January 25, 2012

Underperformer

Cairn India

LKP Since 1948

Industry: Oil & Gas | Industry View: Neutral

Result Update

"Profits in line with estimates"

Q3 FY12 provided a glimpse of normalized revenues & profits after royalty was made cost recoverable; with reported net profit of Rs 22.6 bn in line with our estimate of Rs 22 bn.

Topline adjustments at $ 237 mn in Q3 FY12

The topline for Q3 FY12 was reduced by $ 237 mn on account of royalty being made cost recoverable and profit sharing with the Govt. of India on production from the Rajasthan block. Adjustment towards royalty for the quarter stood at Rs 6,285 mn, 2% lower than our expectation of Rs 6,435 mn. Profit petroleum shared with the Govt. was Rs 5,727 mn, which has been calculated as 20% of profit petroleum for the quarter.

Topline at Rs 31 bn

In spite of blended realization jumping by 33% y-o-y from $ 76/boe in Q3 FY11 to $ 100.3/boe in Q3 FY12, revenue is flat y-o-y owing to royalty being made cost recoverable. The q-o-q rise of 17% in the topline is due to inclusion of one-off impact of royalty adjustment in Q2 FY12, inspite of stagnant production and marginally lower realization q-o-q.

Mangala production @ 125 kbpd, Bhagyam starts producing

Mangala production for the quarter stood at 124.9 kbpd whereas the Saraswati field is producing at its peak level of 0.25 kbpd. Production from Bhagyam field has started on Jan 19, 2012 and the management has guided for ramp up of output to the approved peak level of 40 kbpd by Mar 2012. The company has retained its guidance for FY12 exit production rate of 175 kbpd.

Other income boosted by forex gain of Rs 3 bn

The company reported a forex gain of Rs 3 bn in Q3 FY12 due to the swift depreciation of the rupee against the US dollar. DD&A expense during the quarter stood at $ 8/bbl, which is in line with management guidance. Tax rate came in at 5% during Q3 FY12, as against 9.2% in Q3 FY11. The management has maintained its tax rate guidance at ~10%.

Net profit in line with estimates

Net profit for Q3 FY12 at Rs 22.6 bn was 2.8% higher than our estimate of Rs 22 bn. EPS for the quarter was Rs 11.9, 196% higher q-o-q & 12% y-o-y.

Stock Data

Current Market Price (₹)	350
Target Price (₹)	318
Potential upside (%)	(9)
Reuters	CAIL.CO
Bloomberg	CAIR IN

What's Changed

Target Price (₹)	334 to 318
F2012 EPS (₹)	35.6 to 38.1
F2013 EPS (₹)	45.8 to 53.8

Key Data

Market Cap (₹bn)	665
52-Week Range (₹)	372 / 250
Avg. Daily Trading Value last 6 months (₹mn)	680
Promoters (%)	59
FII Holding (%)	6
DII Holding (%)	8
Public & Others Holding (%)	26

Fiscal YE	FY 11	FY 12E	FY 13E	FY14E
Revenues (₹ bn)	103	122	167	146
EBITDA (%)	83.0	81.0	81.9	78.9
PAT (%)	4.5	59.2	61.3	58.8
EPS (₹)	33.3	38.1	53.8	45.2
EPS growth (%)	503	15	41	(16)
P/E (x)	10.6	9.2	6.5	7.8
P/B(x)	1.7	1.4	1.2	1.0
EV/EBITDA (x)	7.5	5.9	3.8	3.6
Cash per share	24	41	68	115
ROCE(%)	18	18	21	15
ROE(%)	17	17	19	14

Relative Price Performance

One Year Indexed

(%)	1 Month	3 Months	12 Months
Absolute	11	16	3
BSE Relative	1	19	15

Deepak Darisi
deepak_darisi@lkpsec.com
+91 22 6635 1220

Financial Highlights

(₹mn)	Q2FY12	Q1FY12	QoQ	Q2FY11	YoY	H1FY12	H1FY11	YoY
Net Sales	**30,968**	**26,522**	**16.8%**	**30,964**	**0.0%**	**94,616**	**66,235**	**42.9%**
Change in inventory	(114)	(37)	na	49	na	(95)	(352)	na
Operating expenses	4,653	4,708	-1.2%	4,576	1.7%	13,618	11,021	23.6%
Other expenses	973	811	20.1%	705	38.1%	2,850	1,719	65.8%
Operating profit	**25,456**	**21,040**	**21.0%**	**25,634**	**-0.7%**	**78,243**	**53,847**	**45.3%**
OPM (%)	*82.2*	*79.3*	*2.9%*	*82.8*	*-0.6%*	*82.7*	*81.3*	*1.4%*
Other income	4,138	5,930	-30.2%	342	1111.4%	10,588	256	4032.9%
DD&A	5,550	3,531	57.2%	3,086	79.8%	12,729	8,246	54.4%
Interest	240	1,228	-80.5%	742	-67.7%	1,914	2,516	-23.9%
Exceptional item	-	13,552	-100.0%	-	na	13,552	-	na
Taxes	1,184	1,029	15.1%	2,046	-42.1%	3,122	4,576	-31.8%
PAT	**22,619**	**7,630**	**196.4%**	**20,101**	**12.5%**	**57,515**	**38,766**	**48.4%**
EPS	11.9	4.0	196.4%	10.6	12.4%	30.2	20.4	48.2%

