

4 December 2008

India Oil & Gas

E&P the most attractive segment, despite low oil prices

Underweight

Nifty/Sensex: 2658/8739



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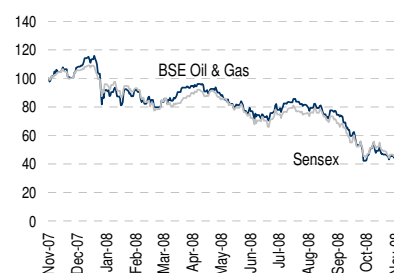
- **E&P focus.** Exploration and production would be the key value driver for the sector, in our view, with Reliance and Cairn the largest beneficiaries as they continue being successful, starting with D6 (Reliance Industries) and the Rajasthan MBA field (Cairn India).
- **Subsidy threat blows over.** With crude peaking in 2QFY09, the subsidy threat to the sector, too, has peaked. The downside to ONGC's earnings from higher subsidy sharing seems to be capped.
- **Regulatory uncertainty, competition hit R&Ms.** Earnings (and hence cash flows) of refining & marketing companies (R&Ms) could continue to be unclear, following regulatory uncertainties over retail pricing of auto fuels and keen competition from private R&Ms.
- **Oil price forecast.** We forecast Brent to average US\$90/bbl in FY09, US\$55/bbl in FY10 and US\$60/bbl in FY11. The long-term average would tend towards crude prices at which exploration in frontier basins and deepwater blocks are viable.
- **Initiate coverage – We prefer RIL, Cairn, and Aban.** We initiate coverage of India's Oil & Gas sector with Buys on RIL, ONGC, Cairn India, Aban Offshore and Reliance Petroleum, a Hold on GAIL and Sells on R&M companies, Indian Oil, Bharat Petroleum and Hindustan Petroleum. Key risk factors include crude prices, refining margins, regulatory policies and exploratory risks.

India Oil & Gas – Sector valuation summary

	Rating	Price (Rs)	Target	PE (x)		PB (x)	
		(As of 2 Dec)	Price (Rs)	FY09e	FY10e	FY09e	FY10e
RIL	Buy	1,074	1,300	11.0	9.3	1.8	1.6
CIL #	Buy	135	175	116.4	8.0	0.9	0.8
ONGC	Buy	662	950	6.5	7.3	2.0	1.7
RPL *	Buy	72	100	7.9	6.3	1.9	1.6
GAIL	Hold	197	220	7.8	10.9	1.7	1.5
Aban Offshore	Buy	640	1,200	2.5	2.1	1.4	0.8
IOC	Sell	395	330	9.6	11.8	1.1	1.0
BPCL	Sell	362	270	11.6	9.4	1.0	0.9
HPCL	Sell	237	230	10.7	7.7	0.7	0.7

Source: Anand Rathi Research # CIL estimates are for CY09e and CY10e *RPL estimates for FY10e and FY11e

BSE Oil & Gas Index vs Sensex



Source: Anand Rathi Research

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