



# Parsoli Corporation Limited

In Touch with Your Investment Needs

Indian Equities  
Oil & Gas

Initiating Coverage

**Oil India Limited**

**BUY**

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<b>CMP</b>	<b>Rs 1,134</b>
<b>Target Price</b>	<b>Rs 1,375</b>
Sensex	16,994
Nifty	4,089

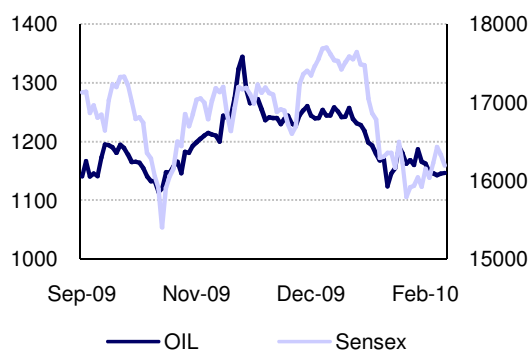
### Stock Details

BSE Code	533106
NSE Code	OIL
Reuters Code	OILI.BO
Bloomberg Code	OINL IN
Market Cap (Rs Cr)	27,274.24
Beta	0.45
52 W High / Low (Rs)	1374.80/1019.00
Avg Daily Volume	1,64,568
Face Value (Rs)	10

### Shareholding Pattern (%)

Promoters	78.43
MF/Banks/Indian FIs	2.90
FII / NRIs / OCBs	3.24
Non-Institutions	11.97
Indian Public	3.46

### Price Chart



### Investment Rationale

**Good operational track record:** As of 31<sup>st</sup> March 2009, Oil India Limited (OIL) has proved plus probable (2P) hydrocarbon reserves of 974.2mn barrels of oil equivalent (boe) which is nearly 1/10th the size of ONGC. However, the proportion of crude oil reserve for OIL is 60% of its total reserves which is higher than ONGC's 53%. Moreover, the lifting costs of crude oil is at US\$ 1.1/barrel and the success rate was 63.9%, much higher in the exploration industry and is expected to increase to 70-80% once the international exploration activities start.

**Aggressive capex plan:** The company has aggressive capex plan of Rs 110.8bn over next three years, which would be utilized to enhance the crude oil and natural gas production. OIL plans to deploy the capex mainly to explore and develop its domestic acreage and expand exploration activities in its international assets. The company plans to increase exploration activities in Libya, Nigeria, Yemen and other countries.

### Outlook and Valuation

At the current market price of Rs 1,134, OIL is trading at P/E of 10.0x FY2010E and 8.6x FY2011E earnings, P/BV of 2.4x FY2010E and 2.0x FY2011E earnings. The company's EV/barrel stands at US\$ 4.6/barrel which is again at a discount to industry average of US\$ 7.5/barrel. Compared with ONGC's EV/barrel of US\$ 5.4/barrel, the stock is trading at a discount of 14.6%. We believe an upward revision in APM gas price, clarity on the subsidy sharing mechanism, and the acquisition of overseas producing assets would be key triggers to the company's growth in the medium to long term. **We recommend a BUY on this stock with a 12-month target price of Rs 1,375.**

### Exhibit 1: Financial Summary

Particulars	FY2008	FY2009	FY2010E	FY2011E	FY2012E
Net Sales (Rs cr)	6,081.9	7,241.5	8,690.4	10,134.1	11,952.5
Total Income (Rs cr)	6,817.5	8,124.9	9,574.6	11,166.7	13,172.0
PAT (Rs cr)	1,788.9	2,161.7	2,723.2	3,187.6	3,755.8
PAT Margin (%)	29.4	29.9	31.3	31.5	31.4
EBIDTA Margin (%)	38.3	39.9	42.3	41.9	41.6
EPS (Rs)	74.4	89.9	113.3	132.6	156.2
P/E (x)	15.2	12.6	10.0	8.6	7.3
P/BV (x)	3.4	2.9	2.4	2.0	1.7
RoE (%)	22.6	23.2	24.3	23.7	23.1
RoCE (%)	22.5	24.4	26.3	25.9	25.5
EV/EBIDTA (x)	10.0	7.4	6.0	5.2	4.1
EV/Sales	3.8	2.9	2.5	2.2	1.7

Source: Company, Parsoli Research



**OIL has 2P hydrocarbon reserves of 974.2mn barrels of oil equivalent, in which crude oil comprises 575.4mn barrel and natural gas is 63.41bcm**

**The company has recorded a success ratio of 63.6% in exploratory wells drilling as compared with ONGC's ~36%**

**Over the next three years, the company has aggressive capex plan of Rs 110.8bn**

**Investment Drivers**

**Focus on new discoveries**

In last 2 years, the company has made 11 small to medium size discoveries with an estimated 2P reserve of nearly 30mn barrels of oil and oil equivalent gas. In addition to this, there were two major discoveries with estimated 2P reserves of over 30mn barrels of oil and oil equivalent gas. As of 31<sup>st</sup> March 2009, OIL has 2P hydrocarbon reserves of 974.2mn barrels of oil equivalent (mmbœ), in which crude oil comprises 575.4mn barrel and natural gas is 63.41bcm.

**Exhibit 2: 2P Hydrocarbon Reserves**

Particulars	FY2007	FY2008	FY2009	% CAGR
Crude Oil (mn barrels)	539.7	587.8	575.4	3.3
Natural Gas (bcm)	46.0	54.9	63.4	17.4

Source: Company, Parsoli Research

On the back of OIL's healthy reserve replacement ratio of more than 2.0x, the crude oil 2P reserves grew at a CAGR of 3.3% and natural gas at 17.4% during FY2007-09. In order to control the decline in crude oil production from its aged fields, the company is aggressively focusing on exploring new prospects in both the productive and new fields. The use of advance recovery techniques like artificial lifting, enhanced oil recovery (EOR) and horizontal drilling has improved the crude oil production and has also yielded high exploratory success rate in past few years.

**High exploration success rate and operational efficiency**

On the operational front, OIL's performance is better when compared with its public sector undertaking (PSU) peers. The company has recorded a success ratio of 63.6% in exploratory wells drilling as compared with ONGC's approximately 36% and the global benchmark of 30-35%. Further, OIL's cost of finding crude oil is nearly US\$ 1.1/barrel which is lower than half the finding cost of ONGC at US\$ 2.6/barrel. On the back of high exploratory success, the reserve replacement ratio for FY2009 was 1.1 while average for the past 2-3 years remained above 2.0 which is better than compared to ONGC. For FY2009, reserve replacement ratio for crude oil was 0.6 while the ratio remained above 1.0 over past 2-3 years. The reserve replacement ratio for natural gas was much strong at 1.9 for FY2009. Hence, we expect that the higher exploratory success rate and reserve replacement ratio would boost the company's E&P activities.

**Aggressive investment plans**

OIL has primarily focused on Northeast Indian onshore blocks and is now gradually expanding to domestic offshore through bidding for NELP blocks as well as by acquiring overseas assets. Since last 12 years, the company has acquired interests in 38 blocks in India and 9 overseas. Over the next three years, the company has aggressive capex plan of Rs 110.8bn which would be utilized to enhance the crude oil and natural gas production as well as reserves. OIL plans to deploy the capex mainly to explore and develop its domestic acreage and expand exploration activities in its international assets.



