Shiv-Vani Oil and Gas - BUY

CMP Rs454, Target Rs560

Sector: Oil and gas	
Sensex:	20,117
CMP (Rs):	454
Target price (Rs):	560
Upside (%):	23.3
52 Week h/l (Rs):	496 / 300
Market cap (Rscr) :	2,106
6m Avg vol ('000Nos):	114
No of o/s shares (mn):	46
FV (Rs):	10
Bloomberg code:	SVOG IB
Reuters code:	SHVD.BO
BSE code:	522175
NSE code:	SHIV-VANI

Prices as on 27 Sep, 2010

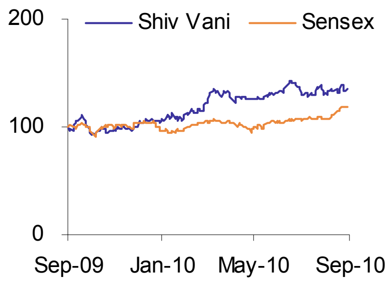
Shareholding pattern

June '10	(%)
Promoters	53.3
Institutions	16.0
Non promoter corp hold	13.9
Public & others	16.9

Performance rel. to sensex

(%)	1m	3m	1yr
Shiv Vani	(7.0)	(10.8)	19.0
Great Off	(9.5)	(28.8)	(53.8)
Aban	(3.4)	(2.3)	(68.2)
Garware Off	(10.1)	(26.4)	(48.4)

Share price trend



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Shiv-Vani Oil and Gas Exploration Services Ltd (SVOG) is well poised to gain on vast emerging opportunities in the E&P space in India. Pending minimum work program (MWP) commitments of NELP rounds, development capex and rising exploration activities in CBM fields, will translate into robust order inflows for SVOG. Its integrated nature of services will provide sustainability to margins. The stock is attractively valued at P/E of 5.7x FY12E EPS of Rs80.

Pending MWP of NELP rounds provide huge opportunities

Substantial portion of MWP committed during the NELP II- VI rounds of NELP is yet to be completed. Work related to ~5,500 line kms of 2-D seismic survey, ~5,000 sqkm of 3-D seismic survey and ~305 exploratory wells are pending. As per our workings, this entails an opportunity of ~US$1.7bn. Furthermore, for NELP VII and VIII rounds, work related to ~10,000 line kms of 2-D seismic survey, ~10,000 sqkms of 3-D seismic survey and 205 wells is yet to be initiated. This, as per our workings, should translate into an opportunity of ~US$1.4bn.

CBM opportunity… a shot in the arm

India, having the fourth largest proven coal reserves in the world, holds significant prospects for exploration and exploitation of coal bed methane (CBM). The total sedimentary area for CBM exploration in India is of the order of 26,000 sqkm. Out of this, exploration has been initiated in only 52% of the area. In other words, a large area remains to be explored. With India being a net importer of gas, we believe CBM activities would gain traction over the near term providing huge order inflow for integrated players like SVOG.

Valuations attractive at P/E of 5.7x FY12E earnings

As compared to a revenue CAGR of 28% during FY10-12E, we expect SVOG to report an earnings CAGR of 35% during the same period. Resultantly, RoE should improve from 18.9% in FY10 to 22.6% in FY12E. Strong earnings growth will also allow its debt/equity ratio to decline from 1.9x in FY10 to 1.5x in FY12E. Such robust earnings profile coupled with an attractive P/E of 5.7x FY12E makes SVOG a compelling investment opportunity. We recommend BUY with a target price of Rs560 (7x FY12E EPS of Rs80).

Valuation summary

Y/e 31 Mar (Rs m)	FY09	FY10	FY11E	FY12E
Revenues	8,713	12,519	16,045	20,518
yoy growth (%)	51.6	43.7	28.2	27.9
Operating profit	3,522	5,591	6,980	8,823
OPM (%)	40.4	44.7	43.5	43.0
Reported PAT	1,927	2,027	2,526	3,716
yoy growth (%)	108.9	5.2	24.6	47.1
EPS (Rs)	43.9	43.7	54.5	80.2
P/E (x)	10.3	10.4	8.3	5.7
Price/Book (x)	2.2	1.7	1.4	1.2
EV/EBITDA (x)	11.2	7.8	6.1	5.1
Debt/Equity (x)	2.3	1.9	1.6	1.5
RoE (%)	23.9	18.9	18.6	22.6
RoCE (%)	14.7	13.5	14.8	17.0

