MOTILAL OSWAL

30 January 2013

Update | Sector: Oil and Gas

Oil India

BSE SENSEX	S&P CNX
20,005	6,056

ऑयल इंडिया लिमिटेड
OIL INDIA LIMITED

Bloomberg	OINL IN
Equity Shares (m)	601.1
M.Cap. (INR b)/(USD b)	316.8/5.9
52-Week Range (INR)	617/431
1,6,12 Rel. Perf. (%)	10/-9/-9

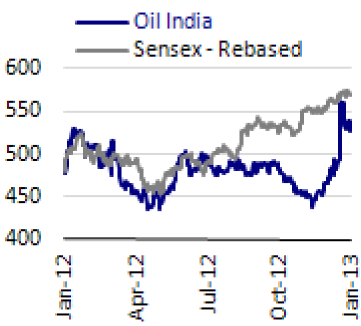
Financials & Valuation (INR b)

Y/E March	2013E	2014E	2015E
Sales	92.9	107.8	124.7
EBITDA	42.0	51.9	64.0
Adj. PAT	35.4	38.6	48.8
Adj. EPS (INR)	58.9	64.2	81.2
EPS Gr. (%)	5.0	8.8	26.5
BV/Sh.(INR)	331	372	428
RoE (%)	18.8	18.2	20.3
RoCE (%)	26.1	25.5	28.3
Payout (%)	38.4	36.1	31.4
Valuation			
P/E (x)	8.9	8.2	6.5
P/BV (x)	1.6	1.4	1.2
EV/EBITDA (x)	4.9	3.9	2.9
Div. Yield (%)	3.6	3.8	4.2

Shareholding pattern %

As on	Dec-12	Sep-12	Dec-11
Promoter	78.4	78.4	78.4
Dom. Inst	4.8	5.1	5.4
Foreign	1.6	1.5	2.1
Others	15.2	15.0	14.0

Stock performance (1 year)



CMP: INR527 | TP: INR638 | Buy

Steady production growth; cash deployment, a trigger

Attractive valuations; reforms to be key catalyst

- **We expect the recently-announced diesel reforms and likely gas price hike before March-14 to lead Oil India Ltd's (OIL) growth in the next 2 years.**
- **OIL's operational performance is on track and we expect the company to report oil/ gas production CAGR of 2%/6% over FY12-15E.**
- **The stock is trading at its historical low P/E of 6.5x and our FY15E EPS estimate of INR81.2, and has a dividend yield of ~4%. Our SOTP-based target price for OIL is INR638/ share, a 21% upside. Maintain Buy.**

Diesel reforms set to reduce subsidy, expect rationalization soon

Post (a) petrol deregulation in June 2010, (b) capping of LPG cylinders in FY13, (c) direct cash transfer pilot plan and now with (d) diesel reforms, we believe the government is nearing its vision of market-linked petro product prices. Diesel reforms (small regular price hikes) are set to reduce under-recoveries by 30% in FY14 and 50% in FY15 over FY13, thus substantially reducing under-recoveries. We conservatively model upstream sharing at 50% in FY14E and 60% in FY15E and expect clarity on long term sharing, which would not only free capital for reinvestment (past 8-year subsidy of INR212b is 3.5x of OIL's capex in the same period), but would also lead to stock's rerating.

Valuations attractive; gas price hike would be a big catalyst

OIL trades at a lowest P/E and P/B since listing and at ~40% discount to global E&P peers on EV/BOE (1P basis). We note OIL's historical net realization/EPS CAGR is of 8%/18% since FY05, despite ad-hoc subsidy. We believe these valuations are very attractive given that a) OIL's EPS CAGR is likely to be 13% during FY12-15E, b) RoE/RoCE at ~20% and c) likely domestic gas price hike before March 2014. MoPNG proposal to adopt Rangarajan Committee gas price formula for APM gas in the current year itself would double the realization to ~USD8/mmbtu. We model USD7/mmbtu from FY15E and likely early implementation in FY14 will increase our FY14E EPS by 19%.

High cash reserves present opportunities; expect steady production

OIL's cash reserves at ~USD2b are ~60% of its balance sheet and though it hampers RoE in the short term, it provides wide investment options. We estimate oil/gas production CAGR of 2%/6% in FY12-FY15E and beyond given that: (a) despite mature fields, production is yet to peak, (b) favorable reserve mix with (i) 62% oil in 2P, (ii) 1P reserves are 50% of 2P, thus more possible upside in 1P and c) R/P (reserves/production) of >24 years. Further, its reserve replacement ratio (RRR) has been consistently >1.

Maintain Buy, target price of INR638

We value OIL at INR638/share based on average of: (1) P/E of 8x FY15E, (2) 4x FY15E EV/EBITDA and (3) DCF (WACC of 11.5%). The stock trades at >40% discount to global peers on EV/BOE (1P basis), and at 6.5x FY15E EPS of INR81.2 and has a dividend yield of ~4%. Maintain **Buy**.

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Story in charts De-risking; strong balance sheet; secular production growth

#1 OIL, with >95% of reserves in North East India, is predominantly an on-land player.

#2 However, higher share of offshore acreage in its exploration portfolio implies efforts to diversify.

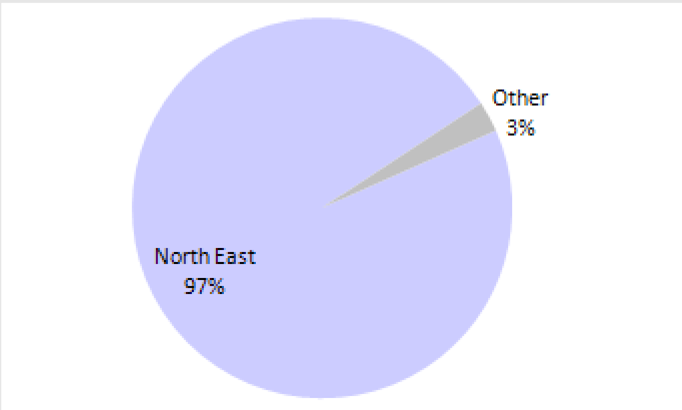
#3 Delays in acquisition have led to cash build-up; despite this, return ratios are impressive.

#4 Planned capex in current acreage implies high focus on exploration and development.

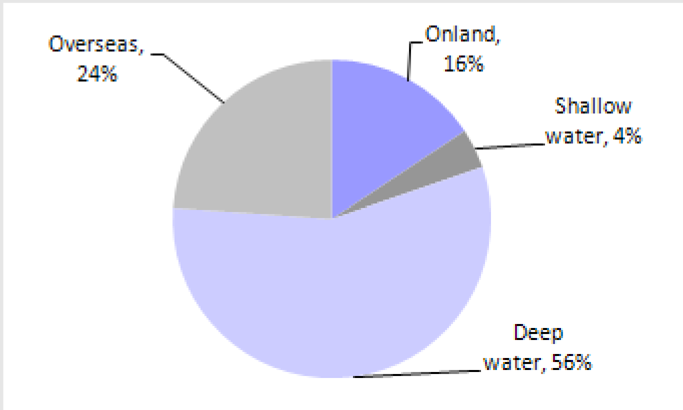
#5 With oil production from current acreage yet to peak out, we expect steady increase in the coming years.

#6 While an increase in gas production is linked to new customer linkages, expect next jump in end-2013.

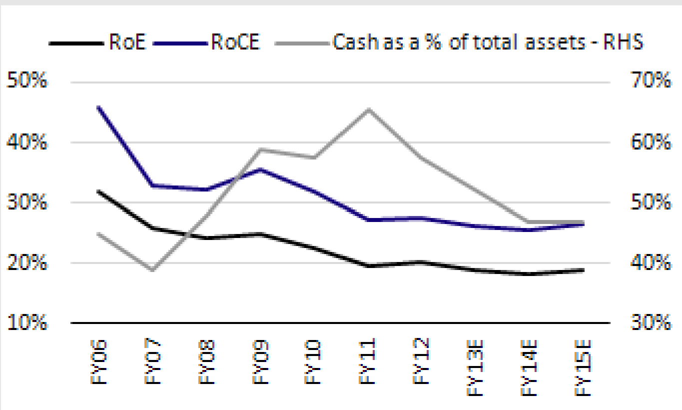
#1 OIL's >95% reserves in North East and 100% in on-land



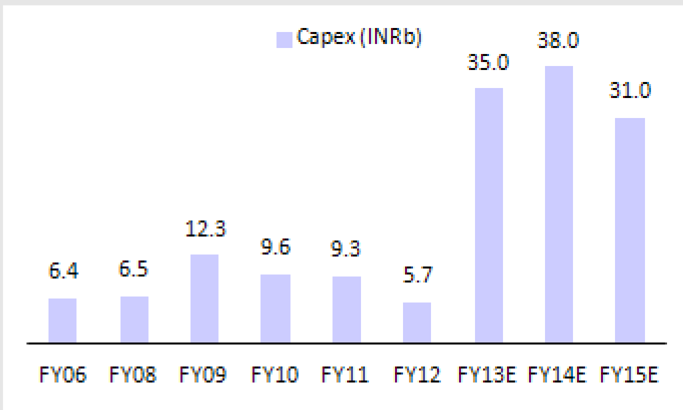
#2 However, exploration area more skewed to offshore



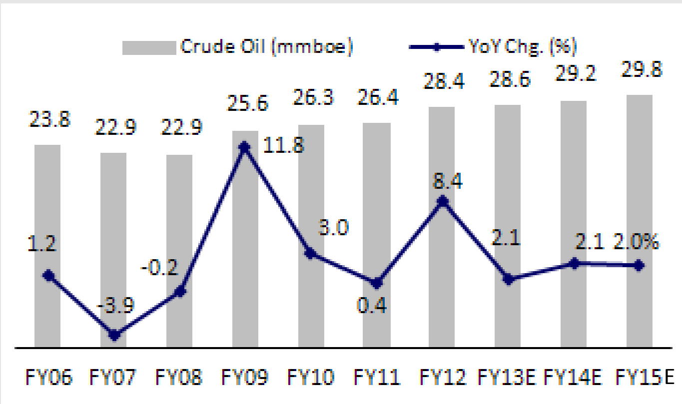
#3 In spite of high cash balance, return ratios impressive (%)



