

April 12, 2010

Rating	Accumulate
Price	Rs1,124
Target Price	Rs1,258
Implied Upside	12.1%
Sensex	17,993

(Prices as on April 9, 2010)

Trading Data

Market Cap. (Rs bn)	3,693.3
Shares o/s (m)	3,286.0
Free Float	53.43%
3M Avg. Daily Vol ('000)	6,740.2
3M Avg. Daily Value (Rs m)	7,065.2

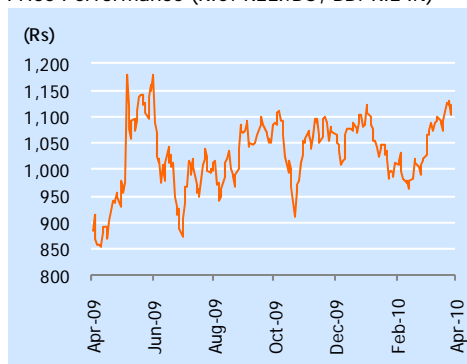
Major Shareholders

Promoters	46.57%
Foreign	16.82%
Domestic Inst.	9.83%
Public & Others	26.78%

Stock Performance

(%)	1M	6M	12M
Absolute	11.1	4.7	31.0
Relative	6.4	(0.8)	(35.4)

Price Performance (RIC: RELI.BO, BB: RIL IN)



Source: Bloomberg

■ **Reliance Industries (RIL) - Atlas Energy Marcellus Shale Gas JV:** RIL on April 10, 2010 entered into a definitive agreement with US based Atlas Energy to acquire 40% interest in Atlas' core Marcellus Shale acreage. The total cost of acquisition for the asset is US\$1.70bn. RIL will pay an upfront payment of US\$339m, while the rest US\$1.36bn will be paid under a carry arrangement over a period of seven and a half year of development program. Further to the acquisition cost, RIL will spend over US\$3.4bn for the development of the asset over a period of 10 years. The company will become a 40% partner in approx. 300,000 acres of undeveloped leasehold in the core area of the Marcellus Shale in South-western Pennsylvania. This acreage is expected to have about 13.3 trillion cubic feet (TCF) of recoverable reserves. RIL's 40% share will account for about 5.3 TCF. Added to this, the company also gains the right of first offer with respect to future sales by Atlas of around 280,000 additional Appalachian acres currently held by Atlas. Although Atlas will be the operator for the JV, RIL will become an operator in certain regions in future as an arrangement of the JV.

■ **Valuation and Recommendation:** After an unsuccessful attempt to acquire LyondellBasell, RIL has successfully added the Shale gas asset into its portfolio. RIL's new refinery at Jamnagar and the KG D6 asset are expected to throw significant amounts of cash flows starting FY11 onwards. With no immediate plans for any organic growth (except capex towards E&P), RIL was scouting for opportunities to deploy this cash. The JV with Atlas Energy seems to be a good long-term investment for RIL with a focus on enhancing its global footprint. We also believe that this is a strategic fit for RIL having a larger focus on the upstream business. The refining environment has also witnessed improvement over the last quarter along with stable petchem prices. We believe that for refining the worst is over and do not foresee any significant threat to the petchem margins considering the capacity additions in the Middle-East. We remain optimistic about RIL's inorganic initiatives which will add further value. Hence, we maintain our 'Accumulate' rating on the stock, with a SOTP based price target of Rs1,258/share (revised from Rs1,227/share).

Key financials (Y/e March)	FY09	FY10E	FY11E	FY12E
Revenues (Rs bn)	1,512	1,930	2,385	2,597
Growth (%)	10.3	27.6	23.5	8.9
EBITDA (Rs bn)	234	303	419	458
PAT (Rs bn)	150	247	223	247
EPS (Rs)	45.6	49.5	67.9	75.2
Growth (%)	(1.9)	8.7	37.2	10.6
Net DPS (Rs)	10.0	13.0	15.0	15.0

Source: Company Data; PL Research

Profitability & valuation	FY09	FY10E	FY11E	FY12E
EBITDA margin (%)	15.5	15.7	17.6	17.6
RoE (%)	14.6	18.8	14.9	14.8
RoCE (%)	9.3	12.3	11.0	11.1
EV / sales (x)	2.8	2.2	1.7	1.5
EV / EBITDA (x)	18.1	13.9	9.9	8.6
PE (x)	24.7	22.7	16.5	15.0
P / BV (x)	3.0	2.6	2.3	2.1
Net dividend yield (%)	0.9	1.2	1.3	1.3

