tax holiday and a sliding-scale production-sharing contract (bidders bid for blocks on offer based on this parameter). We doubt the Indian government will change the regulatory regime unfavorably given that it needs to attract investment (overseas and domestic) in the critical E&P sector.

- **Non-renewal of expired PELs for 15 blocks**. We highlight that the PELs for 15 of the 16 independently-held blocks of OIL have expired. Although the company has applied for extension of the PELs, the approval from the government is awaited. The non-extension of the PEL's would prohibit the company from conducting further exploratory activity on the blocks.

FINANACIALS: STRONG CASH FLOW GENERATION

We model OIL's FY2010E and FY2011E EBITDA to increase to Rs40 bn and Rs45.3 bn versus Rs28.3 bn in FY2009 driven by (1) higher net realized crude oil price and (2) higher production. Our FY2010E and FY2011E EPS are Rs123 and Rs134. We expect OIL to generate free cash flow of Rs14.5 bn in FY2010E and Rs22.5 bn in FY2011E. OIL will likely spend Rs38.7 bn or US$0.8 bn between FY2010-12E towards exploration and development activities. We highlight that OIL has nominal debt (net cash positive) on its books and can utilize the free cash generated to explore new E&P opportunities to augment current reserves.

Key assumptions

Exhibit 14 gives our key assumptions behind our earnings model. We briefly discuss our key assumptions below.

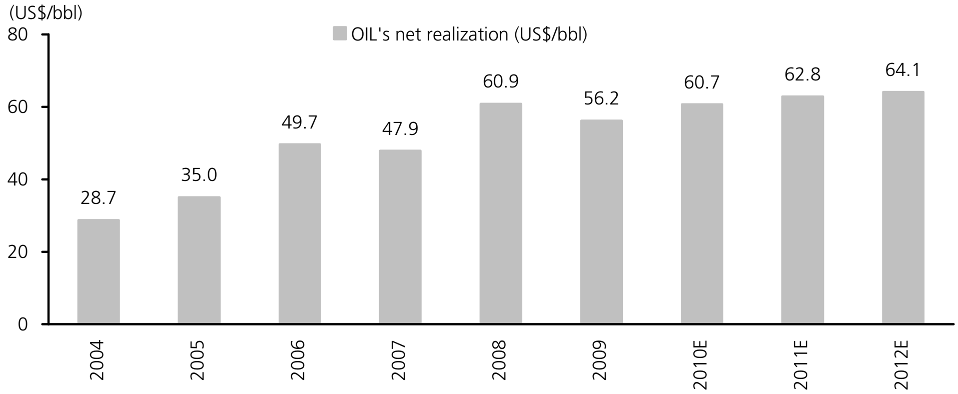
Exhibit 14: Moderate growth in volumes over the next few years
Key assumptions, March fiscal year-ends, 2006-2012E

	2006	2007	2008	2009	2010E	2011E	2012E
Rs/US$ rate	44.3	45.3	40.3	45.8	48.0	47.8	47.5
Subsidy share scheme loss (Rs mn)	9,775	19,938	23,051	30,233	5,250	2,750	7,500
Import tariff on crude oil (%)	5.1	5.1	5.2	0.9	—	—	—
Crude/natural gas prices							
Crude price							
Crude price, Bonny Light (US$/bbl)	57.2	64.8	78.9	83.0	65.0	65.0	70.0
Net crude price, OIL-India (US$/bbl)	49.7	47.9	60.9	56.2	60.7	62.8	64.1
Natural gas price							
Ceiling natural gas price, India (Rs/cu m)	3.52	3.20	3.20	3.20	3.60	4.00	4.50
Ceiling natural gas price, India (US$/mn BTU)	2.12	1.89	2.12	1.87	2.00	2.24	2.53
Net natural gas price, OIL-India (Rs/cu m)	3.16	2.88	2.88	2.88	3.24	3.60	4.05
Net natural gas price, OIL-India (US$/mn BTU)	1.91	1.70	1.91	1.68	1.80	2.01	2.28
Sales volumes—Domestic fields							
Crude oil (mn tons)	3.1	3.0	3.0	3.4	3.5	3.6	3.6
Natural gas (bcm)	1.7	1.8	1.8	1.7	1.8	2.2	2.2
Total sales (mn toe)	**4.7**	**4.6**	**4.7**	**4.9**	**5.1**	**5.6**	**5.6**
Total sales (mn boe)	**34**	**34**	**34**	**36**	**37**	**41**	**41**
Crude oil (%)	67	66	65	68	68	65	65
Natural gas (%)	33	34	35	32	32	35	35