***OIL plans to invest in Baghjan and Barekuri fields where crude production is set to rise to approximately 1.0MT in FY2012 from the current 0.3MT***

The capex would be used to further increase production in its existing fields and bring in new fields to production by investing nearly Rs 17bn. Some major domestic fields in which investments are to be made are Baghjan and Barekuri fields where crude production is set to rise to approximately 1.0MT in FY2012 from the current 0.3MT. The company also has plans to increase exploration activities in Libya, Nigeria, Yemen and other countries. The exploratory activities in these regions are at different stages of execution, offering upside potential to reserves.

<b>Exhibit 3: Capex Plan</b>				<b>Rs cr</b>
<b>Particulars</b>	<b>FY2010E</b>	<b>FY2011E</b>	<b>FY2012E</b>	<b>Total</b>
Exploration & Appraisal activities	1300.2	1527.8	1912.0	4740.0
Development Activities	492.9	552.7	988.8	2034.4
Capital Equipments & Facilities	417.0	269.3	342.3	1028.6
Overseas Projects	250.4	190.3	387.8	828.5
Acquisition & Diversification	167.3	2256.3	27.0	2450.6
<b>Total</b>	<b>2627.8</b>	<b>4796.4</b>	<b>3657.9</b>	<b>11082.1</b>

*Source: Company, Parsoli Research*

As of 31<sup>st</sup> March 2009, OIL had about Rs 65.6bn cash and investments on its books of accounts. The company's cash position has further strengthened by an additional cash of nearly Rs 27.8bn raised through the recent IPO. Hence, we believe that the company is well positioned to fund its capex plans for the next 2-3 years. Moreover, OIL is almost a zero debt company; hence it has scope for leveraging if required.

#### **Lower subsidy payout due to change in policy**

The under-recoveries of oil marketing companies (OMCs) are shared by oil exploration companies like ONGC, OIL and GAIL in the form of discount given on the sale of crude oil. For these companies, their share of under recoveries is calculated on the basis of relative prior-year profits. Earlier, this share of under-recoveries remained unpredictable because of no proper subsidy sharing mechanism. However, the petroleum ministry recently issued a directive wherein it is stated that these upstream oil exploration companies would only share the under recoveries on the auto fuels and not on LPG and kerosene. Due to this, the total burden on upstream companies was only to the tune of Rs 4476.9cr in Q3FY2010 than compared to Rs 6271.6cr in Q3FY2009. Out of which, 11.7% was only borne by OIL. Hence, going forward, we believe the conscious effort by the government to lower the subsidy burden of the upstream companies will lead to better operational and financial performance.

***According to recent government policy, upstream companies will only share under-recoveries on auto fuel which would improve the company's financial performance***

**The economy and the industrial production of any nation depend heavily on the sufficient supply of oil**

**The consumption of liquid fuel is expected to increase from 85.3mn barrels per day (mb/d) in 2006 to 106.6mb/d in 2030**

**IEA expects world liquid fuel production in 2030 to increase by 22.0mb/d from 85.5mb/d in 2006**

### Industry Overview

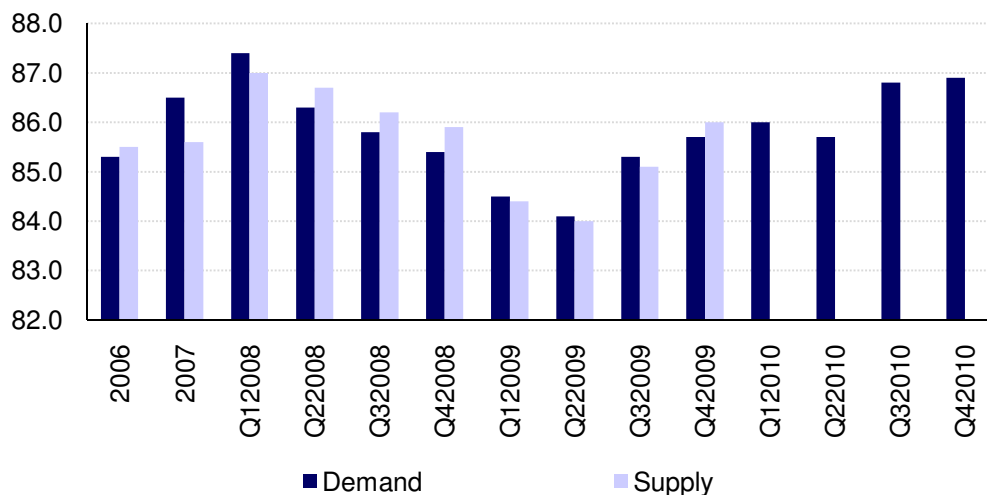
#### Global scenario

Crude oil is the most important energy source in a global perspective. About 36% of the world's primary energy consumption is supplied by oil, followed by coal with 25% and natural gas with 21%. Transport relies over 90% on oil, be it transport on roads, by ships or by aircrafts. Therefore, the economy and the industrial production of any nation depend heavily on the sufficient supply of oil, and moreover, probably also on the cheap supply of oil. Hence, the rising demand for oil, declining reserves and ageing oil fields along with supply disruptions since the last few years have forced economies around the world to increase the focus on E&P.

**Demand-Supply Outlook:** Global economic downturn has affected the demand scenario of fuel but still the demand of fuel is likely to grow steady in long run. IEA expects the consumption of liquid fuel to increase from 85.3mn barrels per day (mb/d) in 2006 to 106.6mb/d in 2030. More than 80% of the increase in total liquid fuel consumption is projected for the nations of non-Organization for Economic Co-operation and Development (OECD) Asia and the Middle East, where strong economic growth is expected in near future.

IEA expects world liquid fuel production in 2030 to increase by 22.0mb/d from 85.5mb/d in 2006. Increases in production are expected for both OPEC and non-OPEC producers; however, 59% of the total increase is expected to come from non-OPEC areas. High oil prices, improvements in exploration and extraction technologies, emphasis on recovery efficiency, and the emergence and continued growth of unconventional resource production are the primary factors leading to the growth of non-OPEC liquid fuel production. However, OPEC producers are expected to maintain their market share of world liquid fuel supply and would invest in incremental production capacity to maintain an approximate 40% share of total global liquids production through 2030.

**Exhibit 4: Crude oil demand-supply trend** mb/d



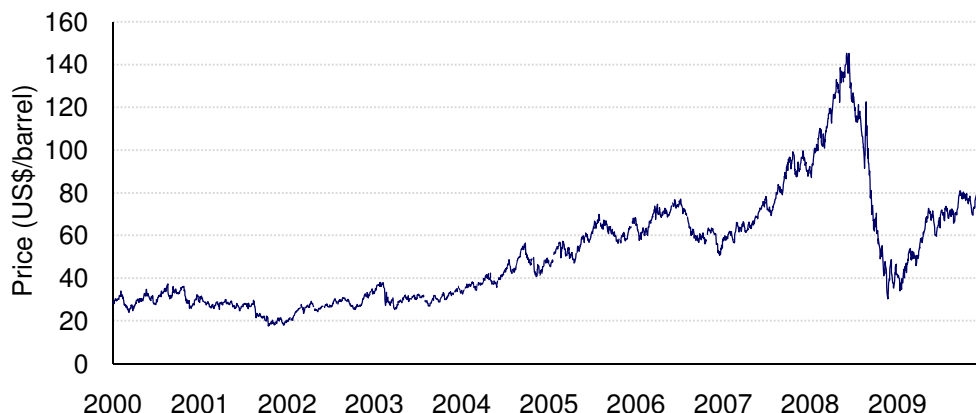
Source: International Energy Agency (EIA), Parsoli Research

**Crude Oil Price Outlook:** Demand-supply scenario, costs of E&P, and other factors like weather conditions, geo-political tensions, US dollar rate and speculative trading are some of the key factors to affect crude oil prices.