Source: Company , LKP Research

Performance highlights

	Q3 FY12	Q2 FY12	*q-o-q (%)*	Q3 FY11	*y-o-y (%)*
Rajasthan (bpd)	125,122	125,251	(0.1)	124,861	0.2
Ravva (boepd)	36,567	36,185	(1.0)	39,434	(7.0)
Cambay (boepd)	7,890	8,508	(7.0)	9,988	(21.0)
Gross Prod (boepd)	169,580	169,944	(0.2)	174,282	(2.7)
WI Prod (boepd)	98,969	99,220	(0.3)	100,270	(1.3)
Avg. oil realization ($/bbl)	101.1	102.8	(1.7)	76	(33.0)
Avg. gas realization ($/mmscf)	4.4	4.5	(1.7)	4.5	(1.4)

Source: Company , LKP Research

Bhagyam to touch 40 kbpd by Mar 2012

Cairn India has started production from Bhagyam field on Jan 19, subsequent to receipt of Govt. approval for the same. Further work on the development of the Bhagyam field is ongoing. A total of 62 development wells have been drilled. Well results from the Bhagyam development drilling have been as per expectations. The reservoir and facilities will require some time for gradual and safe ramp up to reach the currently approved plateau of 40 kbpd. The company expects to receive approval soon for increasing output from Mangala to 150 kbpd. 148 development wells have been drilled in Mangala, of which 85 are currently producing and 30 injector wells are injecting water into the reservoirs. The company has retained its guidance of FY12 production exit rate of 175 kbpd.

Expansion of MPT facilities underway

The company is expanding its production facilities at the MPT to achieve processing capacity beyond the current level of 175 kbpd by end-2012. The current facility can handle higher volumes in line with the basin potential through incremental investments and augmentation of facilities, subject to JV & GoI approval. Further investments have been planned to augment processing capacity and pipeline infrastructure to deliver the envisaged basin potential. The management has guided for flat production of 175 kbpd (+/- 5-8%) for CY12.

Update on other exploratory activities

Mangala EOR: The first phase of the EOR pilot in the Mangala field, consisting of four injectors, one producer and three observation wells have been drilled, completed and hooked up to the facilities. After completion of baseline water flood for more than six months, polymer injection started in Aug 2011. Preparation for the commencement of the ASP phase is currently underway. The results to date are encouraging and based on these results, FDP for a full field application of polymer flood in the Mangala field is under preparation and is expected to be submitted by H1 CY12. This will be the start of the process for monetizing the full EOR potential of the block.

Ravva & Cambay: Recent infill drilling and workover campaigns have helped slow down the rate of production decline from the Ravva field. A 4D seismic survey was carried out previously to help identify bypassed oil zones in the reservoir along with prospects in the deeper zones. Interpretation of the seismic data is currently in progress. The spare gas processing capacity of the CB/OS-2 facilities is planned to be utilized by tolling and processing ONGC's gas from its North Tapti field (adjacent to the Cambay field). ONGC has completed the North Tapti pipeline tie-in with the CB/OS-2 facilities. An infill drilling campaign is planned in the Cambay field to sustain production.

SL 2007-01-001: Cairn Lanka has successfully completed the first phase of the exploration campaign in Sri Lanka Block SL-2007- 01-001. The exploration programme involved the acquisition, processing and interpretation of 1,753 sq km of 3D seismic data and the drilling of three well deep water wells. This resulted in two successive gas and condensate discoveries: the CLPL-Dorado- 91H/1z well and, the CLPL-Barracuda-1G/1 well. The third well, CLPL-Dorado North 1- 82K/1 was plugged and abandoned as a dry hole on Dec 14, 2011. Following this success, Cairn Lanka has notified the government of Sri Lanka of its intention to enter the second phase of exploration.

Other blocks: In the KG-ONN-2003/1 block, an exploration well, Nagayalanka SE-1, is being drilled to test and appraise the Nagayalanka Discovery. Cairn India has decided to sell off its stake in the KG-DWN-98/2 block to its JV partner ONGC and focus on other areas of strategic interest elsewhere in its portfolio. 3D seismic data processing and interpretation has been completed in the KK-DWN-2004/1 block.

