

25 March 2010

Cairn India

Rajasthan exploration potential quantified; retain Sell

Rating: Sell

Target Price: Rs280

Share Price: Rs293

- What's changed?** In its Rajasthan field update, Cairn has raised its "discovered resource base" from 3.7bn boe to 4bn; quantified its "exploration resource base" at 2.5bn boe and raised its "plateau production target" – from Mangala to 150,000bpd (125,000 earlier) and from the overall Rajasthan field to 240,000bpd (185,000 earlier), subject to government approval and tying up buyers.
- Implication on valuation.** The rise in Mangala' peak production arises from the existing reserve base, implying a higher decline rate in future – upside of Rs19/share on account of possible front-ending of cash flows. The rest of the expected rise of 30,000 bpd in the peak production level is from other discoveries in Rajasthan (140m barrels risked resources). Along with the higher exploration resource base (250m barrels risked resources), we ascribe a value of Rs21/share to the possible upside.
- Operations update.** Cairn now produces 20,000 bpd of crude from Rajasthan and aims to touch 125,000 bpd in 1QFY11, on the commissioning of two more trains and the pipeline up to Sayala. It now has sales arrangements with four refiners: MRPL, IOC, RIL (DTA refinery) and Essar, for 143,000 bpd of offtake.
- Earnings and Valuations.** While there is no impact on earnings, our target price rises to Rs280/share, incorporating the higher Mangala peak production and higher exploration and development upside. Possible upside now constitute about 16% of target price.

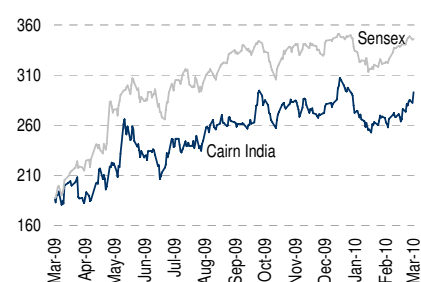
Key financials

Year end 31 March	CY07	FY09	FY10e	FY11e	FY12e
Sales (Rsm)	10,123	14,327	15,366	63,796	105,032
Net profit (Rsm)	(245)	8,036	10,614	34,677	65,852
EPS (Rs)	NM	4.2	5.6	18.3	34.8
Growth (%)	NM	NM	32.1	226.7	89.9
PE (x)	NM	63.6	48.2	14.7	7.8
PBV (x)	1.9	1.7	1.6	1.4	1.2
EV/EBITDA (x)	120.5	66.0	61.4	11.4	6.2
RoE (%)	-0.1	2.6	3.2	9.7	16.2
RoCE (%)	0.7	1.4	1.9	10.0	16.0
Net gearing (%)	(3.5)	(6.6)	14.6	14.2	5.3

Source: Company, Anand Rathi Research

Key data	CAIR IN/ CAIRN.BO
52-week high/low	Rs310/Rs174
Sensex/Nifty	17451/5225
3-m average volume	US\$18.6m
Market cap	Rs555bn/US\$12.2bn
Shares outstanding	1897m
Free float	37.7%
Promoters	62.3%
Foreign Institutions	11.0%
Domestic Institutions	6.9%
Public	19.8%

Relative price performance



Source: Capital Line, Anand Rathi Research

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rsm)

YE 31 March	CY07	FY09	FY10e	FY11e	FY12e
Net sales	10,123	14,327	15,366	63,796	105,032
Sales growth (%)	NM	41.5	7.2	315.2	64.6
- Op. expenses	5,963	6,913	6,228	14,315	18,693
EBIDTA	4,159	7,414	9,137	49,481	86,338
EBITDA margins (%)	41.1	51.7	59.5	77.6	82.2
- Interest	27	64	520	4,750	3,950
- Depreciation	2,077	2,698	1,596	6,383	9,715
+ Other income	1,324	5,072	4,200	2,000	2,000
- non recurring items	(2,120)	156	-	-	-
- Tax	1,505	1,844	607	5,672	8,822
Consolidated PAT	(245)	8,036	10,614	34,677	65,852
PAT growth (%)	NM	NM	32.1	226.7	89.9
FDEPS (Rs/share)	NM	4.2	5.6	18.3	34.8
CEPS (Rs/share)	NM	5.7	6.4	21.7	39.9
BVPS (Rs/ share)	145.8	163.2	168.8	187.1	221.9

