Industry Focus

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India Oil & Gas

Picking Up the Pieces

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- **RIL and Cairn the hardest hit in the recent correction** — The sharp fall in crude prices, concerns about refining and fears of a windfall tax/export tax have led a sharp sell-off in both stocks. We take a look at what we think is factored in at current levels, the risk-reward equation and any further potential downside risks.

- **Cairn offers absolute return** — Cairn (trading at Rs197) seems to be factoring in LT Brent of US$65/bbl and a 10% price discount, with no reserve upside. Even assuming a price discount of 15%, as reported in the press (high compared to WTI-Maya diff. of 10% in last 3 months), the imputed LT crude price is US$70/bbl. While continued weakness in crude prices would weigh on the stock, we think the risk-reward is quite favorable at current levels.

- **RIL: Risk reward turning favorable** — Based on i) a mid-cycle EV/EBITDA of 5.5x FY10E on petchem/refining, ii) refining margins which are US$1.5-2.0/bbl lower and iii) no exploration upside from E&P, our SOTP works out to Rs1,750. While a case can be made for even lower GRM in FY10E, it could be offset by weaker rupee and/or slightly less pessimistic view on reserve accretion, from D6 and beyond. Timelines for resolution of gas dispute & gas production (though unlikely to impact the NAV) and fears of export tax and removal of EOU status for the refinery remain imponderables for the stock.

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

~1Citigroup Global Markets India Private Limited

Figure 1. Cairn India: Sensitivity of Target Price to LT Brent and % Price Discount to Cairn's Crude

Discount to crude / LT Brent (US$/bbl)	7%	8%	9%	10%	11%	12%	13%
90	278	275	272	269	265	262	259
80	246	243	240	238	235	232	229
75	230	227	225	222	219	217	214
70	214	211	209	207	204	202	199
65	198	195	193	191	189	187	185
60	182	180	178	176	174	172	170

Source: Citi Investment Research estimates

Figure 2. RIL Bare-bone SOTP Valuation

	Rs m	Rs/share	Comments
FY10E EBITDA forecast	202,806		
EV of Petrochem & Refining (Rs m)	1,115,435	767	@ EV/E of 5.5x Mar-10E
Net Debt (Rs m)	306,972	211	Estimated as of Mar-09E for standalone RIL
Key investments			
Reliance Petroleum	418,545	288	Based on EV/E of 5.5x FY10E i.e. at RPL price of Rs131/share
E&P Assets	890,674	613	Based on NAVs of D6, NEC-25 and CBM
Organised Retail	80,000	55	Based on book value of investments till date
Total value of investments & other assets	1,389,219	955	
EV of businesses	1,115,435	767	
Net Debt adjusted for key investments	(1,082,247)	(744)	
Value of Treasury stock	346,187	238	At target price
Value for Equity holders (Rs m)	2,543,868	1,750	

Source: Citi Investment Research estimates

Figure 3. RIL Refining — Key Parameters

Year to 31-Mar	Units	FY07	FY08	FY09E	FY10E	FY11E
Singapore Complex Margin	US$/bbl	6.1	7.7	6.5	5.7	5.7
Gross refining & mktg margin						
- new	US$/bbl	10.9	15.0	14.0	12.6	12.1
- old	US$/bbl	10.9	15.0	14.5	14.3	13.9
RIL clean GRMs	US$/bbl	11.7	15.2	14.3	12.7	12.2
Differential to Singapore	US$/bbl	5.6	7.5	7.8	7.0	6.5
Crude throughput	MMT	31.7	31.8	32.5	33.0	33.0
Exchange rate year average	Rs/US$	44.3	40.3	43.0	42.0	41.0

Source: Company Reports and Citi Investment Research estimates

Figure 4. RIL Base-case SOTP Target

	Rs m	Rs/share	Comments
FY09E EBITDA forecast	222,014		
FY10E EBITDA forecast	202,806		
EV of Petrochem & Refining (Rs m)	1,380,666	950	@ EV/E of 6.5x Sep-09E
Net Debt (Rs m)	297,917	205	Estimated as on mid-FY09 for standalone RIL
Key investments			
-Reliance Petroleum	490,901	338	Based on EV/E of 6.5x FY10E i.e. at RPL target price of Rs155
-E&P Assets	1,416,180	974	Based on 12x steady state FCF (incl. KG oil and gas upside in FY11E)
- Organised Retail	80,000	55	Based on BV of investments so far
Total value of investments & other assets	1,987,081	1,367	
EV of businesses	1,380,666	950	
Net Debt adjusted for key investments	(1,689,164)	(1,162)	
Value of Treasury stock	483,860	333	At target price
Value for Equity holders (Rs m)	3,553,690	2,445	
No. of shares (m.)	1,453		

Source: Citi Investment Research estimates

Cairn India (CAIL.BO; Rs201.10; 1M)

Valuation: Our target price of Rs355 is based on estimated NAVs of under-development and producing assets and incorporating recovery & exploration 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. Key assumptions for our NAV analysis are: long-term crude price (Brent) of US$100/bbl; first oil from Rajasthan in 2H09; crude realization at a 7% discount to Brent; cess at Rs918/MT; plateau production at 175kbpd; development capex of US$2.75bn; and inclusion of pipeline capex. Our target price is more leveraged to crude prices and less sensitive to operating parameters and/or reserve upside. The traditional valuation multiples (EV/DACF) will become more relevant as Rajasthan approaches first oil, but contingent 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. We therefore ascribe a Medium Risk rating to Cairn India. Key risks include: 1) Delays and cost overruns; though cost- recoverable, these could impact NAVs; 2) Unfavorable ruling on the cess liability being higher than our base case of Rs918/tonne; and 3) Potential conflict of interest arising out of Cairn PLC's majority ownership in Cairn India, especially in the context of new exploration assets in India. These risks could impede the stock from reaching our target price.