Outlook

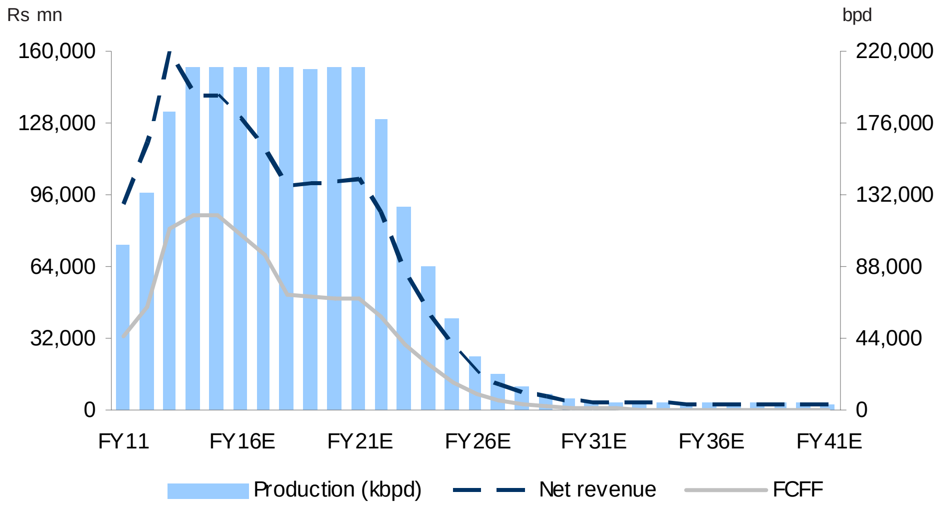
The receipt of approval for production start from Bhagyam marks a return to constructive engagement between Cairn India, ONGC and the Govt. on the issues of ramping up production and realizing the full potential of the Barmer basin. We expect long pending approvals for higher peak production levels from the MBA fields to be given in a timely manner going ahead. We expect output from Rajasthan to reach the targeted level of 175 kbpd by end-FY12 and stay at these levels till end-2012. We expect production of 210 kbpd from the MBA fields from Jan 2013 onwards.

Valuation

As production from Rajasthan improves going forward, so would the profit sharing with the Govt., resulting in a higher portion of the operating cash flow being unavailable for the company. As the block is expected to produce at its peak level from FY14E-21E, revenues would be stagnant whereas profit shared with the Govt. would keep on increasing resulting in a lower topline y-o-y from FY14E onwards. On the other hand, operating costs would go up as opex/bbl for crude produced from EOR reserves is expected to be around $ 7/bbl as against $ 2.5/bbl currently. Hence, we expect the company to report its peak earnings in FY13E, and report lower earnings y-o-y going forward resulting in a series of lower cash flows going forward.

With the stock rallying over the previous 3 months, our previous price target of Rs 334 has been achieved. We introduce our FY14 estimates and roll forward our price target from Mar 2012 to Mar 2013. As a consequence of falling cash flows from FY14E onwards, our price target drops to Rs 318 and we rate the stock as UNDERPERFORMER.

Cash flows tapering post FY13E



Source: Company , LKP Research

Financial Summary

Income statement

YE Mar (₹mn)	FY11	FY12E	FY13E	FY14E
Revenue	**102,779**	**122,419**	**166,876**	**146,259**
Variation in stocks	(264)	(612)	(834)	(731)
Operating exp.	**15,170**	**21,046**	**27,902**	**28,053**
Staff expenses	1,105	1,215	1,337	1,470
Other Exp	1,511	1,662	1,828	2,011
Operating Profit	**85,257**	**99,108**	**136,643**	**115,456**
Operating Margin(%)	*83.0*	*81.0*	*81.9*	*78.9*
Other Income	149	3,259	5,211	8,319
DDA	13,596	17,759	24,440	25,486
EBIT	**71,809**	**84,607**	**117,414**	**98,289**
EBIT Margin(%)	*69.9*	*69.1*	*70.4*	*67.2*
Interest	2,909	3,112	2,444	1,650
PBT	**10,163**	**81,495**	**114,970**	**96,639**
PBT Margin(%)	*9.9*	*66.6*	*68.9*	*66.1*
Tax	5,556	8,964	12,647	10,630
PAT	**4,608**	**72,531**	**102,324**	**86,009**
PAT Margin(%)	*4.5*	*59.2*	*61.3*	*58.8*

