

CAIRN INDIA

INR 224



Fairly valued

ACCUMULATE

Cairn India's (CIL) Q4CY07 results were below above our expectations, both on the net revenue and profit fronts. Gross production fell by 13.2% due fall lower production from Ravva and Cambay fields. CIL reported losses for Q4CY08 at INR 139 mn compared to profits of INR 232 mn for Q3CY07.

Company increased the reserves (2P reserves + contingent resources) estimates by 21.7%, a change we had been expecting for some time and had earlier incorporated in our reserves estimates. The company also announced that it has identified prospects and leads which indicate cumulative unrisks prospective resources of 1,033 mn boe.

We are increasing our fair target value for Cairn from INR 181/share to INR 238/share by 31.5%, after factoring in increase in crude prices and introducing prospective resources (risked by 10%). Despite incorporating exploration upsides, Cairn offers only 6.2% upsides from current levels (CMP = INR 224).

Possible upsides to our fair target value can come from: (1) increase in long-term crude price assumptions; (2) reserves in excess of our estimates for the exploration upsides (we have risked by 10% for the same); (3) further increase in production rate from Rajasthan's development block, and (4) any takeover activity (takeovers generally command premium of ~15-30% over fair value).

On the valuations side, CIL on INR 224 trades at 18.3x CY09E and 5.3x CY10E EPS. Though, CIL trades at low forward P/E multiples for CY10E, falling earnings in the later years (due to increase in government share), brings back the stock to normal valuations.

We believe CIL currently trades at fair value and offers time-value upside for investors. Hence, we downgrade our recommendation from 'BUY' to 'ACCUMULATE' (neutral with a positive bias).

* **Increase in reserves + resources by 21.7%**

CIL has increased the net hydrocarbon 2P reserve + contingent resource estimates from 672 mn boe to 818 mn boe, increase of 21.7% (see table below). Current reserves + resources for Rajasthan fields are 1,077 mn boe, close to our model estimates of 1,165 mn boe.

The company also announced that it has identified prospects and leads which indicate cumulative unrisks prospective resources of 1,033 mn boe. We have incorporated the same in estimating our fair target value after risking by 10%.

Financials

Year to March	Q4CY07	Q3CY07	Growth %	CY07E	CY08E	CY09E
Net revenues (INR mn)	2,667	2,658	0.3	11,589	10,589	40,671
EBITDA (INR mn)	1,439	1,865	(22.8)	8,674	7,692	36,238
Net profit (INR mn)	(139)	232	(159.8)	2,661	3,086	23,049
EPS (INR)	(0.1)	0.1	(159.8)	1.5	1.6	12.2
EPS growth (%)	NA	NA	NA	NA	9.0	643.5
P/E (x)	NA	NA	NA	148.6	136.3	18.3

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Reuters : CAIN.BO
Bloomberg : CAIR IN

Market Data

52-week range (INR) : 269 / 124
Share in issue (INR mn) : 1,778.4
M cap (INR bn/USD mn) : 398.4/10,108.1
Avg. Daily Vol. BSE/NSE ('000) : 1,424.0

Share Holding Pattern (%)

Promoters : 69.0
MFs, Fls & Banks : 5.6
Fls : 10.9
Others : 14.5

* **Gross production fell by 13.2% due fall lower production in Rawa and Cambay field**

CIL's Q4CY07 gross production at 65,327 boepd decreased by 13.2% Q-o-Q, due to fall in both Ravva and Cambay fields (shutdown in both the fields). Ravva production of hydrocarbons was lower by 13.2% Q-o-Q, while production from CB-OS/2 fell by 13.6% Q-o-Q.

Blended realization increased 16.7% Q-o-Q to USD 68.1/boe due to 16.8% Q-o-Q increase in crude realization offset by 12.1% lower gas price realization and 2.7% Q-o-Q rupee appreciation. These resulted in net revenues increasing by 0.3% Q-o-Q to INR 2.7 bn. Gas realization was lower by 12.1% Q-o-Q due to lower gas production which led to penalties as per the gas sales agreement.

Lifting costs increased by 91.1% Q-o-Q due to higher employee and other expenses. Employee expenses increased due to provisions for ESOPs while other expenses increased due activities related to recent fund raising. DD&A expenses for Q4CY07 were at USD 10.7/boe compared to USD 7.3/boe in Q3CY07. Cairn also provided INR 320 mn for FBT expenses related to ESOPs (to be paid in future when exercised). CIL reported losses for Q4CY08 at INR 139 mn compared to profits of INR 232 mn for Q3CY07.