The upswing in crude oil prices during year 2008 was primarily due to speculative trading in commodity markets and weakening of US dollar with respect to other currencies

Exhibit 5: Crude Oil Price Trend



Source: Energy Information Administration (EIA), Parsoli Research

The upswing in crude oil prices during year 2008 was primarily due to speculative trading in commodity markets and weakening of US dollar with respect to other currencies. Presently, crude prices are already towards the northward and we expect an average crude price of US\$ 72/barrel in FY2010 which would rise to US\$ 85/barrel in FY2011.

The spending towards the upstream in 2009 was down by 15.0% as the oil demand decreased to 84.9mb/d from 86.5mb/d due to economic slowdown

**Global E&P Scenario:** The demand-supply mismatch, declining reserves and geopolitical instability are main drivers towards the discovery of new oil supplies for the more demanding areas like India and China. Oil demand has increased at a CAGR of 1.5% from 69.5mb/d to 86.3mb/d in period between 1995 and 2010. Continuous increase in prices since last few years has pulled in investments in E&P division so as to ensure energy security. Since 2000, the investment in E&P division has doubled to nearly US\$ 400bn. The spending towards the upstream in 2009 was down by 15.0% as the oil demand decreased to 84.9mb/d from 86.5mb/d due to economic slowdown. Prior to late 2008, upstream costs had been on an upward trajectory for much of the decade. The upstream spending is expected to rise again by 11.1% to US\$ 439bn from US\$ 395, globally in 2010. National Oil Companies (NOCs) plan to hike their upstream investments by nearly 15.0% in 2010 whereas, International Oil Companies (IOCs) will only spend 1.0% more due to limited access to major new sources of reserves.

**Indian Scenario**

The Indian oil and gas industry traced its beginnings to the initial discoveries of crude oil in October 1889 in Digboi, Assam. The Government of India (GoI) made accelerated development into the sector after independence. Almost all aspects of this industry were highly regulated, including investment, exploration, production, distribution and pricing of all petroleum products sold in the market. In February 1974, ONGC discovered the large Mumbai High offshore oil. In the 1990s, as India's dependence on oil imports increased, the GoI embarked on a series of reforms aimed at reducing India's dependence on imports, deregulating the industry, improving efficiency and encouraging private and foreign investment. In accordance with the liberalization process and in order to introduce new technology for increasing oil production, the GoI offered 69 small and medium-sized oil and gas fields, both onshore and offshore, to the private sector in 1992 and 1993. The New Exploration Licensing Policy (NELP) was launched in the year 1997 by the GoI for accelerating oil and gas exploration in the country. Till now, eight NELP rounds have been over and 207 explorations have been awarded.

NELP was launched in the year 1997 by the GoI for accelerating oil and gas exploration in the country



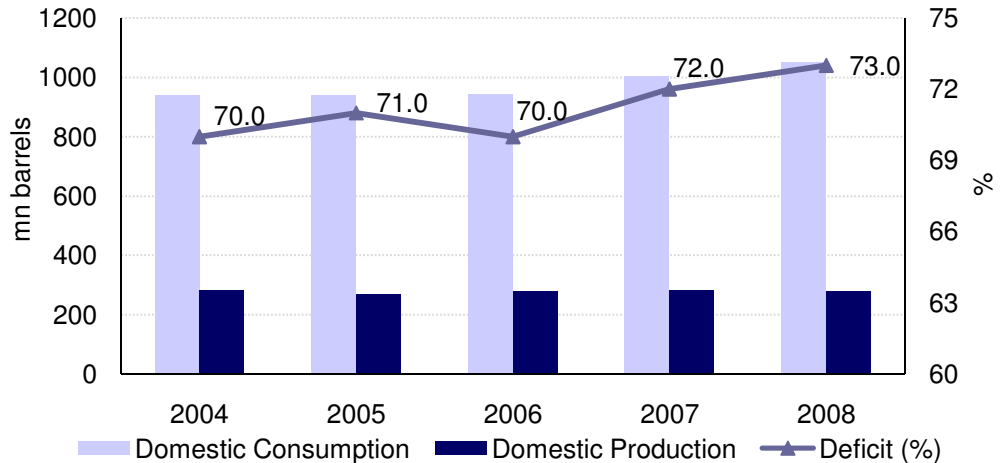
## Oil India

**BUY**

**The domestic demand for crude oil is expected to increase to 1,393mn barrels per year by 2012**

**Domestic Demand-Supply Outlook:** On account of significant growth in India's economy, the consumption of energy has increased. The consumption of petroleum product has increased at a CAGR of 4.4% to 133.4 million metric tons (mmt) from 107.7mmt during FY2004-09 whereas the production not grown at the same pace. India's domestic crude oil reserves have also declined since last 5-years, from 5,431.53mn barrels to 5,314.25mn barrels in FY2008. It is estimated that the domestic demand for crude oil would increase to about 1,393mn barrels per year by 2012.

**Exhibit 6: Domestic demand-supply gap of crude oil**

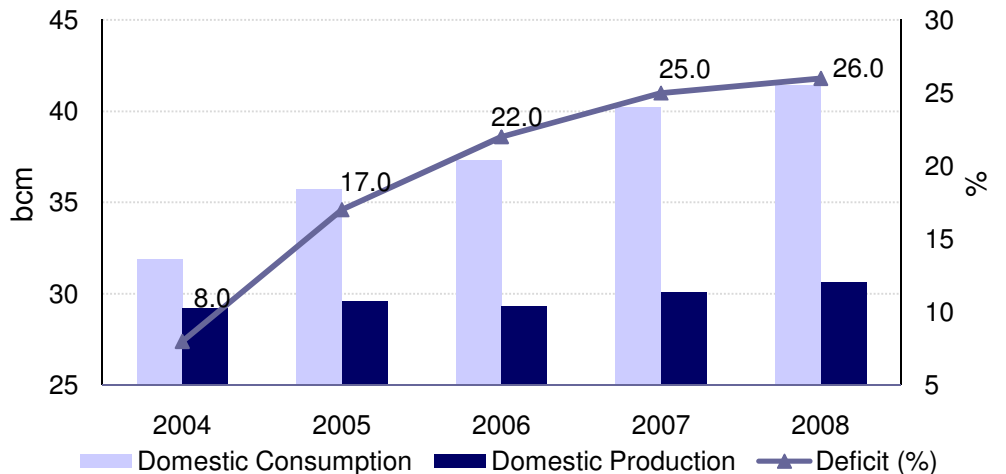


Source: BP Statistical Review of World Energy, Parsoli Research

**The consumption of natural gas has increased at a CAGR of 7.0% to 41.4bcm from 29.5bcm during 2003-08**

In terms of domestic natural gas, consumption has increased at a CAGR of 7.0% to 41.4 billion cubic meters (bcm) from 29.5bcm during 2003-08 whereas production increased at a much slower pace of 0.7% CAGR. But unlike crude oil reserves, domestic gas reserves have climbed over the last 5 years from 751bcm to 1,055bcm in 2008 and its demand is expected to reach 330 million standard cubic meters per day (mmscmd) by 2012, indicating 10.0% CARG during 2005-12. Also, the commencement of production of RIL's KG basin would surge the gas production.

