

Company Focus

20 December 2007 | 7 pages

Cairn India (CAIL.BO)

 Target price change
 Estimate change

Buy: Increasing Target on Higher Oil Price; LT Crude at 75/bbl

- Global oil forecasts raised** — We are adjusting our estimates for Cairn India following the increase in our global oil forecasts to US\$80/bbl (from US\$70/bbl) for 2008E, US\$75/bbl (US\$65/bbl) for 2009E and US\$75/bbl (US\$60/bbl) for 2010E onward (see *2008 Outlook: Another Strong Year Ahead*, Doug Leggate, 20 Dec 2007).
- High leverage to LT crude plays out in target upgrade** — Our core NAV moves up to Rs249 from Rs193, with a target price of Rs262 reflecting a 5% premium to NAV. The premium narrows from 15% as our LT crude assumptions move closer to what could be imputed in a potential bid valuation. Cairn's leverage to long-term oil prices remains one of the highest globally.
- Mid-stream — last remaining hurdles** — We believe the government will either approve the inclusion of pipeline capex (US\$800m) under the FDP or approve tariff-based recovery of pipeline costs. Meanwhile, since the pipeline ROU acquisition has been approved, it will not hold up timeline for first oil (mid-09).
- Core valuation support** — At a long-term crude price of US\$75/bbl, the shares trade at 0.87x NAV. We expect the stock to continue to re-rate gradually if crude stays at US\$85-90/bbl over the next 6-12 months. Increasing exploration activity in Cairn's other domestic exploration blocks in 2008 could provide further upside.

Buy/Medium Risk	1M
Price (19 Dec 07)	Rs218.20
Target price	Rs262.00
	<i>from Rs221.00</i>
Expected share price return	20.1%
Expected dividend yield	0.0%
Expected total return	20.1%
Market Cap	Rs388,047M
	US\$9,805M

Price Performance (RIC: CAIL.BO, BB: CAIR IN)



Figure 1. Cairn India — Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31-Dec	(Rs M)	(Rs)	(%)	(x)	(x)	(%)	(%)
2006	NA	NA	NA	NA	NA	NA	na
2007E	2,201	1.25	NA	175.0	1.3	NA	0.0
2008E	2,791	1.58	26.8	138.0	1.3	1.0	0.0
2009E	22,519	12.76	706.8	17.1	1.3	7.7	0.0
2010E	59,185	33.53	162.8	6.5	1.3	20.2	0.0

Source Powered by dataCentral

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Fiscal year end 31-Dec	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	na	na	175.0	138.0	17.1
EV/EBITDA adjusted (x)	na	na	na	51.2	12.5
P/BV (x)	na	na	1.3	1.3	1.3
Dividend yield (%)	na	na	0.0	0.0	0.0
Per Share Data (Rs)					
EPS adjusted	na	na	1.25	1.58	12.76
EPS reported	na	na	1.25	1.58	12.76
BVPS	na	na	165.03	165.07	165.40
DPS	na	na	0.00	0.00	0.00
Profit & Loss (RsM)					
Net sales	na	na	8,873	8,848	33,460
Operating expenses	na	na	-5,398	-4,025	-6,539
EBIT	na	na	3,475	4,823	26,921
Net interest expense	na	na	-459	-960	-1,560
Non-operating/exceptionals	na	na	130	124	121
Pre-tax profit	na	na	3,145	3,987	25,482
Tax	na	na	-943	-1,196	-2,963
Extraord./Min.Int./Pref.div.	na	na	0	0	0
Reported net income	na	na	2,201	2,791	22,519
Adjusted earnings	na	na	2,201	2,791	22,519
Adjusted EBITDA	na	na	7,286	7,410	31,005
Growth Rates (%)					
Sales	na	na	na	-0.3	278.2
EBIT adjusted	na	na	na	38.8	458.2
EBITDA adjusted	na	na	na	1.7	318.4
EPS adjusted	na	na	na	26.8	706.8
Cash Flow (RsM)					
Operating cash flow	na	na	6,192	5,462	26,313
Depreciation/amortization	na	na	3,812	2,587	4,084
Net working capital	na	na	179	84	-290
Investing cash flow	na	na	-22,827	-16,000	-10,440
Capital expenditure	na	na	-22,827	-16,000	-10,440
Acquisitions/disposals	na	na	0	0	0
Financing cash flow	na	na	5,098	7,640	7,400
Borrowings	na	na	5,098	7,640	7,400
Dividends paid	na	na	0	0	0
Change in cash	na	na	-11,537	-2,898	23,273
Balance Sheet (RsM)					
Total assets	na	na	305,132	312,429	321,240
Cash & cash equivalent	na	na	22,552	19,813	18,466
Accounts receivable	na	na	6,075	5,579	6,703
Net fixed assets	na	na	34,694	45,227	54,261
Total liabilities	na	na	13,805	21,032	29,266
Accounts payable	na	na	5,445	5,032	5,866
Total Debt	na	na	8,360	16,000	23,400
Shareholders' funds	na	na	291,327	291,397	291,974
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	na	na	82.1	83.8	92.7
ROE adjusted	na	na	na	1.0	7.7
ROIC adjusted	na	na	na	1.3	8.2
Net debt to equity	na	na	-4.9	-1.3	1.7
Total debt to capital	na	na	2.8	5.2	7.4

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Figure 2. Cairn India — Earnings Revisions