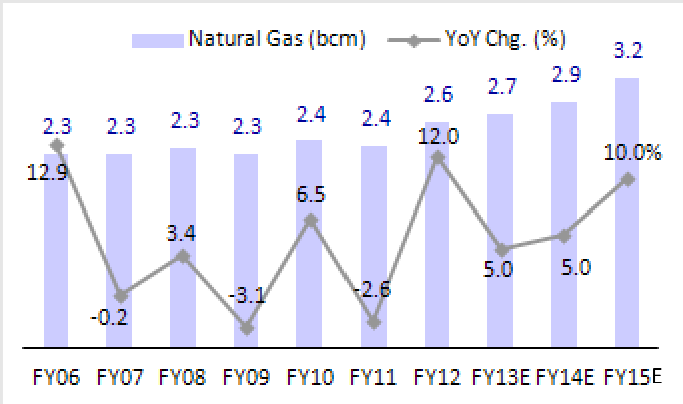
#4 Increasing capex, >INR69b planned in FY14/15 (INR b)



#5 Expect steady increase in crude oil production (mmboe)



#6 Gas output to rise with an increase in customer base (bcm)



Source: Company/MOSL

Story in charts RRR >1; earnings up despite ad-hoc subsidy; valuations attractive; Buy

#7 OIL scores high in the most important metric, i.e. reserve-replacement ratio (RRR) at >1 during the last 8 years.

#8 1P reserves at just 53% of 2P reserves (v/s 73% for ONGC); enough headroom for 1P reserve increase.

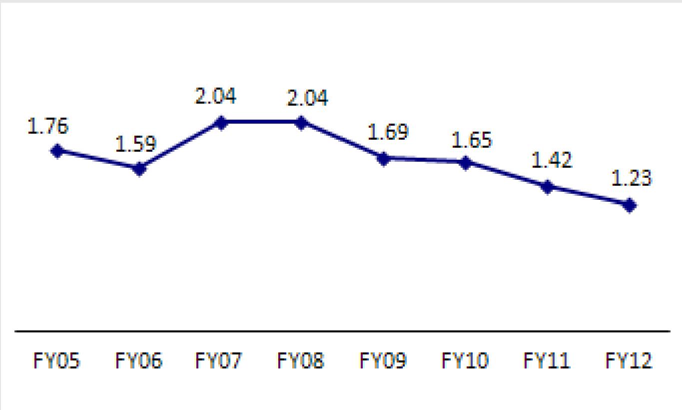
#9 Under-recoveries at peak; expected to decline in the longer term.

#10 Net realizations set to increase.

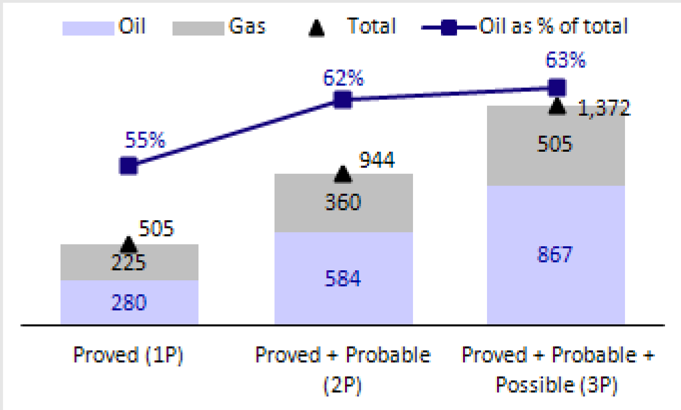
#11 13% PAT CAGR over FY12-15E led by recently announced reforms.

#12 Stock is trading at attractive valuations, dividend yield of 4%. Buy with a target price of INR638, 21% upside from current levels.

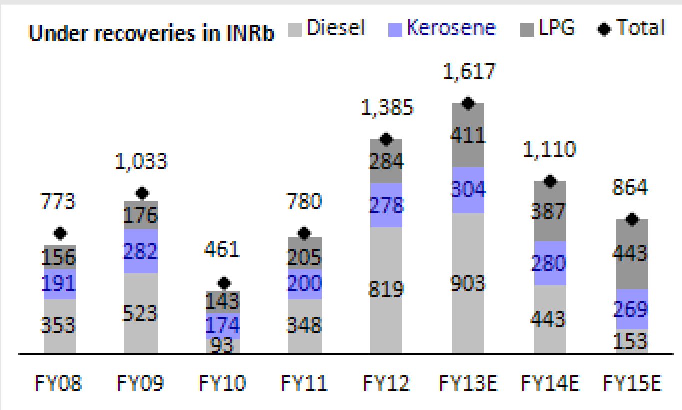
#7 Impressive RRR of >1 in the past 8 years



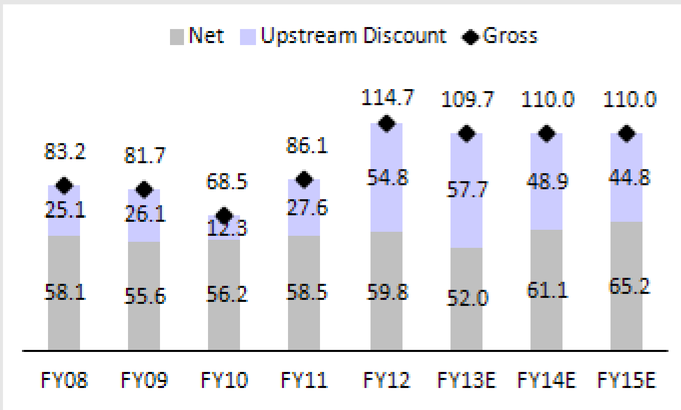
#8 1P reserves just 53% of 2P reserves (v/s 73% for ONGC)



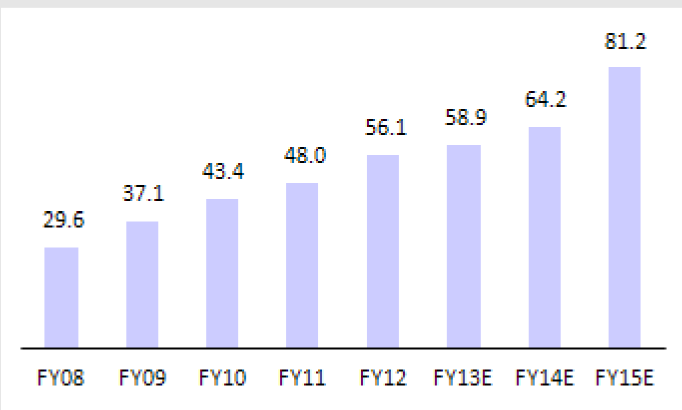
#9 Under-recoveries at a peak (INR b)



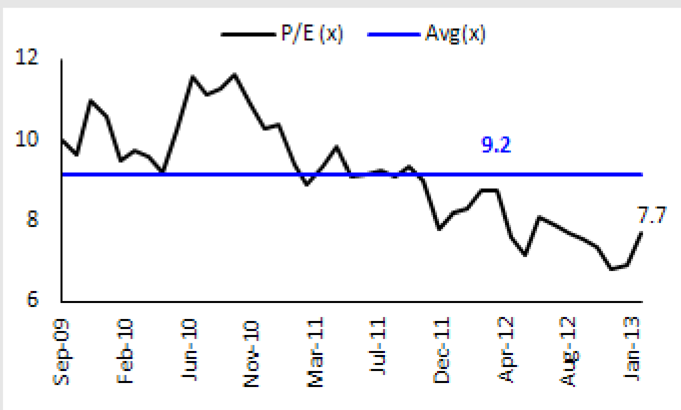
#10 Net realizations set to increase (USD/bbl)



#11 PAT CAGR of 13% over FY12-15E



#12 Stock trading at attractive valuations



*1-year forward P/E

Source: Company, MOSL

Diesel reforms set to reduce subsidy

Expect rationalization soon

- **After (a) petrol deregulation in June 2010, (b) capping of LPG cylinders in FY13, (c) direct cash transfer pilot and now with (d) diesel reforms, we believe that the government is nearing its vision of market-linked petro product prices.**
- **Diesel reforms (small regular price hikes) are set to reduce under recoveries by 30% in FY14 and 50% in FY15 over FY13, thus substantially reducing the under recoveries.**
- **We conservatively model upstream sharing at 50% in FY14 and 60% in FY15 and expect clarity on long-term sharing, which would not only free capital for reinvestment (past 8-year subsidy of INR212b is 3.5x of OIL's capex in the same period), but would also lead to stock's rerating**

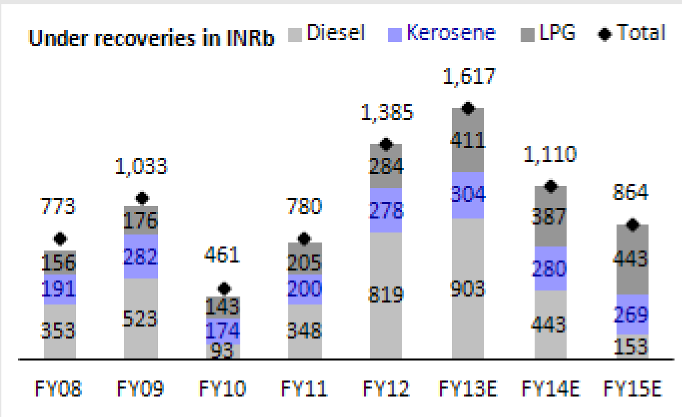
India announced landmark diesel reforms; to reduce under-recoveries by 50% in FY15

Govt. of India, in Jan-2013 announced the unprecedented diesel reforms which will not only reduce under recoveries, but also eventually link the diesel prices to market, thereby eliminating the concern once and for all. These reforms are in-line with the govt's long-term goal of pricing the petroleum fuels in-line with the market pricing, thereby eliminating any inefficiency in its use. The recently announced reforms are:

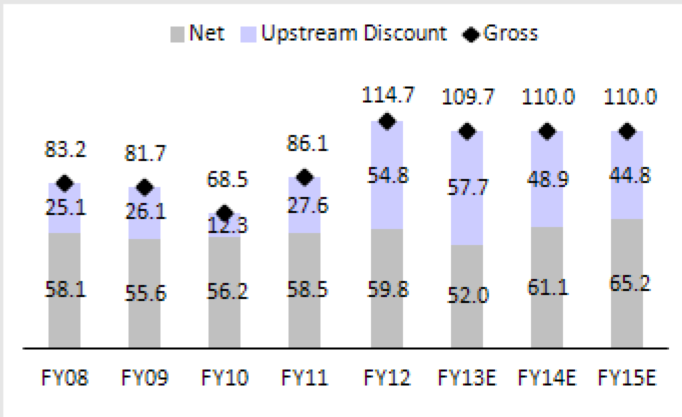
a) OMCs (oil marketing companies) to make small revisions to diesel prices until it's at par with market prices - to hike prices by INR0.5/ltr per month;
b) Sales to bulk diesel buyers at market price (bulk diesel is 12-17% of total sales);
c) LPG cylinder cap increased from 6 to 9 per year per household;
d) Prices of kerosene were however kept unchanged for now.