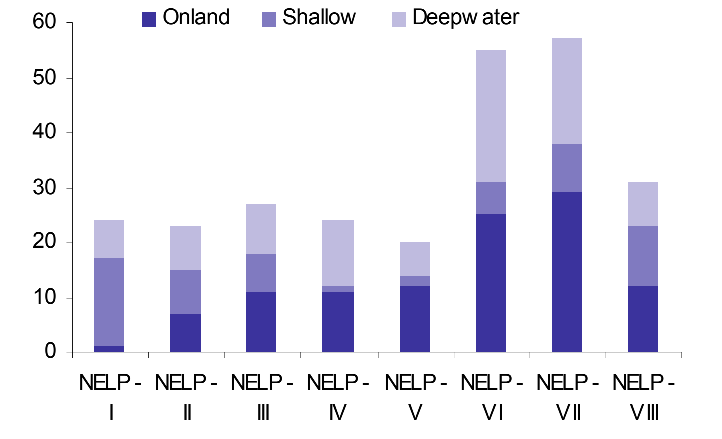
Source: Company, India Infoline Research

Momentum in onshore exploration activities to continue

Rising proportion of onshore blocks in NELP rounds will ensure continuous order inflow for SVOG

Over the last eight rounds of New Exploration Licensing Policy (NELP), Government of India has allocated 261 blocks of which 41% of the blocks (108 blocks) have been onshore blocks. In the last three rounds (VI-VIII), the proportion has been higher at 46% (66 out of 143 blocks). This would translate into robust investments into exploration activities creating vast opportunities for onshore service providers such as SVOG. Furthermore, government is expected to launch NELP IX in the near term, whereby a total of ~45 blocks (as per media reports) will be offered.

Trend in blocks offered



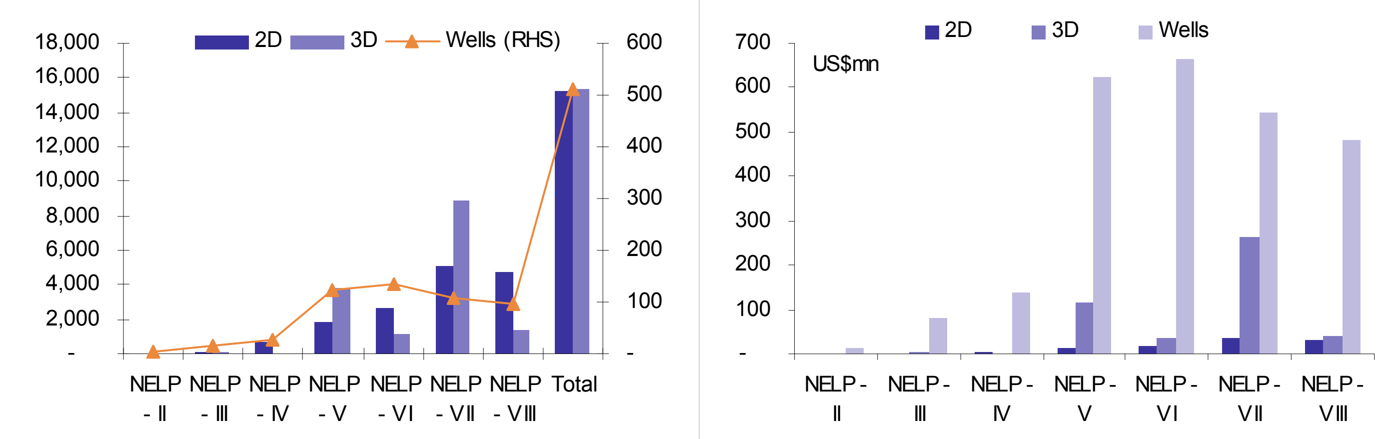
Source: DGH, India Infoline Research

Pending minimum work commitment of earlier rounds will ensure investments in the near term

A total of US$3.2bn worth of commitments made in NELP rounds yet to be completed

Substantial portion of MWP committed during the NELP II- VI rounds of NELP is yet to be completed. Work related to ~5,500 line kms of 2-D seismic survey, ~5,000 sqkm of 3-D seismic survey and ~305 exploratory wells are pending. As per our workings, this entails an opportunity of ~US$1.7bn. Furthermore, for NELP VII and VIII rounds, work related to ~10,000 line kms of 2-D seismic survey, ~10,000 sqkms of 3-D seismic survey and 205 wells is yet to be initiated. This, as per our workings, should translate into an opportunity of ~US$1.4bn.