**Exhibit 7: Domestic demand-supply gap of natural gas**

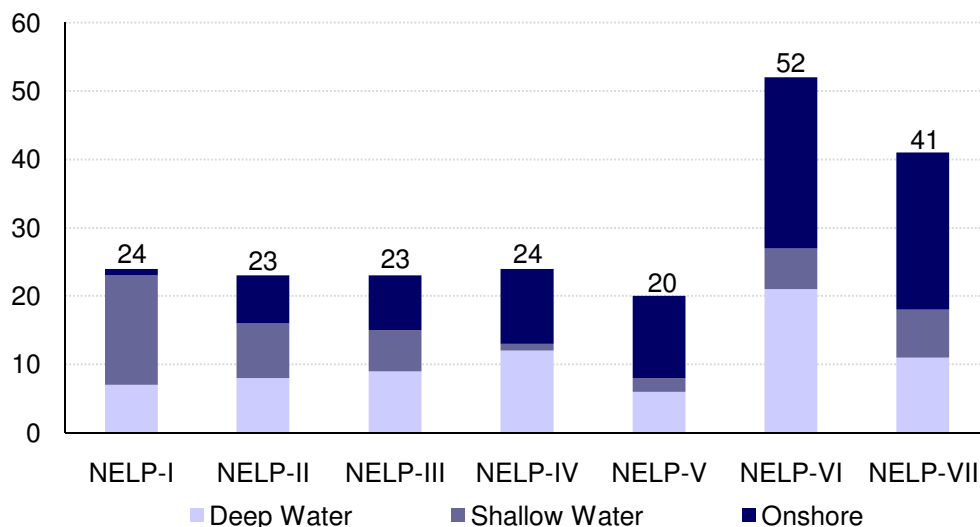


Source: BP Statistical Review of World Energy, Parsoli Research

**NELP has till now completed eight rounds and total 207 exploratory blocks has been awarded till NELP-VII**

**Indian E&P scenario:** As of April 1<sup>st</sup>, 2008, India's total hydrocarbon resources, including deep-water resources, are estimated at 205.9bn barrels of oil and oil equivalent gas, of which 67.9bn barrels of oil and oil equivalent gas is onshore and 137.9bn barrels of oil and oil equivalent gas is offshore. In order to enhance the energy security of the country and to reduce the dependence on import, government has increased its thrust on exploration, leading to substantial investments in this sector. The government launched, NELP has till now completed eight rounds and total 207 exploratory blocks has been awarded till NELP-VII. Almost 58.0% of the Indian sedimentary basins account for offshore fields.

**Exhibit 8: Number of Exploratory Blocks Awarded under NELP**



Source: Directorate General of Hydrocarbons (DGH), Parsoli Research

**In the last 8 years, India's national oil companies, private and joint venture companies have made 183 significant hydrocarbon discoveries, of which 60 are in NELP blocks**

In the last 8 years, India's national oil companies, private and joint venture companies have made 183 significant hydrocarbon discoveries, of which 60 are in NELP blocks. During FY2008, total 67 discoveries were made, of which 38 were by ONGC, 8 by OIL and 21 by private and JV companies. The government's strong focus towards exploration activities has significantly increased the quantum of explored acreages, however a significant number of large basin areas are still unexplored. Thus, India's E&P holds significant growth potential for companies into this industry.

**Exhibit 9: Exploration in sedimentary basins**

mn sq. km

Level of exploration in sedimentary basin areas	Area			
	1995-96	1998-99	2004-05	2007-08
Unexplored	1.6	1.3	0.7	0.5
Exploration Initiated	0.6	0.8	1.2	1.4
Poorly Explored	0.5	0.5	0.7	0.6
Moderate to Well Explored	0.5	0.5	0.6	0.7

Source: Directorate General of Hydrocarbons (DGH), Parsoli Research



***OIL is the second largest oil and gas company in India having produced 10.4% of India's crude oil and 6.9% of its natural gas in FY2009***

***OIL has made 11 small to medium size discoveries with estimated 2P reserves size of less than 30mmboe***

***As of 31st March, 2009, OIL's 2P reserves were nearly 575.4mn barrel of crude oil and 63.4bcm of natural gas***

### Company Overview

OIL, a state-owned oil exploration company, is the second largest oil and gas company in India in terms of total 2P oil and natural gas reserves. The company was incorporated as a private limited company in 1959. It is engaged in exploration & development (E&D), production and transportation of crude oil and natural gas onshore in India. The company has been accorded "Mini Ratna Category I" status since 1997 by the GoI for its operational efficiency and financial strength. In FY2009, the company produced 10.4% of India's total crude oil and 6.9% of its natural gas.

### Lines of Business

**Exhibit 10: OIL's business lines**



Source: Company, Parsoli Research

**Exploration and Development:** The company's oil and gas reserves are primarily located onshore in the Upper Assam Basin in the states of Assam and Arunachal Pradesh with some portion of the natural gas reserves in Rajasthan. It also has participating interest in NELP exploration blocks in Mahanadi Offshore and Krishna-Godavari deep water. In seven rounds of NELP, the company has been awarded 27 exploration blocks, four of which were subsequently relinquished. Under NELP VIII, OIL has provisionally been awarded 9 blocks. OIL is carrying out exploration activities across 33 blocks in India. As of 31<sup>st</sup> March, 2009, OIL's 2P reserves were nearly 575.4mn barrel of crude oil and 63.4bcm of natural gas. Since FY2007, OIL has made 11 small to medium size discoveries with estimated 2P reserves size of less than 30mmboe.

**Exhibit 11: Crude Oil Domestic Reserves**

**mn barrel**

Particulars	Proved (1P)			Proved & Probable (2P)			Proved, Probable & Possible (3P)		
	FY2009	FY2008	FY2007	FY2009	FY2008	FY2007	FY2009	FY2008	FY2007
<b>Independent</b>									
Upper Assam Basin	279.8	293.0	277.9	570.3	582.5	534.4	993.5	1,031.0	994.5
Digboi Field	5.1	0.6	5.2	5.1	0.6	5.2	5.1	0.6	5.2
<b>Total</b>	<b>284.9</b>	<b>293.6</b>	<b>283.1</b>	<b>575.4</b>	<b>583.1</b>	<b>539.6</b>	<b>998.6</b>	<b>1,031.6</b>	<b>999.7</b>
<b>PSC</b>									
Kharsang Field	-	2.0	-	-	4.6	-	-	7.7	-
<b>Total Reserves</b>	<b>284.9</b>	<b>295.6</b>	<b>283.1</b>	<b>575.4</b>	<b>587.7</b>	<b>539.6</b>	<b>998.6</b>	<b>1,039.3</b>	<b>999.7</b>