Assuming INR0.5/ltr diesel price hike every month (base case) over the 12 months, we estimate under recoveries reducing to INR1.1t in FY14 and INR 0.8t in FY15. In our base case scenario, government is expected to share 50/35% for FY14/15 while upstream will share 50/60% during the same period.

FY14 under-recoveries estimated at INR1.1t v/s INR1.6t in FY13



Net realization to rise to USD 65/bbl (all-time high) in FY15



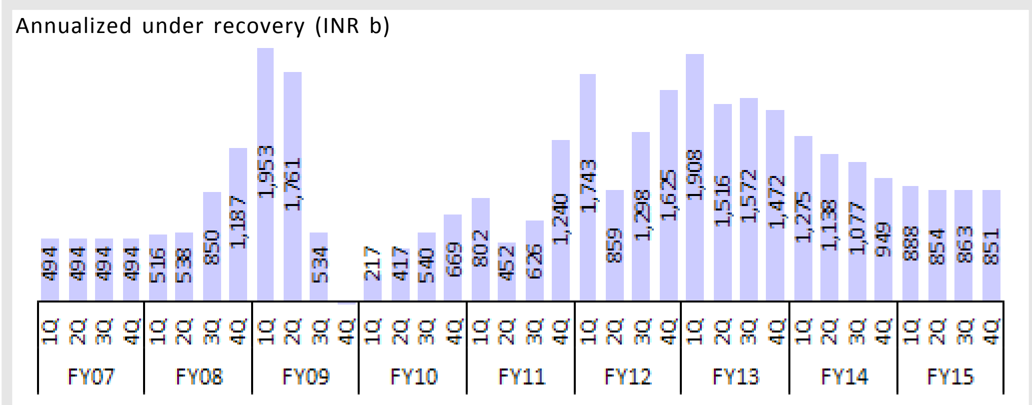
Source: Company, Industry, MOSL

We estimate under recoveries to fall by 50% in FY15 over FY13 (INR b)

	FY08	FY09	FY10	FY11	FY12	FY13E	FY14E	FY15E
Fx Rate (INR/USD)	40.3	46.0	47.5	45.6	47.9	54.5	53.0	53.0
Brent (USD/bbl)	82.3	84.8	69.6	86.3	114.5	110.0	110.0	110.0
Gross Under recoveries (INR b)								
Auto Fuels	426	575	144	375	812	903	443	153
Domestic Fuels	347	458	316	405	573	714	667	711
Total	**773**	**1,033**	**461**	**780**	**1,385**	**1,617**	**1,110**	**864**
Under recoveries Sharing (INR b)								
Government	353	713	260	410	835	970	555	302
Upstream	257	329	145	303	550	647	555	518
OMC's	163	(9)	56	67	0	0	0	43
Total	**773**	**1,033**	**461**	**780**	**1,385**	**1,617**	**1,110**	**864**
Under recoveries Sharing (%)								
Government	46	69	56	53	60	60	50	35
Upstream	33	32	31	39	40	40	50	60
OMC's	21	(1)	12	9	0	0	0	5
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**

Source: MoPNG, MOSL

Monthly diesel price hikes to reduce under recoveries: Annualized reduction of 44% by 1QFY15



Recommendations of various committees point to a common goal of market-linked pricing

Rangarajan Committee (2006)

An appropriate pricing regime which promotes efficiency needs to be evolved in relation to petrol and diesel on the one hand and domestic LPG and PDS kerosene on the other. The issues of adjusting prices and targeting them appropriately become urgent in this context.

Excerpt from Integrated Energy Policy (2006)

- The energy policies that we have adopted since independence to serve the socio-economic priority of development have encouraged and sustained many inefficiencies in the use and production of energy.
- India faces an enormous challenge if it is to meet her energy requirement over the coming 25 years and support a high growth rate. The main areas of action include: Rationalisation of fuel prices to mimic free market prices that promote efficient fuel choice and substitution.

Excerpt from Kirit Parikh led Expert Group recommendations (2010)

- Though future oil prices are difficult to predict, they are generally expected to rise. Given our increasing dependence on imports, domestic prices of petroleum products have to reflect the international prices.

Source: MoPNG, Planning Commission, MOSL

Historical efforts to curb under recoveries were ad-hoc; but helpful

While dismantling the Administered Pricing Mechanism (APM) in 2002, government announced its intention to implement market determined pricing and continue subsidies on kero/LPG as they are consumed by the economically weaker populace. However, government continued to control the prices of petrol and diesel due to continued rise in global oil prices. Various steps to curb the under recoveries were ad-hoc in nature, but nevertheless helped in reducing the under recoveries to some extent.

But over the years as under-recoveries kept increasing led by consumption growth and high product prices, the government intermittently increased petroleum product prices. In the past 3 years, though delayed, the price hikes have been very steep and also steps like (a) decontrolling petrol price and (b) limiting subsidized LPG cylinders to 9 per household; (c) allowing OMC's to increase Diesel prices in small quantities at regular intervals are encouraging, in our view.

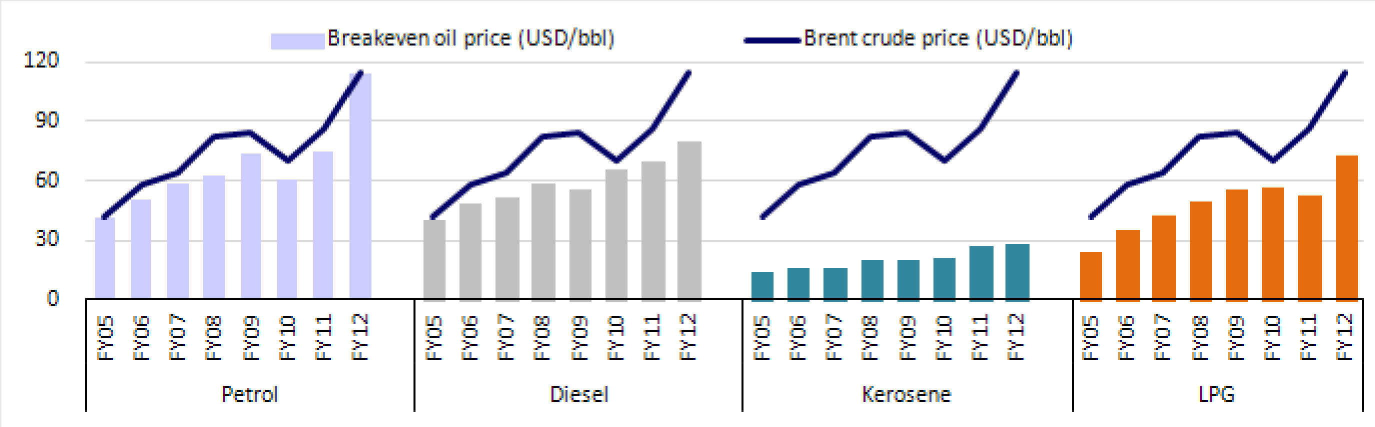
Price hikes over the years have nevertheless resulted in an increase in breakeven prices (prices where under-recovery is nil) for all the products. We estimate that the breakeven price for diesel has risen from USD41/bbl in FY05 to USD80/bbl now, while current retail petrol price largely reflects the market price. Though the breakeven price for PDS kerosene and LPG are still very low (at ~USD30/bbl for PDS kerosene and USD70/bbl for domestic LPG), the government is trying to reduce the subsidy by targeting it only to the deserved consumers.

