

Key Highlights

- ✓ The upstream companies are expected to report disappointing numbers on account of lower realization consequent to fall in crude oil prices.
- ✓ Product cracks revived sequentially however remained lower Y-o-Y on account of sluggish demand globally.
- ✓ Oil marketers had a pleasant quarter on account of lower crude oil price-Likely gain of INR 3/liter for petrol, INR 7/liter for diesel, and under recovery of INR 10/liter in kerosene and INR 44/cylinder in the quarter.
- ✓ Gas distribution players are expected to sustain their performance sequentially. Further delay in commissioning of KG-D6 was a dampener in this quarter.

Upstream

Upstream companies continue to have a tough time this quarter on account of lower crude oil price and no spurt in the volumes. However, fall in rupee did offset the pain of fall in crude oil price to some extent.

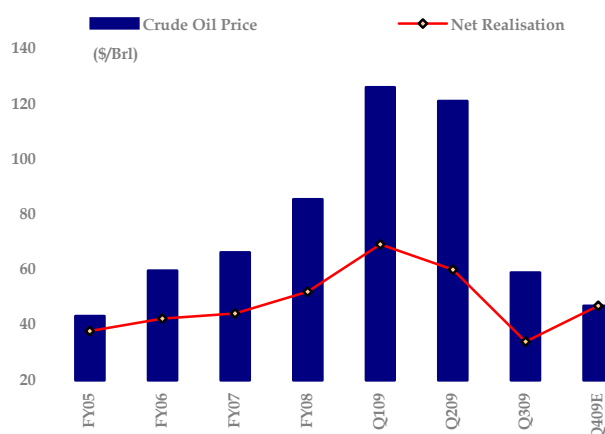
ONGC

- ✓ **Zero subsidy burden?** We believe ONGC won't have to share any subsidy burden with OMCs on account of lower crude oil price. It is likely to have stopped selling crude oil at discount to benchmark crude oil price from 18th November as reported in media. However net realization is expected to remain within the range of \$45 to \$47 per barrel.
- ✓ **Dip in Volumes expected:** Volumes are expected to be lower 5% Y-o-Y on account of decrease in reservoir pressure, increase in water cut, delay in newer platforms, logistic bottlenecks and lower operating rates of the domestic refineries.
- ✓ **Y-o-Y growth in PAT:** Sales are expected to dip by 3.7% Y-o-Y in this quarter. However PAT is expected to increase by 34.4% Y-o-Y despite dip in volumes on account of zero subsidy sharing and weaker rupee.

Valuation

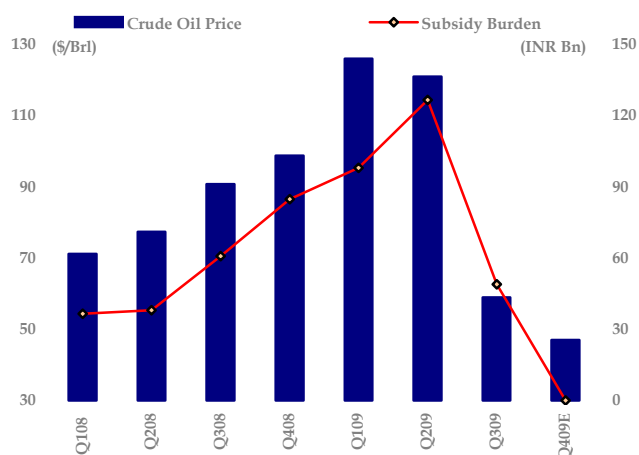
Fundamentally we expect a revival in the crude oil price and average within the range of \$65-70 per barrel in the long term. Banking on sustainable cash earnings we maintain our target price of INR 985/share and downgrade our rating to ACCUMULATE on account of recent spurt in market price.

