Reliance Industries Limited (RIL)

- Really Reliable

CMP: INR 1,674 **Target Price: INR 2,120 (12-Months)** **BUY**

Sensex:	13,968
S&P Nifty:	4,113
52 Wk High INR:	1,785
52 Wk Low INR:	842
Face Value: INR:	10
Equity INR Mln.:	14,532
Mkt Cap: INR Mln.:	2,432,657
Financial Year End:	March

Codes

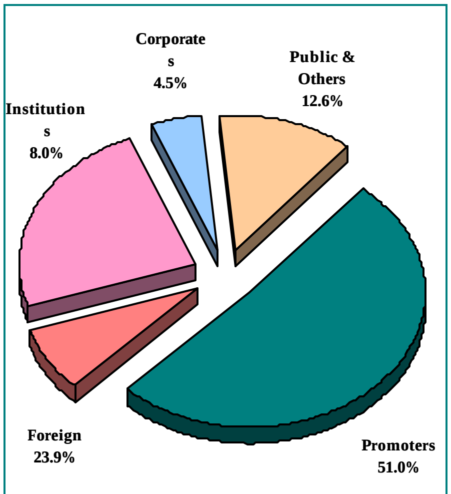
BSE Code:	500325
Bloomberg Code:	RIL@IN
Reuters Code:	RELI.BO
NSE Code:	RELIANCE
BSE Group:	A

Group:	Mukesh Ambani
Industry:	Refineries

Listings

Mumbai, NSE, London, Luxembourg, NASDAQ

Shareholding Pattern (%)



Source: CMIE, as on March 31, 2007

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Investment Argument:

- **Geared for Exploration:**

RIL is all set to start off with its exploration avenue with huge reserves in Panna-Mukta-Tapti fields and KG BASIN. The Panna-Mukta-Tapti Field discoveries are going to increase the oil production of the company to 52,000 barrel per day and natural gas production to 6million square cubic meter per day. The KG BASIN produce of natural gas is set to hit the market in mid 2008 with 80 mmscmd. This produce will increase the share of exploration business to 6-8% of the company business in coming years.

- **Retail robust:**

It is all set to start off its full fledge retail business with target of 100 million square feet space area. We estimate the company would achieve its target by 2012. 12-month down the line we can expect Reliance retail to add Rs 110 to the value per share . It can give an upside in valuation further with capital expenditure of Rs 25,000 crore to spread retail network in around 800 cities.

- **Advantage EOU (export oriented unit):**

The existing Jamnagar refinery is given the status of export oriented unit which is going to exempt it from payment of tax on export earnings. This will benefit the company since 58 % of earnings are generated through exports. This will improve the margins of the company.

- **Merger melody:**

The petrochemical industry is consistently growing at 17%. The industry cycle is expected to face a slowdown in mid 2008 due to higher competition. Reliance geared itself to sustain its dominant position by the merger with IPCL. Both IPCL and RIL are enjoying dominant position and they will have a combined market share of 80%. The possible captive consumption of petrochemical intermediates produced by IPCL can give a synergy of around 5-7%

- **Huge cash generation:**

We expect a major global acquisition by the company in near future with the kind of cash it is generating. The cash per share is calculated at Rs 131/- in 2008,over and above its huge capital expenditure plans in retail and exploration.

- **RPL to give an upside:**

RPL is set to commission its Jamnagar refinery and polypropolene plant with capacity of 580,000 barrels per day of refined products in 2008-09. This being an export-oriented unit is expected to give tax benefits and revenue generation more than the existing Jamnagar refinery.

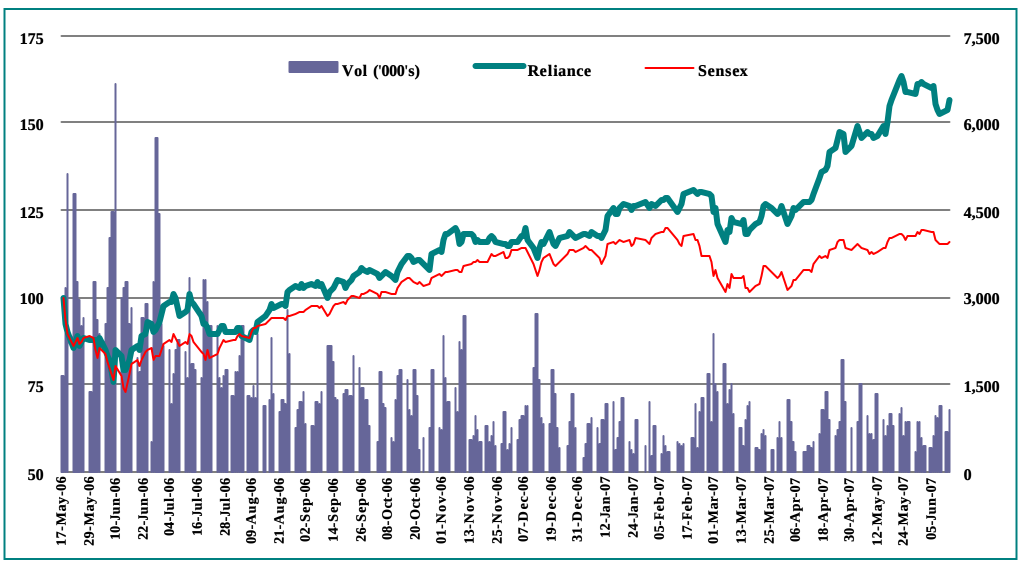
Valuation:

We have arrived at a fair value of INR 2,120 with SOTP valuation with 12 months target of each strategic business unit and investments. The company is currently trading at P/E 21.5x in FY07 15.3x in FY08 and 11x in FY09. We include further rise recently of at least Rs 250 with optimistic scenario of GRMs of $13 per barrel and latest finds in natural gas and oil at north east coast with reserves of around 8TCF. More blocks are expected to be allotted in NELP VII and retail expansion further can also give a major boost to the valuation. We recommend a '**BUY'** for the stock.

Financial Summary:

Particulars (Rs. Mlns.)	FY06	FY07	FY08E	FY09E	FY10E
Sales	8,12,113	11,82,630	13,17,348	14,16,783	14,88,165
EBITDA	1,49,820	2,13,379	2,69,740	3,63,163	4,04,415
Net profit	90,693	1,23,788	1,74,591	2,42,442	2,66,823
Basic EPS (Rs.)	**65.0**	**85.2**	**120.0**	**154.3**	**169.8**
Diluted EPS (Rs.)	57.7	78.8	111.1	154.3	169.8
P/Ex	27.0	21.5	15.3	11	10
P/BVx	4.9	3.8	3.1	2.1	1.8

Comparative share price movement:



SWOT ANALYSIS

Strengths:

- ✓ It enjoys dominant market share in India with
  - 65% in polyester
  - 28% in refining
  - 68% in polymers
  - 78% in fiber intermediates.
- ✓ It contributes 2.8% of the GDP
  - Its contribution to Country's total exports is 8.2%. The total exports stand at US $ 7.3billon
- ✓ Largest private sector business enterprise
- ✓ An export-oriented unit
- ✓ Backward integration leading to cost reduction
- ✓ Huge cash generation expected.
- ✓ Gross refining margins higher than benchmark figures leading to higher profits.
- ✓ Operating the most complex refinery with complexity of 12.

Weakness:

- ✓ Being a private player it is not entitled to the benefit of subsidy sharing burden
- ✓ Relatively lower penetration in the oil and gas marketing arena in domestic market.
- ✓ No major finds of crude oil compared to natural gas.

Opportunities:

- ✓ Entering into exploration arena with huge finds in KG basin.
- ✓ Retail sector expected to grow at CAGR of 40%
- ✓ Access to cheaper crude oil would improve the GRMs further.
- ✓ Going global in exploration and refining area will widen the exposure.
- ✓ The overall gas production is set to double within 3 to 4 years thus demand meeting the supply. This may result in government deregulating the natural gas prices.

Threats:

- ✓ Rise in crude prices can lead to reduction in margin.
- ✓ Political tensions in gulf countries may affect profitability due to volatility of crude prices.
- ✓ Domestic oil marketing makes the company subject to threat of subsidy burden and pricing policies of petroleum ministry.

COMPANY BACKGROUND

Company Profile:

RIL is the largest private sector business enterprise in India. It's operations capture value addition at every stage, from the production of crude oil and gas to polyester, polymer and chemical products, and finally to the production of textiles. The company operates mainly in India but has business activities and customers in more than 100 countries around the world. It has production facilities at three major locations in India and a further four locations in Europe. It also has exploration and production interests in India, Yemen and Oman.

RIL is the world's largest producer of Polyester Fiber & Yarn. The Company is also the world's - 4th largest producer of paraxylene (PX), 5th largest producer of mono ethylene glycol (MEG), 7th largest producer of Purified terephthalic acid (PTA) & largest producer of Polypropylene (PP). Within the country, the market share of the company is in a leading position for all its major businesses in India.

RELIANCE and INDIA:

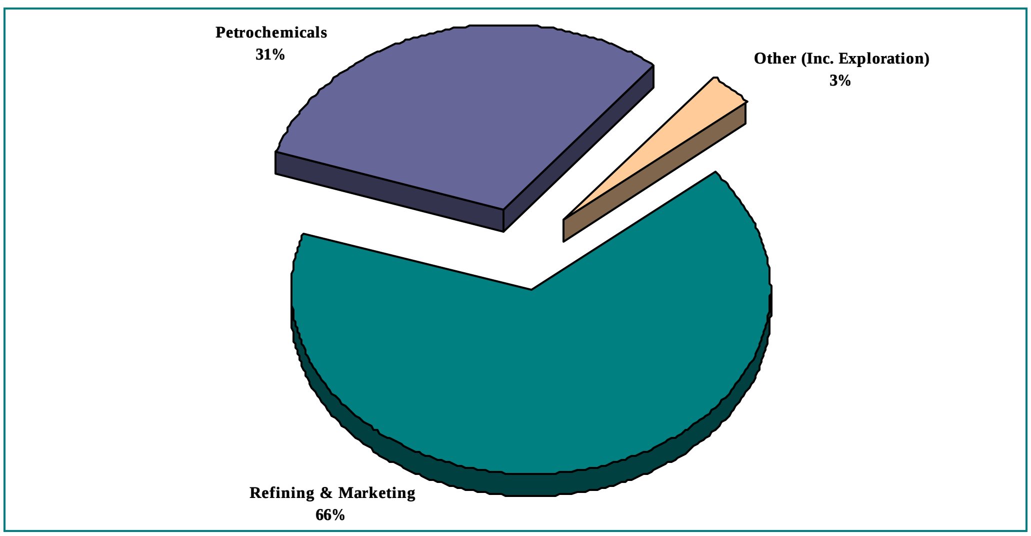
- ✓ It contributes 2.8% of the GDP
- ✓ Its contribution to country’s total exports is 8.2%. The total exports stand at US $ 7.3billon
- ✓ The company contributes 8% of government of India’s indirect tax revenue.

Dominant player:

It enjoys the market share in India of

- ✓ 65% in polyester
- ✓ 28% in refining
- ✓ 68% in polymers
- ✓ 78% in fiber intermediates.

Current product composition:



Ready to explore:

Reliance is the largest exploration acreage holder in the private sector in India. Its operations comprise of (i) 30% interest in Panna-Mukta and Tapti fields; (ii) 29 exploration blocks in India; (iii) exploration and production rights in 5 coal bed methane blocks; and (iv) overseas initiatives in Yemen, Oman, Columbia and East timor.

It is ready to enter into full fledge exploration of oil and natural gas. The KG basin is estimated to have the potential reserves of around 11 trillion cubic feet It is expected to commission from mid 2008 with 80mmscmd of natural gas produce.

Besides the KG BASIN it is having oil and gas blocks in Panna-Mukta-Tapti with 30% in the production-sharing contract. The produce is to hit the market in 2007 with the production increasing to 50,000 barrels per day in case of oil and 6.2 mmscmd in case of natural gas.

It is also estimated to have huge reserves in NEC 25 with potential reserve of 2.3 TCF (trillion cubic feet) of natural gas. Further reserves of 8 TCF is announced recently.

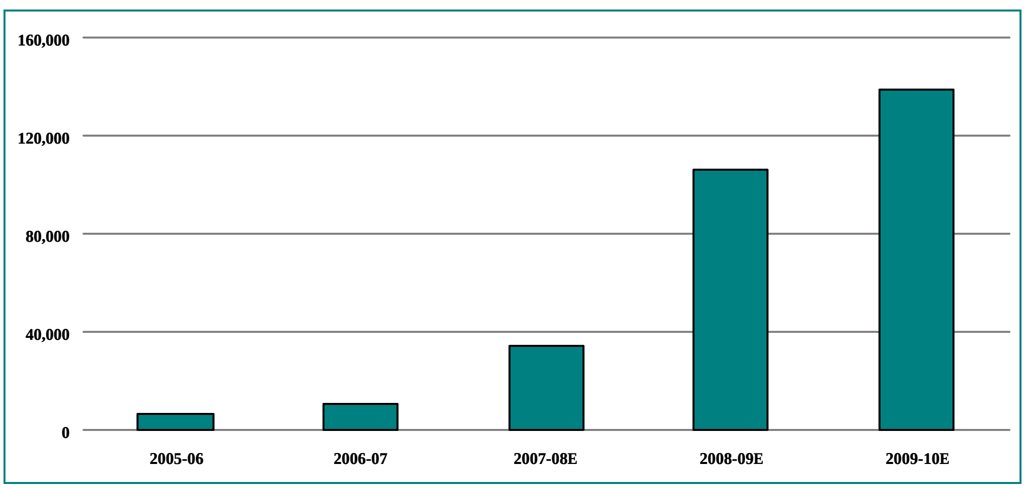
The natural gas price is estimated at Rs 4,000 to Rs 4,500 per billion cubic meters.