Reliance Industries (RELI.BO; Rs1,873.00; 1L)

Valuation: Our target price of Rs2,450 is based on a sum-of-the-parts value: 1) We value RIL's core petrochem and downstream oil business on an EV/EBITDA of 6.5x mid-FY10E, in line with regional chemicals and refining peers; this also captures the impact of a global downturn in refining and petchem; 2) We value total E&P assets including oil & gas prospects and other blocks at Rs974/share based on 12x steady state (FY11E) FCF; 3) We value investment in RPL at 6.5x FY10E EV/EBITDA (in line with RIL); 4) We value organized retail business at

Rs55/share, based on book value of investments so far; and 5) We value treasury stock at target price.

Risks: We rate RIL Low Risk, as opposed to the Medium Risk suggested by our quantitative risk-rating system, which tracks 260-day historical share-price volatility. Diversified earnings and significant value contribution from the emerging E&P business and investment in listed subsidiaries have led to qualitative changes in the value constituents of the stock. Risks that could impede the stock from reaching our target price are: RIL's margins are exposed to the global petrochemical and refining cycles; the group could be asked to offer larger discounts on products sold to oil public sector units; delays in the key KG-D6 gas development and RPL refinery project; delays in the drilling programme for the new blocks (D9, D3, MN-D4); and the organized retail business would call for significant investment in non-core areas.

Appendix A-1

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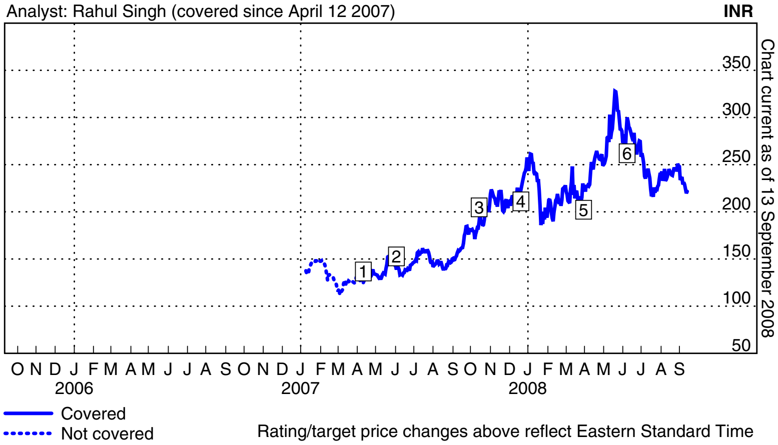
Analyst: Rahul Singh (covered since April 12 2007)



#	Date	Rating	Target Price	Closing Price
1:	11 Apr 07	2M	145.00	125.00
2:	4 Jun 07	*1M	*185.00	138.75
3:	14 Oct 07	1M	*221.00	189.60
4:	20 Dec 07	1M	*262.00	223.35
5:	31 Mar 08	1M	*275.00	224.20
6:	9 Jun 08	1M	*355.00	300.10

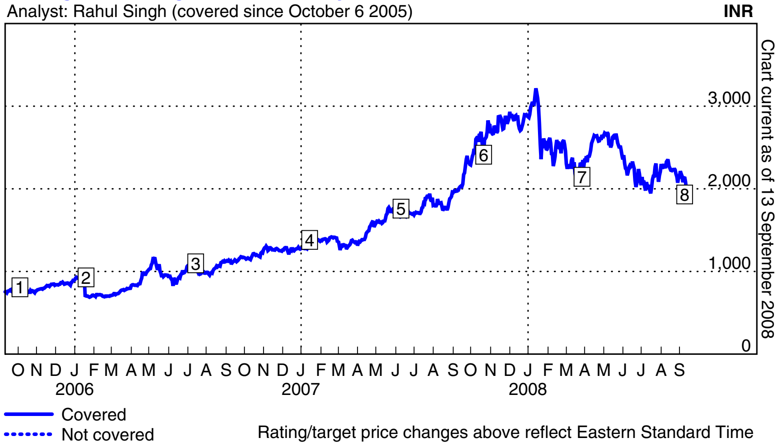
*Indicates change.

Rating/target price changes above reflect Eastern Standard Time

Reliance Industries (RELI.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Rahul Singh (covered since October 6 2005)



#	Date	Rating	Target Price	Closing Price
1:	5 Oct 05	1L	*697.31	801.95
2:	19 Jan 06	1L	*794.00	704.20
3:	14 Jul 06	*2L	*1,150.00	1,065.15
4:	15 Jan 07	2L	*1,450.00	1,364.65
5:	11 Jun 07	*1L	*2,005.00	1,668.20
6:	21 Oct 07	1L	*2,860.00	2,412.75
7:	27 Mar 08	1L	*2,850.00	2,275.00
8:	9 Sep 08	1L	*2,450.00	2,142.85

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