

July 5, 2013

BSE Code: 532792

NSE Code: CAIRN

Reuters Code: CAIL.BO

Bloomberg Code: CAIR:IN

Cairn India Ltd. (CAIR) with a market cap of more than USD 10.5 bn operates ~20% of India's domestic crude oil production and has more than 1 bn barrels reserves / resources base, is engaged in the business of exploration and production of oil & gas. It is the second largest private sector oil and gas company in India as measured by exploration acreage. At present, CAIR holds material exploration and production positions in 8 blocks in west and east India along with new exploration rights in South Africa and Sri Lanka.

Investor's Rationale

During FY13, CAIR's consolidated net profit reported a robust growth of 52% at ₹120.5 bn in FY13 due to an impressive 48% YoY revenue growth with 19% increase in production. The major developments in the fiscal include commencing production from Aishwariya, entering commercial gas sales from Rajasthan block and expansion of portfolio by entry to Orange Basin, South Africa.

With 4x enhancement in the gross in-place estimate for its Rajasthan block to 7.3 billion of barrels of oil equivalent (bboe) and 2.2x increase in recoverable reserve estimate to 1.2 bboe, the company plans to drill in excess of 450 wells in the Rajasthan block over a three year period. With full potential of world-class Rajasthan asset, CAIR focus for the next year will continue to be on Rajasthan oil fields to achieve an output of 300,000 barrels of oil per day (bopd).

The company has a direct play on crude oil and indirect play on rupee depreciation. Thus, higher crude oil prices will result in higher realizations from crude sales for oil exploration firms like CAIR in the coming quarter. And with weakening rupee value, the company's financial performance in the current quarter is expected to be better than the preceding one as the numbers should be boosted from the tottering rupee. Additionally, its dollar cash balance is likely to fetch some forex gains in the June quarter

Improved operating environment with key exploratory approvals coming in, CAIR is well positioned with a cash reserve of USD 3.0 bn to achieve a FY15 exit run rate of 2,40,000 bopd. Further, regulatory clearance for crude oil production and an aggressive production from fields beyond Rajasthan assets are likely to drive growth further.

Key risk

Unsuccessful well: CAIR's future growth in oil and gas production is dependent on finding, acquiring and developing further reserves. If the company fails to find successful wells in new exploratory blocks, it may lead to a decline in the reserves and also impact the profitability on account of write-offs of exploration costs.

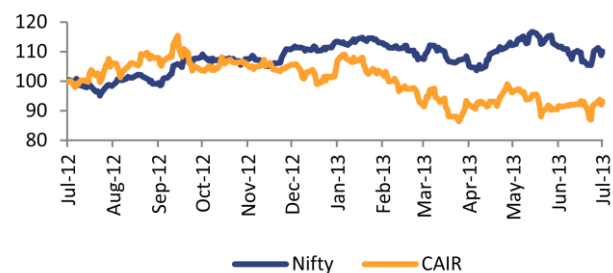
Market Data

| | |
|------------------------|-------------|
| Rating | BUY |
| CMP (₹) | 291 |
| Target (₹) | 332 |
| Potential Upside | ~14.0% |
| Duration | Long Term |
| Face Value (₹) | 10 |
| 52 week H/L (₹) | 365.9/267.9 |
| Adj. all time High (₹) | 401 |
| Decline from 52WH (%) | 20.5 |
| Rise from 52WL (%) | 8.6 |
| Beta | 0.6 |
| Mkt. Cap (₹ bn) | 556.2 |
| Price to Book Value | 1.2 |

Fiscal Year Ended

| Y/E | FY12A | FY13A | FY14E | FY15E |
|------------------|-------|-------|-------|-------|
| Revenue (₹bn) | 118.6 | 175.2 | 170.2 | 186.9 |
| EBITDA (₹bn) | 92.5 | 130.3 | 121.6 | 132.0 |
| Net Profit (₹bn) | 79.4 | 120.6 | 108.3 | 111.0 |
| Adj EPS (₹) | 41.6 | 63.1 | 56.7 | 58.1 |
| P/E (x) | 7.0 | 4.6 | 5.1 | 5.0 |
| P/BV (x) | 1.1 | 1.2 | 1.1 | 1.1 |
| EV/EBITDA (x) | 5.4 | 4.0 | 4.4 | 4.1 |
| ROCE (%) | 18.4 | 27.0 | 25.6 | 25.4 |
| ROE (%) | 16.4 | 25.3 | 22.1 | 21.0 |

