

Equities

14 November 2011 | 8 pages

Oil India (OILI.BO)

Alert: 2Q: Some One-Offs, but Strong Operationally

- **Operationally strong 2Q** — OIL's 2QFY12 PAT came in at Rs11.4bn (+24% yoy, +34% qoq), boosted by a combination of production growth and subsidy burden remaining at one third. Reported PAT was, however, below estimates owing to one-off provisions of Rs2.86bn on employee costs and higher-than-expected DD&A costs, which also included one-offs (provision for minimum work programme) of cRs3.6bn.

- **No subsidy surprises; net realizations at US\$86** — OIL's 2Q net realizations came in at US\$86/bbl, and were driven by strong crude prices, lower subsidy burden following the June price hikes and duty cuts, and upstream share remaining at a third of gross under-recoveries (without including any notional losses). Realizations at these levels are, however, clearly unsustainable, given rising under-recoveries of the OMCs, worsening Gov't finances, and the lack of political will to raise prices of controlled fuels.

- **Production growth continues, but near-term upsides unlikely** — OIL's 2Q crude production came in at 0.99 MMT (+6.2% yoy, +3.6% qoq), in line with expectations. Gas production growth was even stronger (+16.1% yoy, +5.6% qoq), on the back of ramp-up of supplies to the NRL refinery from the Duliajan-Numaligarh pipeline. However, with most production growth now largely behind us, we expect volumes to be sustained at current levels in the near-term.

- **No clarity on subsidy sharing, 2H could be a dampener** — A combination of sustained strength in crude and sharp rupee depreciation has led to the under-recovery situation considerably worsening in the last couple of months. Gross under-recoveries for FY12 are unlikely to come in below Rs1.2 tr (Rs214bn in 2Q) if current trends in crude, currency, and policy continue, considerably increasing uncertainty for the gov't-owned upstream companies for the rest of the year. A re-rating in the absence of a reversal in trend of at least one of the above external factors is unlikely. OIL's cash on books at Rs136bn (Rs565/sh) could, however, provide downside support.

■ Company Update

Buy	1
Price (14 Nov 11)	Rs1,286.25
Target price	Rs1,518.00
Expected share price return	18.0%
Expected dividend yield	2.9%
Expected total return	20.9%
Market Cap	Rs309,284M
	US\$6,185M

Price Performance (RIC: OILI.BO, BB: OINL IN)



Figure 1. Oil India – Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2010A	26,105	108.56	7.5	11.8	2.2	22.6	2.6
2011A	28,878	120.10	10.6	10.7	2.0	19.7	2.9
2012E	32,949	137.03	14.1	9.4	1.7	19.8	3.3
2013E	35,291	146.77	7.1	8.8	1.6	18.8	3.6
2014E	36,197	150.53	2.6	8.5	1.4	17.2	3.7

Source: Citi Investment Research and Analysis

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Oil India – 2QFY12 Results

Figure 2. OIL – 2QFY12 Results (Rupees in millions)

	2QFY11	1QFY12	2QFY12	% yoy	Comments
Net sales	23,724	22,878	32,703	38%	
Other operating income	949	783	869	-8%	
Total income	24,673	23,661	33,571	36%	Driven by higher volumes and realizations. Also includes an incr. of cRs300m on account of higher transportation income due to higher tariffs.
Expenses					
(Increase)/decrease in stock	31	65	(267)	-954%	
Consumption of raw materials	365	299	335	-8%	
Employee cost	2,270	3,004	3,502	54%	Includes a provision of Rs376m on account of differential superannuation benefits
Statutory levies	6,792	6,760	8,784	29%	Driven by higher volumes and realizations
Other expenditure	1,238	1,121	4,147	235%	Includes a provision of Rs2.48bn on account of differential superannuation benefits
Total expenditure	10,696	11,249	16,501	54%	
EBITDA	13,976	12,412	17,070	22%	
EBITDA margin (%)	57%	52%	51%		
DD&A	1,825	2,784	5,901	223%	Incl. one-off provision of cRs3.6bn for MWP capex in certain blocks in Rajasthan and North East, which OIL has decided to exit following poor well results
Interest	9	88	5	-49%	
Other income	1,660	3,026	5,955	259%	Higher due to higher interest income and cRs1.4bn of arrears received on account of the increase in transportation tariffs (retrospectively received for the last 3 years)
Profit before tax	13,802	12,566	17,119	24%	
Tax	4,642	4,070	5,734		
Tax rate	33.6%	32.4%	33.5%		
Profit after tax	9,160	8,496	11,385	24%	