Year to 31-Dec	Net Profit (Rs Mils.)		Diluted EPS (Rs)		
	Old	New	Old	New	% Chg
2008E	2,182	2,791	1.24	1.58	27.9
2009E	18,688	22,519	10.59	12.76	20.5
2010E	46,268	59,185	26.21	33.53	27.9

Source: Citi Investment Research estimates

Figure 3. Cairn India — SOTP Valuation

Field	NPV (end-08) US\$m	NPV p/s Rs	EV/boe (US\$)	Comments
Ravva	133	3	16	
CB-OS/2	97	2	8	
Producing Fields	230	5		
Mangala, Bhagyam, Aishwariya (MBA)	8,588	192	26	Based on cash flow analysis; DCF as at end-08E
Rajasthan Pipeline	(6)	(0)		
Early Oil	48	1	15	Discount to implied EV/boe of MBA fields
Rajasthan 'Core'	8,630	193		
Production & Development	8,859	198		
Overheads	(40)	(1)		
Net Cash/(Debt)	28	1		Estimated Net Debt as at end-08E
Financial Items	(12)	(0)		
Core NAV	8,848	198		
MBA Recovery Factor Upside	606	14	14	Incremental 9% EOR recovery. Discount to implied EV/boe of MBA
LPD Reported Resource	688	15	15	Disclosed 2P resource associated with LPD. Discount to implied EV/boe of MBA
LPD Appraisal Upside	161	4	14	Potential for upside to LPD resource. Discount to implied EV/boe of MBA
Exploration Upside	823	18	14	Potential for basin-wide exploration. Discount to implied EV/boe of MBA
Rajasthan Upside	2,279	51		
Net Asset Value	11,126	249		

Source: Citi Investment Research estimates

Cairn India

Company description

Cairn India was incorporated as a subsidiary of Cairn Energy PLC (UK) to own and operate all of Cairn Plc's Indian E&P assets. Cairn India has operating interests in producing fields in KG Basin and the Cambay Basin offshore. However, most of the reserves accrue from the Rajasthan Block where production commences in 2009. Post-IPO, Cairn Plc holds 69.5% in Cairn India.

Investment strategy

We rate Cairn India Buy/Medium Risk with a target price of Rs262. Cairn India's ownership of valuable oil reserves in Rajasthan (OIP of 3.6bn boe) should generate steady cash flows from 2009E, besides having potential to generate further upside from EOR and exploration. Cairn India's valuations are among the most highly leveraged to crude amongst global E&P peers, offsetting inherent operational risks, in our view. While recent bid talk may prove ephemeral, we believe there is potential upside from a prospective bidder willing to pay over US\$75/bbl.

Valuation

Our target price of Rs262 is based on a 5% premium to 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. The key assumptions for our NAV analysis are: long-term crude price (Brent) of US\$75/bbl; first oil from Rajasthan in 2H09; crude realization at a 7% discount to Brent; cess at Rs918/MT; plateau production at 155-160kbpd; development capex of US\$2.3bn; and the impact of pipeline option. Our target price is more leveraged to crude prices and less sensitive to operating parameters and/or reserve upside. We add a 5% premium to NAV to reflect the potential upside for an acquirer willing to pay over our US\$75/bbl long-term crude forecast. The traditional valuation multiples (EV/DACF) will become more relevant as Rajasthan approaches first oil, but contingent on the extent of exploration success.

Risks

Our quantitative risk-rating system assigns a default Speculative Risk rating to Cairn India as the stock has traded for less than 12 months. However, we believe a Medium Risk rating is more appropriate despite it being in the project stage due to tangible oil reserves which can be monetized, strong track record of the parent, and favorable demand-supply for domestic crude. Key risks include: (1) Delays and cost overruns; though cost recoverable, this 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 the new exploration assets in India. These risks could impede the stock from reaching our target price.

Appendix A-1

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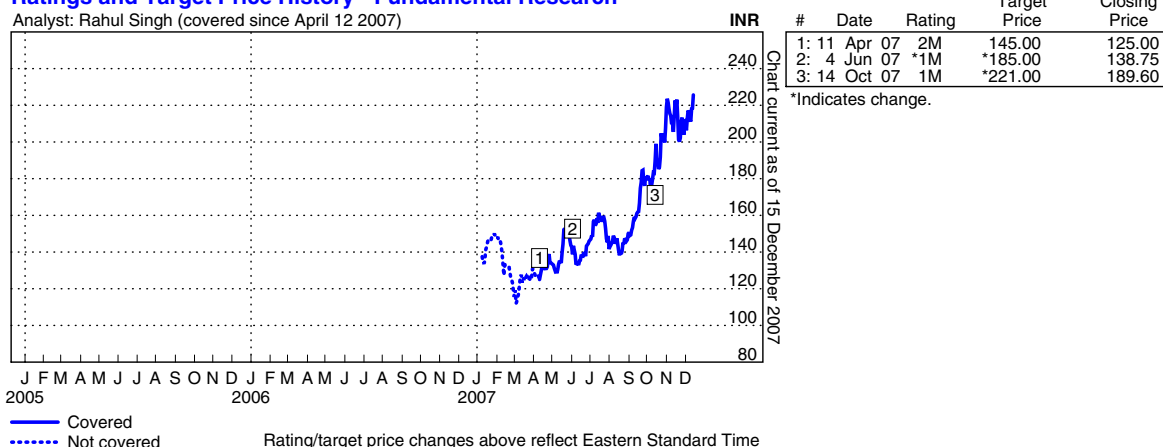
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Analyst: Rahul Singh (covered since April 12 2007)



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