Crude Oil Price and Net Realization



Source: Khandwala Research, Bloomberg

Subsidy burden and crude oil price quarter wise



Source: Khandwala Research, Bloomberg

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Cairn India

- ✓ **Lower crude oil price a major dampener:** Crude oil price is expected to average at ~\$47 per barrel this quarter. Consequently we expect sales and PAT to dip **51% and 55% Y-o-Y**
- ✓ **High exploratory expenses could increase recouped cost:** Company management suggested they would focus on development of wells in 2nd and 3rd quarter of CY08. 4th and 5th quarter (FY09-financial year of 15 months) is expected to be inclined towards exploration and survey which could lead to higher recouped cost.
- ✓ **Uncertainty regarding Non recurring gain/loss:** Cairn India has raised Rs 2,534.6 crore (\$625 million) through preferential allotment of shares to companies for development of MBA fields. Any delay in capex could inflate other income in this quarter. We have not accounted for any forex loss/gain.

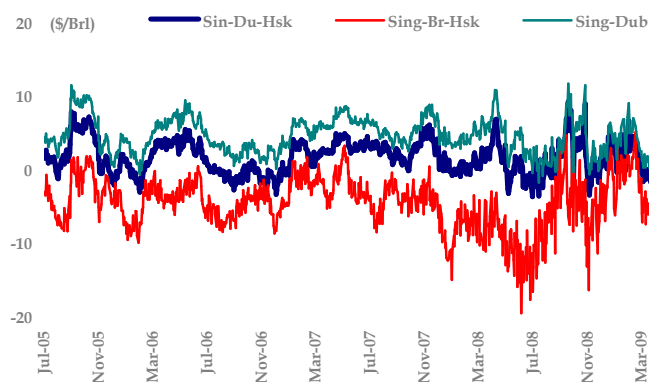
Valuation

We are positive on the stock expecting a revival in the crude oil price. We have included other Rajasthan fields with 2P reserves of 60 mln barrels into our valuation at EV/BOE of \$11 per barrel. It adds INR 20 to our valuation. The recent spurt in the stock has resulted in successful achievement of our previous target price. We believe that there are various upside potential yet untapped which includes resources in Barmer fields. Looking at the upside potential we downgrade our rating from Accumulate to **HOLD**. At long term average crude oil price of \$65 per barrel we value Cairn India Ltd at **INR 195/share**.

Refining

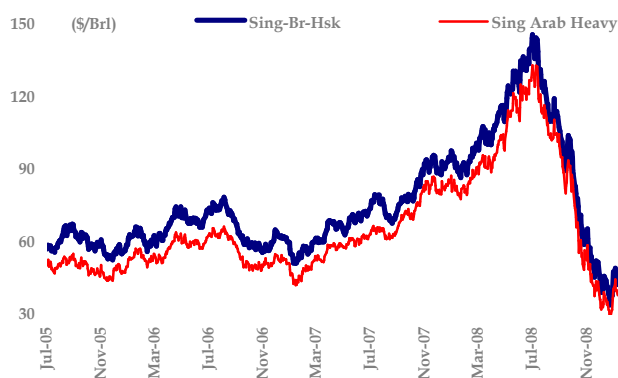
Refining margins witnessed a spurt in the month of February on account of lower operating rates of the refineries globally. It tamed in the month of March when refineries shut for maintenance were back into operations. Singapore margins largely declined again on sharp losses in diesel and jet/kerosene crack spreads. Asia is suffering perhaps more than other regions from a weak distillate market, with China reverting to being a net exporter in recent months. Perhaps middle distillate market momentum may ease further

Indian crude basket consists of Dubai-Oman and Bonny light crude. Singapore Dubai hydrocracking margin averaged at \$3.8 per barrel for 4th quarter of financial year and Dubai hydroskimming(Hsk) margin averaged at \$ 1.89 per barrel. The Singapore Brent (br) Hsk margin averaged at \$ -1.4 per barrel.