Source: Company, Kotak Institutional Equities estimates

- **Crude price.** We assume FY2010E, FY2011E and FY2012E crude oil (Dated Brent) price at US$65/bbl, US$65/bbl and US$70/bbl. However, we would focus more on OIL's net realized crude price and our long-term crude price assumption. Exhibit 15 gives OIL's historical net realized price and our expectation for FY2010E (US$60.7/bbl), FY2011E (US$62.8/bbl) and FY2012E (US$64.1/bbl).

Exhibit 15: OIL's net realization has improved over the past few years
OIL's net crude price realization, March fiscal year-ends, 2004-2012E (US$/bbl)



Source: Company, Kotak Institutional Equities estimates

- **Subsidy amount.** We assume OIL's subsidy amount for FY2010E, FY2011E and FY2012E at Rs5.25 bn, Rs2.75 bn and Rs7.5 bn versus Rs30.2 bn in FY2009. We assume that upstream companies will bear 50% of the auto fuel subsidy and will not bear any subsidy on cooking fuels.

- **Oil and gas volumes.** We model crude oil sales volumes to increase marginally to 3.6 mn tons in FY2011E versus 3.4 mn tons in FY2009. We highlight that the majority of OIL's producing fields (10 out of 15) are in a declining phase. However, we expect the company to enhance production through the implementation of enhanced oil recovery (EOR) techniques. We model gas volumes at 6 mcm/d for FY2011E versus 5 mcm/d in FY2009. We do not rule out potential upside from higher gas sales volumes from sale of gas to Numaligarh refinery and Brahmaputra Cracker and Polymer Limited.

- **Gas price.** We assume FY2010E, FY2011E and FY2012E natural gas price at Rs3.6/cu m, Rs4/cu m and Rs4.5/cu m.

- **Exchange rate assumption.** We model exchange rate for FY2010E, FY2011E and FY2012E at Rs48/US$, Rs47.8/US$ and Rs47.5/US$.

- **Dividend payout.** We assume dividend of Rs46 for FY2010E and Rs52.8 in FY2011E, which results in a dividend payout of 40%. We note that an informal government directive entails a dividend payout of 30% for profitable PSU oil companies; this has been followed by all the major oil and gas PSUs over the past few years. We expect 40% dividend payouts to be sustained.

Key accounting policies

1. **Exploration costs accounted on successful efforts method.** As per Indian Accounting Standards, OIL writes off survey costs as also the cost of dry wells in the year in which the exploration expenses (if unsuccessful) are incurred.

2. **Depletion calculation on unit of production (UOP) method.** OIL follows the unit of production method to provide for depletion costs—UOP rate X production for the period, where UOP rate = depletion base of the cost center/provided oil and gas reserves. The company uses 1P (proved) reserves to compute depletion charges as per standard Indian accounting practice.

3. **Abandonment costs.** Abandonment costs relating to dismantling and restoration of well sites (net of salvage value), if any, are accounted for in the year in which the same are incurred instead of creating provision in line with Guidance Note issued by ICAI.

Exhibit 16 is our P&L model for OIL.