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (Rsm)

YE 31 March	CY07	FY09	FY10e	FY11e	FY12e
Share capital	17,784	18,967	18,967	18,967	18,967
Reserves & surplus	276,204	309,057	319,671	354,347	420,200
Shareholders' fund	293,988	328,023	338,637	373,314	439,166
Long term debt	3,124	43,564	73,564	62,137	50,709
Def. Tax liability	4,916	5,624	6,113	10,835	19,022
Capital employed	302,029	377,211	418,314	446,286	508,898
Total Fixed Assets	29,546	65,674	145,227	217,825	287,090
Goodwill	253,193	253,193	253,193	253,193	253,193
Investments	7,129	1,713	5,000	5,000	5,000
Net Working capital	-1,157	-8,723	-9,356	-38,843	-63,950
Cash	13,318	65,271	24,166	9,028	27,482
Def. Tax Asset	0	84	84	84	84
Capital deployed	302,029	377,211	418,314	446,286	508,898
Net Debt /Equity (%)	(3.5)	(6.6)	14.6	14.2	5.3

Source: Company, Anand Rathi Research

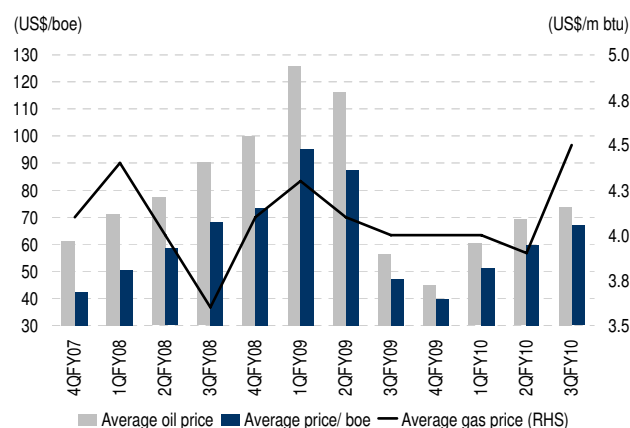
Fig 3 – Cash flow statement (Rsm)

YE 31 March	CY07	FY09	FY10e	FY11e	FY12e
Consolidated PAT	(245)	8,036	10,614	34,677	65,852
+Depreciation	2,077	2,698	1,596	6,383	9,715
+DTL	2,569	707	489	4,722	8,187
Cash profit	4,401	11,441	12,700	45,781	83,755
- Incr. in Cur. Assets	1,272	194	537	25,044	21,324
- Incr. in Cur. Liab.	(31,182)	7,760	1,170	54,532	46,431
Operating cash flow	(28,053)	19,007	13,332	75,269	108,862
-Capex	11,029	38,826	81,150	78,980	78,980
Free cash flow	(39,083)	(19,818)	(67,818)	(3,711)	29,882
+ Equity raised	131	1,183	-	-	-
+ Debt raised	(2,055)	40,440	30,000	(11,427)	(11,427)
-Investments	7,024	(5,416)	3,287	-	-
Net cash flow	(48,030)	51,953	(41,105)	(15,138)	18,454
+Opening cash	61,348	13,318	65,271	24,166	9,028
Closing cash	13,318	65,271	24,166	9,028	27,482