Source: Citi Investment Research and Analysis, Company reports

Figure 3. OIL – Operational Parameters

	2QFY10	3QFY10	4QFY10	1QFY11	2QFY11	3QFY11	4QFY11	1QFY12	2QFY12	Comments
Crude										
Production (MMT)	0.91	0.90	0.90	0.80	0.93	0.93	0.94	0.96	0.99	In-line with expectations; upsides unlikely to be very meaningful in the near-term
Sales (MMT)	0.94	0.90	0.89	0.78	0.95	0.91	0.95	0.97	0.97	
Sales (Rs m)	19,221	18,436	16,379	13,221	20,760	20,475	17,075	19,365	28,577	
Subsidy (Rs m)	3,535	4,676	6,700	7,297	3,994	5,586	16,054	17,807	8,444	11.9% of total 2Q upstream subsidy vs. 12.3% in 1Q; upstream share has been 33% in 1HFY12 vs. 39% in FY11
Crude realizations (US\$/bbl)										
-Gross realization	67.4	73.9	75.7	78.1	75.5	85.7	104.0	116.3	112.5	
-Subsidy payout	10.5	15.1	22.4	28.4	12.3	18.5	51.1	56.8	26.2	
-Net realization	56.9	58.8	53.3	49.7	63.2	67.1	52.9	59.6	86.3	Led by higher crude prices, higher production, and lower subsidy burden
Natural gas										
Production (mmscm)	601	625	585	553	583	616	600	641	677	Sequential increase driven by ramp-up of offtake by NRL refinery to c0.9 mmscmd; further upsides unlikely to be meaningful in the near-term due to poor Rajasthan offtake
Sales (mmscm)	460	485	447	423	442	479	465	508	543	
Sales (Rs m)	1,216	1,239	1,165	1,480	2,270	2,374	2,404	2,644	2,753	
Gas realization (Rs/scm)	3.5	3.4	3.4	4.6	7.2	6.6	6.8	6.6	6.6	

Source: Citi Investment Research and Analysis, Company reports

Oil India

Valuation

Our target price of Rs1,518 comprises: (i) Business valued at P/E of 9x Sep-12E core EPS and (ii) cash at Rs437/share (Sep-11E). The core P/E is at a 10% discount to its larger peer, which we believe is warranted on account of: (i) OIL's smaller size, (ii) still-to-be-tested track record outside the North East, and (iii) risk pertaining to use of OIL's significant cash balance. Further re-rating from here would be dependent on higher net crude realizations, i.e. significant price reforms esp. in diesel (full deregulation), and any positive news flow from new exploration programs.

Risks

The key downside risks to our investment thesis on OIL are: 1) Drop in crude prices; 2) Sharp rupee appreciation; 3) Uncertainty on government policy on subsidy sharing remains a key risk, although implementation of a crude linked subsidy sharing formula would be a key positive for the stock; 4) The government determines the gas price realization for OIL to a large extent. Any downward reduction in APM gas prices would have negative impact on profitability and valuations; 5) Given the significant increase in exploratory activity likely to be initiated in the NELP blocks, there are risks of failures and hence material dry well write-offs which could impact earnings and cash flows in the short-term; 6) Any reversal of the government decision on transportation tariff and sales tax recovery would be a key negative for OIL. If any of these risk factors has a greater downside impact than we anticipate, the share price will likely have difficulty attaining our target price.

Appendix A-1

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Oil India (OILI.BO)

Ratings and Target Price History Fundamental Research

Analyst: Saurabh Handa
Covered since June 18 2010



Date	Rating	Target Price	Closing Price
1 2-Nov-09	*2L	*1,165.00	1,113.70
2 20-May-10	2L	*1,290.00	1,259.80
3 28-Jul-10	2L	*1,370.00	1,367.50

Date	Rating	Target Price	Closing Price
4 12-Nov-10	2L	*1,466.00	1,394.95
5 26-Jun-11	*1L	*1,518.00	1,282.00
6 7-Oct-11	Stock rating system changed		

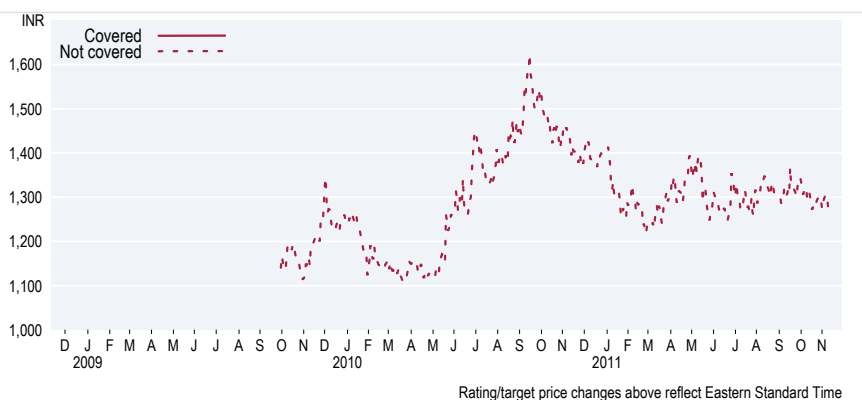
Date	Rating	Target Price	Closing Price
7 7-Oct-11	*1	1,518.00	1,321.45

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Oil India (OILI.BO)
Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Saurabh Handa
Covered since June 18 2010



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