One year Price Chart



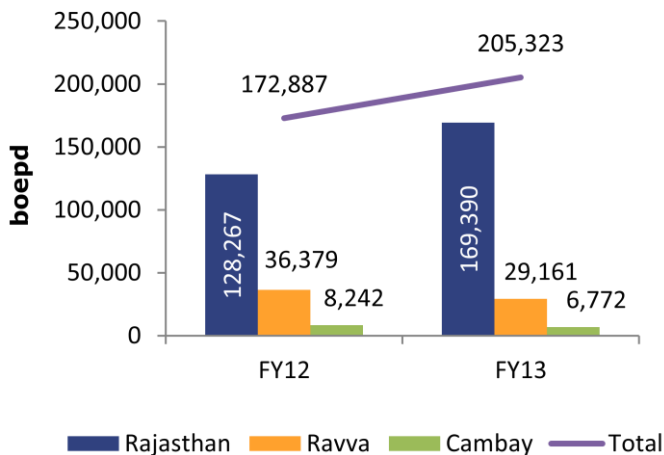
| Shareholding Pattern | Jun'13 | Mar'13 | Diff. |
|----------------------|--------|--------|-------|
| Promoters | 58.8 | 58.8 | 0 |
| FII | 14.3 | 14.6 | (0.2) |
| DII | 11.8 | 11.1 | 0.6 |
| Others | 15.1 | 15.5 | (0.4) |

CAIR has posted robust 47.8% rise in its consolidated revenue growth in FY13 to ₹175,241.5 mn, resulting in to 50.2% YoY growth in FY13 net profit at ₹119,197.4 mn

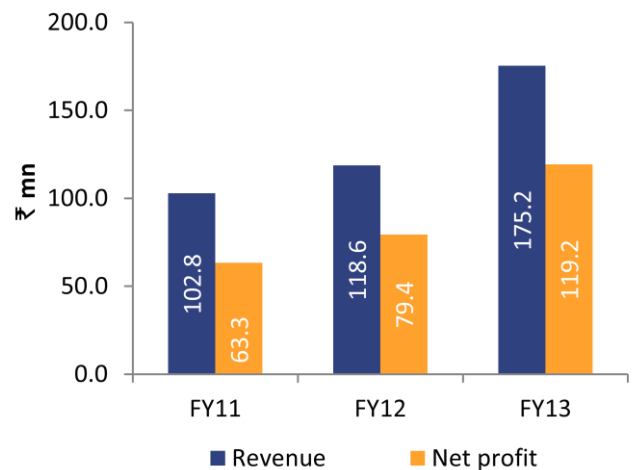
Impressive FY13 performance with robust top-line and bottom-line growth

CAIR recorded its highest ever revenues and net profit during the FY13 as production grew from the Rajasthan block and lower operating costs. The company reported 47.8% YoY consolidated revenue growth in FY13 to ₹175,241.5 mn after profit sharing with Gol and royalty payment at Rajasthan as its renewed exploration efforts in the Rajasthan block raised its total output to 205,323 bopd, 19% higher than the corresponding period. Though, the on-going challenges in the domestic business environment raised its operational expenses by 56.6% (YoY) to ₹63,369.1 mn, the company managed to book an operating profit growth of 43.2% at ₹111,872.4 mn for the year. Further, the company channelized some of the funds from low-yielding assets abroad to India, to cause over two-fold growth in other income at ₹7,228.4 mn and constant rupee appreciation aided forex gain of ₹3,134.0 mn. Further, 69.6% and 51.6% reduction in finance cost and tax expenses to ₹686.6 mn and ₹2,350.8 mn, respectively resulted in robust bottom-line growth of 52% YoY at ₹119,197.4 mn.