Pending MWP of the NELP rounds



Source: DGH, India Infoline Research

Development capex is multifold of exploration capex. Hence any new discoveries would translate into bigger opportunities for SVOG

Development capex would lead to bigger opportunities

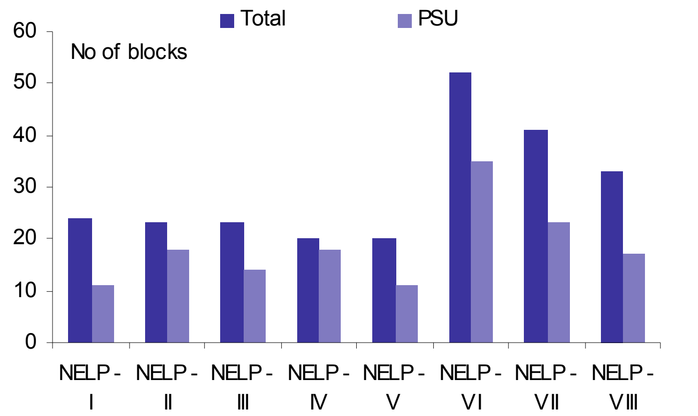
The above mentioned projects are explicitly related to exploration capex. Any commercially viable discoveries during the exploration process will only translate into multi-fold jump in opportunities for service providers. To keep things in perspective, a total of ~US$620mn was invested for exploration activities in the Cairn India's Rajasthan block, while the current estimate for its development capex until CY11 is US$4bn. This would differ from block to block based on the quantum of reserves, reservoir structure and many other factors.

With ONGC and Oil India having aggressive capex plans, SVOG having majority of its revenues from these players will be a major beneficiary

PSU have won majority of the blocks in the NELP rounds

In all the rounds of NELP concluded so far, majority of the blocks awarded have been won by PSU companies (ONGC and Oil India). These two companies have historically formed a substantial portion of SVOG's order book and revenue.

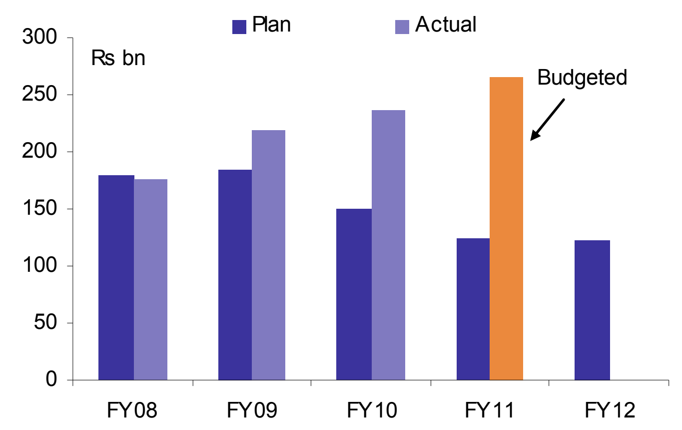
PSU have bagged majority blocks



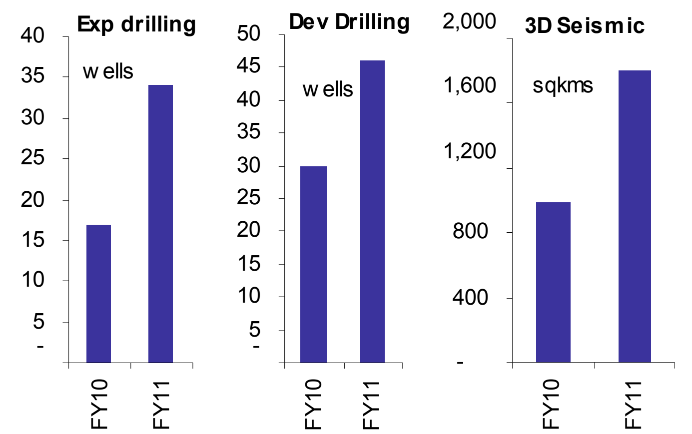
Source: DGH, India Infoline Research

Furthermore, these companies have lined up aggressive capex plans over the medium term, entailing big opportunity for SVOG.