Exhibit 16: Profit model of OIL, March fiscal year-ends, 2006-2012E

	2006	2007	2008	2009	2010E	2011E	2012E
Net sales	**55,502**	**53,892**	**60,819**	**72,414**	**83,489**	**90,717**	**92,916**
Raw materials	(1,441)	(1,892)	(1,931)	(2,390)	(2,358)	(2,580)	(2,580)
Purchase for sale	—	—	—	—	—	—	—
Royalty/taxes	(17,437)	(20,661)	(22,607)	(22,161)	(22,426)	(22,874)	(23,062)
Employee costs	(6,404)	(5,872)	(9,399)	(10,347)	(11,071)	(11,846)	(12,676)
Other costs	(3,666)	(3,176)	(3,031)	(9,177)	(7,645)	(8,132)	(8,172)
EBITDA	**26,554**	**22,292**	**23,852**	**28,339**	**39,989**	**45,284**	**46,427**
Other income	3,639	5,335	6,770	9,372	12,250	17,350	18,975
Interest	(152)	(151)	(383)	(26)	(38)	(24)	(9)
Depreciation and depletion	(3,314)	(2,595)	(3,093)	(3,768)	(9,839)	(13,971)	(15,045)
Pretax profits	**26,728**	**24,881**	**27,145**	**33,916**	**42,362**	**48,640**	**50,348**
Tax	(9,347)	(7,406)	(8,538)	(11,910)	(14,214)	(16,399)	(17,144)
Deferred tax	(498)	(1,020)	(707)	(343)	(185)	(134)	30
Prior-period items	16	(55)	(11)	(46)	—	—	—
Net profits	**16,899**	**16,400**	**17,889**	**21,617**	**27,963**	**32,107**	**33,235**
Shares outstanding (mn)							
Year end	214	214	214	214	240	240	240
Primary	214	214	214	214	227	240	240
EPS (Rs)							
Year end	79.0	76.6	83.6	101.0	116.3	133.5	138.2
Primary	**79.0**	**76.6**	**83.6**	**101.0**	**123.1**	**133.5**	**138.2**
Cash flow per share (Rs)							
Year end	92.7	85.8	93.9	127.3	86.2	88.8	90.6
Primary	**92.7**	**85.8**	**93.9**	**127.3**	**91.3**	**88.8**	**90.6**
Growth (%)							
EPS	59.2	(3.0)	9.1	20.8	21.8	8.5	3.5
Cash flow/share	66.4	(7.5)	9.5	35.5	(28.3)	(2.7)	1.9
Tax rate (%)	**36.8**	**33.9**	**34.1**	**36.1**	**34.0**	**34.0**	**34.0**

Source: Company, Kotak Institutional Equities estimates

Cash flow—strong free cash flow despite heavy capex program

We expect OIL to generate strong free cash flows of Rs62 bn over FY2010-12E. We model OIL to spend Rs69 bn on capex on exploration and development over the same period (see Exhibit 17, our cash flow model for OIL). Exhibit 18 gives estimated yearly breakdown of capex for key segments. We believe that the cash generated may be utilized for (1) acquisition of oil and gas assets and (2) payment of dividends.

Exhibit 17: Cash flow model of OIL, March fiscal year-ends, 2006-2012E (Rs mn)