Source: Company, Parsoli Research

**Exhibit 12: Natural Gas Domestic Reserves**

**bcm**

Particulars	Proved (1P)			Proved & Probable (2P)			Proved, Probable & Possible (3P)		
	FY2009	FY2008	FY2007	FY2009	FY2008	FY2007	FY2009	FY2008	FY2007
<b>Independent</b>									
Upper Assam Basin	36.9	35.3	26.6	59.4	52.4	43.2	79.7	69.8	69.4
Digboi Field	-	-	0.3	-	-	0.3	-	-	0.3
<b>Rajasthan</b>	<b>2.2</b>	<b>1.8</b>	<b>1.8</b>	<b>4.0</b>	<b>2.5</b>	<b>2.5</b>	<b>6.7</b>	<b>5.2</b>	<b>5.2</b>
<b>Total Reserves</b>	<b>39.1</b>	<b>37.1</b>	<b>28.7</b>	<b>63.4</b>	<b>54.9</b>	<b>46.0</b>	<b>86.4</b>	<b>75.0</b>	<b>74.9</b>

Source: Company, Parsoli Research



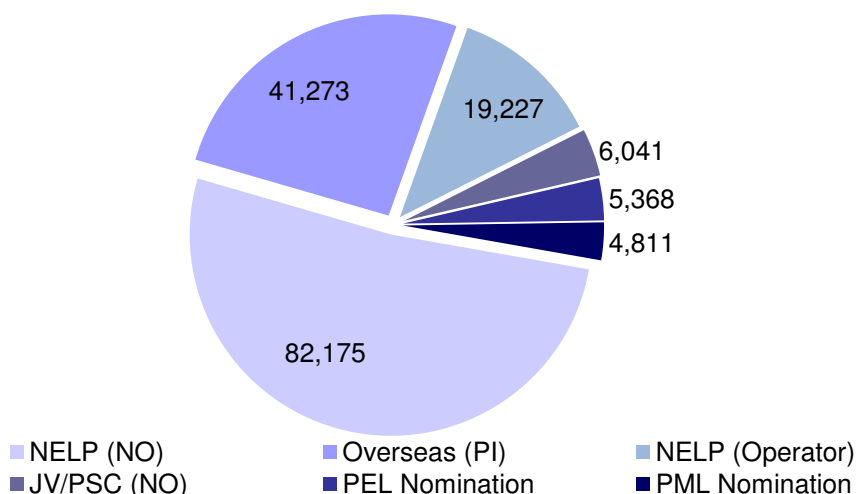
## Oil India

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The company has total acreage of 1,58,895 sq.km, of which domestic acreage is 1,17,622 sq.km and international is 41,273 sq.km

The company also has international presence in countries including Egypt, Gabon, Iran, Libya, Nigeria, Timor Leste and Yemen. It has participating interest in 17 overseas blocks. However, none of the international fields are operational as of now. In early November, 2009, the company had started drilling its first exploratory well overseas in Libya. The company has total acreage of 1,58,895 sq.km, of which domestic acreage is 1,17,622 sq.km and international is 41,273 sq.km.

**Exhibit 13: Summary of acreage** sq. km



Source: Company, Parsoli Research

OIL has 424 wells in production in its independent blocks, comprising of 377 for production of crude oil and 47 for natural gas

**Oil and Gas Production:** OIL has 424 wells in production in its independent blocks, comprising of 377 for production of crude oil and 47 for natural gas. As of 31<sup>st</sup> March, 2009, it has produced 24.9mn barrel of crude oil and 2.3bcm of natural gas. The natural gas production from Kharsang field is utilised from the company's internal consumption.

**Exhibit 14: Crude Oil Production** mn barrels

Particulars	FY2009	FY2008	FY2007
<b>Independent Operation</b>			
Assam	24.50	21.91	21.99
Arunachal Pradesh	0.26	0.30	0.00
<b>Total</b>	<b>24.76</b>	<b>22.21</b>	<b>21.99</b>
<b>PSC</b>	<b>0.19</b>	<b>0.17</b>	<b>0.18</b>
<b>Total Oil Production</b>	<b>24.95</b>	<b>22.38</b>	<b>22.17</b>

Source: Company, Parsoli Research

The natural gas production from Kharsang field is utilised from the company's internal consumption

**Exhibit 15: Natural Gas Production** bcm

Particulars	FY2009	FY2008	FY2007
<b>Independent Operation</b>			
Assam	2.04	2.08	2.26
Arunachal Pradesh	0.02	0.02	0.00
Rajasthan	0.21	0.24	0.00
<b>Total Oil Production</b>	<b>2.27</b>	<b>2.34</b>	<b>2.26</b>

Source: Company, Parsoli Research



*The company also uses advance recovery techniques like artificial lifting, EOR and horizontal drilling which would improve the production*

*The company's owns and operates 1,157km cross country oil pipeline, 600km product pipeline and 192km pipeline to NRL*

*OIL has 26% equity stake in NRL, which is into refining and marketing of petroleum products and also holds 10% stake in BCPL and 23% stake in DNPL*

The company's independent production facilities include 40 installations for crude oil and 29 for natural gas. OIL has approximately 1,315km of internal oil pipelines grid and 571km grid of gas. During last three quarters of FY2010, OIL produced 19.6mmbob of crude oil. All of the independent producing oil and gas fields are located onshore in the Upper Assam basin and Arunachal Pradesh. Recently, OIL has commenced trial production of heavy oil from a well in Baghewala field in Rajasthan. In addition, OIL also has independent natural gas producing fields in the Jaisalmer basin of Rajasthan. Along with the independent operations, the company also has a participating interest in the Kharsang field in the Assam-Arakan basin. The company also uses advance recovery techniques like artificial lifting, enhanced oil recovery (EOR) and horizontal drilling which would improve the production simultaneously arresting the production decline.

**Pipeline and Transportation:** OIL owns and operates 1,157km cross-country crude oil pipeline as a common carrier, on behalf of itself the company, ONGC and Bongaigaon Refinery and Petrochemicals (BRPL). This pipeline has the capacity to transport over 44mn barrels annually. In FY2009, the company transported nearly 45mn barrels of crude oil to four public sector refineries in Digboi, Numaligarh, Guwahati and Bongaigaon. The company owns and operates 660km petroleum product pipeline connecting Numaligarh Refinery Ltd (NRL) to Siliguri in West Bengal with an estimated capacity of 2.1mn kiloliters of refined petroleum products. Along with, the company also holds 23% stake in proposed 192km pipeline of Duliajan-Numaligarh Pipeline Ltd (DNPL) to transport natural gas from Duliajan to Numaligarh. Extending the presence outside India, in pipeline business, the company constructed 741km pipeline construction project in Sudan in joint venture with OVL in 2005. OIL holds 10% equity stake in this pipeline.

**Downstream Investments:** OIL has interests in downstream activities through 26% equity stake in NRL, which is into refining and marketing of petroleum products. The company also holds 10% equity stake in Brahmaputra Cracker & Polymer Ltd (BCPL) and 23% equity stake in DNPL. It is expected that company's stake into these companies would extend natural gas supply to customers beyond the refinery's location in Numaligarh to Guwahati and would also facilitate city gas distribution projects in the future. OIL has also signed MoU with GAIL, IOCL and BPCL for city gas business.



