

RELIANCE INDUSTRIES

INR 1,987



Take-over of Hualon's distress assets

ACCUMULATE

Today, Reliance Industries (RIL) announced signing of agreement to acquire assets of Hualon, a leading polyester producer in Malaysia. The acquisition increases RIL's polyester capacity by 0.5 mmtpa, making it the largest polyester manufacturer in the world. Though RIL has not announced the deal value, we believe that Hualon's large debt and distress situation might have provided RIL an opportunity to buy at cheap asset valuations. We are positive on the acquisition and believe that the large balance sheet size of RIL will allow it to turnaround Hualon. We await more details on the same by RIL and maintain 'ACCUMULATE' on the stock.

* **RIL announces takeover of Malaysia's Hualon**

Today, RIL announced its acquisition of Hualon's assets; Hualon is a leading polyester producer in Malaysia with a polyester (fibre, yarn, and resin) manufacturing capacity of 0.5 mmtpa and downstream textile manufacturing capabilities spread over two locations in Malaysia - Nilai and Malacca.

* **Takeover is positive for RIL**

This acquisition is RIL's second international acquisition after Trevira, Germany in 2004. Though the company has not yet announced the amount paid, we believe it is low due to distress state of Hualon's business. RIL gains from the takeover on the following grounds:

- ◆ Entry into the Malaysian market and better access to western markets.
- ◆ Access to markets for its petrochemical products (PET / MEG) and positioning further down in the textile value chain.
- ◆ Consolidation and increased market share – RIL becomes world's largest polyester fibre and yarn manufacturer with 2.5 mn tonnes capacity and >7% market share globally.
- ◆ Ability to turnaround the acquired entity using RIL's balance sheet size.

Financials

Year to March	FY06	FY07E	FY08E	FY09E
Net revenues(INR mn)	812,113	1,053,630	1,042,597	1,014,583
Revenue growth (%)	23.0	29.7	(1.0)	(2.7)
EBITDA (INR mn)	142,991	182,100	181,510	203,297
Net profit (INR mn)	90,693	109,080	109,575	120,625
Share outstanding (mn)	1,394	1,394	1,394	1,394
EPS (INR)	65.1	78.3	78.6	86.6
EPS growth (%)	19.8	20.3	0.5	10.1
P/E (x)	30.5	25.4	23.5	21.3
EV/EBITDA (x)	20.7	16.5	15.6	14.1
ROE (%)	20.1	20.1	17.3	16.5

September 10, 2007

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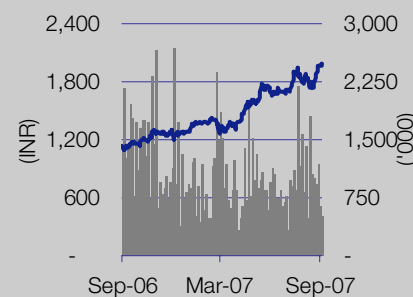
Reuters : RELI.BO
Bloomberg : RIL IN

Market Data

52-week range (INR) : 1,948 / 940
Share in issue (mn) : 1,393.5
M cap (INR bn/USD mn) : 2,769 / 68,072
Avg. Daily Vol. BSE/NSE ('000) : 916.7

Share Holding Pattern (%)

Promoters : 51.0
MFs, Fls & Banks : 7.9
Fls : 20.1
Others : 21.0



* **Hualon is a large distress textile firm**

Incorporated in 1989, Hualon is the largest textile manufacturer and one of the largest exporters in Malaysia with 0.5 mmtpa of polyester capacity, 30 ktpa nylon, 150 ktpa PET bottle grade chips, 250, 000 spindles for spun yarn manufacturing, and 5800 shuttle less looms for weaving along with processing facilities. Hualon owns 289 acres of land for its textile facilities, including 58 acres of vacant land at Port Klang. It employs 7,000 employees.

The company has 90% market share in the domestic market and exports formed 95% of its annual turnover RM 2.8 bn in FY06 (predominantly to Bangladesh, China, Egypt, Hong Kong, India, Iran, South Korea, Syria, Turkey and Vietnam). For FY06, Hualon reported a net loss of ~USD 86 mn on revenues of USD 768 mn. Its accumulated losses for FY06 end stood at RM 1.05 bn, while total receivables stood at USD 172 mn.