ONGC capex plans



Oil India's capex plans



Source: Companies

CBM opportunity… a shot in the arm

India has the fourth larges proven coal reserves in the world leading to high prospects for CBM exploration

The prognosticated CBM resources are about 50 TCF, out of which only 8.39 TCF has been established

India, having the fourth largest proven coal reserves in the world, holds significant prospects for exploration and exploitation of coal bed methane (CBM). The exploration awareness for Coal Bed Methane (CBM) in India shows a dramatic change of scenario from lukewarm response in the first round of bidding (2001) to 'CBM rush' in the third round (2006), within a span of five years. 54 bids were received from 26 companies, including 8 foreign and 18 Indian Companies, for 10 blocks, in CBM-III. In April, 2009, another 10 CBM blocks were offered under CBM-IV. A total of 27 bids were received for 8 blocks. The total sedimentary area for CBM exploration in India is of the order of 26,000 sqkm. Out of this, exploration has been initiated in only 52% of the area. In other words, a large area remains to be explored. 26 blocks altogether have been allocated to different Indian and foreign operators during the previous 3 rounds of CBM bidding. The prognosticated CBM resources are about 50 TCF, out of which only 8.39 TCF has been established. There is, therefore, a huge opportunity for potential CBM in India.

From a current level of a total CBM production of 0.15 MMSCMD in the country, it is expected to go up to 7.4 MMSCMD by the year FY14

Commercial production of CBM has already commenced in Raniganj (South) CBM block in West Bengal. Efforts are also being made in Sohagpur blocks in Madhya Pradesh and Jharia block in Jharkhand for commencement of commercial production at the earliest. From a current level of a total CBM production of 0.15 MMSCMD in the country, it is expected to go up to 7.4 MMSCMD by the year FY14.

Status of CBM Blocks as on 1st May,2010	
Blocks awarded till date	
i) Nomination basis	3
ii) Under round-I	5
iii) Under round-II	8
iv) Under Round-III	10
Total	26
Status of Blocks as on date under	
i) Exploration Phase-I	10
ii) Exploration Phase-II	8
iii) Development Phase-III*	3
iv) Relinquished after Phase-I	3
v) Awaiting grant of PEL	2
Area awareded,sq. km.	13,600
Total CBM Resoures, BCM	1,374
CBM wells drilled so far (Core Hole/Test well/ Pilot well)	300
CBM reserve established (Gas Initial In Place), TCF/BCM for 4 blocks	8.4
Expected Production Potential,MMSCMD	38
Commercial Production commenced, w.e.f	14.07.07
Approved gas sale Price,$/MMbtu	6.79
Present Gas Production from 3 blocks RG(S),SP(E), & SP(W),MMSCMD	0.15
Expected CBM gas production from 3 blocks by 2013 [Raniganj(S),SP (E),SP(W)],MMSCMD	7.4

Source: DGH, India Infoline Research

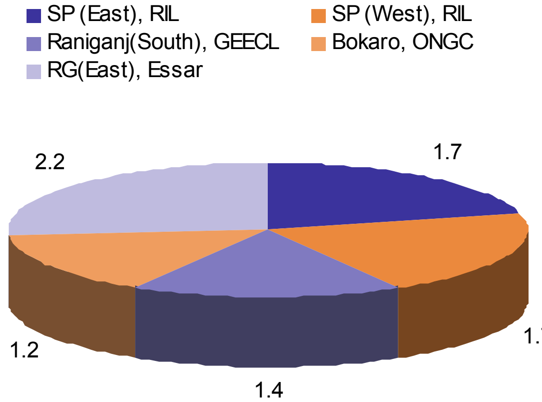
Pending work commitments provide ample opportunities

Akin to conventional exploration activities, substantial portion of work commitments made in four rounds of CBM are yet to be completed. Majority of the pending work is related to development wells. Vis-à-vis a total work commitment of Rs13.7bn, so far about Rs9.8bn have been made. If we exclude, Raniganj (South) block, total work commitment is about Rs13.5bn against which only Rs6.4bn investments have been made. If we assume the ratio of 10x (actual capex/commited capex) for all fields, against 15x for Raniganj (south) block, we estimate an opportunity of Rs125bn in CBM exploration.