Though substantial, historical price hikes were ad-hoc; and insufficient to link to market prices

	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13E
Fx Rate (INR/USD)	45	44	45	40	46	47	46	48	55
Brent (USD/bbl)	42	58	64	82	85	70	86	114	110
Brent (INR/bbl)	1,897	2,568	2,914	3,316	3,900	3,302	3,933	5,484	5,995
Under recoveries (INRb)	201	400	494	773	1,033	461	780	1,385	1,614
Petroleum Product Price Hikes (INR/ltr)									
Petrol	**2.0**	**2.5**	**4.0**	**2.0**	**5.0**	**4.0**	**3.5**		
	(Jun-04)	(Jun-05)	(Jun-06)	(Feb-08)	(Jun-08)	(Jul-09)	(Jun-10)		
	1.1	**3.0**	**-2.0**		**-5.0**	**3.0**	**Deregulated**		
	(Aug-04)	(Sept-05)	(Nov-06)		(Dec-08)	(Feb-10)	**in June -10**		
Diesel	**1.0**	**2.0**	**2.0**	**1.3**	**3.0**	**2.0**	**2.0**	**3.4**	**5.6**
	(Jun-04)	(Jun-05)	(Jun-06)	(Feb-08)	(Jun-08)	(Jul-09)	(Jun-10)	(Jun-11)	(Sep-12)
	1.4	**2.0**	**-1.0**		**-2.0**	**2.6**			**0.5**
	(Aug-04)	(Sept-05)	(Nov-06)		(Dec-08)	(Feb-10)			(Jan-13)
Kerosene							**3.0**	**2.0**	
							(Jun-10)	(Jun-11)	
LPG (INR/cylinder)	**20**				**10**		**35**	**50**	
	(Jun-04)				(Jun-08)		(Jun-10)	(Jun-11)	
	20				**-25**				
	(Nov-04)				(Jan-09)				

Source: MoPNG, MOSL

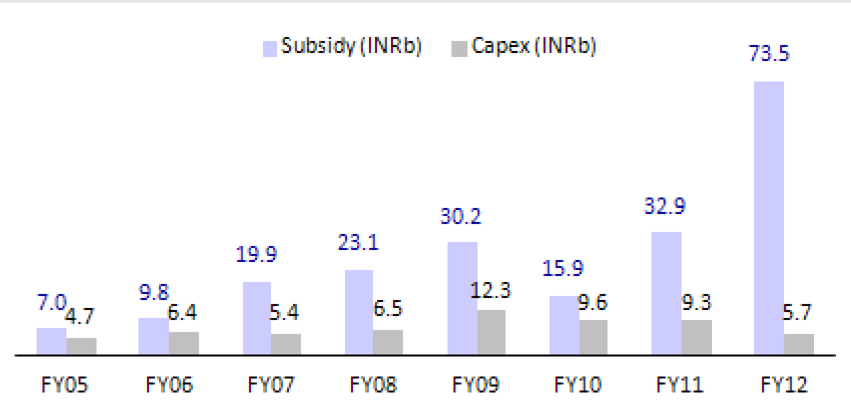
Breakeven price of diesel has doubled in past 7 years

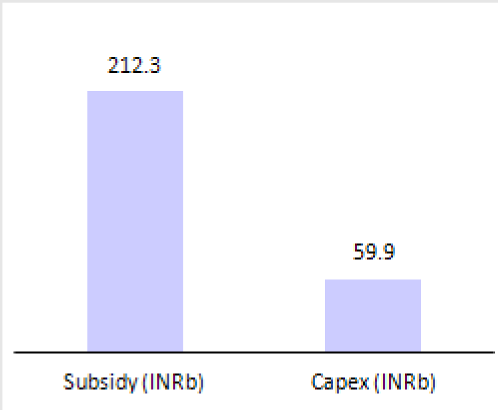


Source: PPAC, MOSL

OIL's subsidy share at 3.5x of capex in past 8 years: During the past 8 years, OIL's subsidy share has been INR212b, which is ~3.5x its capex of INR60b in the same period. Reduction in total under-recoveries would help the company channelize its cash flow to increase production.

OIL has spent 3.5x on subsidy as compared to capex in past 8 years





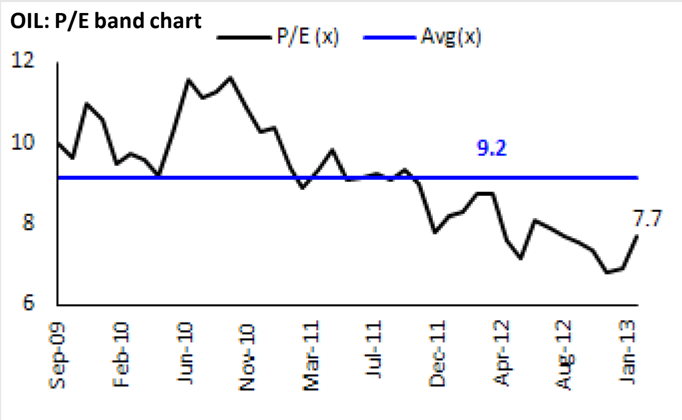
Source: Company, MOSL

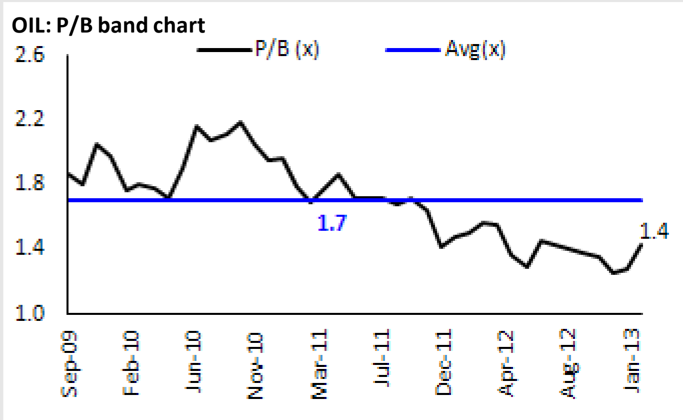
Valuations attractive

Gas price hike would be a big catalyst

- **OIL trades at attractive valuations, at ~40% discount to global peers on EV/BOE (1P basis).**
- **OIL's historical net realization/EPS CAGR at 8%/18% since FY05, despite ad-hoc subsidy.**
- **We believe these valuations are attractive given that a) OIL's EPS CAGR is likely to be 13% in FY12-15E; b) RoE/RoCE at ~20% and c) likely domestic gas price hike before Mar-14.**
- **MoPNG proposal to adopt Rangarajan Committee gas price formula for APM gas in the current year itself would double the realization to ~USD8/mmbtu. We model USD7/mmbtu from FY15 onwards and likely early implementation in FY14 will increase our FY14E EPS by 19%.**

OIL is trading at historical low valuations



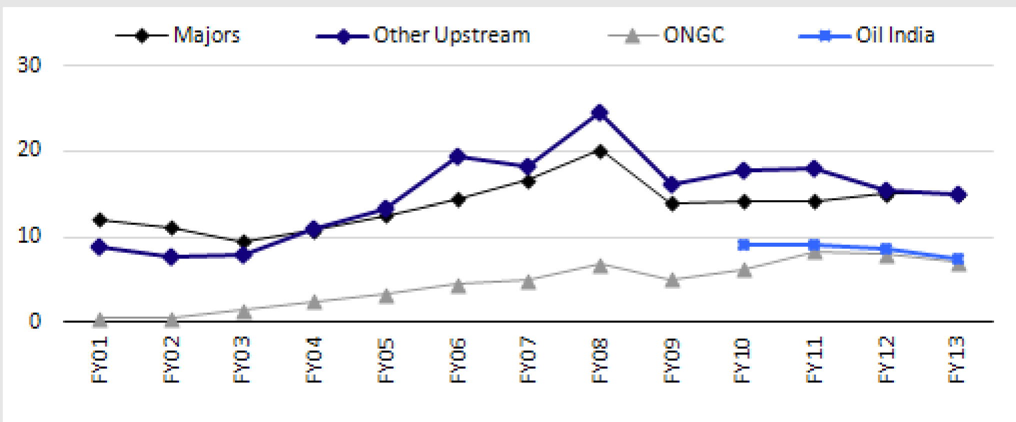


Source: Company, Bloomberg, MOSL

OIL's valuations attractive versus global peers on EV/BOE basis

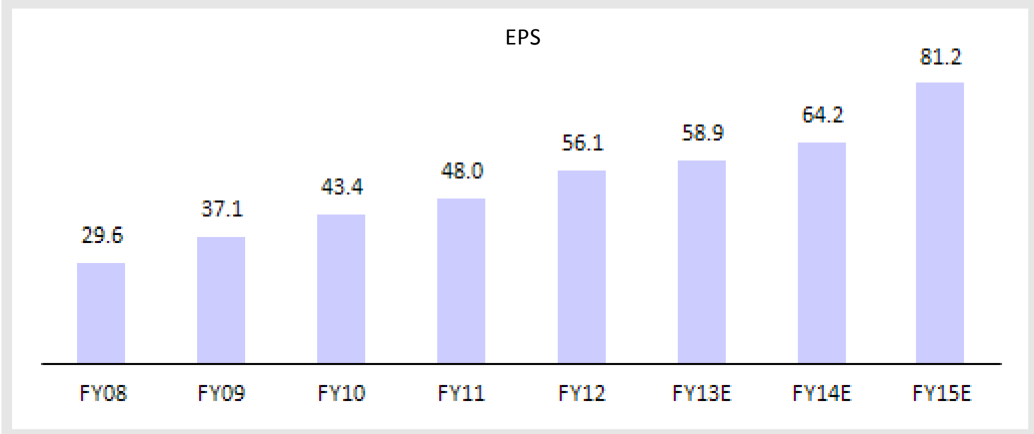
OIL trades at ~40% discount to global E&P peers on EV/BOE (1P basis) partly due to ad hoc subsidy sharing. We expect the gap to narrow as policy initiatives reduce the ad hoc element in subsidy sharing and energy prices in India move towards market determined pricing. We believe rationalization of subsidy sharing would result in the stock's re-rating and expect the discount to global peers to narrow. Historically, despite the government subjecting OIL to harsh subsidy-sharing, its net realization and PAT CAGR since FY05 has been 8% and 18% respectively.

OIL has always traded at a discount to global peers (USD/BOE on 1P basis)



Source: Bloomberg, MOSL

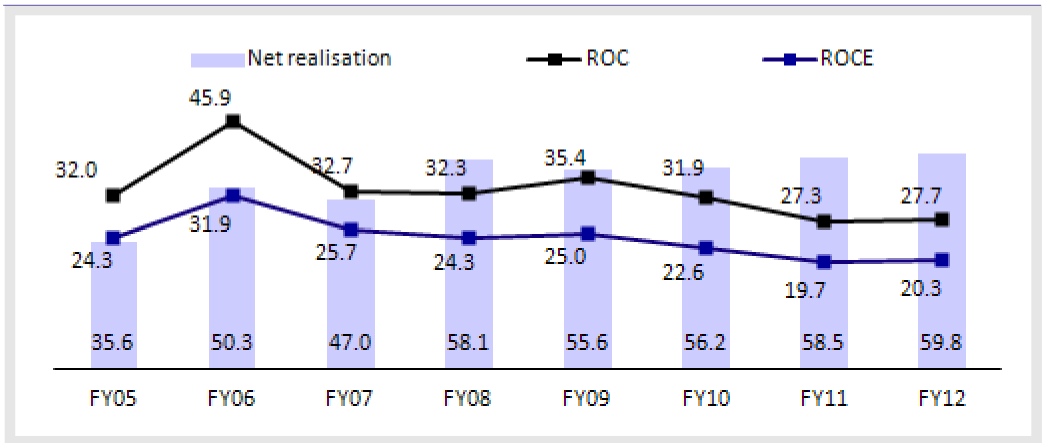
EPS CAGR seen at 13% in next 3 years, led by reforms



Source: Company, MOSL

OIL's RoCE/RoC fell from 24%/32% in FY05 to 20%/28% in FY12 mainly due to higher cash balance in the books and also partly due to ad hoc subsidy sharing.