The crude prices are expected to stabilize at $ 58 per barrel

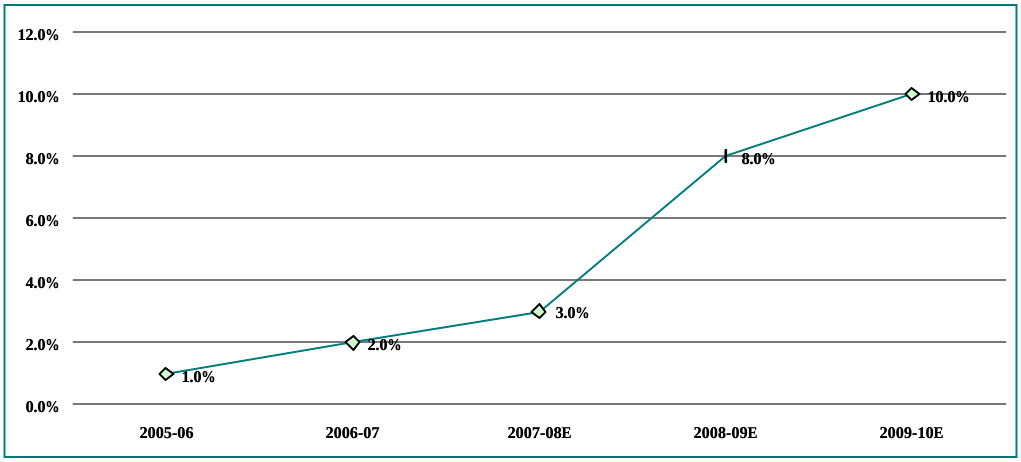
We expect the exploration business to reach the share of 8% after the commissioning of KG BASIN reserves. In 2012 we are expecting the share to increase to 15% of the total business.

We expect RIL to have around 33% share in domestic oil and gas exploration industry in FY 2010. They will be second major shareholder after the oil and exploration major ONGC.

EBITDA in the exploration business: (INR millions)



Exploration share in the total business:



Cost reduction:

The company is bound to reduce the cost and thus increase the margin with captive use of natural gas for the petrochemical production instead of use of imported raw materials. We expect captive use of the natural gas for petrochemical business at 10-15 % of the total produce.

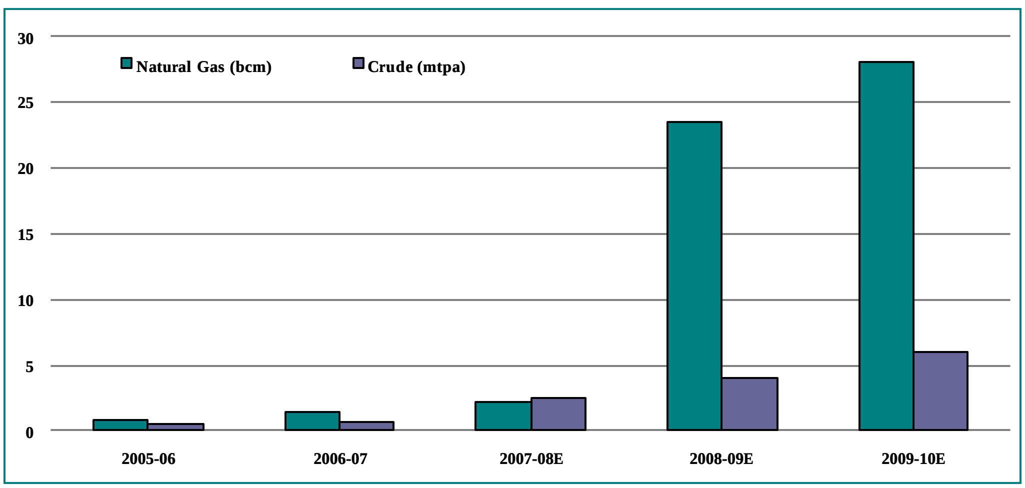
Going Global:

It has been awarded onshore exploration Blocks in Yemen. It has taken local company Hood Oil as partner in the two Yemen blocks.

Blocks 34 and 37, each measuring around 7,500 sq km and located on the border with Oman, are among the seven blocks offered by Yemen in its second licensing round.

It has exploration blocks in Oman, East Timor and Columbia too. It already partners Hood Oil in producing Block 9, where both the companies hold 25 per cent each.

Production details:



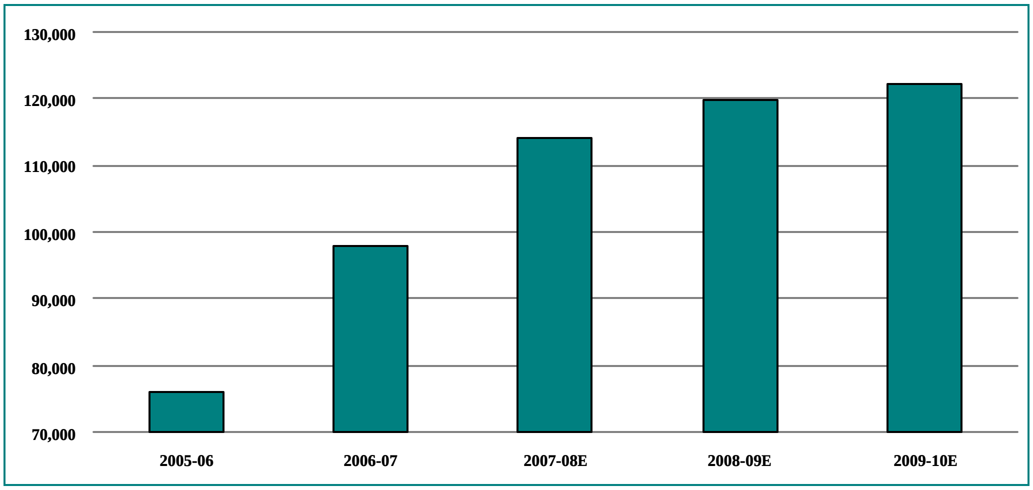
Boost to the valuation:

The exploration business is expected to give a boost to valuations of the company with the kinds of reserves it is having because of its new finds. We expect the exploration business to contribute at least 30% of the EBITDA after commissioning of KG basin produce.