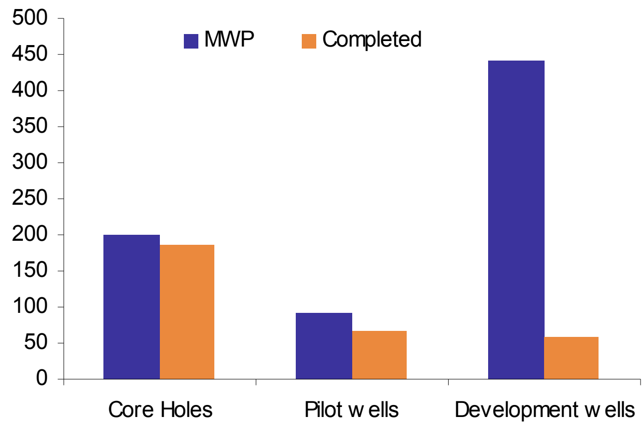
Pending work in CBM blocks

Source: DGH

Breakup of current CBM reserves



Pending work in CBM blocks



Source: Companies

SVOG well placed to leverage on this opportunity

SVOG is the only integrated service provider in India for onshore oil and gas exploration activities

Integrated nature of SVOG business

SVOG provides gamut of services across the value chain of exploration and development in onshore areas.

SVOG is the largest player in the domestic market for seismic studies with a 40% market share

Seismic studies

Seismic studies generally account for ~15% of the spend on exploration and development of a field. SVOG is the largest player in the domestic market for seismic studies and currently has about 40% market share.

Other key highlights of the segment:

- Large fleet of latest Seismic Equipments: 10 sets
- Shot-hole rigs (truck-mounted & portable): 350
- Number of channels: 55,000
- Well-equipped to carry out operations in varied terrains ranging from mountains and dense forests
- Dedicated team of geophysicists, surveyors and engineers

SVOG has a large fleet of 40 deep drilling and workover rigs, which includes advance drilling rigs with capacity to drill wells up-to a maximum depth of 8,000 meters

Deep drilling services

SVOG has a major presence in the deep drilling services and garners majority of its order book from the segment. As per our calculations, pending MWP in NELP II-VIII round for 2-D and 3-D seismic survey is about US$567mn, while that of drilling wells is ~US$2.6bn. SVOG is well poised to serve this opportunity.

Other key highlights of the segment:

- Large fleet of 40 deep drilling and workover rigs
- Fleet includes advance drilling rigs with capacity to drill wells up-to a maximum depth of 8,000 meters, including one 3,000HP drilling rig
- Long term tie-ups with original equipment manufacturers for equipment maintenance
- Adequate inventory of stores and spares; 3 workshops spread across India

SVOG provides a gamut of services for CBM operators and is the only integrated CBM services provider in India

CBM services

SVOG provides a gamut of services for CBM operators and is the only integrated CBM services provider in India. The company has the ability to provide multilateral inseam, horizontal directional drilling which results in significant increase in flow rates and optimises CBM production. It currently has 8 sets of modern Directional drilling equipment and has also procured advanced simulators for production and recovery of methane from coal seam reservoirs. It is currently executing US$200mn pilot project for development of 3 CBM blocks for ONGC on turn key basis. With the vast potential for CBM exploration in the country, we believe CBM would be a key driver for revenue and earnings growth for SVOG over the medium term.

Services provided under CBM portfolio

- Basin assessment and fairway delineation
- Exploration target selection
- Resource mapping and assessment
- Prospect evaluation
- Well testing and production forecasting
- Fracture treatment design and optimisation
- Coal bed reservoir simulation
- Reservoir determination and economic evaluation
- Mentoring and technology transfer

Its integrated well management services include Well logging, cementing, mud engineering, directional drilling, well testing etc.

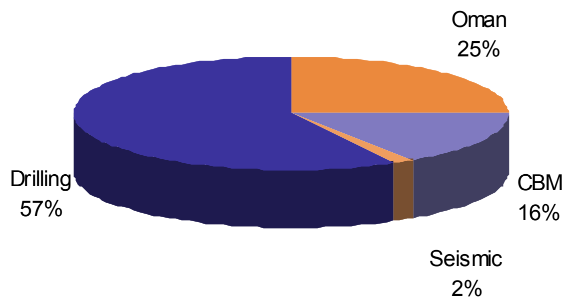
Integrated well management

SVOG is evolving as a one stop solution provider for onshore E&P services. Its integrated well management services include Well logging, cementing, mud engineering, directional drilling, well testing etc. It has technology collaboration with leading international players. Such integrated nature of services gets them preference over other players as the field operators get all services under one roof. For SVOG, this enhances margins as same set of facilities are used for various services.

