

# Upgrade PX margin, oil & GRM; more EPS upside possible

## Strong earnings growth after flat earnings for 2-year; Buy

Singapore GRM is at an 11 quarter high and polyester chain margins at an all time high. We have raised oil price, PX margins and GRM of Reliance Industries (RIL). FY11-FY12 EPS is now expected to rise by 29-30% YoY after flat EPS in FY09-FY10. Growth would be stronger if prevailing strength in polyester margins and GRM sustain. Thus there may be further EPS upgrades. Deal to sell BP Plc 30% stake in 23 blocks at US\$7.2bn has addressed investor concerns in E&P. We therefore expect RIL's under-performance to end. We retain Buy on RIL.

## Raise FY12-FY13E EPS by 4-7% & PO by 2% to Rs1,244

We have raised FY12-FY13 PX-naphtha margin to US\$650/ton from US\$500/ton. RIL's FY12 GRM is also raised by 4% to US\$9.5/bbl. FY11-FY13 Brent price is raised by 7-18%. FY12-FY13 EPS is raised by 4-7% and PO by 2% to Rs1,244.

## Further earnings upgrades appear likely

Our FY12E EPS (Rs80.9) is 11% above consensus. FY12 EPS based on GRM of US\$10/bbl and current polyester chain margins is Rs90.4. It is 12% higher than our EPS and 24% higher than consensus. Thus, there may be more upgrades.

## E&P concerns addressed; under-performance likely to end

RIL's EPS CAGR was 37% in the last refining and petrochemical super-cycle in FY03-FY08. Its share price was up 10.5x (BSE-30 was up 5.1x). However, RIL has under-performed regional peers since August 2010 (RIL down 3% but peers up 22-101%). This is mainly due to disappointment in E&P. However, the recent deal with BP appears to have addressed concerns in E&P. Strong EPS growth, EPS upgrades and positive E&P news flow may help end underperformance.

## Estimates (Mar)

(Rs)	2009A	2010A	2011E	2012E	2013E
Net Income (Adjusted - mn)	152,960	158,976	204,790	265,672	314,305
EPS	46.56	48.39	62.34	80.87	95.67
EPS Change (YoY)	-11.7%	3.9%	28.8%	29.7%	18.3%
Dividend / Share	6.50	7.00	7.50	8.00	8.00
Free Cash Flow / Share	62.01	31.83	45.12	45.16	72.39
GDR EPS (US\$)	2.02	2.04	2.77	3.60	4.25
GDR Dividend / Share (US\$)	0.282	0.295	0.333	0.356	0.356

## Valuation (Mar)

	2009A	2010A	2011E	2012E	2013E
P/E	20.98x	20.19x	15.67x	12.08x	10.21x
Dividend Yield	0.665%	0.716%	0.768%	0.819%	0.819%
EV / EBITDA*	15.61x	12.02x	9.88x	8.67x	7.54x
Free Cash Flow Yield*	6.35%	3.26%	4.62%	4.62%	7.41%

\* For full definitions of *iQmethod*<sup>SM</sup> measures, see page 5.

## Bank of America Merrill Lynch

Vidyadhar Ginde >> +91 22 6632 8673

Research Analyst  
DSP Merrill Lynch (India)  
vidyadhar.ginde@bamll.com

Kenneth Whee >> +852 2536 3943

Research Analyst  
Merrill Lynch (Hong Kong)  
kenneth.whee@bamll.com

Thomas Wong >> +852 2161 7753

Research Analyst  
Merrill Lynch (Hong Kong)  
thomas.m.wong@bamll.com

## Stock Data

Price (Common / GDR)	Rs977.05 / US\$43.28
Price Objective	Rs1,244 / US\$52.57
Date Established	7-Mar-2011 / 7-Mar-2011
Investment Opinion	B-1-7 / B-1-7
Volatility Risk	MEDIUM / MEDIUM
52-Week Range	Rs840.55-Rs1,187
Market Value (mn)	US\$71,353
Shares Outstanding (mn)	3,285.2 / 1,642.6
Average Daily Volume	7,076,045
BofAML Ticker / Exchange	XRELF / BSE
BofAML Ticker / Exchange	RLNIY / LIN
Bloomberg / Reuters	RIL IN / RELI.BO
ROE (2011E)	14.6%
Net Dbt to Eqty (Mar-2010A)	32.0%
Est. 5-Yr EPS / DPS Growth	20.0% / 10.0%
Free Float	45.0%

## Key Changes

(Rs)	Previous	Current
Price Obj.	1,222.00	1,244.00
2011E EPS	62.08	62.34
2012E EPS	75.54	80.87
2013E EPS	92.06	95.67
2011E EBITDA (m)	374,657.9	375,801.8
2012E EBITDA (m)	405,335.1	428,245.3
2013E EBITDA (m)	476,624.9	492,149.8

