Cairn Energy PLC 10/03/2015 **FAT-TRA-001**

CNE GBP £3.34 Spec. **HIGH** B

A history of exploration success and high impact targets ahoy

Oil is one of Fat Prophets preferred commodities and as such we are always on the look out for stocks that have demonstrated exploration and development success combined with strong operating cash flows. This tends to mean looking amongst medium and large petroleum businesses. Another company that we have identified with positive attributes is Cairn Energy PLC. The group has a strong balance sheet with around US$1.2bn in cash and a long history of exploration success.

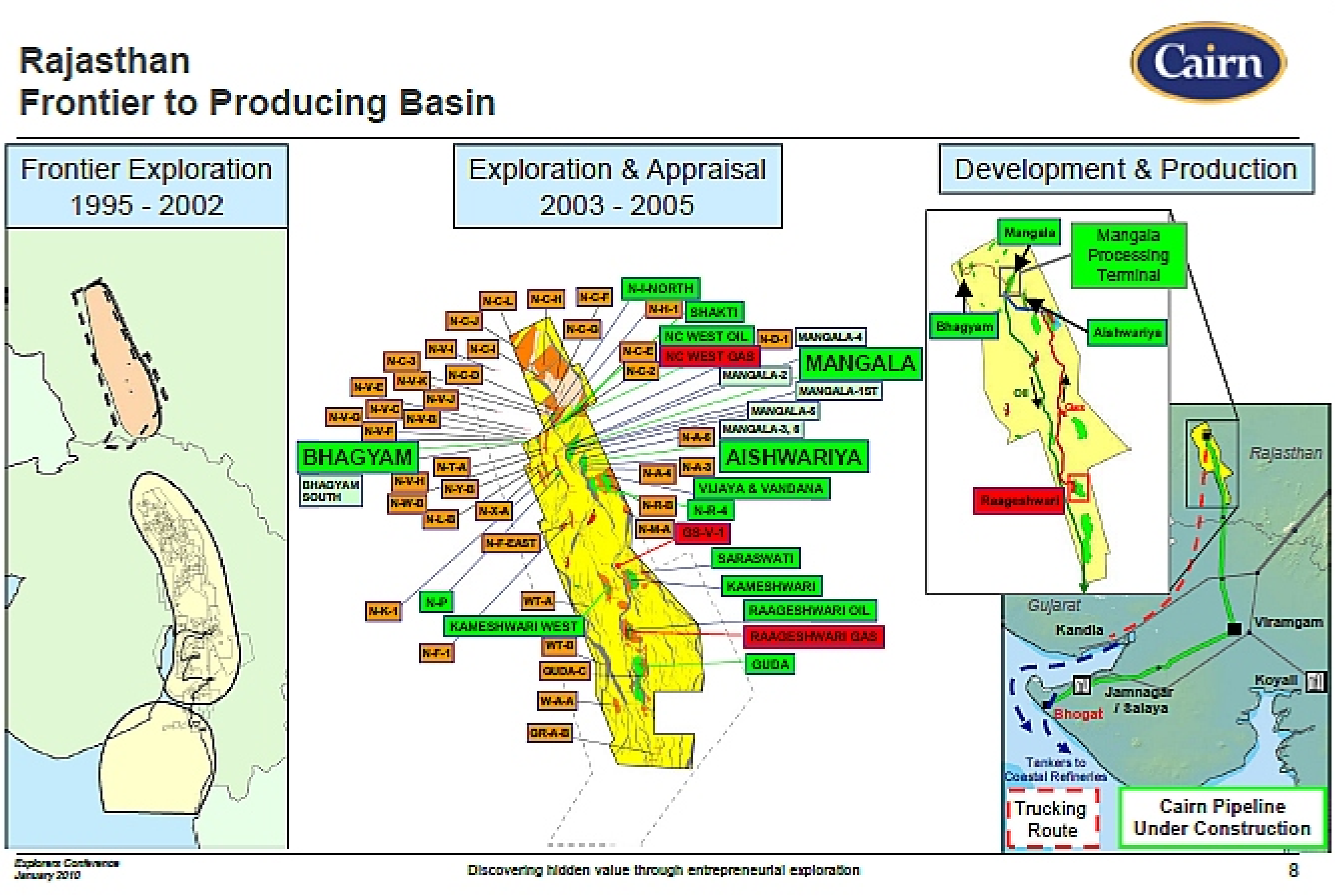
Cairn's discovery of the Mangala Field was the biggest oil discovery in India for two decades. The discovery is in Rajasthan, Block RJ-ON-90/1, in which Cairn India is operator with a 70% interest.