	2006	2007	2008	2009	2010E	2011E	2012E
Operating							
Pretax profits	26,744	24,881	27,134	33,916	42,362	48,640	50,348
Depreciation	3,314	2,595	3,093	3,768	4,839	6,471	7,545
Interest expense	162	140	344	87	38	24	9
Interest paid	(162)	(140)	(344)	(87)	(38)	(24)	(9)
Taxes paid	(9,223)	(7,406)	(8,756)	(5,265)	(14,214)	(16,399)	(17,144)
Other income/dividends	(2,168)	(3,370)	(4,926)	(6,711)	(12,250)	(17,350)	(18,975)
Exchange loss	1,160	1,712	2,393	1,583	—	—	—
Extraordinary items	16	(55)	1,165	(46)	—	—	—
Working capital changes (a)	5,884	(8,696)	7,435	2,368	(1,418)	(185)	(143)
Total operating	**25,727**	**9,661**	**27,539**	**29,613**	**19,319**	**21,177**	**21,632**
Cash generated from operations (b)	**19,843**	**18,357**	**20,104**	**27,246**	**20,737**	**21,362**	**21,775**
Investing							
Capital expenditure (c)	(6,108)	(9,370)	(9,492)	(8,496)	(17,101)	(15,998)	(15,500)
(Purchase)/Sale of investments (d)	(2,482)	226	(811)	—	—	—	—
Interest received	1,670	2,892	4,214	5,470	12,250	17,350	18,975
Total investing	**(6,920)**	**(6,252)**	**(6,089)**	**(3,026)**	**(4,851)**	**1,352**	**3,475**
Financing							
Proceeds from issue of share capital	—	—	—	—	27,773	—	—
Proceeds from borrowings	158	4,799	(6,391)	(1,184)	(190)	(163)	(213)
Dividends paid	(6,591)	(6,466)	(5,007)	(7,511)	(12,941)	(14,858)	(15,380)
Total financing	**(6,432)**	**(1,667)**	**(11,399)**	**(8,696)**	**14,642**	**(15,021)**	**(15,593)**
Net increase in cash and cash equivalents	12,375	1,742	10,051	17,892	29,111	7,508	9,514
Beginning cash	18,640	31,015	32,757	42,808	60,700	89,811	97,319
Ending cash	**31,015**	**32,757**	**42,808**	**60,700**	**89,811**	**97,319**	**106,833**
Gross cash flow (b)	19,843	18,357	20,104	27,246	20,737	21,362	21,775
Free cash flow (b) + (a) + (c) + (d)	**18,807**	**3,409**	**21,450**	**26,587**	**14,469**	**22,529**	**25,107**
Excess cash flow (b) +(a) + (c) + (d) + (e)	12,216	(3,057)	16,443	19,076	1,528	7,670	9,727

Source: Company, Kotak Institutional Equities estimates

Exhibit 18: OIL's planned capex over the next two years
Capital expenditure, March fiscal year-ends, 2010E-11E (Rs mn)

	Estimated cost	2010YTD	2010E	2011E
Exploration and appraisal activities	28,280	2,492	13,002	15,278
Development activities in producing fields	10,456	1,642	4,929	5,527
Purchase of capital equipments and facilities	6,863	456	4,170	2,693
Total capital expenditure	**45,598**	**4,590**	**22,101**	**23,498**

Source: Company, Kotak Institutional Equities

Balance sheet—Cash of Rs253/share as on March 31, 2009

Exhibit 19 is our balance sheet model for OIL. We highlight that OIL has marginal debt of Rs0.6 bn and cash of Rs253/share as on March 31, 2009.

Exhibit 19: Balance sheet model of OIL, March fiscal year-ends, 2006-2012E (Rs mn)

	2006	2007	2008	2009	2010E	2011E	2012E
Equity							
Share capital	2,140	2,140	2,140	2,140	2,405	2,405	2,405
Reserves	56,343	66,351	77,190	91,170	133,701	150,950	168,804
Total equity	**58,483**	**68,491**	**79,330**	**93,310**	**136,105**	**153,354**	**171,209**
Deferred tax liability	7,013	8,033	8,655	8,998	9,184	9,317	9,287
Liability for abandonment cost	10	11	11	15	15	15	15
Liabilities							
Short-term loans	1,550	7,090	1,049	27	—	—	—
Long-term loans	1,791	1,050	700	538	375	213	—
Total borrowings	**3,341**	**8,140**	**1,749**	**565**	**375**	**213**	**—**
Currrent liabilities	11,668	10,320	17,541	30,914	32,753	33,892	34,152
Total capital	**80,515**	**94,995**	**107,286**	**133,801**	**178,432**	**196,791**	**214,663**
Assets							
Cash	31,015	32,757	42,808	60,700	89,811	97,319	106,833
Current assets	14,540	22,350	18,957	22,853	26,111	27,435	27,838
Gross block	20,952	21,889	23,228	29,720	37,076	39,769	42,769
Less: accumulated depreciation	14,829	15,521	16,199	18,383	20,066	22,415	24,831
Net fixed assets	6,122	6,368	7,029	11,338	17,011	17,354	17,938
Capital work-in-progress	3,118	5,301	6,446	3,186	—	—	—
Net producing properties (OIL)	19,157	20,258	22,678	25,215	27,987	31,893	36,765
Exploratory wells in progress	2,260	3,886	4,481	5,623	12,625	17,903	20,403
Total fixed assets	30,658	35,813	40,633	45,361	57,623	67,150	75,105
Investments	4,302	4,075	4,887	4,887	4,887	4,887	4,887
Total assets	**80,515**	**94,995**	**107,286**	**133,801**	**178,432**	**196,791**	**214,663**
Ratios (%)							
Debt/equity	5.1	10.6	2.0	0.6	0.3	0.1	—
Debt/capitalization	4.9	9.6	1.9	0.5	0.3	0.1	—
Net debt/equity	5.1	10.6	2.0	0.6	0.3	0.1	—
Net debt/capitalization	(73.2)	(47.4)	(87.5)	(142.6)	(160.1)	(148.1)	(145.0)
RoAE	28.2	23.1	21.7	22.7	22.6	20.9	19.4
RoACE	**26.8**	**21.6**	**20.8**	**22.5**	**22.5**	**20.8**	**19.4**
BVPS (Rs)	306	358	411	478	639	677	751