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Refer to important disclosures on page 6 to 9. Analyst Certification on Page 3. Price Objective Basis/Risk on page 3. Link to Definitions on page 3. 11027383

# iQprofile<sup>SM</sup> Reliance Industries Ltd.

Key Income Statement Data (Mar)	2009A	2010A	2011E	2012E	2013E
<b>(Rs Millions)</b>					
Sales	1,512,240	2,037,397	2,405,151	2,656,983	2,598,638
Gross Profit	610,639	491,370	521,125	568,190	658,635
Sell General & Admin Expense	(372,719)	(182,431)	(145,323)	(139,944)	(166,485)
Operating Profit	181,410	199,481	247,536	331,455	379,659
Net Interest & Other Income	980	1,262	6,338	15,863	31,239
Associates	NA	NA	NA	NA	NA
Pretax Income	182,390	200,743	253,874	347,319	410,898
Tax (expense) / Benefit	(29,610)	(42,563)	(49,084)	(81,647)	(96,593)
Net Income (Adjusted)	152,960	158,976	204,790	265,672	314,305
Average Fully Diluted Shares Outstanding	3,285	3,285	3,285	3,285	3,285

## Key Cash Flow Statement Data

Net Income	152,960	158,976	204,790	265,672	314,305
Depreciation & Amortization	56,510	109,458	128,266	96,790	112,491
Change in Working Capital	227,316	(159,422)	(23,134)	(18,182)	770
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	14,070	96,523	9,817	16,329	19,319
Cash Flow from Operations	450,856	205,534	319,739	360,609	446,884
Capital Expenditure	(247,130)	(100,967)	(171,500)	(212,258)	(209,062)
(Acquisition) / Disposal of Investments	47,789	(66,767)	(43,724)	0	0
Other Cash Inflow / (Outflow)	NA	NA	NA	324,000	NA
Cash Flow from Investing	(199,341)	(167,734)	(215,224)	111,742	(209,062)
Shares Issue / (Repurchase)	240,429	15,638	0	0	0
Cost of Dividends Paid	(19,350)	(19,860)	(24,309)	(28,096)	(29,969)
Cash Flow from Financing	476,685	(120,733)	29,691	(33,095)	(179,968)
Free Cash Flow	203,726	104,568	148,239	148,352	237,822
Net Debt	518,229	422,871	386,941	(57,315)	(265,168)
Change in Net Debt	(472,595)	(33,578)	(80,206)	(444,256)	(207,854)

## Key Balance Sheet Data

Property, Plant & Equipment	1,686,604	1,678,113	1,721,346	1,512,814	1,609,385
Other Non-Current Assets	47,439	46,847	134,847	134,847	134,847
Trade Receivables	48,450	100,829	119,029	131,492	128,605
Cash & Equivalents	244,337	223,184	313,114	752,371	810,226
Other Current Assets	311,590	451,319	545,895	604,721	568,547
Total Assets	2,338,420	2,500,292	2,834,231	3,136,245	3,251,608
Long-Term Debt	678,170	625,753	625,753	620,754	470,755
Other Non-Current Liabilities	95,513	106,776	116,592	132,922	152,240
Short-Term Debt	84,396	20,302	74,302	74,302	74,302
Other Current Liabilities	388,720	425,856	519,284	574,265	535,972
Total Liabilities	1,246,799	1,178,687	1,335,932	1,402,243	1,233,270
Total Equity	1,091,621	1,321,605	1,498,299	1,734,002	2,018,339
Total Equity & Liabilities	2,338,420	2,500,292	2,834,231	3,136,245	3,251,608

## iQmethod<sup>SM</sup> - Bus Performance\*

Return On Capital Employed	9.6%	8.5%	10.0%	11.5%	12.4%
Return On Equity	15.8%	13.2%	14.6%	16.5%	16.8%
Operating Margin	12.0%	9.8%	10.3%	12.5%	14.6%
EBITDA Margin	15.7%	15.2%	15.6%	16.1%	18.9%

## iQmethod<sup>SM</sup> - Quality of Earnings\*

Cash Realization Ratio	2.9x	1.3x	1.6x	1.4x	1.4x
Asset Replacement Ratio	4.4x	0.9x	1.3x	2.2x	1.9x
Tax Rate (Reported)	16.2%	21.2%	19.3%	23.5%	23.5%
Net Debt-to-Equity Ratio	47.5%	32.0%	25.8%	-3.3%	-13.1%
Interest Cover	10.0x	9.7x	11.1x	13.6x	15.4x

## Key Metrics

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 5.