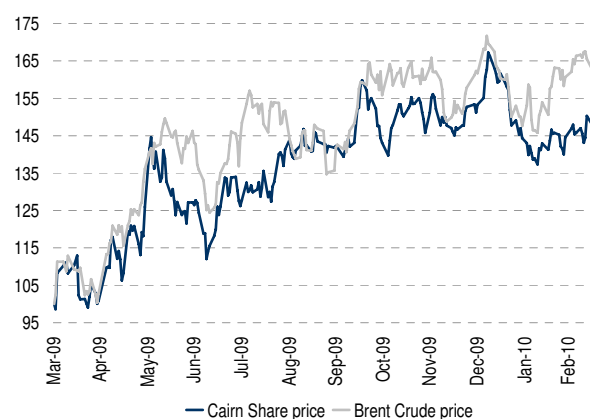
Source: Company, Anand Rathi Research

Fig 4 – Price-to-Book Band


Source: Capital Line, Anand Rathi Research

Fig 5 – Average price realization


Source: Capital Line, Anand Rathi Research

Fig 6 – Relative performance to Crude


Source: Capital Line, Anand Rathi Research

Investment Argument and Valuation

Cairn’s announcement of a higher exploration and development resource base from its Rajasthan field is positive. Along with a higher NAV on account of higher initial plateau production from Mangala and the E&P upside, we see a valuation upside to Cairn of Rs40/share. Accordingly, we raise our target price, based on a long-term Brent price assumption of US\$70/bbl, to Rs280/share (from Rs240 earlier). At prices at which crude now rules (US\$80/bbl), the valuation would be Rs329. We maintain a Sell on the lower crude price assumption.

Resource base expanded

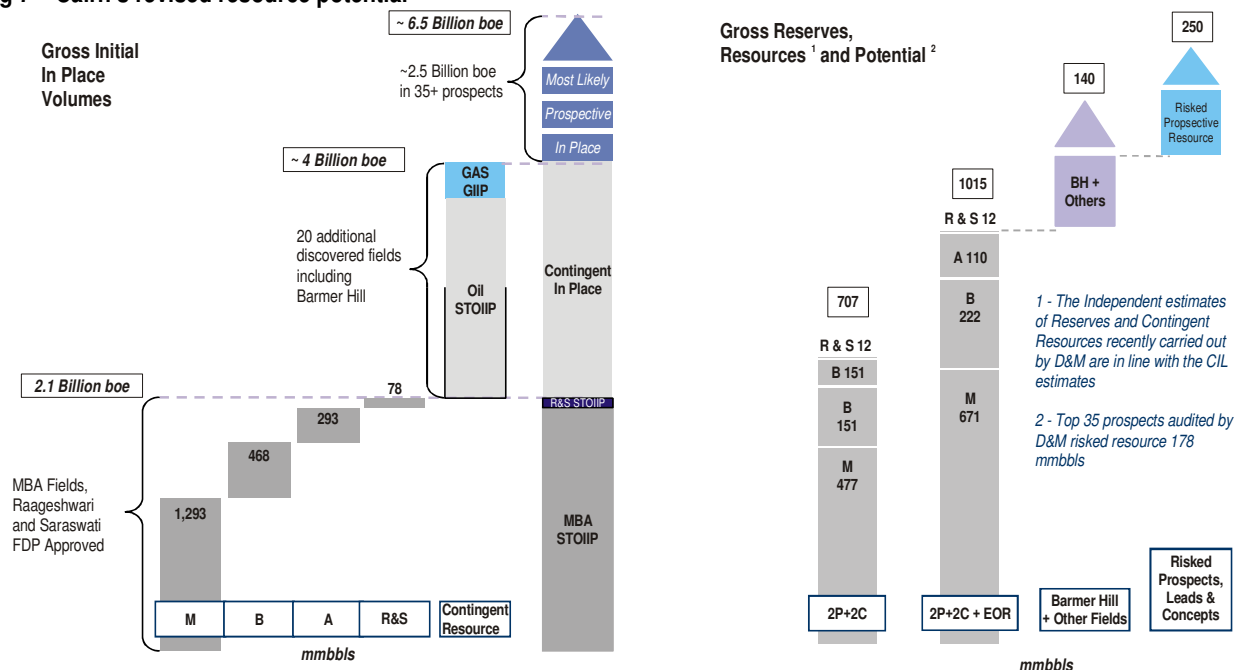
Exploration resource base expanded

Cairn India has announced fresh information with respect to its Rajasthan assets. It has:

- Announced an increase in its discovered ‘resource’ base in its Rajasthan field—from 3.7bn boe to 4bn;
- Quantified its exploration resource base at 2.5bn boe unrisks (250m barrels risked) from its Rajasthan field; and
- Raised its plateau production target from Mangala to 150,000 bpd (earlier 125,000 bpd) and from its overall Rajasthan field to 240,000 bpd (earlier 185,000 bpd), subject to government approvals and the tying up of buyers.