Source: Company, Kotak Institutional Equities estimates

COMPANY PROFILE

OIL, which is India's second largest national oil and gas company, has the advantages of a large reserves base, potentially attractive exploration blocks and the opportunity to participate in India's increasingly attractive E&P sector. Likely large operating cash flow generation will help it pursue a more aggressive E&P strategy.

Four-pronged strategy to grow reserves, revenues and earnings

OIL will follow a four-pronged strategy to grow reserves, revenues and earnings over the next few years—(1) accelerated exploration and development in existing assets to augment reserves and production, (2) improving recovery rate through application of advanced recovery techniques, (3) utilizing cash flows to acquire exploration acreages, discovered blocks and producing properties and (4) monetizing gas reserves in Assam Basin.

OIL is a government of India company with the government holding 78.4% stake. The other major shareholders are IOCL (4.45%), BPCL (2.23%) and HPCL (2.23%). Exhibit 20 gives the shareholding pattern of the company. It recently completed an IPO of 30.45 mn shares to institutional and retail investors.

Exhibit 20: Shareholding pattern of OIL

	Pre-issue and prior to transfer		Post transfer and post-issue	
Shareholder	**Number of equity shares**	**Percentage holding (%)**	**Number of equity shares**	**Percentage holding (%)**
President of India	210,000,000	98.1	188,599,560	78.4
Public (including Employees)	4,004,400	1.9	30,454,382	12.7
IOCL			10,700,220	4.5
HPCL			5,350,110	2.2
BPCL			5,350,110	2.2
Total	**214,004,400**	**100**	**240,454,382**	**100**

Source: Company, Kotak Institutional Equities

As of March 2009, OIL had 575.4 mn boe of oil reserves (proved plus probable) and 63.41 bcm of gas reserves (proved plus probable) with the bulk of reserves located in Assam and Arunachal Pradesh; Exhibit 21 gives details of the OIL's E&P portfolio. We note that OIL also has stakes in 26 exploration blocks in India and 17 exploration blocks overseas.