Overall production remains robust during FY13



Strong FY13 performance



Delivered strong Production Growth in FY13

CAIR reported a remarkable production growth of 19% YoY mainly due to the increased production from its Rajasthan fields and thereby reduced nation's dependence on oil imports by ~₹385 bn. The company's gross production increased 19% YoY in FY13 at 205,323 boepd, of which 169 kbpd was the contribution from its wells in Rajasthan which showed a production increase of 32% YoY. However, production from its Ravva and Cambay fields dropped 20% YoY and 18% YoY to 29,161 boepd and 6,772 boepd, respectively.

Some of the key achievements for the company in FY13 include hydrocarbon discovery Rajasthan following the policy clarity from government on exploration activities, diversification of the portfolio by entering commercial gas sales at the rate of 5 mmscfpd from its Rageeshwari fields to Gujarat Narmada Valley Fertilizer and Chemicals Ltd (GNFC) and extending the reach to South Africa by its entry to Orange basin where it holds 60% WI. With the approval of new exploration well, the company will focus mainly on increased production through aggressive exploration activities in the existing fields esp. in Rajasthan rather than expanding to new countries.

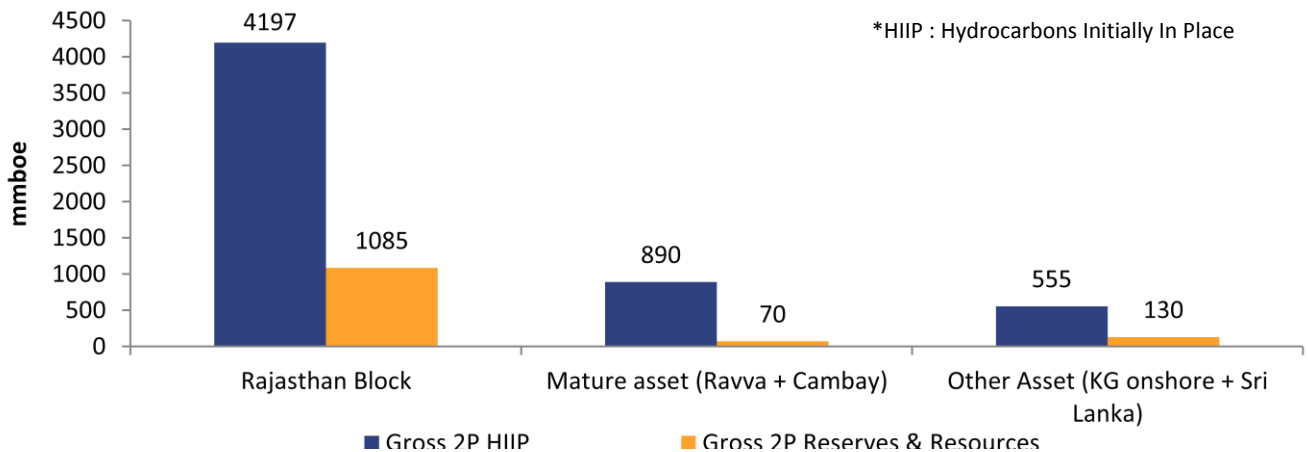
High resource potential from Rajasthan block augurs well for the company

RJ-ON-90/1 oil block currently produces 169,390 barrels of oil per day (~8.7 mn tonne per annum) which constitutes more than 20% of domestic oil production..

CAIR is the major operator of the world class RJ-ON-90/1 oil block, holding 70% participating interest in a joint venture with Oil & Natural Gas Corporation (ONGC). The block currently produces 169,390 bopd (~8.7 mn tonne per annum) consisting of three contiguous development areas that include Mangala, Bhagyam and Aishwariya (MBA) fields, Raageshwari and Saraswati fields; Shakti fields and Kaameshwari West fields. The potential resource base for the Rajasthan block is now estimated at 7.3 bboe gross in-place, mainly due to an increase in the exploration upside with the prospective resource base now estimated at 3.1 bboe gross in-place, from an earlier estimate of 2.5 bboe gross in-place. The Rajasthan recoverable risked prospective resource has increased from 250 million barrels of oil equivalent (mboe) gross to 530 mm boe gross primarily due to generation of additional leads and prospects.

The MBA fields have gross recoverable oil reserves and resources of approximately 1 billion barrels (bn bbl), which includes proved plus probable (2P) gross reserves and resources of 636 mmboe with a further 300 mmboe or more of Enhanced Oil Recovery (EOR) resource potential.

