

Essar Oil

Rs147

OUTPERFORMER

Resource estimates upgraded on CBM blocks

Mkt Cap: Rs178bn; US\$3.9bn

10 March 2010

BSE Sensex: 17098

Event:

Essar oil held an analyst meet to discuss the results of Competent Person Report (CPR) on most of their exploration blocks. Post the evaluation by independent appraisers such as Netherland Sewell; the gross unrisksed resource estimates on all blocks of EOL have been raised to 1.52bn boe, significantly higher than earlier estimates of 1.1bn boe. We believe this raises the certainty and feasibility of the E&P resource base for EOL, and provides potential upside in option value of the E&P business. The upward revision in resource base reinforces our belief in the value proposition of the E&P business. We value the E&P business at Rs88 per share, which is 51% of our SOTP valuation of Rs172 per share.

E&P projects: CBM assets are the key

With test production already underway on the Raniganj block (1 tcf recoverable, 3.5 mmscmd peak output) and sales to commence from May onwards, E&P is set to become a material part of the business from FY11E. The Rajmahal block acquired recently is contiguous to the Raniganj asset and Advanced Resources international has certified the field as having 4.7 tcf (787 mmsboe) of prospective resources, making it potentially as big if not bigger than Raniganj. The other big surprise has come from the Mehsana block, which is a conventional oil block but EOL has estimated a CBM resource base of 0.7 tcf (125 mmsboe). However, exploiting the gas resource on this block is subject to a change in Government policy.

Other assets:

Apart from the CBM assets, EOL also has some conventional blocks such as Ratna (81 mmsboe recoverable, peak output of 35 kb/d estimated), Nigeria (33 mmsboe recoverable, 93 mmsboe prospective resources) and Vietnam (Unrisksed resource base of 167 mmsboe). The PSC signing of Ratna is expected in Q1FY11E, while further progress on the international assets will happen post their transfer to EOL books from that of Essar Energy Holdings.

Refining expansion: Phase I on schedule, Phase II financial closure in Q2CY10

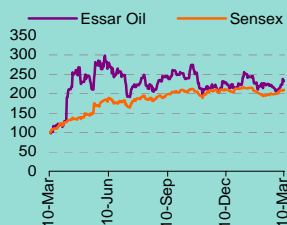
EOL has maintained its guidance of March 2011 for commissioning of phase I (expansion to 18m tpa) with 47% physical completion on the same as on date. However the commissioning of phase II (expansion to 36m tpa) will depend on the financial closure of the same happening over the next three months or so. The company has guided that it can complete the refinery over a period of ~30 months from financial closure.

Our view:

The certification of most of the resource estimates on the E&P blocks, and the imminent start up of production from the Raniganj asset reinforces our view that E&P will provide a significant driver of growth for the company going forward. We currently value the exploration business at US\$2.2bn, or Rs88 per share, implying 51% of our target price of Rs172 per share. Phase I of the refinery expansion continues on schedule, and we do not anticipate slippages on the March 2011 timeline. While phase II remains contingent on financial closure within the next three – four months, we remain optimistic on the management's ability to raise the funds in time, and meet the March 2013 timeline. The expansions of EOL refining capacity are set to coincide with the expected revival in the global economy and hence product spreads, and will lead to a step change in operating and financial metrics for the company. Reiterate Outperformer.

Oil & Gas

Price chart



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Key financials* (standalone)

As on 31 March	Mar 07	Mar 08	Mar 09	Mar 10E	Mar 11E
Net sales (Rs m)	4,740	5,623	378,867	336,256	419,841
Adj. net profit (Rs m)	(675)	(412)	(4,228)	750	4,897
Shares in issue (m)	1,156	1,190	1,218	1,218	1,218
Adj. EPS (Rs)	(0.6)	(0.3)	(3.5)	0.6	4.0
% change	NM	NM	NM	NM	553.0
PER (x)	NM	NM	NM	238.0	36.4
Price/Book (x)	5.6	4.7	4.2	3.5	3.2
EV/EBITDA (x)	NM	NM	20.9	18.2	11.4
RoE (%)	NM	NM	NM	1.6	9.1
RoCE (%)	NM	NM	4.3	6.6	8.4

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2. Neutral: Within 0-5% to Index
3. Underperformer: Less than 5% to Index

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