*OIL has negligible debt with debt-equity ratio of 0.01 which is lowest among its peer*

*OIL has highest current ratio implying company being more capable of paying its obligation*

*OIL has lower lifting cost of crude with high success rate of 67.0% and net realization of US\$ 57.8*

**Relative Performance**

**Exhibit 16: Peer Comparison, 2009**

Particulars	Cairn India	Hind.Oil Explor.	ONGC	Oil India	Selan Explor.
Net Sales (Rs cr)	1432.7	85.2	63629.9	7241.5	99.9
EBIDTA Margin (%)	61.2	87.6	39.9	49.2	75.3
Current Ratio	2.6	1.3	1.8	2.7	1.4
Fixed Assets Ratio	0.1	0.4	0.7	1.1	6.4
Inventory Ratio	7.9	1.9	15.4	14.5	10.8
Debtors Ratio	8.0	4.9	15.2	17.9	9.4
Debt-Equity Ratio	0.1	0.1	0.2	0.0	0.3
Interest Cover Ratio	135.7	7.1	202.6	388.5	22.0
EPS (TTM)	4.4	2.9	71.1	93.6	12.6
P/E Ratio	61.6	85.8	15.4	12.1	34.7
NAV/share (Rs)	172.7	81.2	368.1	388.1	64.0
EV/EBIDTA	50.5	36.0	6.2	6.2	17.9

Source: Capitaline, Parsoli Research

Oil and gas industry is highly government regulated and capital intensive industry. PSUs are the predominant players. OIL has negligible debt with debt-equity ratio of 0.01 which is lowest among its peer. Also, its interest coverage ratio is highest. OIL has highest current ratio implying company being more capable of paying its obligation. At current market price of Rs 1,134, OIL is trading at the lowest P/E.

**Exhibit 17: Comparison with ONGC, FY2009**

Particulars	OIL	ONGC
Crude oil Production (mn barrel)	25.0	186.0
Gas Production (bcm)	2.3	22.5
Net realization (US\$/barrel)	57.8	47.7
Finding cost (US\$/boe)	1.1	2.6
Lifting cost (US\$/boe)	6.8	6.9
Success rate (%)	67.0	36.6
Reserve replacement ratio (%)	1.7	1.4
2P Oil reserves (mn barrels)	575.4	5079.0
2P Gas reserves (bcm)	63.4	630.0
Total 2P reserves (mn barrels)	974.2	9041.7
EV(cr)	21260.7	231138.3
EV/Barrel (US\$/barrel)	4.6	5.4

Source: Company, Parsoli Research

ONGC is a direct competitor to OIL. Compared to ONGC, OIL stands better as finding cost and lifting cost of crude oil for OIL is lower with high success rate of 67.0% and net realization of US\$ 57.8. Moreover, at CMP, OIL's EV/barrel stands at US\$ 4.6/barrel which is at 14.6% discount to that of ONGC.



## Quarterly Performance

Exhibit 18: Quarterly Analysis					Rs cr
Particulars	Q3FY2010	Q3FY2009	YoY (%)	Q2FY2010	QoQ (%)
Net Sales	2041.3	1393.5	46.5	2100.3	(2.8)
Other Income	222.8	202.3	10.1	278.2	(19.9)
Total Income	2264.1	1595.8	41.9	2378.4	(4.8)
Total Expenditure	978.4	864.6	13.2	1101.4	(11.2)
PBIDT	1063.0	528.9	101.0	998.9	6.4
Interest	0.8	2.3	(64.8)	1.0	(16.5)
Depreciation	175.4	223.8	(21.6)	143.1	22.6
Profit before Tax	1109.5	505.1	119.7	1133.0	(2.1)
Tax	392.2	-75.8	(617.7)	410.4	(4.4)
Profit After Tax	717.3	580.9	23.5	722.6	(0.7)

Source: Company, Parsoli Research

## Revenue surges 46.5% to Rs 2041.3cr

During the quarter, crude oil production increased 3.8% to 0.9mmt and natural gas production increased by 9.0% to 6.8mmscmd

In Q3FY2010, OIL reported a strong revenue growth of 46.5% yoy to Rs 2041.3cr. The growth in revenue was on back of increased production volume of crude oil and natural gas along with higher crude oil realizations. During the quarter, crude oil production increased 3.8% to 0.9mmt and natural gas production increased by 9.0% to 6.8mmscmd. The increase was mainly due to adoption of new technologies and by IOR/EOR methods. Furthermore, in Q3FY2010, the crude oil realization surged by 56.8% to US\$ 58.8/barrel, which boosted the revenue growth. During last nine months, drilling area has gone up by 32.8% to 1,07,328m than compared to same period last year, with OIL drilling 32 wells during the three quarters, against 24 wells drilled during the same period in FY2009.

## Exhibit 19: Performance Details

	Q3FY2010	Q3FY2009	% chg	Q2FY2010	% chg
<b>Production</b>					
Crude Oil (mmt)	0.91	0.88	3.8	0.90	0.9
Natural Gas (mmscmd)	6.80	6.24	9.0	6.54	4.0
<b>Realizations - Crude Oil (US\$/barrel)</b>					
Gross Oil Price	73.9	54.3	36.2	67.4	9.6
Subsidy sharing	15.1	16.8	(10.0)	10.5	44.6
<b>Net Realization</b>	<b>58.8</b>	<b>37.5</b>	<b>56.8</b>	<b>56.9</b>	<b>3.2</b>

Source: Company, Parsoli Research

## Higher realizations and lower subsidy sharing boosts OPM to 52.1%

This improved margin was on account of 56.8% higher crude oil realizations along with 10.9% lower subsidy sharing with OMCs

During Q3FY2010, operating margin of the company expanded to 52.1% from 38.0% in Q3FY2009. This improved margin was on account of 56.8% higher crude oil realizations along with 10.9% lower subsidy sharing with OMCs. For Q3FY2010, the gross crude oil realization stood at US\$ 73.9/barrel which is 36.2% higher than



**The subsidy burden of the company jumped by 32.3% on qoq basis to Rs 467.6cr from 353.5cr in Q2FY2010 due to higher crude oil price during the quarter**

compared to corresponding quarter last year and 9.6% higher than compared to Q2FY2010. After subsidy sharing with OMCs, the net realization of the company stood at 56.8% higher compared to Q3FY2009. Although, due to higher crude oil price throughout the quarter, the subsidy burden of the company jumped by 32.3% on qoq basis to Rs 467.6cr from 353.5cr in Q2FY2010 but on yoy basis, it declined by 10.9% from 524.8cr in Q3FY2009. Furthermore, the decrease in employee cost, statutory levies cost and other expense with respect to sales, surged operating profit by 101.0% to Rs 1063.0cr from Rs 528.9cr in Q3FY2009.

**Exhibit 20: Cost Analysis as per Sales (% of sales)**

	Q3FY2010	Q3FY2009	bps chg	Q2FY2010	bps chg
Raw Materials	1.4	1.0	41.6	2.3	(91.5)
Employee Cost	11.3	15.5	(422.0)	13.7	(238.6)
Statutory Levies	29.2	34.0	(472.7)	29.4	(18.2)
Other Expenses	6.1	10.0	(392.7)	6.2	(10.0)
Total Expenditure	47.9	62.0	(1411.5)	52.4	(451.2)

Source: Company, Parsoli Research

**Depreciation restricts PAT growth at 23.5%**

During Q3FY2010, the income from surplus fund increased other income by 10.1% yoy to Rs 222.8cr. The cost due to depreciation, depletion and write-offs in the quarter was 21.6% lower on yoy whereas on qoq basis, it increased by 22.6% to Rs 175.4cr, thus restricted the PAT growth at 23.5% yoy to Rs 717.3cr.