The increase in its discovered and exploration resource base has come primarily from re-assessment of present discoveries, seismic surveys and performance of the development wells drilled as part of the Mangala development.

Fig 7 – Cairn’s revised resource potential



Source: Company

The increase in higher peak-production expectations from the Rajasthan field has two components. The increase in peak production (from 185,000 bpd now to 210,000) is expected on account of higher peak-production capacity from the Mangala field. The higher peak production is expected from the existing ‘reserve’ base and implies a higher decline rate in future, and thus overall, the same expected recovery from the field as before. The higher peak production, though, means front-ending of cashflows from Mangala and thus a higher NAV for stakeholders. We calculate an upside of Rs19/share on account of this possible front-ending of cash flows.

The second component to expected increase in peak production, to 240,000 bpd is a rise of 30,000 bpd (above the 210,000 bpd as explained above) expected from the revised higher development resource base of 1.9bn barrels of un-risked resources (140m barrels risked resources), which comes from 22 other discoveries in the field, including the discoveries in the Barmer Hill formation.

The company has indicated that a Declaration of Commerciality (DoC) has been submitted for the Barmer Hill formation. Along with the higher exploration resource base (250m barrels of risked resources), we ascribe a value of Rs21/share to these possible upsides.

While Cairn expects to increase the plateau production levels to 240kbpd on the back of better reservoir performance from Mangala field and higher resource potential, we can't rule out the possibility of government favoring a longer plateau period rather than a higher peak production. Though, from a NAV point this might not be the best thing for the government to do, the propensity to limit export of crude out of the country might make this a possibility.

Valuation

We value Cairn India using the DCF method for its 2P and contingent (EOR) reserves and a multiple-based approach to calculate its exploration and development upside. We have revised our valuation on higher peak production expectation from Mangala and higher development and exploration upsides. Our DCF-based valuation assumes a long-term Brent price of US\$70/bbl. We factor in the cess payment by Cairn India of Rs927/ton for the Rajasthan crude (implying an impact of Rs10/share if cess payment is higher at Rs2,575/share).

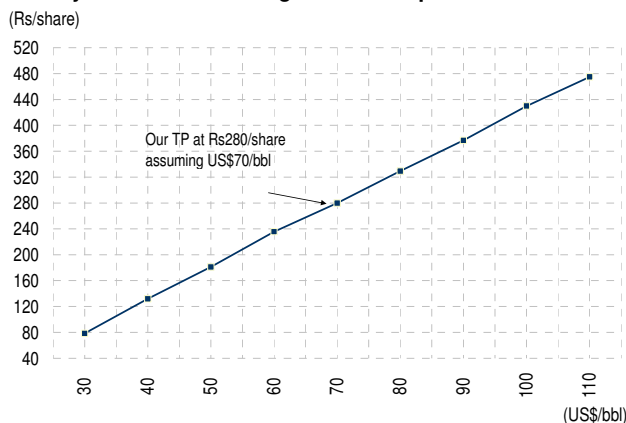
We see a rise in our per-share target price—of Rs40, an upside of Rs19 on account of possible front-ending of cash flows from the Mangala field and another Rs21 from the development (140m barrels of risked resources) and exploration (250m barrels risked resources) resource base.

Fig 8 – Valuation matrix

	Assumptions		US\$ m	Rs/share
Long-term Brent price (US\$/bbl)	70	Rajasthan (EV)	10,154	261
Proven, probable and EOR potential (%)	100	Cambay (EV)	42	1
WACC (%)	12.1	Rawa (EV)	94	2
2P gas reserve entitlement (m boe)	9.0			
2P oil reserve entitlement (m boe)	404.5	Less: Net debt	1.155	28
Shares outstanding (m)	1,897	Equity Valuation	9,135	236
		Exploration/ Development Upside (at average US\$8/boe)		44
		Target Price		280