* **Incremental developments in Rajasthan fields**

- ◆ Development of Rajasthan fields is on schedule to produce first oil target from Mangala from H2CY07 onwards.
- ◆ 2P + contingent reserves of Rajasthan block has been increased from earlier estimate of 888 mboe to 1,077 mboe. 2P reserves have been increased from 632 mboe to 693 mboe. Cairn's net 2P reserves (net of share) increased to 485 mboe.
- ◆ CIL maintained the total peak plateau production at 175,000 bpd (Mangala - 125,000 bpd, Bhagyam – 40,000 bpd; Aishwarya – 10,000 bpd)
- ◆ Pipeline construction is expected to commence in H2CY08 with the completion planned in early 2009. Pipeline estimated cost is USD 800 mn. Cairn's share of pipeline is USD 560 mn.
- ◆ Capital costs for the upstream development till CY09 is USD 1.8 bn (Cairn's 70% share at USD 1.26 bn). This brings the total Cairn's entitlement of capital cost to USD 1.8 bn.
- ◆ Bhagyam FDP got approved today (Production of 40,000 bpd).

Table 1: Rajasthan block's 2P reserves + resources have been increased by 21%

	OGIP	2P + Contingent
Now - Q4CY07 results (Cairn)		
MBA fields	2054	993
Small fields	300	12
Others fields (contingent blocks)	1,397	72
Rajasthan block (gross)	3,751	1,077
Cairn's share (@70%)	2,626	754
Earlier estimate - During IPO		
MBA fields	1,919	820
Small fields	298	14
Others fields (contingent blocks)	1,443	54
Rajasthan block	3,660	888
Cairn's share (@70%)	2,562	622
% change		
MBA fields	7%	21%
Rajasthan block	2%	21%

Source: Edelweiss research

Table 2: Cairn's reported 22% increase in net 2P reserves + resource estimates

	OGIP			2P reserves + contingent resources		
	Earlier	Now	% increase	Earlier	Now	% increase
Rajasthan block (70%)	3,660	3,751	2%	888	1,077	21%
MBA fields	1,919	2,054	7%	820	993	21%
Small fields	298	300	1%	14	12	-14%
Others fields (contingent blocks)	1,443	1,397	-3%	54	72	33%
Ravva (22.5%)	506	584	15%	106	82	-23%
CB/OS-2 (40%)	126	116	-8%	30	25	-17%
KG-DWN-98/2 (10%)	302	650	115%	143	353	147%
Total Gross Reserves	4,594	5,101	11%	1,167	1,537	32%
Total Reserve Entitlement	2,756	2,869	4%	672	818	22%

Source: Edelweiss research

* **Exploration plans and resources**

Cairn plans to drill 15 wells which include 5 wells in Rajasthan block. In addition, CIL planned for six seismic surveys. Total expenditure for the same is expected to be ~USD 100 mn.

* **~6% dilution post-placement of shares to Petronas/Orient Global**

Cairn India has, on March 17, 2008, approved issue of 113.0 mn shares of the company to Petronas and Orient Global on a preferential allotment basis for INR 224.30/share. This will cause dilution of shares by 5.97% of the total post issue paid up equity share capital of the Company on a fully diluted basis. Post issue, Cairn plc, will hold 64.86% of Cairn India.

* **Factoring increase in crude price; increase in CY10 PAT increased by 38%**

We had earlier revised our crude price assumptions upwards to USD 80/bbl in CY09E (from USD 60/bbl) due to higher prevailing crude prices and increased long-term crude price assumption to USD 70/bbl (from USD 60/bbl). Pursuant to these macro changes, we have revised our net revenues estimates upwards for CY09 and CY10 by 57.7% and 27.4%, to INR 40.7 bn and INR 102.4 bn, respectively. Our net profit estimates for CY09 and CY10 have been increased by

169.7% and 38% to INR 23.0 bn and INR 79.5 bn, respectively. We have also factored in dilution due to preferential issue of shares to Petronas/Orient Global.