* **Hualon has been clocking average revenues of RM 2.8 bn (USD 730 mn) from FY01 to FY06**

Table 1: Hualon's financials

RM (mn)	CY01	CY02	CY03	CY04	CY05	CY06
						<i>(unaudited)</i>
Revenue	2,695	2,349	2,374	2,922	3,388	2,817
Pre-tax loss	642	912	622	154	239	314
Net loss	445	594	479	154	243	314
Total borrowings	2,903	2,910	2,923	3,589	3,549	3,532
Total receivables	956	698	596	605	645	630
Total payables	1,453	1,673	1,893	1,156	1,272	655

Source: Industry

Table 2: Hualon's financials in USD *

USD (mn)	CY01	CY02	CY03	CY04	CY05	CY06
						<i>(unaudited)</i>
Revenue	709	618	625	769	894	768
Pre-tax loss	169	240	164	40	63	86
Net loss	117	156	126	40	64	86
Total borrowings	764	766	769	945	936	962
Total receivables	252	184	157	159	170	172
Total payables	382	440	498	304	336	178

Source: Industry

* Average yearly exchange rates used

* **Poor corporate governance and working capital management led to Hualon losses**

Hualon's fast growth has been one of the reasons for its failure. Since 1989, Hualon has established ~28 plants and by 1999 it had debt of around USD 868 mn on revenues of USD 553 mn. The strained balance sheet was precipitated by its inability to collect payments, mostly from related group companies. Hualon's inability to collect payment caused its receivables to climb from USD 8.9 mn in 2000 to USD 131.6 mn in 2001.

Poor corporate governance, working capital management issues (poor collections of receivables), and tough industry status (stiff competition from Chinese, Vietnamese, and Cambodian textile manufacturers) led to Hualon repeatedly reporting losses. After defaulting repeatedly, Hualon went into receivership on November 2006, which was later put on sale on August 2007.

Table 3: Hualon Time-line

Year	Important events
1989	Hualon Corporation (M) Sdn Bhd was established, with a paid-up capital of USD 10.3 mn
1990	Hualon's plant in Tanjung kling, Malacca, covering about 8 hectare, was set up
1992	Hualon's plant in Nilai, covering about 73 hectares, believed to be the largest in Southeast Asia, was set up
1998	Hualon's paid-up capital reached USD 225.8 mn, turnover breached USD 526mn
1999	Company faced USD 868 mn debt, due to skyrocketing receivables
2002	Debts reached USD 1 bn. It went into a scheme of arrangement with the lenders to restructure the defaulted debts
Nov, 2006	Lenders jointly appointed the receivers and managers from E&Y to take over administration of Hualon
June, 2007	The receivers and managers put Hualon's business and assets up for sale

Source: Industry

*** Valuations**

At INR 1,987, RIL trades at 23.5x and 21.3x FY08E and FY09E EPS respectively. The stock trades at ~12% premium to our fair SOP value of INR 1,774. We maintain our '**ACCUMULATE**' recommendation on the stock.

Company Description

Reliance Industries Limited (RIL) is the largest private player in refining, petrochemical, and E&P sector in India. Historically RIL's refining and petrochemical segments have been contributing ~90% to its total revenues but that is set to change, as the company scales up its E&P business and is set to emerge as an integrated E&P player. RIL is also venturing into areas of consumer retailing and urban infrastructure.

Investment Theme

RIL's strength is in its ability to build businesses of global size and scale and execute complex, time-critical, and capital-intensive projects. Such projects would prove advantageous in its huge plans in E&P sector, organized retailing and SEZ infrastructure. The core business of refining and chemicals will sustain cash flows till FY08E as we expect the refining margins to sustain till CY08E after which the E&P business would drive RIL's earnings growth as RIL's EBITDA is set to double by FY11E on account of the company's growing exploration and production (E&P) business. Also, there could be potential upward to our estimated in-place reserves. With its foray into consumer retailing and SEZ infrastructure, we believe that it is an ideal company to play the India story.

Key Risks

RIL benefits from protected refinery margins in the Indian market due to the duty differential between products and crude. Reduction in the duty differential will be negative for the company.

Rupee appreciation may impact negatively as RIL is positively leveraged to a depreciating currency.

Any slow down in global demand could result in a fall in the refining and chemicals margins.