Cairn has discovered 3.7Bn barrels of which more than half is in the Mangala, Bhagyam and Aishwarya oilfields. Recoverable 2P reserves are 685M boe with a further 300M boe which has Enhanced Oil Recovery potential.

The discovery was very important for India where imports of crude oil exceed 70% of oil requirements. Demand is growing apace, and in combination with strong growth in demand from China, the price of oil is under upward pressure, which will increase as the recovery in the US gains pace.

Production from Mangala is underway and is expected to peak at around 120,000 bopd during 2010. A pipeline that will deliver oil to Reliance's Jamnagar oil refinery is in advanced stages of commissioning. Gas has been introduced into the gas section of the pipeline and the company is in talks with buyers to optimise production with off-take.

The scope of Rajasthan project is shown in the following map taken from a recent company presentation.



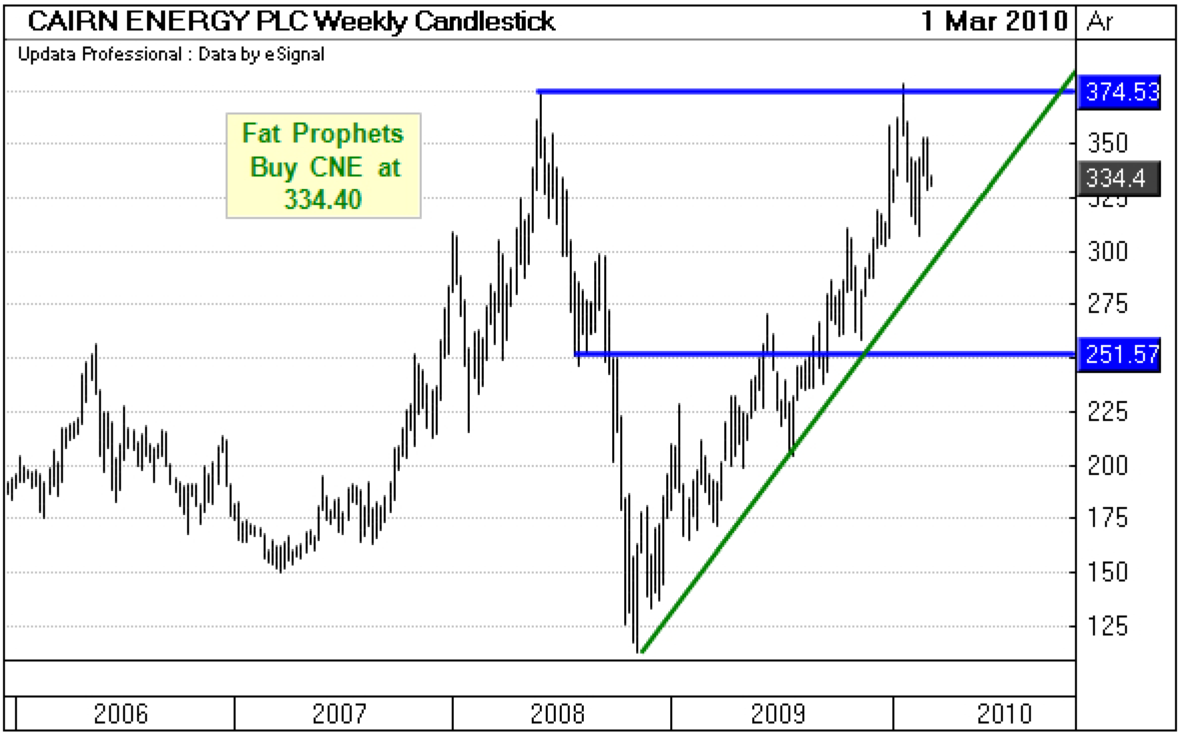
The company's Mangala Processing Terminal has a production capacity of 30,000 bopd increasing to 100,000 bopd in 1H10. The company believes that the Rajasthan will deliver 175,000 bopd with production from the Bhagyam and Aishwarya fields. At the current price of oil, gross revenues are expected to build to over US$2.0Bn per annum in 2011.