Table 3: Revision in assumptions and estimates

	Revised Estimates			Previous Estimates			(% Change)		
	CY08	CY09	CY10	CY08	CY09	CY10	CY08	CY09	CY10
Assumptions									
WTI (USD/bbl)	85.0	80.0	75.0	65.0	60.0	61.2	30.8	33.3	22.5
INR/USD	39.0	38.0	37.0	39.9	39.5	39.0	(2.3)	(3.8)	(5.1)
Estimates									
Revenues (INR mn)	10,589	40,671	102,391	8,619	25,785	80,400	22.9	57.7	27.4
EBITDAX (INR mn)	7,692	36,238	94,361	5,710	21,689	72,723	34.7	67.1	29.8
Net profit (INR mn)	3,086	23,049	79,486	1,445	8,547	57,606	113.6	169.7	38.0
EPS (INR)	1.6	12.2	42.1	0.8	4.8	32.5	105.4	154.5	29.6

Source: Edelweiss research

*** Outlook and valuations: Increasing fair target value by 31.5%; Reduce to 'ACCUMULATE'**

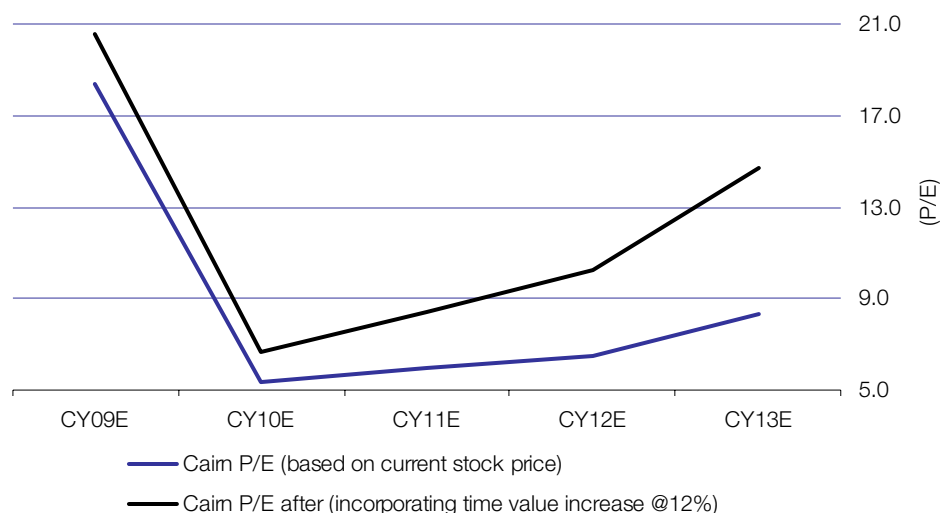
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On the valuations side, CIL on INR 224 trades at 18.3x CY09E and 5.3x CY10E EPS. Though, CIL trades at low forward P/E multiples for CY10E, falling earnings in the later years (due to increase in government share), brings back the stock to normal valuations (see chart below).

We believe CIL currently trades at fair value and offers time-value upside for investors. Hence, we downgrade our recommendation from 'BUY' to 'ACCUMULATE' (neutral with a positive bias).

Chart 1: Cairn P/E valuations (including time value impact)



Source: Edelweiss research

Table 4 SOTP valuations

Block	NPV (INR mn)	NPV (INR/share)	EV/boe
RJ-ON-90/1 (Rajasthan)	341,136	182	10.7
KG-DWN-98/2	9,670	5	2.5
CB/OS-2	4,016	2	6.7
Rawa	11,541	6	7.6
Exploration upsides	84,227	45	10.7
CY08 end net debt	4,258	2	
CY08 end fair target value	446,332	238	
CMP		224	
% return		6.1%	