Other E&P services

- Operation of 4 offshore logistics support vessels
- Natural gas compression
- Design and building of gas gathering stations
- Laying of pipelines etc
- Marginal field service contract at Charaideo, Assam with ONGC
- Additional opportunities to be explored wherever there are synergies of utilizing existing equipment

Breakup of current order book of Rs32bn



Source: Company, India Infoline Research

Majority of the assets that SVOG uses for its operations are self-owned. This reduces its dependence on any third-party

Owned assets enhances margins

Majority of the assets that SVOG uses for its operations are self-owned. This reduces its dependence on any third-party for its operations providing its customers more reliable and sustainable operations during the course of the contract. Furthermore, this asset base is spread across the country and it also owns majority of the logistics support vessels leading to reduction in transportation time translating into better margins for the company.

SVOG's cost advantage

SVOG has substantial cost advantages over its peers, which translates into higher order wins for the company relative to peers. These advantages include

- With vast and integrated asset portfolio, SVOG enjoys economies of scale leading to lower cost of operations
- Lower manpower costs, including cost of rotation
- Pan-India presence
- Own engineering workshops resulting in significant cost advantages and reduction in dependencies

Domestic advantage

SVOG enjoys an advantage over its international peers, as Indian PSUs provide 10% price preference to domestic players in bidding for their contracts

SVOG enjoys an advantage over its international peers vying for a major market share in India, as Indian PSUs provide 10% price preference to domestic players in bidding for their contracts. Historically, ~90% of SVOG's revenue have been from the domestic PSUs. This leaves a proven track record for private players as well. Furthermore, re-location of rigs and assets involves a lot of bureaucratic hurdles (approval from all districts through which the rig moves), where an established player like SVOG has an upper hand.

Strong topline growth driven by deep drilling and CBM segments

Revenue CAGR of 28% during FY10-12E led by 42% CAGR in drilling services and 15% CAGR in CBM operations

We expect SVOG to report a 28% revenue CAGR during FY10-12E. The growth will be on back of 42% CAGR in drilling services and 15% CAGR in CBM services. There exists an upside risk to our assumption in CBM services as CBM exploration activities are still gathering momentum. With evolution of technology, we expect improved traction in CBM exploration activities leading to quantum jump in opportunities for SVOG. We expect SVOG's seismic survey segment to register a revenue CAGR of 10% during the same period.

Margins sustainable at current levels

With substantial cost advantages as enumerated above, we believe, SVOG can sustain operating margins in the range of 43-44%. The drilling business earns an OPM of about 40-42% as against ~48% for its seismic survey business. CBM business currently earns around 40% margins. We believe, this can increase further as the business gains momentum. An increase in integrated contracts will provide additional upsides to our margin assumptions.

Valuations attractive at P/E of 5.7x FY12E earnings

Robust earnings profile, reduction in D/E ratio, improvement in RoE along with P/E of 5.7x FY12E EPS makes SVOG a compelling BUY

As compared to a revenue CAGR of 28% during FY10-12E, we expect SVOG to report an earnings CAGR of 35% during the same period. Resultantly, RoE should improve from 18.9% in FY10 to 22.6% in FY12E. Strong earnings growth will also allow its debt/equity ratio to decline from 1.9x in FY10 to 1.5x in FY12E. Such robust earnings profile coupled with an attractive P/E of 5.7x FY12E makes SVOG a compelling investment opportunity. We recommend BUY with a target price of Rs560 (7x FY12E EPS of Rs80).