Reserves and resources accelerating exploration efforts



The company guided exit production rate of 200,000-215,000 bopd for FY14 from the Rajasthan Block.

With 105 producer and 47 injector wells, the production from Mangla field reached 150,000 bopd. Besides this, 48 infill wells are planned which will expand the plateau and to ensure that the decline from existing wells are compensated. Following a successful EOR polymer flood pilot, a Field Development Plan (FDP) for a full field application of polymer flood in the Mangala field has been submitted to the JV and is under the approval process.

The company has added another major milestone in the journey to unlock the full potential of world class Barmer basin. This is the fifth producing oil field from the block by commencing production from Aishwariya field. The company anticipates achieving a peak production level of 10,000 bopd from Aishwariya field.

At Bhagyam field, 66 development wells have been drilled against as FDP approval of 81 wells. Bhagyam field is currently producing in a range of 20,000 to 25,000 bopd and further aims to ramp up the approved plateau production of 40,000 bopd by H2FY14 by drilling 30+ wells which is already FDA approved. The commissioning of Bhagyam is a key milestone towards achieving the total exit capacity of 240 thousand barrels of oil per day (kbopd) by FY15E.

CAIR has initiated the largest ever exploration and appraisal programme in its history to unlock further potential in Rajasthan as well as focus on its next stage of growth beyond Rajasthan

New discovery will be the trigger for potential upside of the stock

CAIR is keeping eye on aggressive exploration program on Rajasthan block to unlock full potential of the block after the receiving government approval on exploration activity in development blocks. The management of the company expects to expand production from ~175 kbopd (MBA Fields) to 200-215 kbopd by the end of FY14, on account of production start from Aishwariya, Bhagyam and Barmer hill and satellite fields. As a part of portfolio expansion plan, the company aims to ramp up its total production from 205 kboepd to 225-240 kboepd. In order to achieve the production growth target, CAIR also focuses on accelerating the potential of Ravva by a high value high risk prospect. One exploratory and two infield wells are planned in Ravva for FY14. Aggressive infield campaigns planned for Ravva and Cambay in FY14 based on 4D data in addition to EOR project evaluation. An infill drilling campaign on CB/OS-2 has already started. In KG-ONN-2003/1 block, appraisal of largest onshore discovery in KG basin planned in Q1FY14 to evaluate size & commerciality of 2nd discovery and NayaLanka Southeast-1. With all these expansion activities in place, we forecast exit production of 219kbpd for FY14 and 234 kbpd for FY15.

Portfolio exploration work program to augment growth

| Block | Working interest | Exploration Work Program |
|------------------------|------------------|--|
| RJ-ON-90/1 | 70% | Plan to drill 100 E&A well drilling in next three years. |
| Ravva | 22.5% | Exploration well drilling in FY14 |
| CB/OS-2 | 40% | Infill drilling on going |
| KG-ONN-2003/1 | 49% | Second well appraisal program in Nagalanka and NayaLanka Southeast with target well spud by the end of Q1FY14. |
| KG-DWN-98/2* | 10% | Under divestment (Gol approvals obtained) |
| KG-OSN-2009/3 | 100% | |
| PR-OSN-2004/1 | 35% | Gol granted conditional access; discussion on-going for unrestricted access |
| MB-DWN-2009/1 | 100% | |
| SL-2007-01-001 | 100% | Phase 2 Exploration drilling completed |
| Block 1 (South Africa) | 60% | Tendering for acquisition of 3D seismic data completed |