Though net realizations have been stable, RoCE/RoC declined by ~400bp in the past 7 years



Source: Company, MOSL

Natural gas price hike likely before March 2014

Expect uniform gas prices in India over the long term: Unlike developed markets, where gas pricing is market determined, in India it is approved by the government and varies from USD4.2/mmbtu (APM) to USD5.75/mmbtu (PMT) and imported LNG is quoted at ~USD10-14/mmbtu. With domestic gas prices at a significant discount to imported gas prices, there is little incentive for upstream companies to invest at the fixed gas price of USD4.2/mmbtu. Also, the breakeven price for new deep water discoveries in the country is pegged at USD5-6/mmbtu.

Thus, Government of India had formed an expert committee under the chairmanship of Dr. C Rangarajan to (a) review and recommend adequate mechanism for PSC's for the domestic E&P blocks and (b) provide guidelines/formula for determining the domestic gas pricing.

The committee, in its report submitted in Jan-13, has recommended an unbiased arm's length pricing based on international prices. Committee suggests to take trailing 12-month average of (a) volume-weighted net-back pricing at well-head for gas producers and (b) volume-weighted price of US's Henry Hub, UK's NBP and Japan's JCC linked price. The gas pricing will be uniformly applicable to all the sectors and domestic gas allocation will be as per government's gas utilization policy.

We estimate FY15E gas price at USD8/mmbtu based on the Rangarajan Committee formula

(A) Net-back pricing for producers who export to India					
In USD/mmbtu	**Volume (mmscmd)**	**FOB Price**	**Liquifaction cost**	**Treatment Cost**	**Net-back Price**
Qatar (Long Term)	33.2	12.5	3.0	0.5	9.0
Qatar (Medium-term/Spot)	3.9	14.0	3.0	0.5	10.5
Others	14.0	14.0	3.0	0.5	10.5
Weighted average by India imports (A)					**9.5**
(B) Net-back for Japan imports / Market pricing at gas hubs in US and Europe					
In USD/mmbtu	**Volume (mmscmd)**	**FOB Price**	**Liquifaction cost**	**Treatment Cost**	**Net-back Exchange Price**
Henry Hub (US)	1,891				4.0
NBP (Europe)	1,853				7.0
JCC linked (Japan)	289	14.0	3.0	0.5	10.5
Weighted average by consumption (B)					**5.8**
Simple average of above two methodologies (A & B) in USD/mmbtu					**7.7**

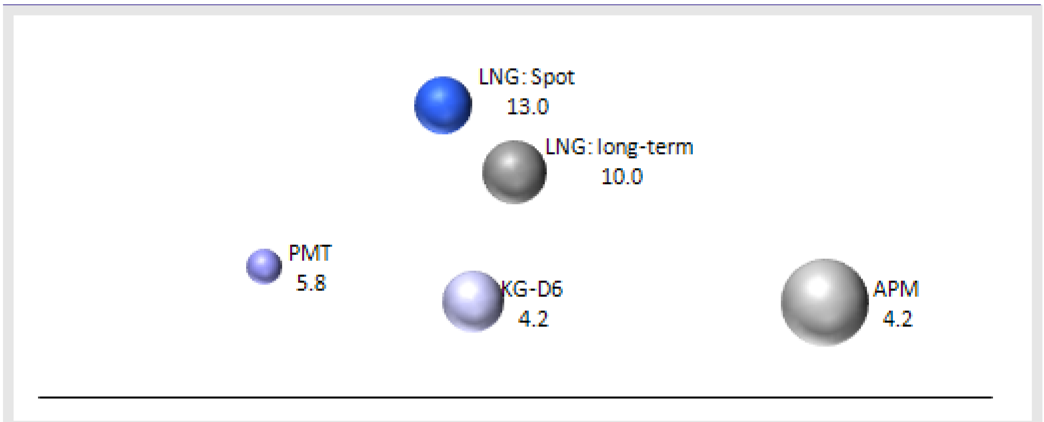
Key assumptions for our calculations

- We assume Qatar pricing at March 2014 based on its formula
- Pricing for others is assumed at USD14/mmbtu and actual can vary depending on the prevalent demand-supply situation
- Henry Hub/NBP gas price is assumed at USD4/7/mmbtu v/s current price of USD3.4/6.2/mmbtu

Net-back price = A - B - C

- A = Imported LNG price on net-back FOB available from World Energy Intelligence
- B = Liquefaction costs at the respective loading port (source)
- C = Transportation

Differential gas pricing in India (USD/mmbtu)



Source: Industry, MOSL

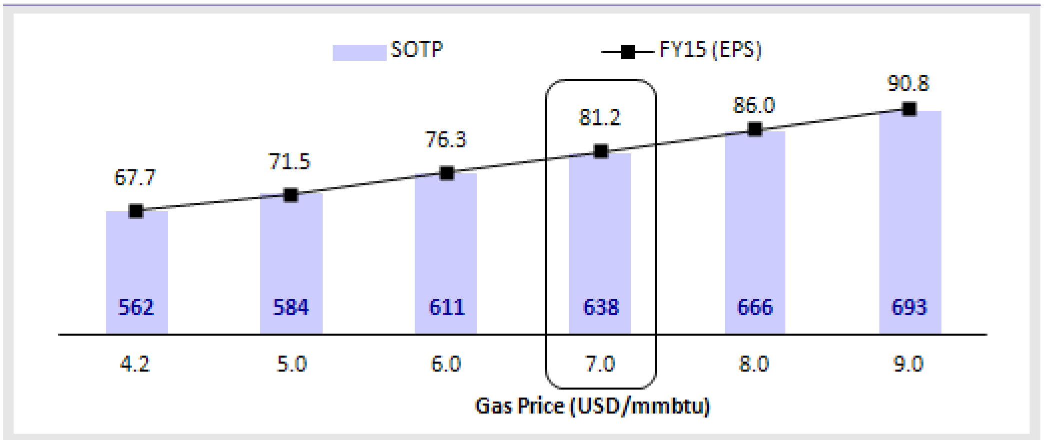
Further, Media reports indicate that the Oil Ministry (MoPNG), in its recent cabinet note (Jan-13), has proposed to accept the recommendation given by the Rangarajan Committee on gas pricing, implying new gas price of USD8/mmbtu v/s currently at USD4.2/mmbtu. The note further states that the new price (if approved by the cabinet) will be applicable immediately for APM gas (OIL/ONGC).

- As per the article, the new gas price will be applicable to all the natural gas producers (conventional, shale and CBM) in the country and actual applicability/ timing of the new price will vary for each company. OIL might get the new price applicable for APM gas immediately (full impact during FY14), while the same will be applicable for RIL only from Apr-14.

We have modeled in gas price hike to USD 7/mmbtu from FY15 in our base case. We present below the earnings sensitivity to OIL's EPS at different levels of domestic gas prices.

If gas price is hiked to USD8/mmbtu, our FY15 EPS estimate will be upgraded by 6% (base case at USD 7/mmbtu). Also our SOTP will be upgraded by 5% to INR 666/share.

If gas price is hiked to USD8/mmbtu, our FY15 EPS estimate will be upgraded by 6% (base case at USD 7/mmbtu from FY15)



Source: Company, MOSL

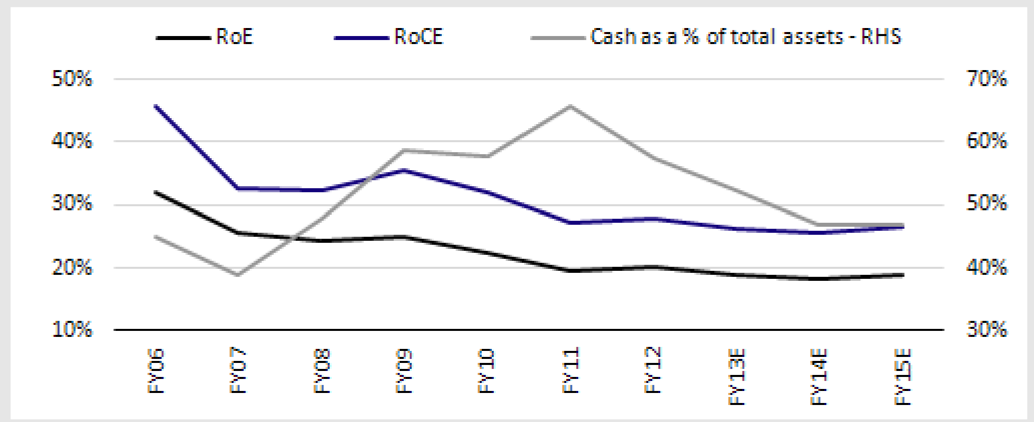
High cash reserves present opportunities

Expect steady production growth

- **OIL's cash reserves at ~USD2b are ~60% of its balance sheet size and though it hampers RoE in the short term, we believe it provides wide investment options like overseas acquisitions.**
- **We expect oil/gas production CAGR of 2%/6% in FY12-FY15E and beyond given that: a) despite mature fields, production is yet to peak; b) OIL's reserve mix is favorable with 62% oil in 2P reserves and 1P reserves are 50% of 2P, indicating a large scope for increase in 1P and c) R/P (total reserves/annual production) of >24 years.**
- **Further, its reserve replacement ratio (RRR) has consistently remained above one and the lower F&D cost of USD5.5/bbl proves its competence in current operating area.**

High cash reserves present opportunities: OIL's cash reserves built through internal accruals and proceeds from its IPO in 2009 has been a major positive for a long time. The opportunity is primarily from the perspective of a likely EPS-accretive acquisition, though impacting RoE in the interim. However, recent concerns on the government's precarious finances might result in OIL deploying its cash for acquiring government's stake in a PSU company. We believe if the government wants to utilize cash from the company, a special dividend would be the best option and also in the interest of minority shareholders.