Financials

Income statement

Y/e 31 Mar (Rs m)	FY09	FY10	FY11E	FY12E
Revenue	8,713	12,519	16,045	20,518
Operating profit	**3,522**	**5,591**	**6,980**	**8,823**
Depreciation	(502)	(1,097)	(1,408)	(1,688)
Interest expense	(845)	(1,933)	(2,374)	(2,406)
Other income	307	45	50	50
Profit before tax	**2,482**	**2,607**	**3,248**	**4,779**
Taxes	(555)	(579)	(722)	(1,062)
Net profit	**1,927**	**2,027**	**2,526**	**3,716**

Balance sheet

Y/e 31 Mar (Rs m)	FY09	FY10	FY11E	FY12E
Equity capital	439	464	464	464
Reserves	8,573	11,969	14,231	17,683
Net worth	**9,012**	**12,433**	**14,695**	**18,147**
Debt	20,712	23,737	23,737	26,737
Def tax liab (net)	533	974	600	650
Total liabilities	**30,256**	**37,144**	**39,032**	**45,534**
Fixed assets	25,816	31,373	31,291	36,604
Investments	15	15	15	15
Net working cap	**3,391**	**4,760**	**5,308**	**5,923**
Inventories	878	768	967	1,237
Sundry debtors	2,323	4,011	5,275	6,745
Other curr assets	2,947	4,024	4,166	4,366
Sundry creditors	(2,134)	(3,439)	(4,396)	(5,621)
Other curr liabilities	(624)	(604)	(704)	(804)
Cash	1,033	996	2,417	2,993
Total assets	**30,256**	**37,144**	**39,032**	**45,534**

Cash flow statement

Y/e 31 Mar (Rs m)	FY09	FY10	FY11E	FY12E
Profit before tax	2,482	2,607	3,248	4,779
Depreciation	502	1,097	1,408	1,688
Tax paid	(555)	(579)	(722)	(1,062)
Working capital Δ	635	(1,369)	(548)	(615)
Operating cashflow	3,064	1,755	3,386	4,789
Capital expenditure	(15,945)	(6,653)	(1,326)	(7,000)
Free cash flow	**(12,881)**	**(4,898)**	**2,060**	**(2,211)**
Equity raised	33	1,658	-	-
Investments	-	-	-	-
Debt financing/disposal	13,012	3,025	-	3,000
Dividends paid	(51)	(264)	(264)	(264)
Other items	286	442	(374)	50
Net Δ in cash	**399**	**(38)**	**1,422**	**575**

Key ratios

Y/e 31 Mar	FY09	FY10	FY11E	FY12E
Growth matrix (%)				
Revenue growth	51.6	43.7	28.2	27.9
Op profit growth	59.3	58.8	24.8	26.4
EBIT growth	77.7	36.5	23.8	27.8
Net profit growth	108.9	5.2	24.6	47.1
Profitability ratios (%)				
OPM	40.4	44.7	43.5	43.0
EBIT margin	38.2	36.3	35.0	35.0
Net profit margin	22.1	16.2	15.7	18.1
RoCE	14.7	13.5	14.8	17.0
RoNW	23.9	18.9	18.6	22.6
RoA	7.8	5.5	5.9	7.7
Per share ratios (Rs)				
EPS	43.9	43.7	54.5	80.2
DPS	1.0	5.0	5.0	5.0
CEPS	55.3	67.4	84.9	116.6
BVPS	205.3	268.2	317.0	391.4
Valuation ratios (x)				
P/E	10.3	10.4	8.3	5.7
P/CEPS	8.2	6.7	5.3	3.9
P/B	2.2	1.7	1.4	1.2
EV/EBIDTA	11.2	7.8	6.1	5.1
Payout (%)				
Dividend payout	2.7	13.0	10.5	7.1
Tax payout	22.3	22.2	22.2	22.2
Liquidity ratios				
Debtor days	97	117	120	120
Inventory days	37	22	22	22
Creditor days	89	100	100	100
Leverage ratios				
Net debt / equity	2.2	1.8	1.5	1.3
Net debt / op. profit	5.6	4.1	3.1	2.7

Du-Pont Analysis

Y/e 31 Mar (Rs m)	FY09	FY10	FY11E	FY12E
Tax burden (x)	0.78	0.78	0.78	0.78
Interest burden (x)	0.75	0.57	0.58	0.67
EBIT margin (x)	0.38	0.36	0.35	0.35
Asset turnover (x)	0.35	0.34	0.38	0.43
Financial leverage (x)	3.08	3.46	3.15	2.93
RoE (%)	**23.9**	**18.9**	**18.6**	**22.6**

Recommendation parameters for fundamental reports:

Buy – Absolute return of over +10%

Market Performer – Absolute return between -10% to +10%

Sell – Absolute return below -10%

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