Source : Anand Rathi Research

Fig 9 – Sensitivity of fair value to long-term crude price



Source: Bloomberg, Anand Rathi Research

Sensitivity of valuations to crude price and WACC assumption

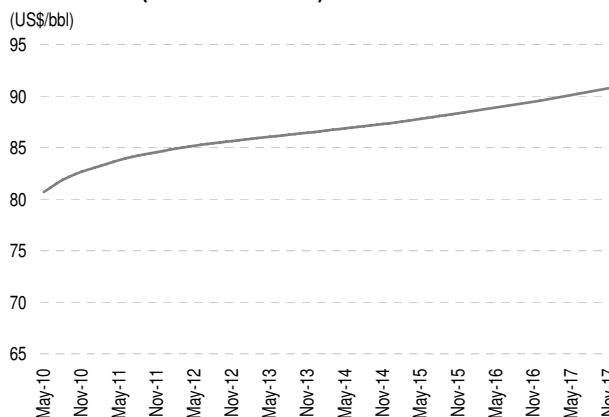
Fig 10 – Valuation sensitivity matrix

Crude price (US\$/bbl)	Discount rate (%)				
	10	11	12	13	14
50	198	189	181	174	167
60	256	246	236	226	218
70	304	291	280	269	259
80	357	343	329	317	305
90	409	392	377	363	350

Source : Anand Rathi Research

Fig 11 below (ICE Brent futures prices) shows the crude price range to be US\$80-92/bbl until 2018. This is much higher than our assumption of a long-term Brent price of US\$70/bbl. At crude prices based on this scenario of Rs87/share (on the forward curve), Cairn India would be valued at about Rs361 a share. A higher assumed long-term Brent price would have a significant impact on valuations, as the company is highly geared to oil prices.

Fig 11 – Forward curve (dated 23 Mar '10)



At current forward prices as seen in the ICE Brent curve, Cairn India would be valued at Rs361/share

Source: Bloomberg, Anand Rathi Research

Risks

- Long term crude prices being higher than our estimate of US\$70/bbl.
- Reserves upsides being higher than our estimates
- Ramp up and peak production from Rajasthan fields being higher than our estimates.

Fig 12 – Income Statement (Rsm)

Year end 31 March	CY07	FY09	FY10e	FY11e	FY12e
Net Revenue	10,123	14,327	15,366	63,796	105,032
Total Expenditure	5,963	6,913	6,228	14,315	18,693
Royalty/Cess (%)	8.2	6.6	6.5	5.0	4.7
Operating cost (%)	9.9	9.9	11.2	6.5	6.3
Administrative cost (%)	38.4	23.1	22.8	11.0	6.8
EBIDTA	4,159	7,414	9,137	49,481	86,338
EBITDA (%)	41.1	67.1	81.2	85.7	90.2
Depreciation	2,077	2,698	1,596	6,383	9,715
EBIT	2,082	4,716	7,541	43,099	76,624
EBIT (%)	20.6	32.9	49.1	67.6	73.0
Interest	27	64	520	4,750	3,950
Other income	1,324	5,072	4,200	2,000	2,000
PBT	3,379	9,724	11,221	40,349	74,674
Current Tax	740	1,221	118	951	634
Deferred Tax	764	623	489	4,722	8,187
Effective tax (%)	45	19	5	14	12
PAT	(245)	8,036	10,614	34,677	65,852
PAT growth (%)	NM	NM	32.1	226.7	89.9

Source: Company, Anand Rathi Research

Fig 13 – Balance sheet (Rsm)

Year end 31 March	CY07	FY09	FY10e	FY11e	FY12e
Share capital	17,784	18,967	18,967	18,967	18,967
Reserves & surplus	276,204	309,057	319,671	354,347	420,200
Shareholder Equity	293,988	328,023	338,637	373,314	439,166
LT Debt	3,124	43,564	73,564	62,137	50,709
Net deferred tax liability	4,916	5,624	6,113	10,835	19,022
Capital employed	302,029	377,211	418,314	446,286	508,898
Gross Fixed Assets	34,571	70,795	151,945	230,925	309,905
Accumulated Depreciation	5,025	5,121	6,718	13,100	22,815
Total Fixed Assets	29,546	65,674	145,227	217,825	287,090
Investments	7,129	1,713	5,000	5,000	5,000
Goodwill	253,193	253,193	253,193	253,193	253,193
Cash and Equivalents	13,318	65,271	24,166	9,028	27,482
Current Assets net cash	7,215	7,409	7,946	32,990	54,314
Current Liabilities	8,372	16,132	17,301	71,834	118,264
Deferred Tax Asset	-	84	84	84	84
Capital Deployed	302,029	377,211	418,314	446,286	508,898