High cash balance impacts profitability (%)



Source: Company, MOSL

As in September 2012, OIL has a cash balance of INR139b (INR231/sh), which is equivalent to ~83% of its balance sheet size and ~50% of its current market capitalization. Apart from the current cash balance, we expect the company to generate free cash flow of over INR62b over FY13E-15E, giving it more flexibility to go for large acquisitions.

Strong free cash generation (INR b)

	FY08	FY09	FY10	FY11	FY12	FY13E	FY14E	FY15E
Operating Cash Flow	28	30	14	31	31	51	53	62
Capex	(9)	(8)	(11)	(10)	(9)	(35)	(38)	(31)
Dividend (incl. tax)	(5)	(8)	(9)	(10)	(15)	(14)	(14)	(14)
Net Free Cashflow	18	21	3	21	22	16	15	31

Source: Company, MOSL

We note that some of the key factors decided by OIL for overseas acquisition are:

a) Targeting to acquire producing fields: Currently, most of OIL's overseas portfolio comprises of exploratory blocks, which if proven successful shall need 3-5 years to start production. Hence, there would not be any significant revenue contribution from existing overseas blocks in the near term. Thus, to increase oil equity in the near term, company is targeting to acquire producing fields.

b) Scouting for small-to-medium sized fields: Its acquisition strategy is to look out for small-to-medium sized assets that would fit its current requirement (though cash balance gives its flexibility to go for large sized acquisitions).

OIL's overseas portfolio is largely in exploration stages

Sr. No.	Block	Country	Operator	Area (sq. km.)	OIL's Stake (%)	Status
1	Farsi Block	Iran	OVL	3,500	20	Awaiting acceptance of Master Development Plan by NIOC
2	Area 86	Libya	OIL	7,087	50	Drilled three wells, no commerically viable discoveries
3	Block 102/4	Libya	OIL	2,710	50	
4	Area 95/96	Libya	Sipex	6,629	25	
5	Block OPL-205	Nigeria	Summit	1,295	17.5	OML awarded by Nigerian Government
6	Block 'K'	Timor Leste	REPDMCC	1,788	13	Drilling of first well expected by Nov, 2010
7	Block 82	Yemen	MEDCO AMED	1,857	15	Action initiated to commence seismic survey
8	Block 83	Yemen	MEDCO ARAT	360	15	
9	Block 3	Egypt	GSPC	6,725	25	Signing of PSC awaited
10	Block 4	Egypt	GSPC	2,610	25	
11	Block Shakti	Gabon	OIL	3,761	45	100sqkm of 3D acquisition to complete by Jan-2011; drilling likely in 2011
12	Carabobo 1 North	Venezuela		203	4	Production likely to commence in 1HFY14
13	Carabobo 1 Central	Venezuela		180	4	

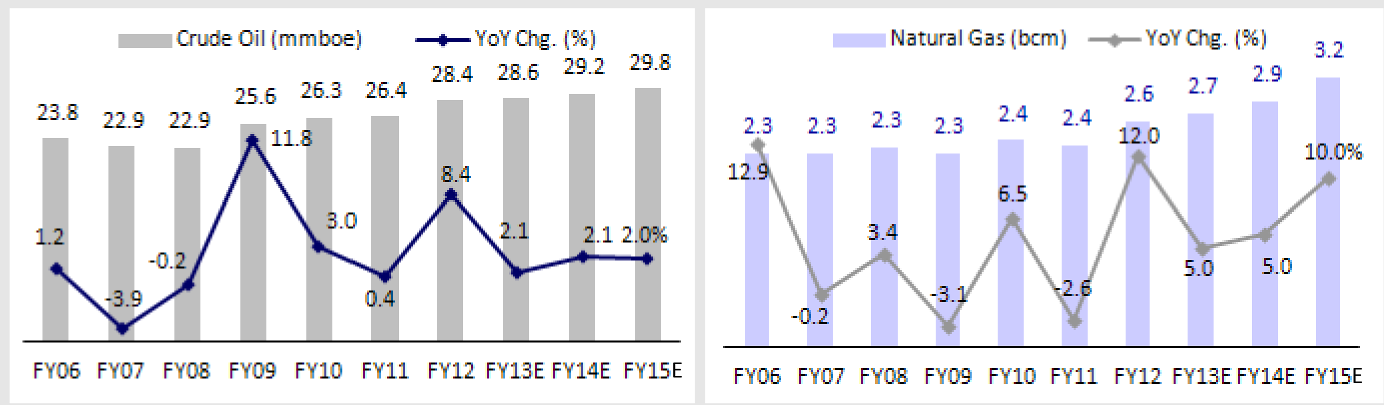
Source: Company, MOSL

Expect oil/gas production CAGR of 2%/6% in FY12-FY15E: We expect OIL's crude oil and natural gas production to post a CAGR of 2% and 6% respectively over FY12-15E. Over FY08-12, crude oil production grew at 6% and natural gas production at 3%. We believe the company's domestic oil and gas sales to be driven by two key factors:

(1) IOR/EOR techniques in currently producing blocks: Most of OIL's fields are mature and in declining stages. However, it is employing improved and enhanced oil recovery (IOR/EOR) techniques to improve recovery. Management expects that IOR/EOR techniques would not only help sustain current production levels but also boost production. Sustaining current levels of crude oil production and also boosting them is expected from (1) revitalization of old fields, (2) implementing IOR-EOR techniques in mature fields and (3) drilling of horizontal and J-bend wells, which have a production potential of 3.5x normal vertical drilling and costs just 40-45% more. Also, over the long term, to increase gas production, company is developing non-associated gas fields, drilling more development wells along with de-bottlenecking and re-routing pipeline network for optimum utilization of available gas.

(2) Management's efforts to develop customers for natural gas: OIL's gas sales in the north-east have been constrained due to lack of customers in the region. Despite 2P gas reserves of 57.3bcm, production has been only 2.6bcm (R/P ratio of 22). Company is making efforts to find/develop markets for its natural gas. OIL's existing gas customer base mainly consists of power plants, fertilizer companies and small consumers like tea gardens. To increase gas sales, company is scouting for new industries like refining and petrochemicals. It has entered into a MoU with Indian Oil Corporation (IOC) to supply gas to the latter's Guwahati refinery and is supplying ~1mmscmd gas to Numaligarh refinery, post completion of pipeline from Duliajan to Numaligarh in March 2011. OIL would also supply natural gas to the Assam Gas Cracker once the project gets completed by end-2013 (~1.4mmscmd initially with peak potential of 6mmscmd). Company has entered into a new sales agreement to supply gas from its Rajasthan field at higher volumes of 0.9mmscmd v/s 0.6mmscmd earlier. Crude oil sales account for ~64% of its oil and gas sales volumes and 88% of its revenues (excluding other income).

Oil and gas production trends



Source: Company, MOSL

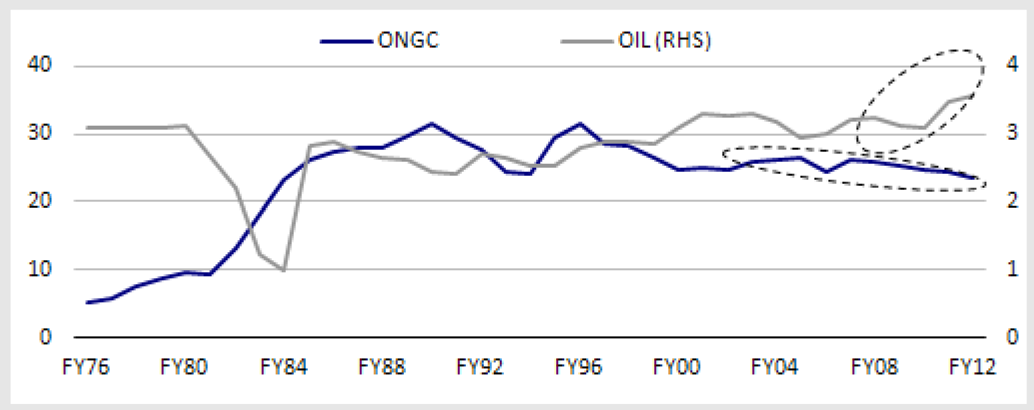
We estimate 4% oil and gas production CAGR over FY12-15E for OIL

	FY08	FY09	FY10	FY11	FY12	FY13E	FY14E	FY15E	CAGR (%)	
									FY08-12	FY12-15
Production										
Oil (mmt)	3.10	3.47	3.57	3.59	3.85	3.88	3.96	4.04	6	2
YoY CHG (%)		12	3	0	7	1	2	2		
Gas (bcm)	2.34	2.27	2.42	2.35	2.63	2.73	2.87	3.16	3	6
YoY CHG (%)		-3	6	-3	12	4	5	10		
Total (mmtoe)	**5.44**	**5.74**	**5.99**	**5.94**	**6.48**	**6.61**	**6.83**	**7.20**	**4**	**4**
YoY CHG (%)		5	4	-1	9	2	3	5		
Sales Details										
Oil Sales (mmt)	3.11	3.45	3.60	3.59	3.75	3.80	3.88	3.96	5	2
YoY CHG (%)		11	5	0	4	1	2	2		
Gas Sales (bcm)	1.83	1.74	1.86	1.81	2.09	2.19	2.30	2.53	3	6
YoY CHG (%)		-5	7	-3	16	4	5	10		
Total (mmtoe)	**4.94**	**5.18**	**5.46**	**5.40**	**5.84**	**5.99**	**6.18**	**6.48**	**4**	**4**
YoY CHG (%)		5	5	-1	8	2	3	5		

Source: Company, MOSL

OIL's production from current acreage yet to peak out: Currently, the oil producing blocks of both OIL and ONGC are mature (under production for long period). While OIL's production in FY12 was the highest-ever, ONGC is finding it difficult to maintain the production levels (oil production in FY12 was 35% below the peak production achieved in FY96). Though ONGC is spending huge amounts to maintain the oil production levels, no near term increase is expected. On the other hand, OIL is confident of increasing its oil production and guides 3-4% annual increase in the medium term. Compared to ONGC's flat domestic production trend, OIL's production has registered 6% CAGR over FY08-12.