Refining

Reliance operates the third largest refinery in the world at any single location, with a capacity of 33 million tons per year or 0.6 million barrels per day of crude throughput, at Jamnagar, Gujarat.

Refining EBIDTA: (INR millions)



High Gross Refining Margins:

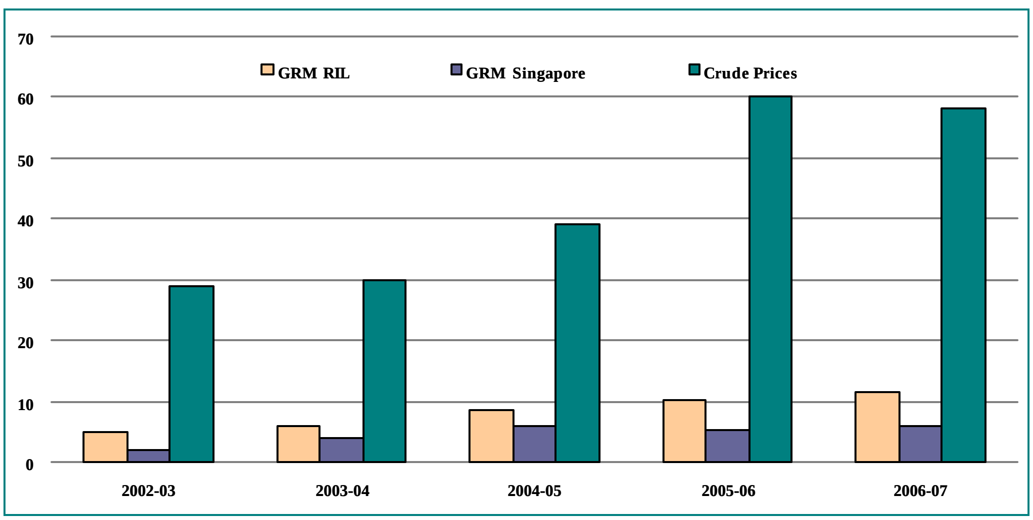
The Jamnagar refinery has the advantage of being highly complex at the Nelson complexity of 12. Essentially a high Nelson Complexity Index as the Reliance Jamnagar Refinery is subject to the following characteristics.

*Ability to process inferior quality crude or heavy sour crude.

*Ability to have a superior refinery product slate comprising of high percentage of LPG, light distillates and middle distillates and low percentage of heavies and fuel oil.

Because of the complexity it is able to process heavier crude, which are cheaper than the light and sweet crude oil as a result of which it enjoys the highest gross refining margin of $ 11.7 per barrel above average GRM of Indian refineries of $4per barrel.

GRM and Crude: ($per barrel)



Advantage EOU (export oriented unit):

The Jamnagar refinery is given the status of export-oriented unit, which is definitely going to sustain the margins. 58% of the realization is out of exports, which will not be subject to tax. We expect the share of exports to the total revenues to remain stable at the present level in future.

Deregulation awaited:

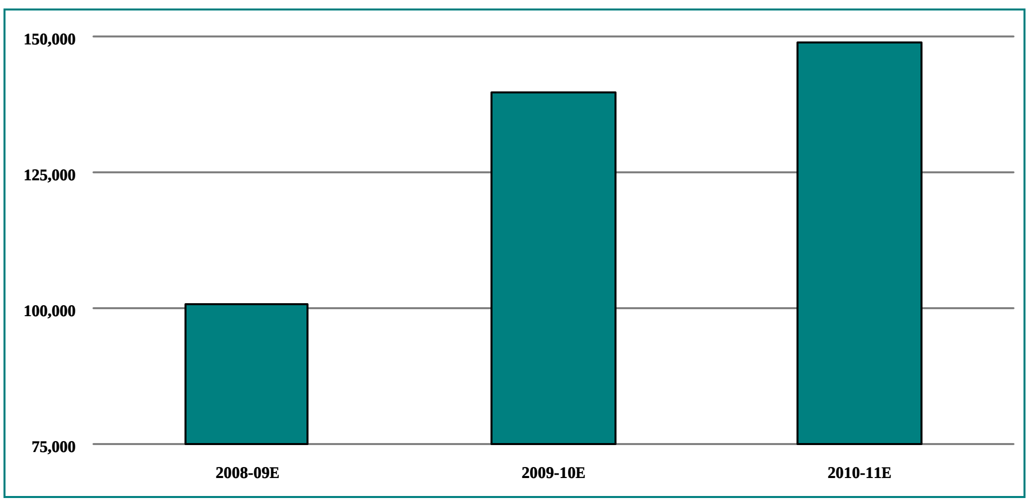
The domestic market could be taken the maximum benefit of only if the petroleum products pricing are deregulated. The retail outlets and the refined products are not able to generate full potential revenues because of the price control. Being a private sector company it is not able to enjoy the subsidy sharing system of government. We expect the petroleum prices to deregulate in near future with crude prices stabilizing. This will give reliance the maximum benefit in the domestic market.