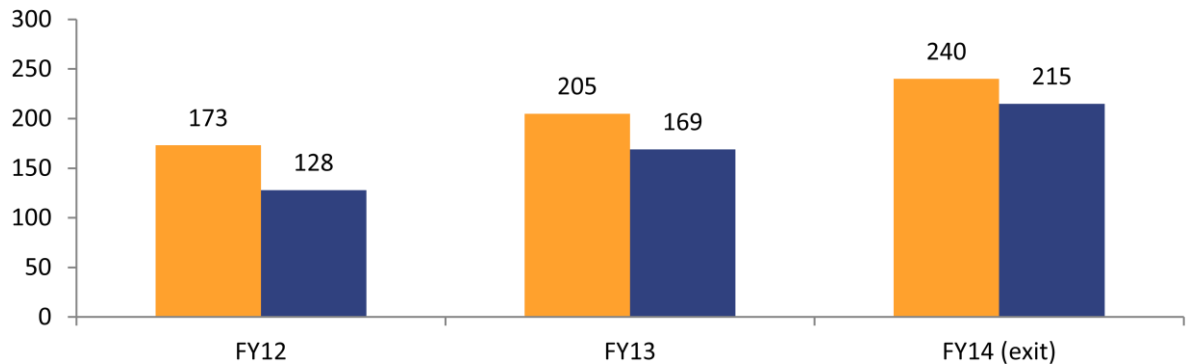
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CAIR plans to drill in excess of 450 wells in the Rajasthan block over a three year period; includes 100 Exploration and Appraisal (E&A) wells and the balance as development wells. 100 E&A wells target a gross recoverable risked prospective resource of 530 mmmboe; drilling in the first year is expected to test around half of the prospective resource volumes which in turn would help it to reach long-term target of 300 kbpd.

Aggressive exploration program slated-:

- Identified ~100 prospects in the block; targeting 530 mmmboe gross recoverable risked prospective resource
- Plan to drill ~30 E&A wells in a year (~100 wells in 3 years)
- Plan to initially drill out high potential prospects and number of play types

New discoveries to expand production



The company achieved success with its 26th discovery in Rajasthan block, which further reaffirmed belief that this world class block has significant untapped potential.

CIL has expanded its overseas presence by associating itself with Petro SA for commercializing the existing discovery and exploring crude oil and natural gas in the offshore block 1 in Orange Basin on the west coast of South Africa.

Recently, the company has made its latest 26th oil discovery, after a gap of four years from its RJ-ON-90/1 block in Rajasthan. This comes on the back of clarity from the government that oil companies can conduct exploration activity in development blocks. Technical evaluations indicate D~10 meters of oil column within Dharvi Dungar formation. Oil has been discovered for the first time in Dharvi Dungar sands in Raageshwari-Tukaram and the volume and potential resource base associated is still under evaluation. In March 2013, the company commenced the commercial sale of gas from the Raageshwari deep gas field. This is the first step towards unlocking the natural gas potential of the Rajasthan assets. The discovery in the block reaffirmed the company's belief that an aggressive exploration drilling programme would help harness the full potential of the Barmer basin in Rajasthan.

Thus, we believe that regulatory clearance for crude oil production and aggressive production from fields beyond Rajasthan assets are likely to drive growth further. Despite delays in ramp up of capacities, we remain confident on the company's ability to ramp up volumes in Bhagyam field and Aishwarya field and expect CAIR's volumes to spurt in FY14.

Diversifying its asset base to secure long-term growth through exploration

The company has world-class asset portfolio with 8 blocks in India, one in Sri Lanka and one in South Africa. After having successful operation in Sri Lanka, CIL has expanded its overseas presence by associating itself with PetroSA for commercializing the existing discovery and exploring crude oil and natural gas in the offshore block 1 in Orange Basin on the west coast of South Africa. Block 1, which is in the initial stages of exploration covers a large area of 19922 sq. km. CIL through its wholly owned South African subsidiary, holds a 60% interest in the block.

In Sri Lanka, the company has successfully completed phase-1 of the exploration of SL-2007-01-001 block in mannar basin with the acquisition, processing and interpretation of 1,753 sq km of 3D seismic data and the drilling of three well deep water wells. The phase -1 of three wells resulted in two fruitful discoveries – a gross 25 metres hydrocarbon column in the first well and 24 metres zone in the second well while third well was plugged and abandoned as a dry hole. However, the Phase-11 of exploratory well in Sri Lanka encountered multiple reservoirs without hydrocarbon, as there were no successful oil discoveries. The company decided to continue work on the Sri Lanka block in order to find resource potential.