Source: Company, Anand Rathi Research

Fig 14 – Du pont

Year end 31 March	CY07	FY09	FY10e	FY11e	FY12e
EBIT/ Sales (%)	20.6	32.9	49.1	67.6	73.0
Sales/ Avg. CE (x)	0.0	0.0	0.0	0.1	0.2
EBIT/Avg.CE (RoCE) (%)	0.7	1.4	1.9	10.0	16.0
Avg. CE/ Avg.Equity (x)	1.0	1.1	1.2	1.2	1.2
PBT/EBIT (x)	1.6	2.1	1.5	0.9	1.0
PAT/PBT (x)	(0.1)	0.8	0.9	0.9	0.9
PAT/Avg.Equity (ROE) (%)	(0.1)	2.6	3.2	9.7	16.2

Source: Company, Anand Rathi Research

Fig 15 – Key ratio

Year end 31 March	CY07	FY09	FY10e	FY11e	FY12e
Diluted Shares (m)	1,894.0	1,894.0	1,894.0	1,894.0	1,894.0
FDEPS (Rs)	NM	4.2	5.6	18.3	34.8
CEPS (Rs)	NM	5.7	6.4	21.7	39.9
BV (Rs)	145.8	163.2	168.8	187.1	221.9
P/BV (x)	1.9	1.7	1.6	1.4	1.2
EV/Net Sales (x)	49.5	34.2	36.5	8.8	5.1
EV/EBITDA (x)	120.5	66.0	61.4	11.4	6.2
Net Debt/ Ebitda (x)	0.8	5.9	8.1	1.3	0.6
Interest Cover (x)	77.0	73.7	14.5	9.1	19.4

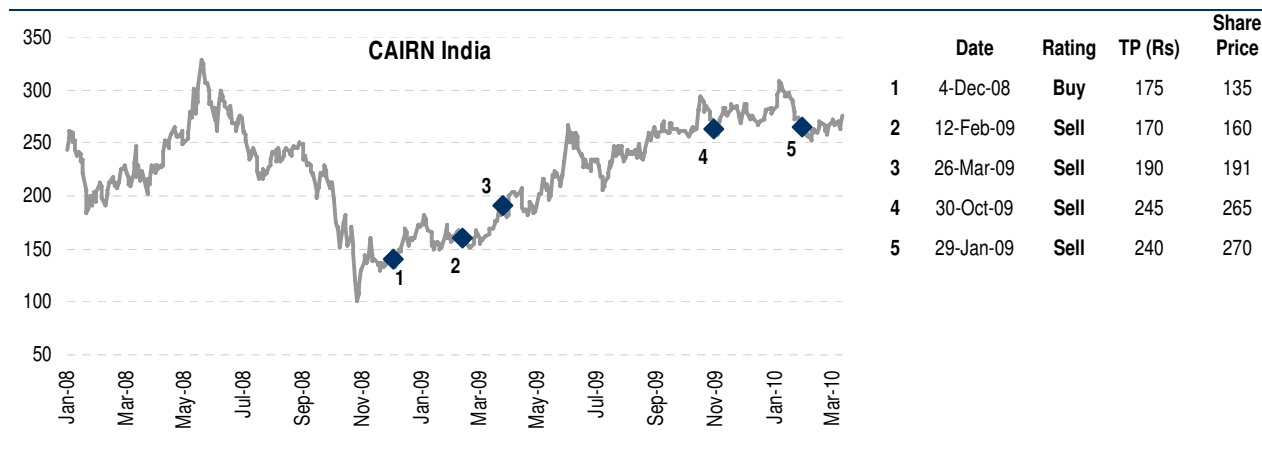
Source: Company, Anand Rathi Research

Appendix 1

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