RIL remains committed to the petroleum retail sector, a lack of level playing field between public sector and private sector marketing companies remains an area of concern. Reliance's substantial investment in a world-class retail network is underutilized due to controls on domestic prices of transportation fuels, apart from a direct impact on all stakeholders including dealers, consumers and employees.

RPL to give an upside:

Reliance petroleum limited will give an upside to its valuation. It is all geared to start of its EOU refinery in FY2008-09 with the capacity of 580,000 barrels per day .It is going to have the nelson complexity of 14 bringing them at par with the existing refinery in Jamnagar. The refinery is located in SEZ, which will give them the Tax benefits. Being an export-oriented unit it is not subject to the price control on its products by the Indian government. With its huge potential revenue as well as margins are expected to give a boost to its valuation. Currently its market price is fairly valued at INR 98 per share.

RPL's EBIDTA: (INR millions)



Global plans: It is going to set up 50,000 barrels per day refinery in Yemen where it has already picked up a stake in two oil blocks. The refinery capacity might be doubled later. The project will begin this year and it will take 36 months to complete. It will have an obligation to sell products from the refinery in the domestic market for the first five months and can opt for exports thereafter.

Petrochemical: RIL has wide product range in the petrochemical business producing polymers, polyester, fiber intermediaries' ethylene, propylene, and other chemicals

It enjoys the market dominance by having 67% market share in the polymer and 56% market share in polyester. The total production by the company in petrochemical area is at its peak with 16 mmtpa (millions tones per annum). The petrochemical industry is growing at CAGR of 17%, which is likely to slowdown with more capacity coming in. However the merger with IPCL will sustain its dominant position in the market with estimated growth of 13% in the coming years.

RIL IPCL merger: A major intelligent move by the company is the merger with IPCL. The merger would provide good amount of synergies and competitive advantage.

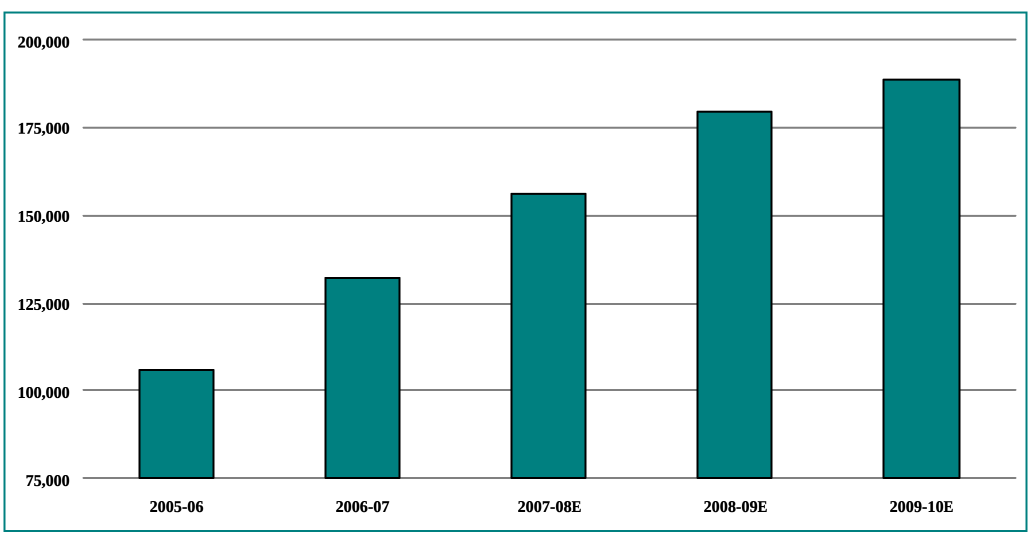
It is expected that the petrochemical cycle is likely at its peak. By 2008-09 with planned expansion of Iran in petrochemical the prices are bound to come down with more capacity expansions and stronger supply side. The competition is also likely to increase. In such situation it was wise of the company to merge with IPCL. Together with IPCL it is going to enjoy the market share of around 80% in the petrochemical market. There are bright chances of further acquisitions in the petrochemical arena.

The operational synergy is expected to be around Rs 5-7 % in the future

This synergy could be due to the low cost consequent to captive consumption of natural gas as the raw material. This would be added with the captive consumption of the fibre intermediaries produced by IPCL

The other benefits of the RIL IPCL merger turn out to be in the form of feedstock integration and infrastructure sharing.

Petrochemicals EBIDTA: (INR millions)



Petrochemical complex: It is about to build the largest integrated petrochemical complex with capacity of 2MMTPA at Jamnagar SEZ. The project is expected to commission by 2010-11. This is going to give them competitive advantage in petrochemical arena.