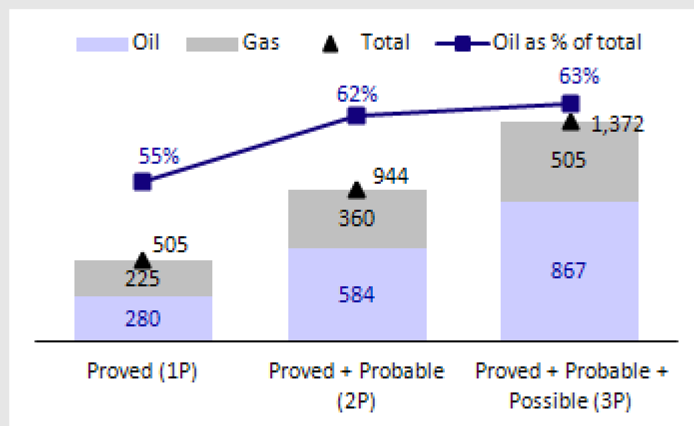
OIL's FY12 production was the highest-ever, while ONGC's was 35% below peak level (mmt)

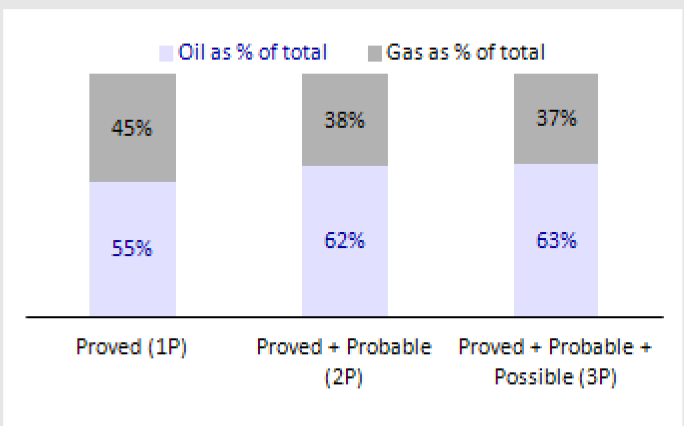


Source: Company, MOSL

Healthy oil/gas reserve ratio: Crude oil accounts for 64% of OIL's 941mmboe 2P reserves. Also, its 1P reserves are 50% of its 2P reserves (v/s 73% for ONGC), indicating larger scope for an increase in 1P reserves.

Oil and gas production trends

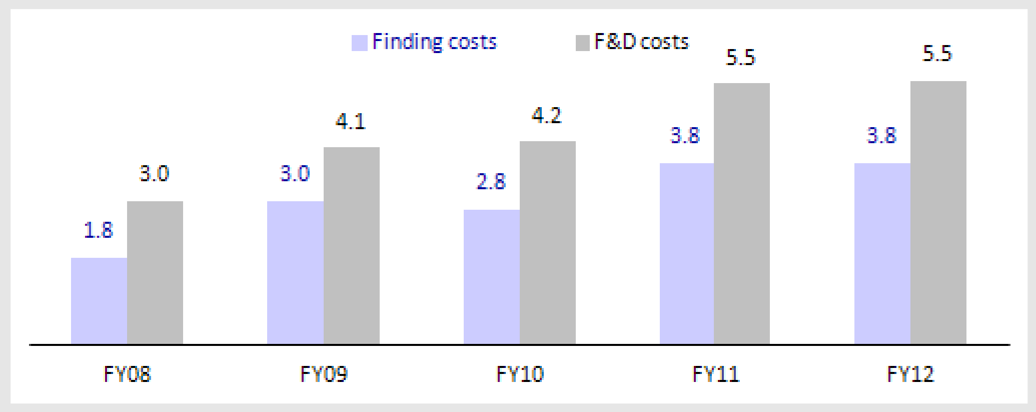




Source: Company, MOSL

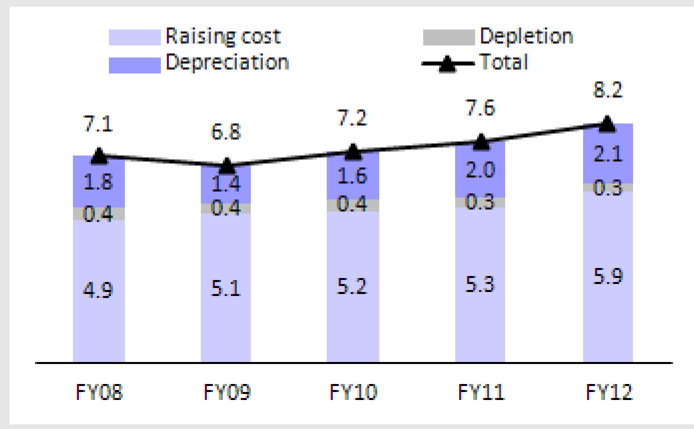
OIL has an impressive exploration track record, with success rate of over 60%. Of its 109,498sqkm domestic acreage, 72,641sqkm lies in the highly prospective deep water. It has an impressive lower finding cost at USD3.8/bbl.

Low finding and development costs (USD/bbl)

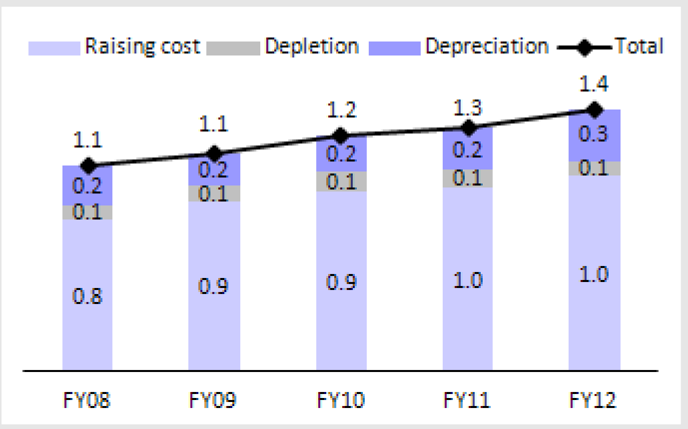


Source: Company, MOSL

Crude oil production cost lower than peers (USD/bbl)



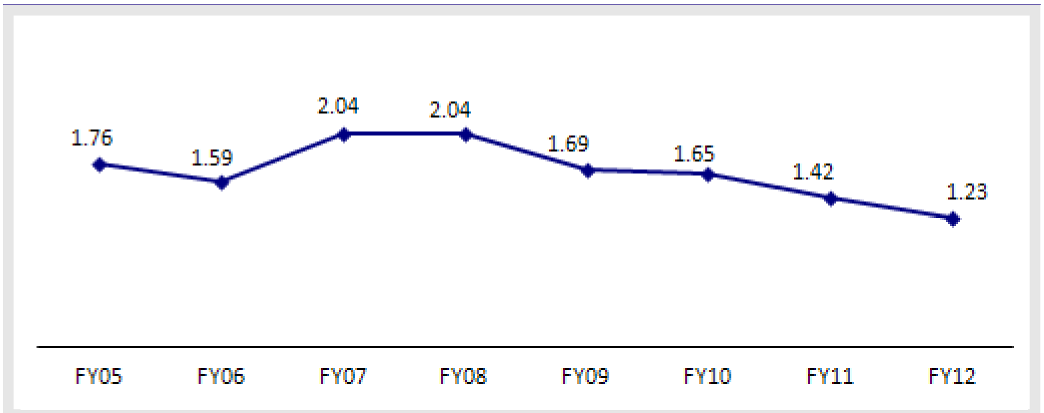
Natural gas production cost (USD/mmbtu)



Source: Company, MOSL

OIL's reserve replacement ratio (RRR) has been significant at more than 1 for the past 8 years. However, RRR has declined from a peak of 2.04 in FY08 to 1.23 in FY12 due to no acquisitions being made.