Financial Statements

Income statement					(INR mn)
Year to March	FY05	FY06	FY07	FY08E	FY09E
Net revenues	660,513	812,113	1,053,630	1,042,597	1,014,583
Cost of goods sold	464,562	562,111	769,190	758,228	696,673
Gross profit	195,951	250,002	284,440	284,369	317,909
Employee expenses	8,464	9,785	11,970	13,766	15,830
SG&A expenses	59,377	97,227	90,370	89,093	98,782
Operating expenses	67,841	107,011	102,340	102,859	114,613
EBIDTA	128,110	142,991	182,100	181,510	203,297
Depreciation & amortisation	37,235	34,009	40,090	38,289	46,294
EBIT	90,875	108,982	142,010	143,222	157,003
Interest	14,687	8,770	11,140	13,326	15,521
Other income	14,498	6,829	1,930	3,733	3,849
Profit before tax (PBT)	90,687	107,041	132,800	133,628	145,331
Current taxes	7,050	9,000	14,840	17,053	17,706
Deferred taxes	7,920	7,040	8,510	7,000	7,000
Taxes	14,970	16,347	23,720	24,053	24,706
Profit after tax (PAT)	75,717	90,693	109,080	109,575	120,625
Equity shares outstanding (mn)	1,394	1,394	1,394	1,394	1,394
Equity shares outs. exc. tre. shares (mn)	1,220	1,220	1,220	1,220	1,220
EPS (INR)	54.3	65.1	78.3	78.6	86.6
EPS - excluding treasury shares (INR)	62.1	74.3	89.4	89.8	98.9
Dividend per share (INR)	7.5	10.0	11.0	12.5	12.5
Dividend payout (%)	13.8	15.4	14.1	15.9	14.4

Common size metrics (% sales)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Cost of goods sold	70.3	69.2	73.0	72.7	68.7
Operating expenses	10.3	13.2	9.7	9.9	11.3
EBITDA	19.4	17.6	17.3	17.4	20.0
Depreciation & amortisation	5.6	4.2	3.8	3.7	4.6
Interest	2.2	1.1	1.1	1.3	1.5
Net profit	11.2	11.0	10.2	10.4	11.7

Growth metrics (%)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Net revenues	27.5	23.0	29.7	-1.0	-2.7
EBITDA	30.1	11.6	27.4	-0.3	12.0
PBT	43.9	18.0	24.1	0.6	8.8
Net profit	46.7	19.8	20.3	0.5	10.1
EPS	47.0	19.8	20.3	0.5	10.1

Balance sheet		(INR mn)				
As on 31st March	FY05	FY06	FY07E	FY08E	FY09E	
Equity share capital	13,931	13,932	13,932	13,932	13,932	
Reserves and surplus	390,102	484,111	575,712	664,909	765,154	
Shareholder's Equity (A)	404,033	498,043	589,644	678,840	779,086	
Secured loans	79,729	76,649	80,000	80,000	80,000	
Unsecured loans	108,117	142,007	189,520	211,593	249,233	
Total debt (B)	187,846	218,656	269,520	291,593	329,233	
Net deferred tax liability (C)	42,668	49,708	58,218	65,218	72,218	
Capital employed (A+B+C)	634,547	766,407	917,382	1,035,652	1,180,537	
Accounts payable	136,597	125,635	210,737	207,734	190,869	
Provisions	34,718	38,910	47,204	45,701	41,991	
Current liabilities & provisions (D)	171,315	164,545	257,941	253,435	232,861	
Total liabilities (A+B+C+D)	805,863	930,952	1,175,324	1,289,087	1,413,398	
Gross fixed assets	551,258	849,701	958,209	999,989	1,058,208	
Accumulated depreciation	248,728	292,534	332,624	370,913	417,206	
Net fixed assets	302,530	557,168	625,585	629,077	641,002	
Capital WIP	48,293	69,578	50,000	150,000	250,000	
Total fixed assets (A)	350,823	626,745	675,585	779,077	891,002	
Investments (B)	170,515	58,462	82,983	96,833	121,813	
Inventories	74,129	101,198	131,326	129,753	122,249	
Accounts receivables	39,278	41,636	53,403	52,844	51,424	
Cash and cash equivalents	36,088	21,462	31,609	31,278	30,437	
Loans and advances	114,154	81,198	199,363	198,260	195,458	
Other current assets	20,877	251	1,054	1,043	1,015	
Current assets (C)	284,525	245,745	416,755	413,177	400,583	
Total assets (A+B+C+D)	805,863	930,952	1,175,324	1,289,087	1,413,398	

Cash flow statement		(INR mn)				
Year to March	FY05	FY06	FY07E	FY08E	FY09E	
Op. cash flow before working capital chang	114,603	79,068	157,680	154,864	173,919	
(Incr)/Decr in working capital	18,181	17,384	(67,467)	(1,259)	(8,821)	
Cash flow from operations (A)	132,784	96,452	90,213	153,605	165,098	
Net purchase of fixed assets	(30,977)	(94,791)	(88,930)	(141,780)	(158,219)	
Net purchase of investments	(30,801)	(31,210)	(24,521)	(13,850)	(24,980)	
Net cash flow from Investing (B)	(61,777)	(126,001)	(113,451)	(155,630)	(183,199)	
Net incr./(decr.) in equity capital	(3,602)	2	-	-	-	
Net incr./(decr.) in debt	(21,601)	30,810	50,864	22,073	37,640	
Dividends paid	(11,959)	(15,890)	(17,478)	(20,379)	(20,379)	
Cash flow from financing (C)	(37,162)	14,923	33,385	1,694	17,261	
Net incr./(decr.) in cash (A+B+C)	33,846	(14,626)	10,147	(331)	(840)	