Source: Company Data; PL Research

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Shale gas - background

Shale gas is defined as natural gas from shale formations. The shale acts as both the source and the reservoir for the natural gas. Older shale gas wells were vertical, while more recent wells are primarily horizontal and need artificial stimulation, like hydraulic fracturing, to produce. Only shale formations with certain characteristics will produce gas. The most significant trend in US natural gas production is the rapid rise in production from shale formations. In large measure, this is attributable to significant advances in the use of horizontal drilling and well stimulation technologies and refinement in the cost-effectiveness of these technologies. (Source: www.api.org)

Shale gas reserves and development in the US

US is estimated to have over 650TCF (about 115barrels of oil equivalent (boe)) of Shale gas reserves. Shale gas currently accounts for about 8% in the total gas production in North America. The share of Shale gas in total gas production in North America is expected to move up to 15-16% by 2020 and further to 25-30% by 2030. Total capex for the development of these Shale gas reserves is expected to be about US\$850bn out of which a significant portion of over US\$400bn is expected to be invested in the development of the Marcellus Shale gas. The Original Gas Initially in Place (OGIIP) in Marcellus Shale formations is expected to be over 1,500TCF out of which recoverable reserves are estimated at about 260TCF.

About Atlas Energy

Atlas Energy is a leading Marcellus Shale operator with over 581,736acres of area. 90% of the acreage is in the core area. The royalty rate for gas production is very competitive at 13% compared to about 15-18% for other acreages. The company has identified over 3,169 drilling locations in the Marcellus Shale acreage. The total recoverable reserve potential for the acreage is estimated at 13.4TCF. The company has drilled over 180 wells so far with about 14-16 horizontal wells.

Marcellus Dry Gas economics

Parameter	Value
Estimated gross reserves/ well	6.0billion cubic feet
Estimated gross drilling costs	US\$3.75-4.00mn
Net F&D costs	US\$0.75/scf
Overall operating costs	US\$1.2-1.3/scf
Estimated Royalty rate	About 15-18%
IRR/Well	
@US\$5.0/scf	61%
@US\$7.0/scf	116%
@US\$9.0/scf	193%

Source: Company Data, PL Research

Highlights of the JV

How the asset will be developed?

The total development period for the asset is 10 years. The JV is expected to drill over 3,000 wells over this development period. Over 300 wells will be drilled every year. The cost of drilling a horizontal well is about US\$3.75-4.00m which translates into total development capex of over US\$12bn over the 10 year development period. The rate of production from a well is the highest during the first year of operation, with over 70% of gas production which declines to over 30% in the second year and declines further thereafter. Hence, most of the gas is recovered in the initial 2-3 years from the commencement of gas production.

How much value it will add to RIL SOTP valuation?

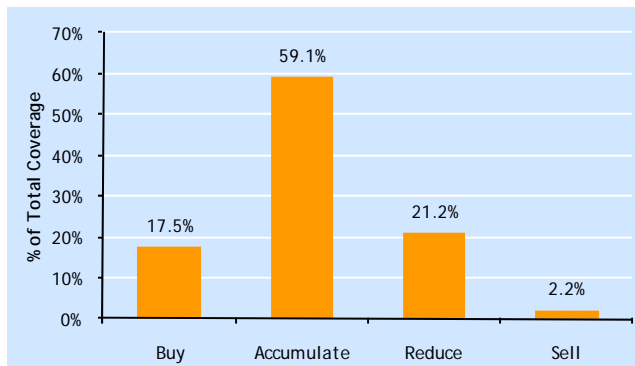
Revenue recognition will start once the wells are drilled and start producing gas. The approx. break-even price for natural gas is about US\$3.60/scf (US\$3.60/mmbtu). The bench mark price for sale of Shale gas is the Henry Hub spot natural gas price which is currently hovering at about US\$4.0/scf. The Shale gas usually commands a premium of about US\$0.30-0.70/scf over the Henry Hub spot natural gas prices. The management expects RIL to garner EBITDA of over US\$1.0bn (at natural gas price of about US\$6.0/scf) from the sixth year onwards up to the tenth year. Hence, the cost recovery will start happening post five years of commencement of the development. We are ascribing an EV/boe multiple of US\$3/boe to the RIL's share of 5.3TCF (945mmboe) of recoverable reserves. With this, we arrive at a value of Rs39/share for the Marcellus Shale gas asset.

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Rating Distribution of Research Coverage



PL's Recommendation Nomenclature

BUY	: Over 15% Outperformance to Sensex over 12-months	Accumulate	: Outperformance to Sensex over 12-months
Reduce	: Underperformance to Sensex over 12-months	Sell	: Over 15% underperformance to Sensex over 12-months
Trading Buy	: Over 10% absolute upside in 1-month	Trading Sell	: Over 10% absolute decline in 1-month
Not Rated (NR)	: No specific call on the stock	Under Review (UR)	: Rating likely to change shortly

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