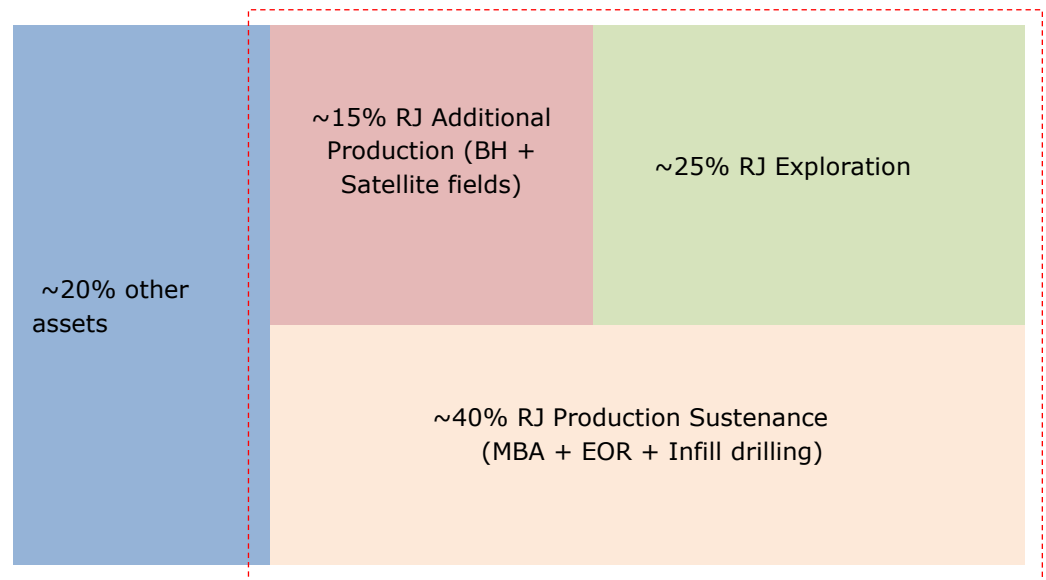
The company has a direct play on crude oil and indirect play on rupee depreciation. Thus with higher crude oil prices and weakening rupee value, earning visibility of the company is likely to enhance in Q1FY14E.

Rising crude oil prices and rupee depreciation to augment future growth prospects

CAIR's financials and valuations are highly sensitive to changes in crude oil prices. Any decline in oil prices would have an adverse impact effect on the company's profitability. We are expecting the Brent crude oil prices at around USD 100/bbl for the coming two fiscals. CAIR is expecting a reduction in discount rates from its current rate of 10.7% for Rajasthan crude and reduced its guideline rates from 10-15% to 8 -13% for the coming fiscals.

But, CAIR's sensitivity to weakening rupee is highest as the valuation improves by ₹6 per share per rupee fall. Indian Rupee has depreciated sharply by about 10.5% against the US dollar since the beginning of the FY14 and has plummeted past the 60 to the dollar mark. Nevertheless, the company's financial performance in the current quarter is expected to be better than the preceding one, as the numbers should be boosted from the tottering rupee.

USD 3 bn capex plan in next three years



~80% of the capex is expected to be spent in Rajasthan block.

CAIR plans to invest around USD 3bn in oil exploration and raising output from its Rajasthan oilfields within next three years.

CAIR is a debt free company generated strong cash flow of USD 2.0 bn in FY13 which reflects balance sheet strength with a cash reserve of ~USD 3.0 bn. The company plans to invest USD3bn in next three years. 80% of the planned capex is expected to Rajasthan fields (50-50 share of development and exploration), and rest 20% on exploration of other assets including international blocks i.e South Africa and Sri Lanka. However, exploration expenditure is contingent on government approvals, which the company hopes to receive without major difficulties.