Source: Khandwala Research, Bloomberg

Frequent supply cuts by OPEC have resulted in narrowing of Heavy-Light Crude oil spread thus reducing complex cracking margins. Refineries like RIL Jamnagar are earning GRMs at premium relatively to the domestic refineries, however Y-o-Y they are expected to report a dip in margins. We expect RIL to report gross refining margin of \$10 per barrel.



Source: Khandwala Research, Bloomberg



Reliance Industries

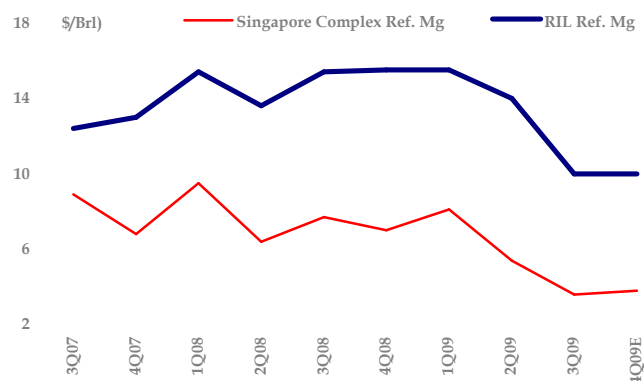
- ✓ **Petchem margins to improve sequentially:** Petchem margin may improve sequentially on account of stability in feedstock prices, and higher delta. The polymer and polyester spreads are expected to recover after a lull last year.
- ✓ **GRM of \$10 per barrel expected:** Company is expected to report \$6.2 per barrel premium to Singapore complex margins (\$3.8 per barrel) as against \$15.5 per barrel in corresponding quarter previous year. The refining EBIT is expected to dip 33% Y-o-Y this quarter.
- ✓ **Technical hindrances kept MA oil fields shut:** RIL shut its oil-producing field off the nation's east coast to attach two more wells to increase output. Reliance had shut the field on Dec. 9 after equipment failed at the site. It resumed production in mid-March. Production was again closed on March 22 as reported in media and is expected to resume on April 20. The field was producing 18,000 barrels a day before it was shut down which will increase gradually to 40,000 barrels per day post resuming production.
- ✓ **KGD6 - Ready to go:** RIL has started production from the KG basin gas fields. It has signed gas sale-purchase contracts with the 12 fertiliser firms that have been chosen to receive the first produce from the company's offshore Krishna-Godavari (KG) D6 fields on the east coast.

KG D6 gas will come onshore at Kakinada (Andhra Pradesh) from where it is supposed to be transported to Bharuch (Gujarat) through a 1,386-km pipeline laid by RIL. In Gujarat, RIL will use the pipeline network of Gujarat State Petronet to take the gas to end-consumers as well as connect to Gail's HBJ pipeline.

KG D6 is expected to initially produce a volume that would be enough to meet the fuel deficit of the 15 urea-making plants operated by the 12 fertiliser companies. A total of 15.35 million cu m per day of gas would go to fertiliser plants.

RIL plans to start production with 10-12 mscmd of gas in April and will ramp it up to 40 mscmd by July and reach peak production of 80 mscmd in a year.

Singapore Complex Refining Margin vis-à-vis RIL



Source: Khandwala Research, Bloomberg

Valuation

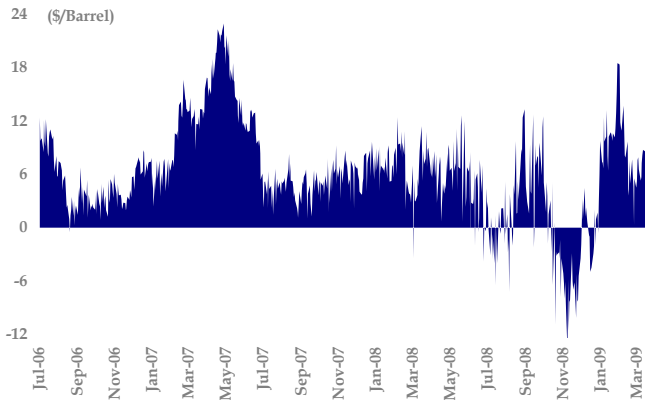
Pressurized Refining and petchem margins would be a matter of concern in medium term consequent to global slowdown. However even any small sign of revival in global economy could trigger the valuation upwards. Timely commencement of production in RPL would give them an edge over other global complex refiners since their projects have been delayed on slowdown concerns and financial crunch. RIL has started production from the KG basin gas fields. The stock has achieved our previous target price. We increase our target price to **INR 1,650** on account of merger with RPL, and increase in market value of treasury stocks. We downgrade our rating on the stock to **HOLD** considering potential resources in KG basin and upsides in other fields.