RRR consistently above 1x



Source: Company, MOSL

Valuation and view

Attractive valuations; reforms to be key catalyst

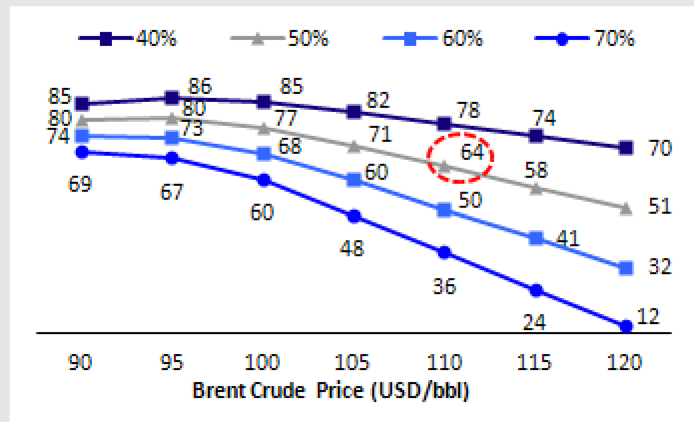
- **Apart from sector triggers like subsidy rationalization and diesel de-regulation, likely acquisition would be a near term trigger for OIL.**
- **We value the company at INR638/share based on the average of three methodologies: (1) P/E of 8x FY15E, (2) 4x FY15E EV/EBITDA and (3) DCF (WACC of 11.5%).**
- **The stock trades at >40% discount to global peers on EV/BOE (1P basis), and at 6.5x FY15E EPS of INR81.2 and has an implied dividend yield of ~4%. We maintain a Buy.**

Key assumptions - Oil India

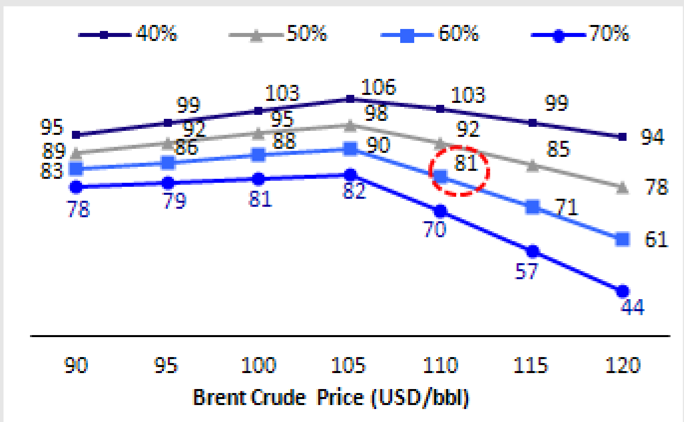
Y/E March	FY08	FY09	FY10	FY11	FY12	FY13E	FY14E	FY15E
Exchange Rate (USD/bbl)	40.2	46.0	47.6	45.6	47.9	54.5	53.0	53.0
Brent Crude Price (USD/bbl)	82.3	84.7	70	87	114	110	110	110
Gas Price (USD/mmbtu)	1.8	1.8	1.8	3.9	4.2	4.2	4.2	7.0
Taxes & Duties								
Royalty rate - Oil (%)	20	20	20	20	20	20	20	20
Royalty rate - Gas (%)	10	10	10	10	10	10	10	10
Cess (INR/MT)	2,500	2,500	2,500	2,500	2,500	4,500	4,500	4,500
Production Details								
Oil (mmt)	3.10	3.47	3.57	3.59	3.85	3.86	3.94	4.02
Gas (bcm)	2.34	2.27	2.42	2.35	2.63	2.73	2.87	3.16
Total (mmtoe)	5.44	5.74	5.99	5.94	6.48	6.59	6.81	7.18
Subsidy Sharing (INR b)	2	3	2	33	74	86	74	75
Oil Price Realization (USD/bbl)								
Gross	83.2	81.7	68.5	86.1	114.7	109.7	110.0	110.0
Upstream Discount	25.1	26.1	12.3	27.6	54.8	57.7	48.9	44.8
Net	58.1	55.6	56.2	58.5	59.8	52.0	61.1	65.2
EPS (INR)	29.6	37.1	43.4	48.0	56.1	58.9	64.2	81.2

Source: Company, MOSL

FY14 OINL EPS at different oil price/upstream share (INR)



FY15 OINL EPS at different oil price/upstream share (INR)



Source: MOSL

OINL: Valuation at INR638 per share

Methodology	Fair Value (INR)	Remarks
DCF	626	11.5% WACC
EV/EBITDA	643	4x FY15 EBITDA
P/E	649	8x FY15E EPS
Average	**638**	

Source: MOSL

Financials and Valuation

Income Statement (INR Million)

Y/E March	2010	2011	2012	2013E	2014E	2015E
Net Sales	**79,056**	**83,034**	**97,741**	**92,947**	**107,819**	**124,717**
Change (%)	9.2	5.0	17.7	-4.9	16.0	15.7
Change in Stocks	106	-76	-88	-111	0	0
Production Costs	13,451	13,789	23,074	19,748	21,899	24,405
Statutory Levies	23,573	24,423	27,904	31,262	34,046	36,277
EBITDA	**41,926**	**44,898**	**46,851**	**42,048**	**51,874**	**64,035**
% of Net Sales	53.0	54.1	47.9	45.2	48.1	51.3
D,D&A	11,343	12,669	15,263	10,806	14,787	16,648
Interest	37	139	105	8	8	8
Other Income	9,542	12,458	19,536	21,387	20,672	25,674
Prior period & other adj.	1,137	1,421	0	0	0	0
PBT	**38,951**	**43,127**	**51,019**	**52,621**	**57,751**	**73,054**
Tax	12,846	14,255	17,273	17,188	19,183	24,267
Rate (%)	33.0	33.1	33.9	32.7	33.2	33.2
PAT	**26,105**	**28,872**	**33,746**	**35,433**	**38,567**	**48,787**
Adj. PAT	26,105	28,872	33,746	35,433	38,567	48,787
Change (%)	20.8	10.6	16.9	5.0	8.8	26.5

Balance Sheet (INR Million)

Y/E March	2010	2011	2012	2013E	2014E	2015E
Share Cap. (incl sh. suspense)	2,405	2,405	6,011	6,011	6,011	6,011
Reserves	135,233	153,614	171,202	193,024	217,673	251,127
Net Worth	**137,638**	**156,019**	**177,213**	**199,035**	**223,685**	**257,138**
Total Loans	375	10,143	101	101	101	101
Deferred Tax	10,209	11,491	10,767	12,169	14,027	16,378
Well Abandonment	19	1,645	2,031	2,031	2,031	2,031
Capital Employed	**148,241**	**179,297**	**190,113**	**213,336**	**239,844**	**275,648**
Gross Fixed Assets	32,110	33,203	35,340	38,840	42,340	45,840
Less: Depreciation	21,358	23,305	24,757	26,262	28,011	29,974
Net Fixed Assets	**10,752**	**9,897**	**10,584**	**12,578**	**14,329**	**15,866**
Capital WIP	3,287	4,137	5,106	5,106	5,106	5,106
Producing/pre-producing	35,421	40,632	40,560	63,558	88,170	104,229
Investments	8,594	8,904	26,142	26,142	26,142	26,142
Curr. Assets, L & Adv.						
Inventory	4,534	5,004	5,333	5,590	6,131	6,650
Debtors	6,597	9,322	10,518	9,721	11,276	13,044
Cash & Bank Balance	85,429	117,675	109,355	111,462	112,077	130,461
Loans & Adv. and Other CA	26,136	16,742	19,214	19,214	19,214	19,214
Current Liab. & Prov.						
Liabilities	18,049	21,505	23,188	26,524	29,091	31,553
Provisions	14,648	11,509	13,511	13,511	13,511	13,511
Net Current Assets	89,999	115,728	107,721	105,952	106,097	124,304
Misc. Expenses	187	-	-	-	-	-
Application of Funds	**148,240**	**179,297**	**190,113**	**213,336**	**239,844**	**275,648**

E: MOSL Estimates

Financials and Valuation

Ratios

Y/E March	2010	2011	2012	2013E	2014E	2015E
Basic (INR)						
EPS (Adj)	43.4	48.0	56.1	58.9	64.2	81.2
Cash EPS	51.4	56.0	64.7	67.6	73.4	91.1
Book Value	229.0	259.5	294.8	331.1	372.1	427.8
DPS	13.6	15.0	19.0	19.0	20.0	22.0
Payout (incl. Div. Tax.)	36.6	36.4	38.4	38.4	36.1	31.4
Valuation (x)						
P/E	12.1	11.0	9.4	8.9	8.2	6.5
Cash P/E	10.2	9.4	8.1	7.8	7.2	5.8
EV / EBITDA	5.5	4.7	4.4	4.9	3.9	2.9
EV/Sales	2.9	2.5	2.2	2.2	1.9	1.5
EV / BOE (1P Reserves)	9.6	9.1	8.6	7.5	7.7	7.0
Price / Book Value	2.3	2.0	1.8	1.6	1.4	1.2
Dividend Yield (%)	2.6	2.8	3.6	3.6	3.8	4.2
Profitability Ratios (%)						
RoE	22.6	19.7	20.3	18.8	18.2	20.3
RoCE	31.9	27.3	27.7	26.1	25.5	28.3
Turnover Ratios						
Debtors (No. of Days)	25	35	38	38	38	38
Fixed Asset Turnover (x)	3	3	3	3	3	3
Leverage Ratio						
Net Debt / Equity (x)	-0.6	-0.7	-0.6	-0.6	-0.5	-0.5

Cash Flow Statement (INR Million)

Y/E March	2010	2011	2012	2013E	2014E	2015E
OP/(Loss) before Tax	38,951	43,132	51,019	52,621	57,751	73,054
Depreciation	4,811	4,790	5,142	5,195	5,557	5,963
Interest /Other Income	-6,774	-7,886	-13,509	8	8	8
Direct Taxes Paid	-12,520	-13,819	-18,968	-15,786	-17,325	-21,916
(Inc)/Dec in Wkg. Capital	-9,113	4,016	3,125	3,876	470	177
Other op activities	-858	288	4,163	4,813	6,080	7,440
CF from Op. Activity	**14,497**	**30,522**	**30,972**	**50,727**	**52,540**	**64,726**
(Inc)/Dec in FA & CWIP	-11,485	-9,518	-8,599	-35,000	-38,000	-31,000
(Pur)/Sale of Investments	-4,201	4,692	-16,688	0	0	0
Other In activities	7,268	6,343	11,335	0	0	0
CF from Inv. Activity	**-8,418**	**1,517**	**-13,951**	**-35,000**	**-38,000**	**-31,000**
Change in Equity	27,772	0	0	0	0	0
Inc / (Dec) in Debt	-190	9,893	-10,042	0	0	0
Interest paid	11	-153	-68	-8	-8	-8
Dividends Paid	-8,944	-9,533	-15,231	-13,611	-13,918	-15,334
CF from Fin. Activity	**18,650**	**206**	**-25,340**	**-13,620**	**-13,926**	**-15,342**
Inc / (Dec) in Cash	24,729	32,245	-8,320	2,108	615	18,384
Add: Opening Balance	60,700	85,429	117,675	109,355	111,462	112,077
Closing Balance	**85,429**	**117,675**	**109,355**	**111,462**	**112,077**	**130,461**

E: MOSL Estimates

Disclosures

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