## Company Description

India's largest petrochemical and refining company, Reliance, owns two refineries with 1.25mbpd capacity. It has over 2m tpa ethylene cracker and is the world's largest polyester producer. It also has large polypropylene and fibre intermediate capacity. Refining was 30%, petrochemical 43% and E&P 27% of FY10 EBIT. Its 2P reserves and resources in India are 4.7bn boe and 0.88bn boe in US shale gas.

## Investment Thesis

We expect strong earnings growth for RIL in FY11-FY12E, driven by refining margin recovery and a surge in oil & gas volumes. RIL has 4.7bn boe 2P reserves from the exploration of 5% of its Indian acreage. It has large unexplored prospective acreage and, thus, large reserve-accretion potential. RIL also has a lot of cash and treasury shares, and should generate strong free cash flow. This may be used to make value-accretive acquisitions.

## Stock Data

Shares / GDR	2.00
Price to Book Value	2.2x

## Key Changes (GDR)

(US\$)	Previous	Current
Price Obj.	51.64	52.57
2011E EPS	2.76	2.77
2012E EPS	3.36	3.60
2013E EPS	4.09	4.25

## Price objective basis & risk

### Reliance Inds (XRELF / RLNIY)

Our PO of Rs1,244 (GDR US\$52.57) is based on a sum-of-the-parts valuation. The value of the refining and petrochemical business and oil and gas reserves and resources is calculated on DCF basis, using a WACC of 11.8pct. Refining and marketing (Rs433) is 35pct of our PO, E&P valuation (Rs377) 31pct and petrochemicals (Rs415) 34pct. Downside risks are (1) 7-year income tax holiday being disallowed on gas production, which would mean lower cash flow, profit and fair value, (2) Lower-than-expected oil price, (3) Huge disappointments on the E&P front, as we have valued exploration upside at Rs75/share, and (4) refining and petrochemical margins being lower than expected, (5) Large acquisitions, which are value dilutive. Upside risks are (1) Refining and petrochemical margins being better than expected, (2) Higher-than-expected oil price, (3) Higher-than-expected reserve accretion in the next 12-24 months and (4) Large acquisitions that increase fair value significantly.

## Link to Definitions

### Basic Materials

Click [here](#) for definitions of commonly used terms.

## Analyst Certification

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SEBI Regn no. : BSE - INB/INF 011348134 NSE – INB/INF 231348138

Address – Mafatlal Centre, 8th Floor, Nariman Point, Mumbai, India. 400021

Tel : +91 22 6632 8000

08 March 2011

**APR - Energy Coverage Cluster**

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	Formosa Plastics	FSAPF	1301 TT	Kenneth Whee
	GS Holdings	GSHDF	078930 KS	Kenneth Whee
	Hindustan Petro.	XHTPF	HPCL IN	Vidyadhar Ginde
	IOC	IOCOF	IOCL IN	Vidyadhar Ginde
	Kolon Industries	XKLN	120110 KS	Joon-Ho Lee
	Kunlun Energy	CNPXF	135 HK	Vitus Leung
	LG Chem	LGCLF	051910 KS	Kenneth Whee
	Nan Ya Plastics	NNYPF	1303 TT	Joon-Ho Lee
	Oil India Ltd	XLCRF	OINL IN	Vidyadhar Ginde
	ONGC	ONGCF	ONGC IN	Vidyadhar Ginde
	Reliance Inds	XRELF	RIL IN	Vidyadhar Ginde
	Reliance Inds -G	RLNIY	RIGD LI	Vidyadhar Ginde
	Sinopec	SNPMF	386 HK	Thomas Wong
	Sinopec - A	SNP	SNP US	Thomas Wong
	SK Innovation	XVERF	096770 KS	Kenneth Whee
<b>NEUTRAL</b>				
	BPCL	XBPCF	BPCL IN	Vidyadhar Ginde
	Citic Resources	CTJHF	1205 HK	Vitus Leung
	CNOOC	CEOHF	883 HK	Thomas Wong
	CNOOC	CEO	CEO US	Thomas Wong
	Formosa Chemicals & Fibre	XFUMF	1326 TT	Kenneth Whee
	Formosa Petrochemical	FPTCF	6505 TT	Kenneth Whee
	PetroChina	PCCYF	857 HK	Thomas Wong
	PetroChina - A	PTR	PTR US	Thomas Wong
	S-Oil	SOOCF	010950 KS	Kenneth Whee
<b>UNDERPERFORM</b>				
	COSL	CHOLF	2883 HK	Vitus Leung
	Petronet LNG Ltd	POLNF	PLNG IN	Vidyadhar Ginde
	Sinopec Shanghai Petrochemical	SPTJF	338 HK	Joon-Ho Lee
	Sinopec Yizheng Chemical Fibre	YZCFF	1033 HK	Joon-Ho Lee
<b>RSTR</b>				
	Cairn India	XCANF	CAIR IN	Vidyadhar Ginde