Oil Marketing Companies

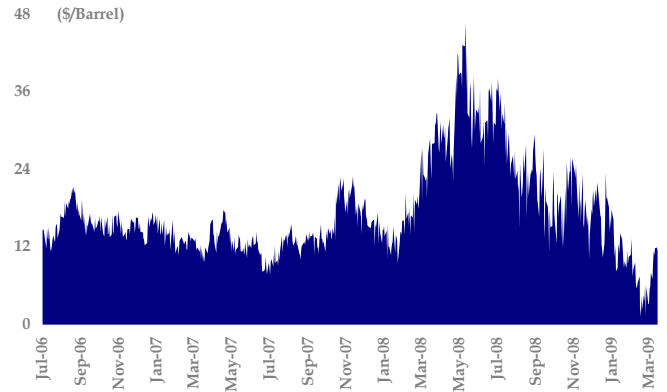
They enjoyed a surplus of INR 3/ liter for petrol, INR 7/ liter for diesel, and borne under recovery of INR 10/ltr in kerosene and INR 44/cylinder in the quarter. Slump in the middle and light distillate market led them to earn surplus in absolute terms in marketing segment since Indian consumption pattern is more inclined towards middle distillates. We expect oil marketing companies to report improvement in earnings in the marketing segment consequent to fall in crude oil price; however lower product cracks in the refining segment, and fuel price cut (petrol INR5/liter and diesel INR 2/liter and Rs 25/cylinder) would dilute the positives. We remain neutral on OMCs due to uncertainty over fuel pricing policy and election likely to delay any decisions on it..



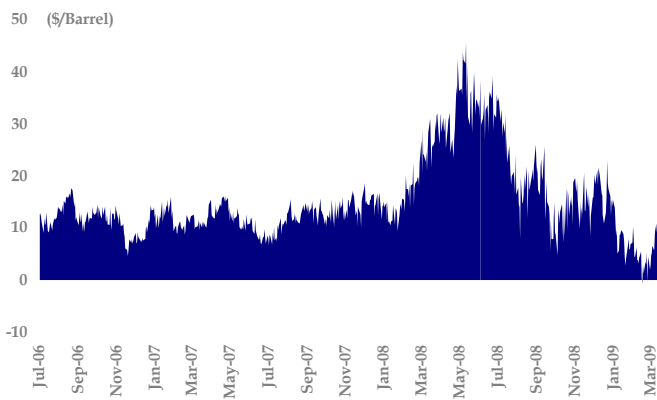
Gasoline Spread: Refinery glitches in Asia along with limited regional supply due to lower refinery utilization rates provided support for gasoline markets



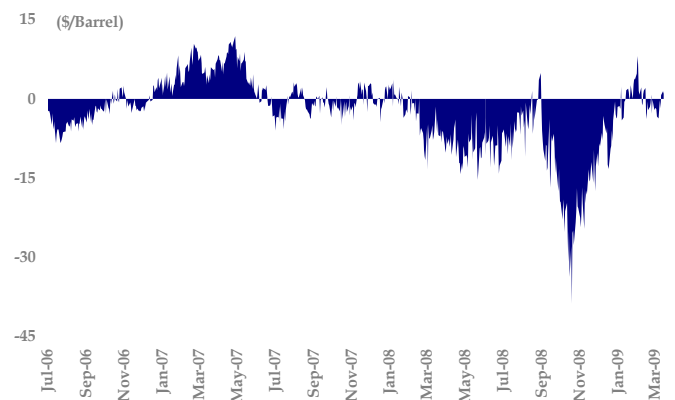
Jet Kerosene prices also fell due to lower demand from the regional aviation industry especially China and the lack of export opportunity in Europe.