**The income from surplus fund increased other income by 10.1% yoy to Rs 222.8cr**



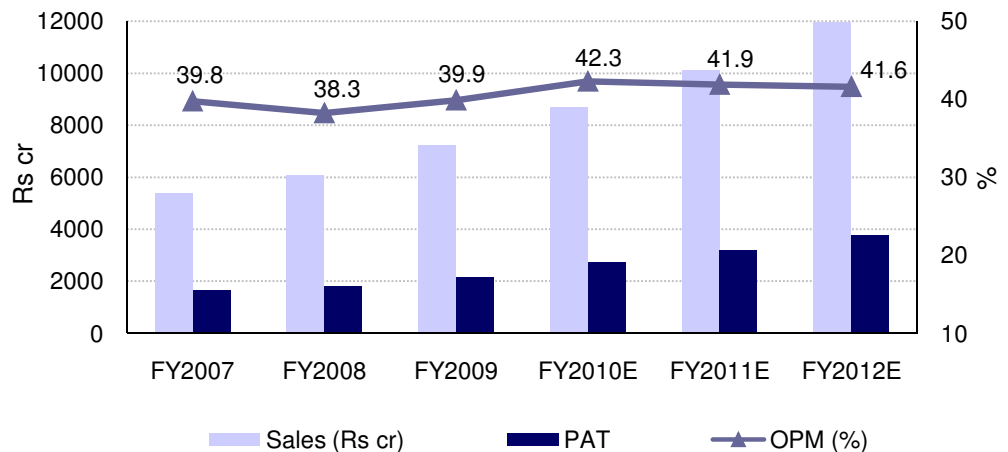
*We expect the company to register revenue growth at a CAGR of 18.2% and net profit growth of 20.2% during FY2009 and FY2012E*

### Financial Performance

#### Revenue expected to grow at a CAGR of 18.1% on higher realization

Considering OIL's aggressive capex plan into E&P activities and increased sales volume, we expect the company to register revenue growth at a CAGR of 18.2% and net profit growth of 20.2% during FY2009 and FY2012E. Also, we anticipate the operating profit of the company to grow despite subsidy sharing for under-recoveries of OMCs, supported by the expected volume growth and higher price realizations. The oil ministry has recently issued guidelines restricting the upstream subsidy burden only to auto fuel under-recoveries which previously included all under-recoveries on price-capped products such as petrol, diesel, kerosene and domestic LPG. Thus, this would boost the crude oil price realization.

**Exhibit 21: Sales, Net Profit and PAT Margin**



Source: Company, Parsoli Research

**Exhibit 22: Subsidy sharing and Net Realizations**

Particulars	FY2007	FY2008	FY2009	Q1FY2010	Q2FY2010	Q3FY2010
Total subsidy (Rs cr)	1993.8	2305.1	3023.3	57.6	353.5	467.6
Gross Realized Price	66.7	85.5	83.9	57.5	67.4	73.9
Discount	19.3	25.1	26.1	1.8	10.5	15.1
<b>Net Realized Price</b>	<b>47.4</b>	<b>60.4</b>	<b>57.8</b>	<b>55.7</b>	<b>56.9</b>	<b>58.8</b>

Source: Company, Parsoli Research

#### Strong cash balance of Rs 60.7bn

*OIL has a strong balance sheet with net cash of Rs 60.7bn which would be used to fund the company's capex plan*

OIL has a strong balance sheet with net cash of Rs 60.7bn. Also, the company has recently raised nearly Rs 27.8bn through IPO which has further strengthened its cash position. Thus, this will support the company to fund its aggressive capex plan over next 2-3 years and.



***Significant surge in oil prices may affect the subsidy burden for OIL***

***The under-recoveries to be shared by upstream companies, both, individually or as a group remain unclear***

***OIL's assets concentration in a single region increases its exposure to any event that may adversely affect the development or production of oil and natural gas***

### **Key Concerns**

#### **Crude oil price volatility and fluctuation in exchange rate**

The recent volatility in crude oil prices was mainly on account of economic crisis, speculation in crude oil, OPEC regulation and war in oil producing countries. These factors may affect the sales and profit margins of oil producing companies. Hence, the decline in crude prices, internationally, may adversely affect the OIL's revenue. At the same time, a significant surge in oil prices may affect the subsidy burden for OIL which may consequently affect its profitability. Moreover, volatility in the exchange rate can also affect its earnings significantly.

#### **Uncertainty in subsidy sharing mechanism**

The exploration and development activities in India are regulated by the Ministry of Petroleum and Natural Gas (MoPNG). The under-recoveries of OMCs are shared between the government and upstream companies. The percentage of under-recoveries to be shared by upstream companies, both, individually or as a group remains unclear due to no subsidy sharing formula till date. For, FY2009, subsidy burden for OIL was Rs 30.2bn. With the government's decision to restrict the upstream subsidy burden only to auto fuels, the company's subsidy share for past nine months of FY2010 dropped to Rs 8.8bn. With rising crude oil prices, the under-recoveries would increase leading to rise in the share of auto fuel subsidy which would adversely impact OIL's profitability.

#### **Majority asset concentration in limited area**

As of March 2009, OIL's independent 2P oil reserves and nearly 93.66% of the estimated independent 2P gas reserves were concentrated in the Upper Assam basin in Assam and Arunachal Pradesh. Moreover, the company's downstream investment and business including 1,157km cross country oil pipeline, 600km product pipeline and 192km pipeline to NRL are also concentrated in this region. This concentration of assets in a single region increases OIL's exposure to events that could adversely affect the development or production of oil and natural gas. Moreover, there is always security risk in this region and any adverse event may lead to material loss to the business.



**Over the past five year, OIL had reported 17.3% jump in crude oil production and 18.0% jump in natural gas sales**

**We have valued OIL using relative and DCF valuation methodology**

**OIL's EV/barrel is US\$ 4.6/barrel which is 14.6% discount to ONGC**

### Outlook and Valuation

Over the past five years, OIL had reported 17.3% jump in crude oil production and 18.0% jump in natural gas sales. With the company's aggressive capex plan for the next three years, we expect the oil and gas production to improve further. Petroleum ministry's proposal of increasing APM gas prices by 40% would benefit the upstream companies and hence would boost the company's earnings. Despite, the subsidy sharing for auto fuel, we expect, OIL to register revenue growth at a CAGR of 18.2% and net profit growth of 20.2% during FY2009 and FY2012E.

We have valued OIL using relative and DCF valuation methodology. The relative valuation - P/E, P/BV and EV/EBITDA gives the earning capacity of the company with respect to its peers whereas the absolute valuation - DCF includes the future cash flow which is discounted to present value using the company's weighted average cost of capital (WACC) to give absolute value of the company. Averages of relative valuations and DCF show an upside of 21.2%.

#### Exhibit 23: Valuation Summary

Particulars	Fair Value (Rs)	Upside (%)
Relative Valuation	1372.7	21.0
DCF	1377.4	21.4
<b>Average</b>	<b>1375.0</b>	<b>21.2</b>

Source: Parsoli Research

### Relative Valuation

We have used Relative Valuation based on P/E, P/BV and EV/EBIDTA methodologies. At the current market price of Rs 1,134, OIL is trading at P/E of 10.0x FY2010E and 8.6x FY2011E earnings, P/BV of 2.4x FY2010E and 2.0x FY2011E and of EV/EBIDTA of 6.0x FY2010E and 5.2x FY2011E which are at discount to its peers. When compared with PSU peer, EBITDA/barrel for OIL is Rs 46.2/barrel which is nearly same as that of ONGC but it has higher reserve to production ratios. Given the higher relative reserve base, OIL's EV/barrel is US\$ 4.6/barrel which is 14.6% discount to ONGC. To value the stock, we have assigned 10.5x P/E, 2.5x P/BV multiple and EV/EBIDTA of 6.2x after discounting the industry average.