08 March 2011

**iQmethod<sup>SM</sup> Measures Definitions**

<b>Business Performance</b>	<b>Numerator</b>	<b>Denominator</b>
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
<b>Quality of Earnings</b>		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
<b>Valuation Toolkit</b>		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales} + \text{Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

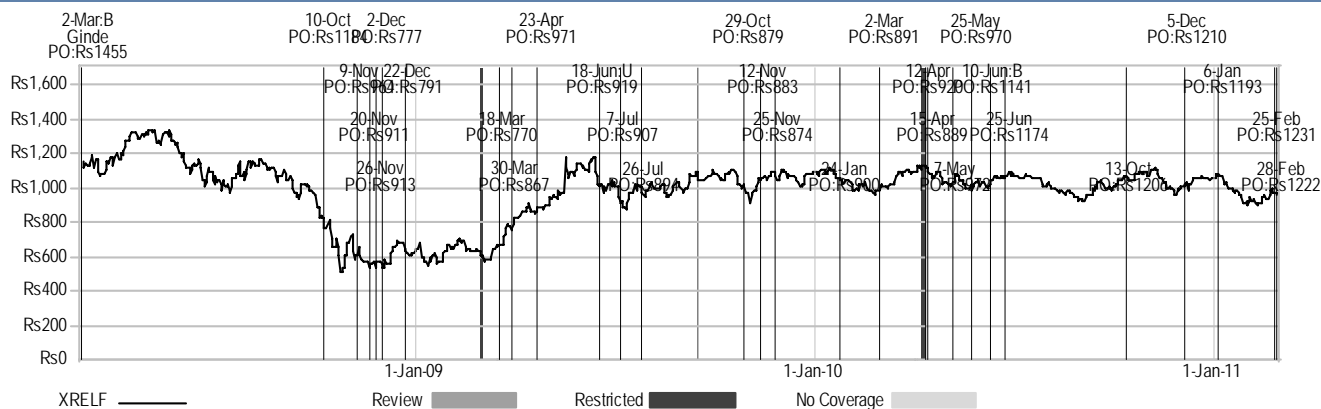
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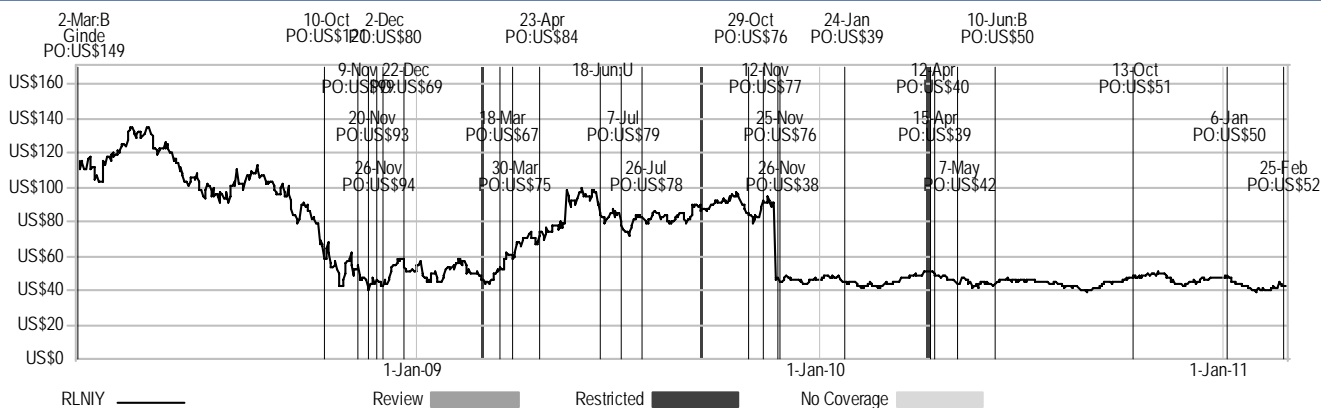
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B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid, NR: No Rating

Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of February 28, 2011 or such later date as indicated.

### RLNIY Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid, NR: No Rating

Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of February 28, 2011 or such later date as indicated.

### Investment Rating Distribution: Chemicals Group (as of 01 Jan 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	65	61.90%	Buy	29	51.79%
Neutral	18	17.14%	Neutral	10	62.50%
Sell	22	20.95%	Sell	6	28.57%

### Investment Rating Distribution: Global Group (as of 01 Jan 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	2011	53.86%	Buy	874	48.31%
Neutral	925	24.77%	Neutral	444	52.30%
Sell	798	21.37%	Sell	276	36.75%

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

\* Ratings dispersions may vary from time to time where BofA Merrill Lynch Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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