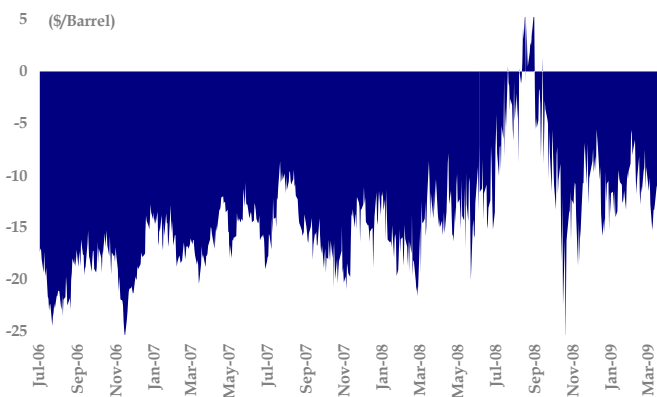
Middle distillate market in Asia continued the downtrend due to ample regional supply, sluggish demand from China and deceleration in Asian economic activities.



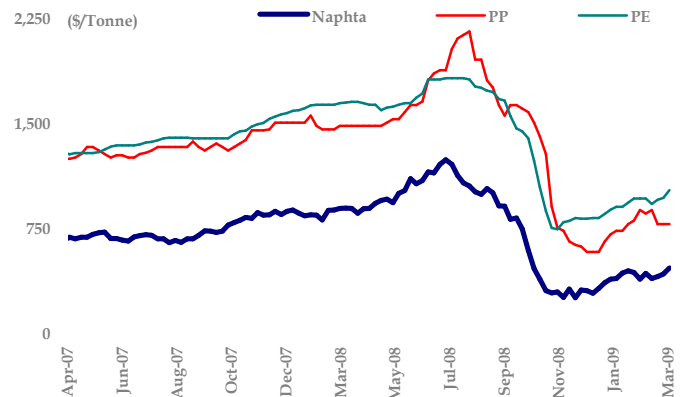
Naphtha market sentiments has weakened due to slowing demand from China and globally lower operating rates of petrochemical plants. However it has revived sequentially in the previous quarter



Fuel Oil Spread remained firm although negative on account of lower supplies from Middle East and South Korea.



Polymer spreads with naphtha revived this quarter on account of stabilization in feedstock prices.





Gas transmission and distribution companies

The new regulations to determine transmission tariff could have various implications on the distribution companies. The regulatory board requires companies to earn 12 % post tax return on net capital employed (net of accumulated depreciation) for transmission infrastructure and 14% post tax return for distribution infrastructure. Gail could have their tariff reduced on account of aging asset. GSPL tariffs won't be affected significantly considering their relatively newer assets. IGL are earning relatively higher returns relative to its peers. However marketing margins doesn't come under regulatory purview and hence can be charged higher. We are cautious that any rationalization of returns on marketing assets could reduce margins of IGL.

GAIL

- ✓ **Decrease in petchem volumes sequentially:** Company sold higher volumes of petchem in 3QFY09 on account of destocking of products due to steep fall in prices. We expect GAIL to sell normalized volumes this quarter keeping it flat Y-o-Y.
- ✓ **Marginal Revival in transmission volumes:** Favorable spot LNG economics could bring volumes back in Dahej-Vijaipur pipeline on account of revival in naphtha price.
- ✓ **Zero subsidy burden?** We believe GAIL won't have to share any subsidy burden with OMCs and sell LPG at discount. OMCs are expected to report over recoveries on account of lower crude oil price.
- ✓ **Spinning off trading business:** GAIL is planning to spin off its trading business into a separate unit. We believe that the move unlocks the potential of the trading business however our valuation doesn't factor any additional upside for the same.