Exhibit 21: OIL's portfolio of exploration blocks

	Area (sq. kms)	Consortium	Operator	OIL's stake (%)
Domestic blocks				
Upper Assam and Assam-Arakan basin				
AAP-ON-94/1	305	IOCL (43.55%), HOEC (40.32%)	HOEC	16.13
AA-ONN-2001/3	110	ONGC (85%)	ONGC	15
AA-ONN-2002/3	1,460	ONGC (70%), Suntera Cyprus (10%)	OIL	20
AA-ONN-2002/4	1,060	ONGC (90%)	ONGC	10
AA-ONN-2003/3	275	HPCL (15%)	OIL	85
AA-ONN-2004/1	144	Shiv Vani (15%)	OIL	85
AA-ONN-2004/2	218	Suntera Cyprus (10%)	OIL	90
MZ-ONN-2004/1	3,213	Suntera Cyprus (10%), Shiv Vani (15%)	OIL	75
AA-ONN-2005/1	363	ONGC (60%), ACL (10%)	ONGC	30
Rajasthan basin				
RJ-ONN-2000/1	1,268	Suntera Cyprus (40%)	OIL	60
RJ-ONN-2001/1	1,698	ONGC (30%), Suntera Cyprus (30%)	OIL	40
RJ-ONN-2002/1	7,425	ONGC (40%)	OIL	60
RJ-ONN-2004/2	2,196	Geoglobal (25%)	OIL	75
RJ-ONN-2004/3	1,330	Geoglobal (25%), HPCL (15%)	OIL	60
RJ-ONN-2005/2	1,517	HMEL (20%), HOEC (20%)	OIL	60
Krishna-Godavari basin				
KG-DWN-98/4	4,970	ONGC (85%)	ONGC	15
KG-DWN-2002/1	10,600	ONGC (70%), BPCL (10%)	ONGC	20
KG-ONN-2004/1	549	Geoglobal (10%)	OIL	90
KG-DWN-2004/5	11,922	ONGC (50%), GAIL (10%), GSPCL (10%), HPCL (10%), BPCL (10%)	ONGC	10
KG-DWN-2004/6	10,907	ONGC (60%), GAIL (10%), GSPCL (10%), HPCL (10%)	ONGC	10
Cauvery basin				
CY-DWN-2001/1	12,425	ONGC (80%)	ONGC	20
Mahanadi basin				
MN-OSN-2000/2	4,061	ONGC (40%), IOCL (20%), GAIL (20%)	ONGC	20
MN-DWN-2002/1	9,980	ONGC (36%), BPCL (10%), ENI (34%)	ONGC	20
Andaman-Nicobar basin				
AN-DWN-2005/1	11,837	ONGC (90%)	ONGC	10
Bengal Onshore basin				
WB-ONN-2005/4	3,940	ONGC (75%)	ONGC	25
Saurashtra and Gujarat Offshore basin				
GK-OSJ-3	5,725	RIL (60%), ONGC (25%)	RIL	15
Overseas blocks				
Egypt				
Block 3	8,287	HPCL (25%), GSPC (50%)	GSPC	25
Block 4	2,600	HPCL (25%), GSPC (50%)	GSPC	25
Gabon				
Block Shakti	3,761	IOC (45%), Marvis Petroleum Holding (10%)	OIL	45
Iran				
Farsi block	3,500	OVL (40%), IOC (40%)	OVL	20
Libya				
Area 86	7,087	IOC (50%)	OIL	50
Block 102/4	2,710	IOC (50%)	OIL	50
Area 95/96	6,629	IOC (25%), Sonatrech (50%)	Sonatrrach	25
Nigeria				
Block OPL-205	2,094	IOC (17.5%), Suntera Cyprus (35%), Summit Oil (30%)	Summit Oil	17.5
Timor Leste				
Block K	2,384	Reliance (75%), IOC (12.5%)	Reliance	12.5
Yemen				
Block 82	1,857	Medco Yemen (45%), KEC (25%), IOC (15%)	Medco Yemen	15
Block 83	364	Medco Yemen (45%), KEC (25%), IOC (15%)	Medco Yemen	15

Source: Company, Kotak Institutional Equities

Exhibit 22: Profit model, balance sheet, cash model of OIL, March fiscal year-ends, 2006-2012E (Rs mn)