Cairn is targeting low operating costs of around US$5.00 per barrel, comprising a lifting cost of US$3.50 and US$1.50 for transportation. The price of its oil is linked to the Nigerian Bonny Light, which sells at a 10-15% discount to the last six-month average of Brent Crude.

India is producing a strong cash flow and Greenland has excellent exploration potential. The company's share price has been a bit weaker over recent days, thus offering an opportune time to build an exposure to the company.

SHARE PRICE CHARTS AND COMMENTS:

Looking at the long term technical picture of Cairn Energy we can see that the strong run for the duration of 2009 has seen the stock fully retrace the sell off endured in the latter half of 2008.



Taking a closer look at the daily technical situation of CNE we can see that after spiking above the 375p level which coincides with the 2008 high the share price pulled back to support at the uptrend line providing an a good buying opportunity.

STATE OF PLAY

Gross production of oil and gas for 4Q09 was 66,843 boepd. The company's working interest in production of 24,599 boepd, which was 43% higher than a year ago. Oil production from Mangala was 15,430 bopd but this has since risen to 20,000 bopd. Trains 2 and 3 at the processing terminal will increase capacity to 125,000 bopd by the end of 1H10.

Development drilling is progressing and 33 from 43 wells have been completed to support the ramp up in production.

Exploration has started in the Palar-Pennar basin (offshore East Coast India) and in the Mannar Basin in Sri Lanka, starting with 3D seismic.

Consolidated revenue of US$106M was sharply higher than a year ago.

The consolidated profit after tax for 4Q09 was US$62M, up from US$49M in 4Q08. Cash flow from operations was US$59M compared with US$20M a year ago.

Cairn India had US$591M in cash at 31 December 2009 and had drawn down US$688M of a US$1.6Bn facility provided by a syndication of 14 banks.

Cairn is diversifying its exploration interest to Greenland in 2H10 where two rigs have been secured to drill up to four high impact wells. The success rate for wildcat wells is around 1:9 on a global basis. This means the company might drill many wells in Greenland before having success.

Through Capricorn Oil the company has acquired a leading acreage position offshore Greenland. Capricorn has interests in 8 exploration blocks, and is the operator for six blocks. After selling down some of its interests the company has maintained high leveraged positions with 77.5% in the Sigguk and Eqqua blocks and an 82% interest in the Kingittoq, Saqqamuit, Salliit and Uummannarsuaq blocks.

The eight blocks cover 72,000 km2 with water depths ranging from a shallow 50m to 2,200m.

The US Geological Survey (USGS) has released its Circum-Artic Resource Appraisal report that concluded:

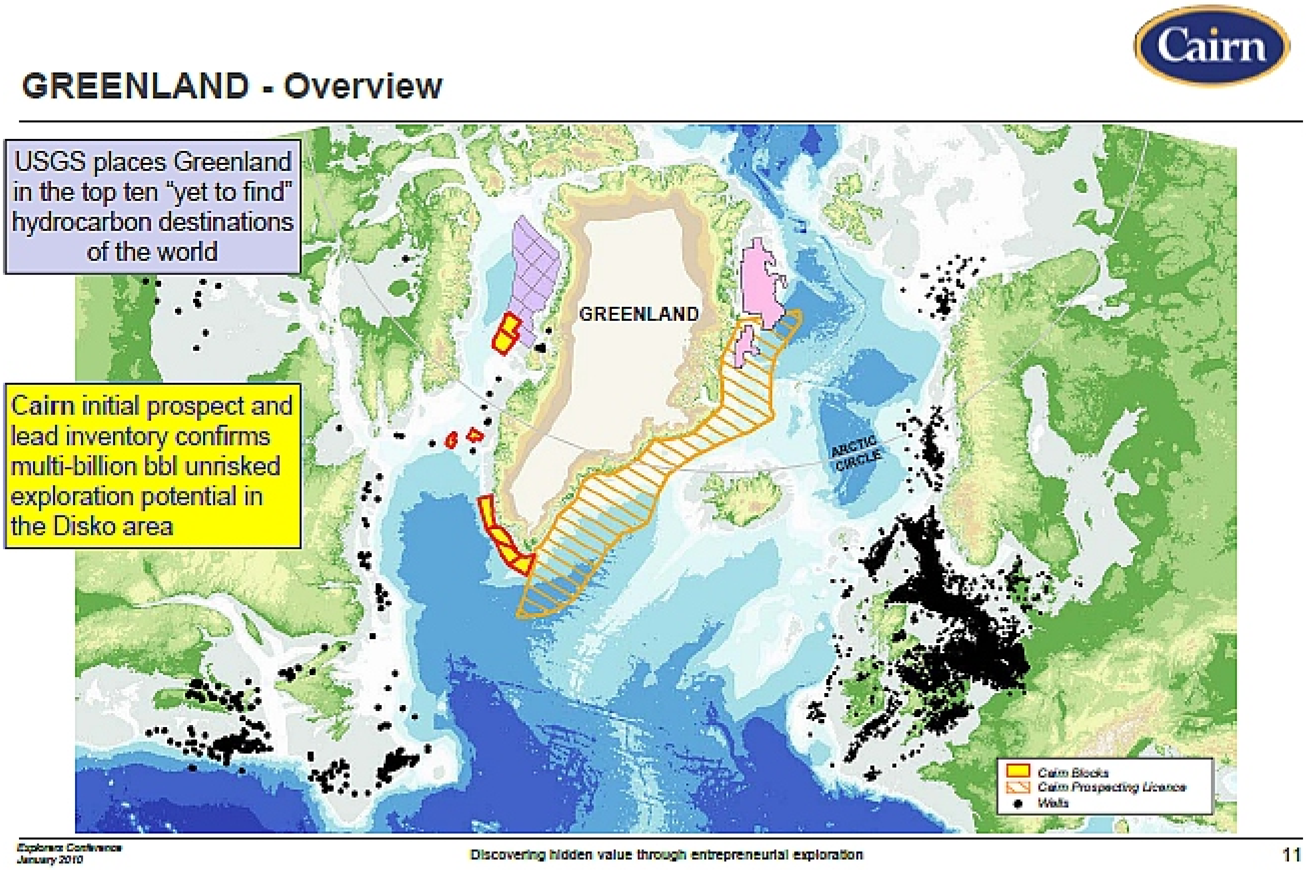
"The extensive Arctic continental shelf may constitute the geographically largest unexplored prospective area for petroleum remaining on earth."