Balance sheet

YE Mar (₹mn)	FY11	FY12E	FY13E	FY14E
SOURCES OF FUNDS				
Equity Share Capital	19,019	19,019	19,019	19,019
Stock options	555	555	555	555
Reserves & Surplus	383,913	456,444	558,767	644,776
Total Networth	402,932	475,463	577,787	663,795
Total debt	26,782	26,500	13,000	7,500
Deferred tax liability	5,612	5,612	5,612	5,612
Total Liabilities	**435,326**	**507,575**	**596,398**	**676,907**
APPLICATION OF FUNDS				
Net Fixed Assets	80,085	106,126	126,936	111,950
Pre Producing prop.	39,819	54,069	63,569	72,819
Goodwill	253,193	253,193	253,193	253,193
Investments	10,944	10,944	10,944	10,944
Current Assets				
Cash and Bank	45,194	77,727	129,530	218,580
Inventories	3,277	3,354	4,572	4,007
Sundry Debtors	14,829	13,416	18,288	16,028
Loan, Adv & others	16,308	16,808	17,308	17,808
Current Liab & Prov				
Current liabilities	12,638	11,434	11,313	11,795
Provisions	16,628	16,628	16,628	16,628
Net Current Assets	**50,343**	**83,243**	**141,756**	**228,001**
Misc. Expenses	943	-	-	-
Total Assets	**435,326**	**507,575**	**596,398**	**676,907**

Key Ratios

YE Mar (mn)	FY11	FY12E	FY13E	FY14E
Per Share Data (₹)				
EPS	33.3	38.1	53.8	45.2
CEPS	39.6	46.7	65.7	57.6
BVPS	201.9	240.0	293.8	339.0
Cash per share	23.8	40.9	68.1	114.9
Growth Ratios(%)				
Revenue	533.3	19.1	36.3	(12.4)
EBITDA	763.5	16.2	37.9	(15.5)
PAT	502.6	14.5	41.1	(15.9)
Cash PAT	525.8	18.0	40.8	(12.4)
Valuation Ratios (X)				
P/E	10.6	9.2	6.5	7.8
P/CEPS	8.9	7.5	5.4	6.1
P/BV	1.7	1.4	1.2	1.0
EV/Sales	6.2	5.0	3.2	3.1
EV/EBITDA	7.5	5.9	3.8	3.6
Turnover Ratios (Days)				
Recievable Days	31.8	40.0	40.0	40.0
Inventory Days	11.0	10.0	10.0	10.0
Profitability Ratios (%)				
ROCE	17.7	17.9	21.3	15.4
ROE	17.1	16.5	19.4	13.9

Source: Company , LKP Research

Cash Flow

YE Mar (₹mn)	FY11	FY12E	FY13E	FY14E
Consolidated PAT	4,608	72,531	102,324	86,009
Depreciation/Depletion	11,930	16,259	22,690	23,486
Interest	2,909	3,112	2,444	1,650
Chng in working capital	5,538	368	6,710	(2,806)
Other operating activities	(216)	(943)	0	0
CF from operations (a)	**11,216**	**89,364**	**118,303**	**112,300**
Capital expenditure	33,935	56,550	53,000	17,750
Chng in investments	(6,180)	0	0	0
CF from investing (b)	**(27,755)**	**(56,550)**	**(53,000)**	**(17,750)**
Free cash flow	**(19,810)**	**35,926**	**67,747**	**96,200**
Equity raised/(repaid)	49	0	0	0
Inc/dec in borrowings	(7,225)	(282)	(13,500)	(5,500)
Dividend paid (incl. tax)	0	0	0	0
Adj in R&S	856	0	0	0
CF from financing (c)	**(6,320)**	**(282)**	**(13,500)**	**(5,500)**
Net chng in cash (a+b+c)	**(22,859)**	**32,532**	**51,803**	**89,050**
Closing cash & cash equiv	**45,194**	**77,727**	**129,530**	**218,580**

Team LKP

Pratik Doshi	Director	-	98210 47676		pratik_doshi@lkpsec.com
S. Ranganathan	Head of Research	Pharmaceuticals , Agriculture	98212 22510	6635 1270	s_ranganathan@lkpsec.com
Ashwin Patil	Research Analyst	Automobiles & Telecom	98195 78395	6635 1271	ashwin_patil@lkpsec.com
Deepak Darisi	Research Analyst	Energy	99301 44866	6635 1220	deepak_darisi@lkpsec.com
Hardik Mehta	Sales	-	98190 66569	6635 1246	hardik_mehta@lkpsec.com
Varsha Jhaveri	Sales	-	93241 47566	6635 1296	varsha_jhaveri@lkpsec.com
Hitesh Doshi	Sales	-	93222 45130	6635 1281	hitesh_doshi72@lkpsec.com
Gurdarshan Singh	Dealing	-	93228 61461	6635 1246	gurdarshan_singh@lkpsec.com
Bharat Shah	Dealing	-	98337 97256	6635 1210	bharat_shah@lkpsec.com