Source: Edelweiss research

Financials snapshot (Consolidated)						(INR mn)
Year to December	Q4CY07	Q3CY07	Growth %	CY07E	CY08E	CY09E
Net revenues	2,667	2,658	0.3	11,589	10,589	40,671
Increase/Decrease in stocks	(51)	0	(54,040.4)			
Raw materials costs	0	0	NA			
Cost of goods sold	(51)	0	(54,040.4)			
Gross profit	2,718	2,658	2.3			
Operating expenses		508				
Employee expenses	423	238	77.9			
Other operating expenses	232	47	397.4			
Lifting costs	1,279	793	61.3	2,915	2,896	4,434
EBITDAX	1,439	1,865	(22.8)	8,674	7,692	36,238
Interest and finance costs	17	1	1,533.1	399	1,199	2,930
Exploration costs	577	720	(19.9)	2,767	728	4,509
Depreciation, Depletion, Amortisation, Site restoration	633	512	23.6	1,733	1,625	3,055
Other income	268	343	(21.8)	660	1,004	1,780
Profit before tax before non-recurring/prior period	481	975	(50.6)	4,435	5,144	27,523
Non-recurring expenses	276	300	(8.2)			
Prior period adjustments	0	0	NA			
Profit before tax	205	674	(69.6)	4,435	5,144	27,523
Current taxes	55	114	(52.0)			
Deferred taxes	(33)	316	(110.6)			
Other taxes	323	11	2,719.7			
Total tax	344	442	(22.1)	1,774	2,058	4,475
Net profit	(139)	232	(159.8)	2,661	3,086	23,049
Equity capital (FV INR 10)	17,784	17,784	0.0	17,653	18,783	18,866
No. of shares (mn)	1,778	1,778	(100.0)	1,765	1,878	1,887
EPS (INR)	(0.1)	0.1	(159.8)	1.5	1.6	12.2
as % of net revenues						
Operating expenses	(1.9)	0.0	NA	25.2	27.4	10.9
EBITDAX	54.0	70.2	NA	74.8	72.6	89.1
Profit before tax	7.7	25.4	NA	38.3	48.6	67.7
Net profit	(5.2)	8.7	NA	23.0	29.1	56.7
Tax rate	10.4	63.8	NA	40.0	40.0	16.3

Company Description

Cairn India (CIL) is an independent oil & gas exploration company and has been promoted by Cairn Energy plc, UK. CIL was formed to take control of all oil and gas assets of Cairn Energy plc in India. After the public issue and corporate structure rejig all subsidiaries with oil and gas interests in India were consolidated under a company "Cairn India Holding" in which CIL has a 100% stake. Cairn India's total reserves and resources in production or under development are 703 mn boe (D&M estimates). 92% of CIL's reserves are contained in the developing Rajasthan block (RJ-ON-90/1) with further reserves in Ravva, CB-OS/2 and KG-DWN-98/2.

Investment Theme

Cairn India is the most leveraged oil play among Indian E&P companies with high sensitivity to crude prices. Given current high crude prices, nearing certainty in meeting production schedules and target (175,000 b/d by CY09) for its Rajasthan block and favorable midstream solution (pipeline) solution likely Cairn India is our best E&P bet on Crude prices. Its Rajasthan block would increase production by >5.5x from current levels and with lower government share (< 50% till CY12), no royalty for Cairn and market determined crude prices the Rajasthan block offers very attractive fiscal terms.

Key Risks

Higher discounts to benchmark prices for Mangala would affect Cairn's realizations and hence our fair price.

Cess resolution at higher than assumed rates (INR 927/MT) would affect our fair SOP value

As Cairn India is the most leveraged oil play, lower crude prices would have significant effect on Cairn's valuations.

Financial Statements

Income statement					(INR mn)
Year to December	CY07E	CY08E	CY09E	CY10E	CY11E
Total levies	9,896	9,321	9,387	15,104	29,737
Net revenues	11,589	10,589	40,671	102,391	89,376
Lifting cost	2,915	2,896	4,434	8,030	8,553
EBITDAX	8,674	7,692	36,238	94,361	80,823
Recouped costs	4,501	2,353	7,564	6,544	6,974
EBIT	4,174	5,339	28,674	87,817	73,850
Financing costs	399	1,199	2,930	3,554	2,942
Other income	660	1,004	1,780	3,790	6,913
Profit before tax (PBT)	4,435	5,144	27,523	88,054	77,821
Taxes	1,774	2,058	4,475	8,567	7,254
Profit after tax (PAT)	2,661	3,086	23,049	79,486	70,567
Eq. shares outstanding (mn)	1,765	1,878	1,887	1,887	1,887
EPS (INR)	2	2	12	42	37
Dividend per share (INR)	0	0	0	5	7
Dividend payout (%)	0	0	0	12	19