Balance Sheet (Consolidated)

| Y/E (₹mn) | FY12A | FY13A | FY14E | FY15E |
|---------------------------------------|----------------|----------------|----------------|----------------|
| Share Capital | 19,074 | 19,102 | 19,102 | 19,102 |
| Reserve and surplus | 463,847 | 457,892 | 471,675 | 510,444 |
| Net Worth | 482,921 | 476,994 | 490,778 | 529,546 |
| Long term provisions | 18,740 | 24,041 | 23,366 | 24,631 |
| Deferred tax liability (net) | 6,841 | 4,641 | 4,641 | 3,109 |
| Current Liabilities | 26,034 | 34,336 | 32,367 | 32,977 |
| Total Assets | 534,536 | 540,012 | 551,152 | 590,263 |
| Fixed Assets | 387,694 | 289,750 | 308,239 | 340,240 |
| Deferred tax assets (net) | 104 | 0 | 0 | 0 |
| Loans & Advances | 25,380 | 48,665 | 50,836 | 55,816 |
| Other Non-current Assets | 6,908 | 4,459 | 4,682 | 4,916 |
| Current Assets | 114,450 | 197,138 | 187,394 | 189,292 |
| Total Equity & Liabilities | 534,536 | 540,012 | 551,152 | 590,263 |

Key Ratios (Consolidated)

| Y/E | FY12A | FY13A | FY14E | FY15E |
|-------------------------|-------|-------|-------|-------|
| EBITDA Margin (%) | 78.0 | 74.4 | 71.4 | 70.6 |
| EBIT Margin (%) | 73.8 | 69.8 | 69.5 | 67.5 |
| NPM (%) | 66.9 | 68.8 | 63.6 | 59.4 |
| ROCE (%) | 18.4 | 27.0 | 25.6 | 25.4 |
| ROE (%) | 16.4 | 25.3 | 22.1 | 21.0 |
| Adj EPS (₹) | 41.6 | 63.1 | 56.7 | 58.1 |
| P/E (x) | 7.0 | 4.6 | 5.1 | 5.0 |
| BVPS (₹) | 253.2 | 249.7 | 256.9 | 277.2 |
| P/BVPS (x) | 1.1 | 1.2 | 1.1 | 1.1 |
| EV/Operating Income (x) | 4.9 | 3.7 | 3.8 | 3.6 |
| EV/EBITDA (x) | 5.4 | 4.0 | 4.4 | 4.1 |
| EV/EBIT (x) | 5.7 | 4.2 | 4.5 | 4.3 |

Profit & Loss Account (Consolidated)

| Y/E (₹mn) | FY12A | FY13A | FY14E | FY15E |
|--------------------------------|----------------|----------------|----------------|----------------|
| Net Sales | 118,607 | 175,242 | 170,231 | 186,906 |
| Expenses | 26,062 | 44,910 | 48,616 | 54,863 |
| EBITDA | 92,544 | 130,332 | 121,615 | 132,042 |
| Other Income | 9,380 | 10,362 | 19,577 | 18,691 |
| Depreciation | 14,403 | 18,459 | 22,802 | 24,649 |
| EBIT | 87,521 | 122,235 | 118,389 | 126,084 |
| Interest | 2,258 | 687 | 0 | 0 |
| Profit Before Tax and exp item | 85,263 | 121,548 | 118,389 | 126,084 |
| Exceptional Items | -1,028 | 0 | 0 | 0 |
| Profit Before Tax | 84,235 | 121,548 | 118,389 | 126,084 |
| Tax | 4,857 | 2,351 | 10,063 | 15,130 |
| Scheme of arrangement | 0 | 1,367 | 0 | 0 |
| Profit after tax | 79,377 | 120,564 | 108,326 | 110,954 |

Valuation and view

We believe that recent concerns about a potential decline in crude oil production from Mangala field were overdone with incremental production from its other Rajasthan field.

On short term production concern, we do not expect any change in the overall recoverable reserves and maintain gross recovery estimate at 1.2bboe. Our overall exit forecast after considering the possible technical problems and unsuccessful exploration stands at 219 kbpd for FY14 and 234 kbpd for FY15 and for Rajasthan alone at the rate of 184 kbpd and 207 kbpd for FY14 and FY15 respectively.

At a current market price (CMP) of ₹291, the stock trades at 5.1x FY14E and of 5.0x FY15E, earnings. We recommend 'BUY' with a target price of ₹332, which implies potential upside of ~14.0% to the CMP from 1 year persctpeive.



Indbank Merchant Banking Services Ltd.
I Floor, Khiviraj Complex I,
No.480, Anna Salai, Nandanam, Chennai 600035
Telephone No: 044 – 24313094 - 97
Fax No: 044 – 24313093
www.indbankonline.com

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