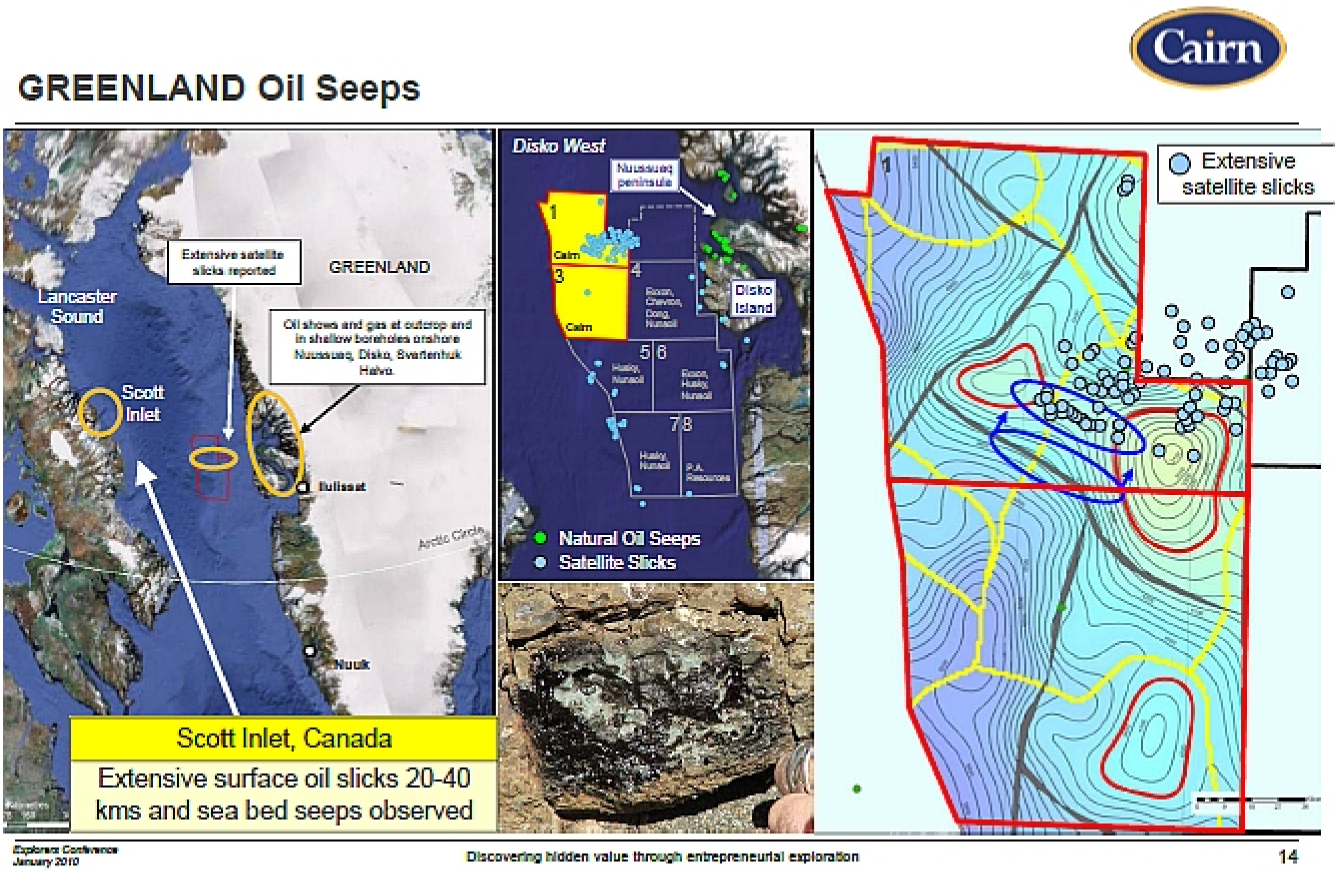
Extensive oil slicks have been identified off the west coast of Greenland from satellites and onshore, there are oil and gas shows in outcrop, and shows have been recorded from shallow bore holes.

The company has identified prospects and leads in the Disko area with potential for billions of barrels of unrisked oil. The second half of 2010 is going to be a very exciting one for the company and its shareholders.

The companies 8 prospects are shown in the following map outlined in red. The last map shows extensive oil slicks over the northern part of the company's Disko acreage. It is no wonder that the stock is performing well in anticipation of successful exploration.

Speculators are almost certain to spike the company's share price ahead of spudding the first well in the anticipation of a major discovery – only time will tell. But with onshore oil seeps and gas shows, and oil slicks identified from satellite, perhaps the odds are going to be far less than 1:9.





In terms of value, Cairn India Limited will easily underwrite the company's current valuation. The consensus earnings forecasts for Cairn Energy show strong revenue growth from US$480M in 2010 to US$835M in 2012. From 2013, earnings decline because of natural field decline which all oilfields suffer from.

The price earnings multiple for 2010 is 16X and the cash flow multiple is 7X. On these multiples the stock is fair value but looking ahead to 2011 and 2012, higher production from Rajasthan lifts revenues to over US$800M, and the price earnings multiples fall to 9.2X for 2011, and 8.7X for 2012. The cash flow multiples are very low at 3.9X and 3.4X respectively.

Cairn is not carrying a premium for exploration. A major discovery in Greenland will result in a very big increase in the company's share price.

The valuation metrics for the company are very undemanding. The company has a strong cash flow and has over US$1Bn on the balance sheet. Better still; the exploration potential is obviously very high with up to four high impact wells scheduled for 2H10.

Cairn Energy is recommended as a BUY for all Members.

Snapshot CNE

Cairn Energy PLC

Cairn Energy's activities are focused on oil and gas in India, and exploration in Greenland. The company operates in India through its 62.4% owned Cairn India Limited (CIL). CIL is listed on the Bombay stock exchange and generates a strong cash flow. Capricorn Oil is a wholly subsidiary with core assets in Greenland, Mediterranean and South Asia. The company has been very successful exploring in South Asia where it has made more than 40 oil and gas discoveries. Cairn made a major oil discovery in Northwest India in 2004.

Market Capitalisation:GBP 4.67Bn