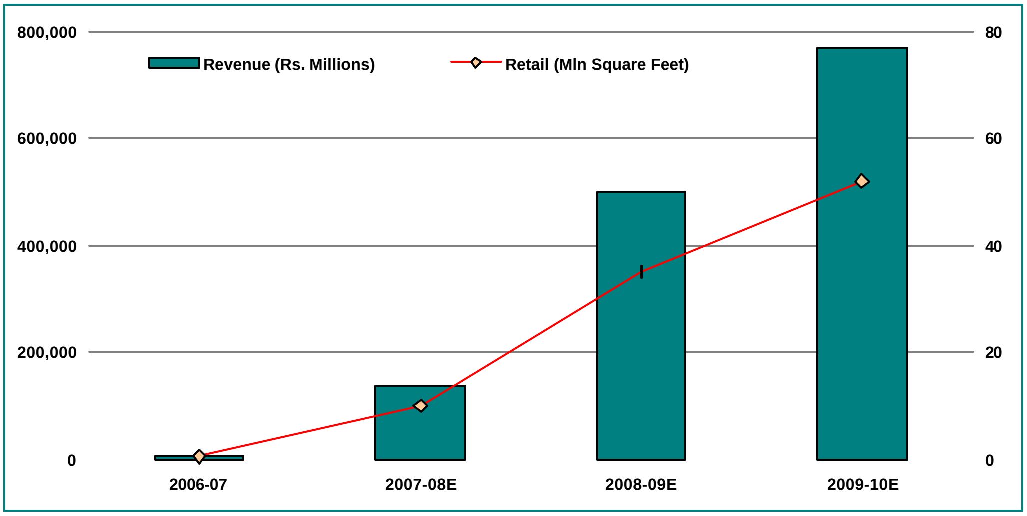
Retail:

Reliance is all set to enter into retail venture with a target of 100 million square feet expansion across 800 cities in India. We expect the target of 100 million square feet to be achieved by 2012.with an average revenue generation of RS 13,800 per square feet.

We are expecting the retail sector to grow at CAGR 40% and RIL Retail to grow above the industry average at 42%.

First store was launched in November 2006 in Hyderabad. Capital expenditure of 25,000 crore is slated in the coming three years in the retail venture.67 stores are operational in Chennai, Hyderabad, Jaipur and Delhi.

We expect RIL retail to be valued at INR 110 per RIL share.



Backward vertical integration:

Backward vertical integration has been the cornerstone of the evolution and growth of Reliance. Starting with textiles in the late seventies, Reliance pursued a strategy of backward vertical integration - in polyester, fibre intermediates, plastics, petrochemicals, petroleum refining and oil and gas exploration and production - to be fully integrated along the materials and energy value chain. The integration will always keep reliance ahead of other players due to cost reduction. We expect the inter-segment sales to remain at the levels of 16% of total revenues in near future.

VALUATION

With the SOTP valuation of the different strategic business units we have arrived at a fair value of Rs 2120 with a target of 12 months. The company is trading at an attractive P/E multiple of 21.3x currently and estimated at 15.1x in FY08 and 11xinFY09. We include upside of Rs 250 recently in the valuations in optimistic scenario regarding GRMs of $13 and recent finds in North east coast of 8TCF and KGD6 basin and retail expansion. The details of the valuation are as follows

Refining -EV/EBITDA (2007-08) x6	473.36
Petrochemical-EV/EBITDA (2007-08) x6	499.43
Exploration-EV/Total Oil Equivalent (TOE) x2	878
Retail EV/sales (2007-08) x2.6	110
RPL at market price INR98	230
Others	48
	2238.79
Less-debt (per share)	250
Add-cash equivalent (per share)	131.886
Value per share	2120.67

Upside to the valuations:

- ✓ More finds in KG basin and north east coast with estimated reserves to be announced in the near future will add up to the valuations.
- ✓ Retail grows faster than the expectation and it achieves its target of 10million square feet early by 2010.
- ✓ Synergy could be more than expected due to RIL-IPCL merger if company uses its captive resources at its peak.
- ✓ GRM growing further due to increased efficiency in the refineries at the levels of $14-15 per barrel.

Downside Risks:

- ✓ Crude soaring due to tensions in Iran
- ✓ Retail growth facing the political obstacles and thus the target of 100mln square feet being delayed
- ✓ Increasing competition in petrochemical due to upcoming capacity additions further leading to fall in the petrochemical prices.
- ✓ Major acquisition in petrochemical or the retail area could lead to cash crunch

FINANCIALS

Income Statement:

Particulars (Rs. millions)	2005-06	2006-07	2007-08E	2008-09E	2009-10E
INCOME					
Turnover	891,245	1,252,860	1,395,578	1,500,918	1,576,538
Less: Excise Duty / Service Tax Recovered	79,131	70,230	78,230	84,135	88,373
Net Turnover	**812,113**	**1,182,630**	**1,317,348**	**1,416,783**	**1,488,165**
Other Income	6,829	17,386	31,886	48,886	54,886
Variation in Stocks	21,312	34,891	18,744	9,158	9,707
	840,254	**1,234,907**	**1,367,977**	**1,474,826**	**1,552,758**
Manufacturing and Other Expenses	690,434	1,021,528	1,098,238	1,111,663	1,148,343
EBITDA	**149,820**	**213,379**	**269,740**	**363,163**	**404,415**
Interest and Finance Charges	8,770	12,740	16,846	14,838	13,697
Depreciation	34,009	45,570	46,765	56,226	69,244
Profit Before Tax	**107,041**	**155,069**	**206,129**	**292,099**	**321,474**
Provision for Current Tax	9,000	22,760	31,538	49,657	54,651
Provision for Fringe Benefit Tax	307	-	-	-	-
Provision for Deferred Tax	7,040	8,521	-	-	-
Profit after Tax	**90,693**	**123,788**	**174,591**	**242,442**	**266,823**
Proposed Dividend on Equity Shares	13,935	18,707	34,918	48,488	53,365
EPS Basic (Rs.)	**65.10**	**85.18**	**120.14**	**154.31**	**169.83**
EPS Diluted (Rs.)	57.73	78.79	111.13	154.31	169.83

Balance Sheet:

Particulars (Rs. millions)	2005-06	2006-07	2007-08E	2008-09E	2009-10E
SOURCES OF FUNDS					
Shareholders' Funds					
Share Capital	13,932	14,532	14,532	15,732	15,732
Reserves and Surplus	484,111	631,950	771,622	1,134,776	1,348,235
Total	**498,043**	**646,481**	**786,154**	**1,150,508**	**1,363,967**
Loan funds	218,656	279,279	369,279	325,260	300,260
Deferred Tax Liability	49,708	69,555	69,555	69,555	69,555
TOTAL	**766,407**	**995,315**	**1,224,988**	**1,545,323**	**1,733,782**
APPLICATION OF FUNDS					
Fixed Assets	-				
Gross Block	849,701	1,030,680	1,120,680	1,203,536	1,296,098
Less: Depreciation	292,534	396,989	443,754	499,980	569,224
Net Block	557,168	633,691	676,926	703,556	726,873
Capital Work-in-Progress	69,578	125,578	115,578	115,250	135,555
Investments	58,462	61,069	161,069	333,256	381,256
Current Assets, Loans and Advances					
Current Assets					
Inventories	101,198	133,882	152,626	161,783	171,490
Sundry Debtors	41,636	54,491	62,120	65,847	69,798
Other Current Assets	251	251	251	251	251
Loans and Advances	81,198	99,659	109,659	189,659	225,659
	224,283	**288,283**	**324,656**	**417,541**	**467,198**
Cash	21,462	107,382	191,407	232,454	290,308
Less: Curr. Liab. and Prov.					
Current Liabilities	125,635	177,472	201,430	213,516	224,192
Provisions	38,910	43,217	43,217	43,217	43,217
	164,545	**220,689**	**244,647**	**256,733**	**267,409**
Net Current Assets	59,738	67,595	80,008	160,807	199,789
TOTAL	**766,407**	**995,315**	**1,224,988**	**1,545,323**	**1,733,782**

Cash Flow Statement:

Particulars (Rs. Millions)	2005-06	2006-07	2007-08E	2008-09E	2009-10E
Cash from operating activities	144,627	213,379	269,740	363,163	404,415
Change in working capital	32,186	7,856	12,413	80,799	38,982
Cash generated from operations	112,439	205,522	257,326	282,364	365,433
Taxes paid	9,423	22,760	31,538	49,657	54,651
Net cash from operating activities	103,016	182,762	225,788	232,707	310,783
Cash from investing activities					
Fixed assets and investments	126,468	124,799	180,000	256,694	160,867
Cash from financing					
Debt	12,107	48,609	90,000	(25,000)	(25,000)
Warrants		17,040		153,360	
Dividend paid	11,853	18,707	34,918	48,488	53,365
Interest paid	15,684	12,740	16,846	14,838	13,697
Net increase / decrease	(14,627)	75,125	84,025	41,047	57,854
Opening balance	36,088	32,257	107,382	191,407	232,454
Closing balance	21,462	107,382	191,407	232,454	290,308

Key Financials:

Particulars	2005-06	2006-07	2007-08E	2008-09E	2009-10E
Current Ratio	1.62	1.79	2.11	2.53	2.83
Profitability Ratio					
Net Profit %	10.18	9.88	12.51	16.15	16.92
EBITDA Margin %	16.81	17.03	19.33	24.20	25.65
Return on Capital Employed %	15.11	16.86	18.20	19.86	19.33
Return on Equity %	18.21	19.15	22.21	21.07	19.56
Debt Equity	0.44	0.43	0.47	0.28	0.22
Valuation					
P/E multiple	27.02	20.9	13.9	10.5	9.4
P/BV multiple	4.93	3.80	3.12	2.13	1.80

INDIA

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