Income statement (USD/bbl)					
Year to December	CY07E	CY08E	CY09E	CY10E	CY11E
Gross revenue	63.1	63.1	67.2	67.4	63.8
Levies	29.1	29.5	12.6	8.7	15.9
Net revenues	34.0	33.6	54.6	58.7	47.8
Lifting cost	8.6	9.2	6.0	4.6	4.6
EBITDAX	25.5	24.4	48.7	54.1	43.3
DD&A	13.2	7.5	10.2	3.8	3.7
EBIT	12.3	16.9	38.5	50.4	39.5

Common size metrics (% sales)					
Year to December	CY07E	CY08E	CY09E	CY10E	CY11E
Levies	46.1	46.8	18.8	12.9	25.0
Cost of goods sold	25.2	27.4	10.9	7.8	9.6
EBITDAX	40.4	38.6	72.4	80.3	67.9
Recouped costs	20.9	11.8	15.1	5.6	5.9
Net profit	12.4	15.5	46.0	67.7	59.2

Growth metrics (%)					
Year to December	CY07E	CY08E	CY09E	CY10E	CY11E
Net revenues	3,132.5	(8.6)	284.1	151.8	(12.7)
EBITDAX	(12,691.2)	(11.3)	371.1	160.4	(14.3)
PBT	(3,507.8)	16.0	435.1	219.9	(11.6)
Net profit	(1,526.2)	16.0	646.8	244.9	(11.2)
EPS	(1,526.2)	9.0	643.5	244.9	(11.2)

Balance sheet					(INR mn)
Year to December	CY07E	CY08E	CY09E	CY10E	CY11E
Equity share capital	17,653	18,783	18,866	18,866	18,866
Reserves and surplus	278,212	305,860	329,105	399,159	456,519
Shareholder's equity (A)	295,865	324,643	347,971	418,025	475,385
Secured loans	0	15,000	38,250	30,600	22,950
Unsecured loans	4,985	10,000	10,000	10,000	10,000
Total debt (B)	4,985	25,000	48,250	40,600	32,950
Net deferred tax liability (C)	4,395	4,395	4,395	4,395	4,395
Capital employed (A+B+C)	305,245	354,038	400,616	463,020	512,730
Accounts payable	1,074	995	2,503	5,875	5,956
Provisions	232	212	813	2,048	1,788
Current liabilities & prov. (D)	1,306	1,207	3,316	7,923	7,743
Total Liab. (A+B+C+D+E)	306,551	355,245	403,933	470,942	520,473
Total fixed assets (A)	38,825	77,178	107,769	115,394	117,179
Goodwill	254,115	254,115	254,115	254,115	254,115
Investments (B)	4	4	4	4	4
Inventories	1,719	1,593	4,005	9,400	9,529
Accounts receivables	1,719	1,593	4,005	9,400	9,529
Cash and cash equivalents	10,149	20,742	34,015	82,610	130,097
Other current assets	20	20	20	20	20
Current assets (C)	13,606	23,948	42,044	101,429	149,175
Total Assets (A+B+C+D)	306,551	355,245	403,933	470,942	520,473

Cash flow statement					(INR mn)
Year to December	CY07E	CY08E	CY09E	CY10E	CY11E
Oper cash flow bfr wkg cap ch.	261,677	284,116	284,924	340,145	331,656
(Incr)/Decr in working capital	(35,397)	153	(2,715)	(6,184)	(438)
Cash flow from oper. (A)	226,279	284,270	282,210	333,962	331,217
Net purchase of assets	(23,364)	(40,706)	(38,155)	(14,169)	(8,759)
Net purchase of investments	(254,115)	(254,115)	(254,115)	(254,115)	(254,115)
Net cash flow from inv. (B)	(277,479)	(294,821)	(292,270)	(268,284)	(262,874)
Net incr./.(decr.) in equity cap.	0	1,130	83	0	0
Net incr./.(decr.) in debt	0	20,015	23,250	(7,650)	(7,650)
Dividends paid	0	0	0	(9,433)	(13,206)
Cash flow from financing (C)	0	21,145	23,333	(17,083)	(20,856)
Net incr./.(decr)in cash (A+B+C)	(51,199)	10,594	13,273	48,595	47,487