Valuation

We believe current market price already discounts transmission expansion ahead and benefit of being second primary carrier of KG-D6 gas. We downgrade our rating to **UNDERPERFORMER** for the stock on concerns over leverage due to aggressive capex slated ahead, reduction in tariff of existing pipelines, and pressurized petchem margins.

GSPL

- ✓ **Increase in volumes sequentially:** Favorable spot LNG economics and supply to Torrent power would increase the volumes this quarter which could lead to reduction in average tariff.
- ✓ **Expected contribution of 30% of EBT:** Contribution for social projects in Gujarat could lead company report loss this quarter. However we have not assumed the same since the contribution is project linked and if this project doesn't get declared in FY09 provisioning won't be required.
- ✓ **Uncertainty in gas distribution policy:** RIL can consume its own gas only after meeting the requirements of the power, fertilizer and CGD companies. This would require close to 50 mmscmd of production. The take or pay contract with RIL for transporting gas to the Jamnagar refinery has not yet materialized since force majeure clause has been put into implementation. .

Valuation

We don't see material change in transmission tariffs post implementation of new regulations on tariff determination. We maintain our rating for GSPL as **UNDERPERFORMER** on account of uncertainty in the gas distribution policy, State provisioning of 30%, higher leverage, and lower naphtha prices.

IGL

- ✓ **Y-o-Y growth in volumes:** Production of CNG is expected to grow by ~17 % Y-o-Y in this quarter and PNG is expected to grow by ~28 %.
- ✓ **Margins expected to shrink:** PAT margins are expected to dip from 30% to 20% Y-o-Y at INR 0.42bn on account of spurt in prices of Natural gas, weakening rupee and rigid pricing of CNG.

Valuation

IGL are earning relatively higher returns relative to its peers. Any rationalization of returns on marketing assets could reduce margins of IGL. It is planning to expand its CNG network by 50 outlets to capitalize commonwealth games which could be an upside risk. We maintain our **UNDERPERFORMER** rating on stock in backdrop of regulatory uncertainty and limited scope of expansion outside the capital region.



4QFY09 Results Estimates

Descriptions (INR Mn)	Recom.	Mar-09 4QFY09E	Mar-08 4QFY08	YoY' % Growth	Dec '08 3QFY09	QoQ' % Growth	Mar-09 FY2009E	Mar-08 FY2008	YoY' % Growth
Cairn India	HOLD								
Net Sales		1,538	3,158	-51.3	2,108	-27.0	14,047	10,123	38.8
PAT		522	1,164	-55.2	2,364	-77.9	8,370	(245)	LP
Equity		18,783	18,783	-	18,783	-	18,783	18,783	-
EPS (Ann.) (Rs)		1.1	2.5	-55.2	5.0	-77.9	4.5	(0.1)	-
GAIL	UNDPERF								
Net Sales		62,542	49,352	26.7	58,160	7.5	239,735	180,082	33.1
PAT		5,159	7,223	-28.6	2,534	103.6	26,896	26,015	3.4
Equity		12,686	12,686	-	12,686	-	12,686	12,686	-
EPS (Ann.) (Rs)		16.3	22.8	-28.6	8.0	103.6	21.2	20.5	3.4
GSPL	UNDPERF								
Net Sales		1,180	1,161	1.6	1,174	0.5	4,735	4,179	13.3
PAT		308	406	-24.1	276	11.4	1,194	999	19.5
Equity		5,620	5,620	-	5,620	-	5,620	5,620	-
EPS (Ann.) (Rs)		2.2	2.9	-24.1	2.0	11.4	2.1	1.8	19.5
IGL	UNDPERF								
Net Sales		2,160	1,874	15.3	2,204	-2.0	8,435	7,060	19.5
PAT		420	482	-12.8	383	9.7	1,746	1,745	0.1
Equity		1,400	1,400	-	1,400	-	1,400	1,400	-
EPS (Ann.) (Rs)		12.0	13.8	-12.8	10.9	9.7	12.5	12.5	0.1
ONGC	ACCUM								
Net Sales		150,485	156,261	-3.7	125,386	20.0	651,390	598,485	8.8
PAT		35,319	26,271	34.4	24,748	42.7	174,514	167,017	4.5
Equity		21,389	21,389	-	21,389	-	21,389	21,389	-
FDEPS (Ann.) (Rs)		66.1	49.1	34.4	46.3	42.7	81.6	78.1	4.5
RIL	HOLD								
Net sales		277,599	372,860	-25.5	315,630	-12.0	1,456,889	1,334,430	9.2
PAT		35,080	39,120	-10.3	35,010	0.2	152,409	194,580	-21.7
Equity		15,732	15,732	-	15,732	-	15,732	15,732	-
EPS (Ann.) (Rs)		89.2	99.5	-10.3	89.0	0.2	96.9	123.7	-21.7