#### Exhibit 24: Relative Valuation

Particulars	Multiple	Fair Value (Rs)	Upside (%)
P/E	10.5	1397.8	23.2
P/BV	2.5	1406.5	24.0
EV/EBIDTA	6.2	1313.7	15.8
<b>Average Value</b>		<b>1372.7</b>	<b>21.0</b>

Source: Parsoli Research

By taking an average of the price estimated through P/E, P/BV and EV/EBIDTA methods, we arrive at a price of Rs 1,372.7, thus indicating a 21.0% upside from the current market price.



**According to DCF model, we arrive at a fair value of Rs 1,377.4, indicating 21.4%**

**DCF Valuation**

According to DCF model, we arrive at a fair value of Rs 1,377.4, indicating 21.4% upside from the current market price. For valuation, we have assumed a risk-free rate of 7.9%.

**Exhibit 25: DCF Assumptions**

**Particulars**

Risk Free Return (%)	7.9
Beta	0.5
WACC (%)	12.4
Total Enterprise Value (Rs cr)	38268.4
Total Value of Equity (Rs cr)	33118.8
<b>Fair Value per share (Rs)</b>	<b>1377.4</b>

*Source: Parsoli Research*

**We recommend a BUY on this stock with a 12-month target price of Rs 1,375**

We believe an upward revision in APM gas price, clarity on the subsidy sharing mechanism, and the acquisition of overseas producing assets would be key triggers to the company's growth in the medium to long term. **We recommend a BUY on this stock with a 12-month target price of Rs 1,375.**



## Financial Statements

Exhibit 26: Profit & Loss Statement					Rs cr
Particulars	FY2008	FY2009	FY2010E	FY2011E	FY2012E
Net Sales	6,081.9	7,241.5	8,690.4	10,134.1	11,952.5
<i>% chg</i>	12.9	19.1	20.0	16.6	17.9
Total Expenditure	3,755.4	4,353.8	5,013.1	5,888.5	6,981.3
<i>% chg</i>	15.7	15.9	15.1	17.5	18.6
EBIDTA	2,326.6	2,887.6	3,677.2	4,245.6	4,971.2
<i>Margin (%)</i>	38.3	39.9	42.3	41.9	41.6
Other Income	677.0	937.2	884.2	1,032.6	1,219.6
Depreciation & Amortization	309.3	376.8	490.3	515.8	581.6
PBT	2,713.4	3,387.0	4,064.6	4,757.6	5,605.6
<i>Margin (%)</i>	44.6	46.8	46.8	46.9	46.9
Total Tax	924.5	1,225.3	1,341.3	1,570.0	1,849.9
<i>(% of PBT)</i>	34.1	36.2	33.0	33.0	33.0
PAT	1,788.9	2,161.7	2,723.2	3,187.6	3,755.8
<i>% chg</i>	9.1	20.8	26.0	17.1	17.8
<i>Margin (%)</i>	29.4	29.9	31.3	31.5	31.4

Source: Company, Parsoli Research

Exhibit 27: Balance Sheet					Rs cr
	FY2008	FY2009	FY2010E	FY2011E	FY2012E
<b>SOURCES OF FUNDS</b>					
Equity Share Capital	214.0	214.0	240.5	240.5	240.5
Reserves & Surplus	7719.0	9117.0	10954.1	13213.3	16040.7
Net Worth	7933.0	9331.0	11194.5	13453.8	16281.2
Total Loans	174.9	56.5	42.3	30.9	22.3
Deferred Tax Liability	866.7	901.3	899.8	899.8	899.8
Capital Employed	8974.5	10288.8	12136.7	14384.5	17203.3
<b>APPLICATION OF FUNDS</b>					
Net Block	702.9	1133.8	1280.5	1297.8	1354.2
Capital Work-in-Progress	644.6	318.6	317.4	294.3	286.8
Net Cost	2267.8	2521.5	2866.5	3290.4	3958.7
Pre-producing Properties	448.1	562.3	896.5	2853.7	3185.6
Investments	488.7	488.7	488.7	488.7	488.7
Current Assets	6176.6	8355.3	8576.6	8854.1	11133.6
Current Liabilities	1754.1	3091.4	2289.4	2694.6	3204.2
Net Current Assets	4422.5	5264.0	6287.2	6159.5	7929.4
Capital Deployed	8974.5	10288.8	12136.7	14384.5	17203.3

Source: Company, Parsoli Research



<b>Exhibit 28: Cash Flow Statement</b>					<b>Rs cr</b>
<b>Particulars</b>	<b>FY2008</b>	<b>FY2009</b>	<b>FY2010E</b>	<b>FY2011E</b>	<b>FY2012E</b>
EBITDA	2713.4	3387.0	4064.6	4757.6	5605.6
Depreciation	309.3	376.8	490.3	515.8	581.6
Change in Working Capital	1061.3	947.7	(1815.9)	(42.3)	(34.1)
Direct taxes paid	(986.7)	(1259.6)	(1341.3)	(1570.0)	(1849.9)
Cash Flow from Operations	3097.4	3451.9	1397.6	3661.1	4303.3
(Inc.)/Dec. in Fixed Assets	(767.3)	(899.9)	(1315.0)	(2891.3)	(1630.6)
Free Cash Flow	2330.1	2552.0	82.6	769.8	2672.8
Misc	2.8	119.2	(1.5)	0.0	0.0
Change in Equity	0.0	0.0	26.5	0.0	0.0
Borrowings	(639.1)	(118.4)	(14.1)	(11.4)	(8.6)
Dividend paid (incl. tax)	(688.5)	(763.7)	(886.2)	(928.4)	(928.4)
Cash Flow from Financing	(1324.9)	(762.9)	(875.3)	(939.8)	(937.0)
Inc./(Dec.) in Cash	1005.1	1789.2	(792.7)	(170.0)	1735.8
Opening Cash balances	3275.7	4280.8	6070.0	5277.3	5107.3
Closing Cash balances	4280.8	6070.0	5277.3	5107.3	6843.1

Source: Company, Parsoli Research

<b>Exhibit 29: Key Ratios</b>					
<b>Particulars</b>	<b>FY2008</b>	<b>FY2009</b>	<b>FY2010E</b>	<b>FY2011E</b>	<b>FY2012E</b>
<b>Per Share Data (Rs)</b>					
EPS	74.4	89.9	113.3	132.6	156.2
Cash EPS	90.2	107.0	133.6	154.0	180.4
DPS	24.5	27.1	31.5	33.0	33.0
Book Value	329.9	388.1	465.6	559.5	677.1
<b>Returns (%)</b>					
ROE	22.6	23.2	24.3	23.7	23.1
ROCE	22.5	24.4	26.3	25.9	25.5
Dividend Payout	32.9	30.2	27.8	24.9	21.1
<b>Valuation Ratios (x)</b>					
P/E	15.2	12.6	10.0	8.6	7.3
P/CEPS	12.6	10.6	8.5	7.4	6.3
P/BV	3.4	2.9	2.4	2.0	1.7
EV/EBITDA	10.0	7.4	6.0	5.2	4.1
EV/Sales	3.8	2.9	2.5	2.2	1.7

Source: Company, Parsoli Research



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