Valuation parameters						
Year to March	FY05	FY06	FY07E	FY08E	FY09E	
EPS (INR)	54.3	65.1	78.3	78.6	86.6	
EPS Y-o-Y growth (%)	47.0	19.8	20.3	0.5	10.1	
CEPS (INR)	86.7	94.5	113.2	111.1	124.8	
P/E (x)	36.6	30.5	25.4	23.5	21.3	
P/E (x) - w/o treasury shares	32.0	26.7	22.2	20.5	18.7	
Book value per share (INR)	289.9	357.4	423.1	487.1	559.1	
P/BV (x)	6.9	5.6	4.7	3.8	3.3	
EV/Sales (x)	4.4	3.7	2.9	2.7	2.8	
EV/EBITDA (x)	22.8	20.7	16.5	15.6	14.1	
Dividend yield (%)	0.4	0.5	0.6	0.6	0.6	

Liquidity ratios

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Current ratio	2.1	2.0	2.0	2.0	2.1
Quick ratio	1.5	1.2	1.4	1.4	1.5
Cash ratio	0.3	0.2	0.1	0.2	0.2
Receivable turnover (x)	16.8	19.5	19.7	19.7	19.7
Inventory turnover (x)	6.3	5.6	5.9	5.8	5.7
Payables turnover (x)	3.4	4.5	3.7	3.7	3.7
Receivables (days)	22	19	19	19	19
Inventory (days)	58	66	62	62	64
Payables (days)	107	82	100	100	100
Cash conversion cycle (days)	(27)	3	(19)	(19)	(17)

Operating ratios (x)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Total asset turnover	0.8	0.9	0.9	0.8	0.7
Fixed asset turnover	2.2	1.5	1.7	1.7	1.6
Equity turnover	1.6	1.6	1.8	1.5	1.3

Profitability ratios (%)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Gross profit margin	29.7	30.8	27.0	27.3	31.3
EBITDA margin	19.4	17.6	17.3	17.4	20.0
ROCE	16.4	16.2	16.1	13.8	13.7
ROE	20.2	20.1	20.1	17.3	16.5
ROA	13.2	13.0	12.9	11.0	11.2

Financial ratios

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Debt-equity (x)	0.1	0.1	0.1	0.1	0.1
Long term debt / Capital employed (%)	29.6	28.5	29.4	28.2	27.9
Total debt / Capital employed (%)	63.3	56.5	63.8	58.9	53.7
Interest coverage (x)	3.4	4.1	4.3	4.5	4.1

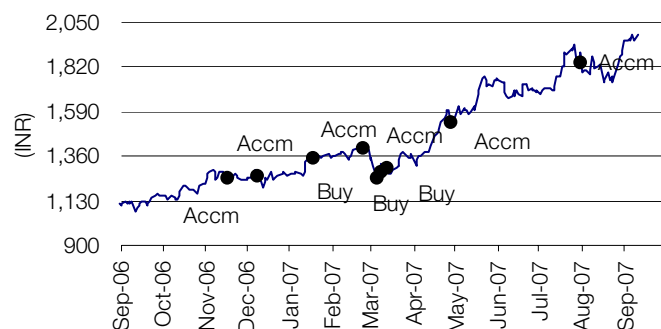
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Coverage group(s) of stocks by primary analyst(s): Oil & Gas, Petrochemicals

Bharat Petroleum Corporation, Cairn India, Chennai Petroleum Corp., Engineers India, Finolex Industries, Hindustan Petroleum Corporation, Indian Oil Corporation, Indraprastha Gas, ONGC, PSL, Reliance Industries

Reliance Industries



Recent Research

Date	Company	Title	Price (INR)	Reccs
06-Sep-07	Oil & Gas	Monthly Update		
07-Aug-07	Oil & Gas	Monthly Update		
31-Jul-07	Cairn India	Steady progress; Result Update	145	Buy
31-Jul-07	Indian Oil	GRMs and forex gains come to the rescue Result Update	395	Accum.

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	94	44	23	6	177

* 8 stocks under review / 2 rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	76	66	35

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 20% over a 12-month period
Accumulate	appreciate up to 20% over a 12-month period
Reduce	depreciate up to 10% over a 12-month period
Sell	depreciate more than 10% over a 12-month period

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