Source: Khandwala Research, Companies

Note: Cairn india Ltd FY09 15 months; Gail issued bonus of 1 share for every two shares

LP: Loss to Profit



INDIA

EQUITY RESEARCH		TEL. NO. +91 22 4076 7373	FAX +91 22 4076 7378
Name	Designation	Sectors	E-mail
Ashok Jainani	VP, Head Research	Market Strategy	ashokjainani@kslindia.com
Dipesh Mehta	Research Analyst	IT, Telecom	dipesh@kslindia.com
Hatim K Broachwala	Research Analyst	BFSI	hatim@kslindia.com
Vinay Nair	Research Analyst	Energy	vinay.nair@kslindia.com
Giriraj Daga	Research Analyst	Metals & Minings	giriraj@kslindia.com
Kruti Shah	Research Associate	Economics	kruti.shah@kslindia.com
Sandeep Shrimali	Research Associate	Cement	sandeep.shrimali@kslindia.com
Dinesh Bhatia	Research Associate	Technical Analysis	dinesh.bhatia@kslindia.com
Sandeep Bhatkhande	Research Associate	Publishing	sandeep@kslindia.com
Lydia Rodrigues	Research Executive	Data Mining	lydia@kslindia.com

INSTITUTIONAL DEALING		TEL NO. +91 22 4076 7342-47/56	FAX NO. +91 22 4076 73 77-78
Biranchi Sahu	Head	Institutional Equity	bsahu@kslindia.com
Gopi Doshi	Senior Dealer	Institutional Equity	gopi.doshi@kslindia.com
Mayank Patwardhan	Dealer	Institutional Equity	mayank.patwardhan@kslindia.com

PRIVATE CLIENT GROUP		TEL No. +91 22 4076 7317-21	FAX NO. +91 22 4076 73 77
Sanjay K Thakur	President	Sales & Marketing	thakursk@kslindia.com
Subroto Duttaroy	General Manager	Equity & Portfolio Mgmt. Service	subroto@kslindia.com
Jagdish R Modi	Manager	Equity & Portfolio Mgmt. Service	jrmodi@kslindia.com

BRANCH OFFICE (PUNE)		TEL NO. +91 20 2567 1404/06	FAX NO. +91 20 2567 1405
Ajay G Laddha	Vice President		ajay@kslindia.com

Corporate Office:

Vikas Building, Ground Floor,
Green Street, Fort,
MUMBAI 400 023.
Tel. No. (91) (22) 4076 7373
Fax No. (91) (22) 4076 7377/78
E-mail: research@kslindia.com

Web site: www.kslindia.com

Branch Office:

C8/9, Dr. Herekar Park,
Off. Bhandarkar Road,
PUNE 411 004
Tel. No. (91) (20) 2567 1404/06
Fax. No. (91) (20) 2567 1405
Email: pune@kslindia.com

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