	2006	2007	2008	2009	2010E	2011E	2012E
Profit model (Rs mn)							
Net sales	55,502	53,892	60,819	72,414	83,489	90,717	92,916
EBITDA	**26,554**	**22,292**	**23,852**	**28,339**	**39,989**	**45,284**	**46,427**
Other income	3,639	5,335	6,770	9,372	12,250	17,350	18,975
Interest	(152)	(151)	(383)	(26)	(38)	(24)	(9)
Depreciation and depletion	(3,314)	(2,595)	(3,093)	(3,768)	(9,839)	(13,971)	(15,045)
Pretax profits	26,728	24,881	27,145	33,916	42,362	48,640	50,348
Tax	(9,347)	(7,406)	(8,538)	(11,910)	(14,214)	(16,399)	(17,144)
Deferred tax	(498)	(1,020)	(707)	(343)	(185)	(134)	30
Net profits	**16,883**	**16,454**	**17,901**	**21,663**	**27,963**	**32,107**	**33,235**
Earnings per share (Rs)	**78.9**	**76.9**	**83.6**	**101.2**	**123.1**	**133.5**	**138.2**
Balance sheet (Rs mn)							
Total equity	58,483	68,491	79,330	93,310	136,105	153,354	171,209
Deferred tax liability	7,013	8,033	8,655	8,998	9,184	9,317	9,287
Liability for abandonment cost	10	11	11	15	15	15	15
Total borrowings	3,341	8,140	1,749	565	375	213	—
Currrent liabilities	11,668	10,320	17,541	30,914	32,753	33,892	34,152
Total liabilities and equity	**80,515**	**94,995**	**107,286**	**133,801**	**178,432**	**196,791**	**214,663**
Cash	31,015	32,757	42,808	60,700	89,811	97,319	106,833
Current assets	14,540	22,350	18,957	22,853	26,111	27,435	27,838
Total fixed assets	30,658	35,813	40,633	45,361	57,623	67,150	75,105
Investments	4,302	4,075	4,887	4,887	4,887	4,887	4,887
Total assets	**80,515**	**94,995**	**107,286**	**133,801**	**178,432**	**196,791**	**214,663**
Free cash flow (Rs mn)							
Operating cash flow, excl. working capital	19,843	18,357	20,104	27,246	20,737	21,362	21,775
Working capital changes	5,884	(8,696)	7,435	2,368	(1,418)	(185)	(143)
Capital expenditure	(6,108)	(9,370)	(9,492)	(8,496)	(17,101)	(15,998)	(15,500)
Investments	(2,482)	226	(811)	—	—	—	—
Other income	1,670	2,892	4,214	5,470	12,250	17,350	18,975
Free cash flow	**18,807**	**3,409**	**21,450**	**26,587**	**14,469**	**22,529**	**25,107**
Ratios (%)							
Debt/equity	5.7	11.9	2.2	0.6	0.3	0.1	0.0
Net debt/equity	(33.1)	(32.8)	(31.9)	(31.9)	(41.9)	(41.4)	(42.5)
RoAE	28.1	23.2	21.8	22.8	22.6	20.9	19.4
RoACE	**28.0**	**23.0**	**21.5**	**22.7**	**22.6**	**20.8**	**19.4**
Key assumptions							
Rs/dollar rate	44.3	45.3	40.3	45.8	48.0	47.8	47.5
Crude fob price (US$/bbl)	57.2	64.8	78.9	83.0	65.0	65.0	70.0
Ceiling/actual natural gas price (Rs/'000 cm)	3,515	3,200	3,200	3,200	3,600	4,000	4,500
Subsidy loss (Rs bn)	9.8	19.9	23.1	30.2	5.3	2.8	7.5

Source: Company, Kotak Institutional Equities estimates

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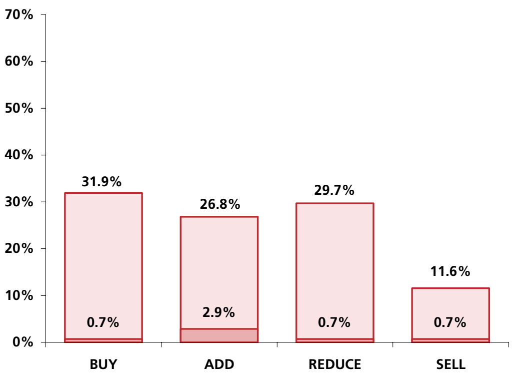

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Source: Kotak Institutional Equities As of June 30, 2009

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