Valuation parameters					
Year to December	CY07E	CY08E	CY09E	CY10E	CY11E
EPS (INR)	1.5	1.6	12.2	42.1	37.4
EPS Y-o-Y growth (%)	(1,526.2)	9.0	643.5	244.9	(11.2)
CEPS (INR)	4.1	2.9	16.2	45.6	41.1
P/E (x)	148.6	136.3	18.3	5.3	6.0
Book value per share (INR)	167.6	172.8	184.4	221.6	252.0
P/BV (x)	1.3	1.3	1.2	1.0	0.9
EV/Sales (x)	33.7	37.7	10.1	3.5	3.3
EV/EBITDAX (x)	45.0	52.0	11.3	3.7	3.7
Dividend yield (%)	0.0	0.0	0.0	2.2	3.1

Liquidity ratios

Year to December	CY07E	CY08E	CY09E	CY10E	CY11E
Current ratio	12.7	24.1	16.8	17.3	25.0
Quick ratio	11.1	22.5	15.2	15.7	23.4
Cash ratio	9.4	20.8	13.6	14.1	21.8
Receivable turnover (x)	12.5	12.5	12.5	12.5	12.5
Inventory turnover (x)	12.5	12.5	12.5	12.5	12.5
Payables turnover (x)	20.0	20.0	20.0	20.0	20.0
Receivables (days)	29	29	29	29	29
Inventory (days)	29	29	29	29	29
Payables (days)	18	18	18	18	18
Cash conversion cycle (days)	40	40	40	40	40

Operating ratios (x)

Year to December	CY07E	CY08E	CY09E	CY10E	CY11E
Total asset turnover	0.0	0.0	0.1	0.2	0.2
Fixed asset turnover	0.6	0.3	0.5	1.0	1.0
Equity turnover	0.0	0.0	0.1	0.2	0.2

Profitability ratios (%)

Year to December	CY07E	CY08E	CY09E	CY10E	CY11E
Gross profit margin	74.8	72.6	89.1	92.2	90.4
EBITDA margin	74.8	72.6	89.1	92.2	90.4
ROCE	0.9	0.9	6.1	18.4	14.5
ROE	0.9	1.0	6.9	20.8	15.8
ROA	0.8	0.9	6.1	18.2	14.2

Financial ratios

Year to December	CY07E	CY08E	CY09E	CY10E	CY11E
Debt-equity (x)	0.0	0.1	0.1	0.1	0.1
Long term debt / Cap Emp (%)	1.6	7.1	12.0	8.8	6.4
Total debt / Capital emp (%)	3.5	8.6	14.0	11.4	8.8

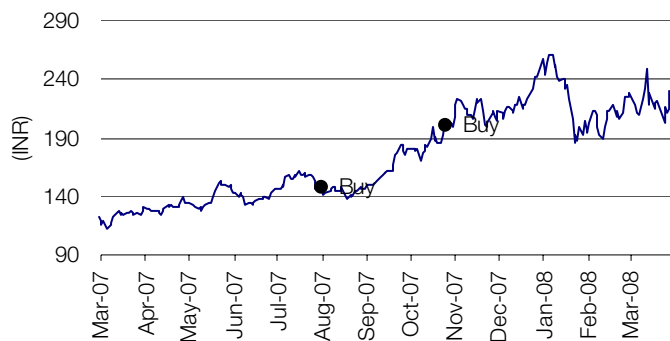
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Coverage group(s) of stocks by primary analyst(s): Oil & Gas, Petrochemicals

Bharat Petroleum Corporation, Cairn India, Chennai Petroleum Corp., Engineers India, Finolex Industries, Hindustan Petroleum Corporation, Indian Oil Corporation, Indraprastha Gas, ONGC, PSL, Reliance Industries

Cairn



Date	Company	Title	Price (INR)	Recos
3-Mar-08	Oil & Gas Monthly	Auto fuel prices increased <i>Monthly Update</i>		
18-Feb-08	Reliance Industries	Incorporating D9 & D3 reserves; <i>Company Update</i>	2,552	Accum
14-Feb-08	Oil & Gas	Fuel price hike & higher govt. support increases visibility; <i>Sector Update</i>		
01-Feb-08	BPCL	No respite for under-recoveries; <i>Result Update</i>	386	Accum

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	110	49	10	1	190

* 14 stocks under review / 6 rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	96	70	24

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 20% over a 12-month period
Accumulate	appreciate up to 20% over a 12-month period
Reduce	depreciate up to 10% over a 12-month period
Sell	depreciate more than 10% over a 12-month period

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