

INDIA

Oil&Gas and Petrochemicals

Opportunities galore

Reasons for report: Management meet

We recently met the management of Indraprastha Gas (IGL), Cairn India and GAIL in Delhi. Based on our interaction, we are positive on IGL's growth prospects: i) given its continued expansion in Delhi, ii) incremental growth from targetting industrial segment in Noida & Greater Noida and iii) net addition of 3,000 CNG buses for the upcoming Commonwealth Games 2010. Cairn's busy exploration programme through '10 might lead to positive newsflow – plans are ongoing to drill nine exploration wells (two each in Rajasthan & KG offshore non-operated blocks and five in KG onshore). Also from '10, Cairn will commence its pilot enhanced oil recovery (EOR) project in Barmer Hill (400mmbbl in-place oil) that could lead to reserve accretion (to take more than a year). However, major short-term triggers (start of production & crude offtake from Rajasthan) have been priced in and we maintain our negative stance on Cairn as it is trading at an 18% premium to our end-FY11E target price of Rs235. GAIL expects to complete its entire Gas Rehabilitation and Expansion Project (GREP) pipeline by October '10. The management has maintained its FY10-12 capex guidance of ~Rs135bn, primarily to be spent on gas transmission pipelines. Current valuations are reasonable as our end-FY11E target price of Rs452 yields an 8% upside.

- ▶ **IGL – Room for expansion; BUY.** IGL would add 21 more CNG stations (taking the total to 230) in Delhi in '10. Also, till March '10, the company's compression capacity would be raised 30% YoY to 4.6mmscmd, as IGL is building necessary infrastructure to cater to higher CNG & PNG demand. In preparation of the upcoming Commonwealth Games 2010 in Delhi, IGL expects to add 3,000 CNG buses in Delhi, providing a major boost to CNG demand. The company is also targetting industrial customers in Noida & Greater Noida, implying further growth visibility.
- ▶ **Cairn – Exploration programme might yield positive newsflow, but valuation still rich; SELL.** Drilling is planned for nine exploratory wells in '10; drilling has started in one well in the Cambay basin in '09. Cairn has completed 3D surveys in Palar basin and has finished 3D surveys in Sri Lanka, but exploratory drilling might take at least a year. Though we are still negative on Cairn due to rich valuations (the stock is trading at an 18% premium to our end-FY11E target price of Rs235), any positive newsflow from exploratory wells might lead to an upgrade.
- ▶ **GAIL – Significant pipeline capex to continue; HOLD.** Capex through FY10E-12E will likely be ~Rs135bn, primarily to be spent on gas pipelines. GAIL expects the Myanmar gas block to start production from May '13. Also, core drilling is ongoing in Chhattisgarh for coal bed methane (CBM) blocks. We maintain HOLD as current valuation is reasonable, implying an 8% upside to our end-FY11E target price of Rs452/share.
- ▶ **Gujarat Gas to receive 0.6mmscmd KG gas from Reliance Industries.** As per our interaction with ministry officials, Gujarat Gas (GGCL) would receive 0.6mmscmd KG-D6 gas (also confirmed by the management). Cheaper KG-D6 would replace costlier imported LNG, leading to 6% improvement in gross margin to Rs4/scm and increased supply of reliable domestic gas.

Indraprastha Gas
Buy (Rs224)

Cairn India
Sell (Rs277)

GAIL
Hold (Rs419)

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IGL – Management meet

Additional 21 CNG stations will start operating in Delhi by March '10, leading to a total of 230 – 27% YoY growth. Moreover, IGL's compression capacity would be raised 30% YoY to 4.6mmscmd.

Capex for FY10 & FY11 is expected to be Rs3.5bn each – FY10 capex in Delhi alone is Rs2-2.5bn owing to the upcoming Commonwealth Games 2010.

IGL is targetting industrial customers in Noida & Greater Noida, and subsequently expects 40% YoY growth to be maintained for its industrial customer segment in the next two years.

Incremental growth likely from additional 3,000 high-capacity CNG buses in Delhi for the upcoming Commonwealth Games 2010.

IGL is confident of easily passing on 44% APM gas price hike to its CNG/PNG customers. The company's CNG prices are at ~Rs21.2/Kg already, significantly lower than that is other cities of India – ~Rs30/Kg in Gujarat and Rs40/Kg in Moradabad.

Cairn – Management meet

Pilot EOR project in Barmer Hill likely to start this year. Cairn expects 400mmbbl in-place oil in Barmer Hill, of which 10% can be easily recoverable from primary recovery mechanism; this will further increase with secondary oil recovery techniques.

Cairn has drilled ~10 natural gas development wells in Raageshwari deep field, Rajasthan. Cairn is using the gas from Raageshwari deep field for heating its crude pipeline. Hydro-fracturing, an enhanced gas recovery technique, has also yielded good results. Prior to hydro-fracturing, the gas production rate from Raageshwari deep field was 1-2mmcfpd, which has been ramped up to 15-16mmcfpd post hydro-fracturing.

Rajasthan crude sales trial to Indian Oil Corporation would commence soon; this was earlier delayed due to the fire in IOC's premises in Jaipur last year. After trial sales, formal sales will commence in the next quarter.

Cairn has recently finished its 3D seismic surveys in Sri Lanka. Processing of 3D results will be completed by '10 and exploratory drilling will start in beginning-'11.

Nine exploratory wells are planned in '10 – two each in Rajasthan & KG offshore blocks (non-operated) and five in KG onshore. Moreover, the company has completed 3D surveys in its Palar basin and commenced 4D seismic survey in its Ravva basin.

GAIL – Management meet

Significant capex plans maintained through to FY10-12. GAIL's FY10, FY11 and FY12 capex is at Rs35bn, Rs50bn and Rs50bn respectively, primarily to be spent on new gas transmission pipelines. The management does not expect fund raising to be a concern (which will be used to partially fund GAIL's capex plans).

GAIL expects entire GREP pipelines to be completed by October '10, excluding additional compression facilities that would be delayed by 4-6 months. However, the company anticipates a slight delay in the DVPL pipeline section, which is now expected to be completed by end-FY10.

De-bottlenecking ongoing in Pata petchem plant, which will raise the plant capacity further by 30,000te/annum to 440,000te/annum. However, the nameplate capacity expansion would take 3-4 years.

Myanmar gas production would commence from May '13 – GAIL's share in the overall capex is Rs15bn.

CBM block status. Out of its three CBM blocks, GAIL's Chhattisgarh block has some prospects, wherein core well drilling is currently ongoing.

Marketing margin. GAIL is earning Rs8.9/mmbtu and Rs5.7/mmbtu marketing margins on imported LNG & PMT gas respectively.

I-Sec investment ratings (all ratings relative to Sensex over next 12 months)

BUY: +10% outperformance; **HOLD:** -10% to +10% relative performance; **SELL:** +10% underperformance

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