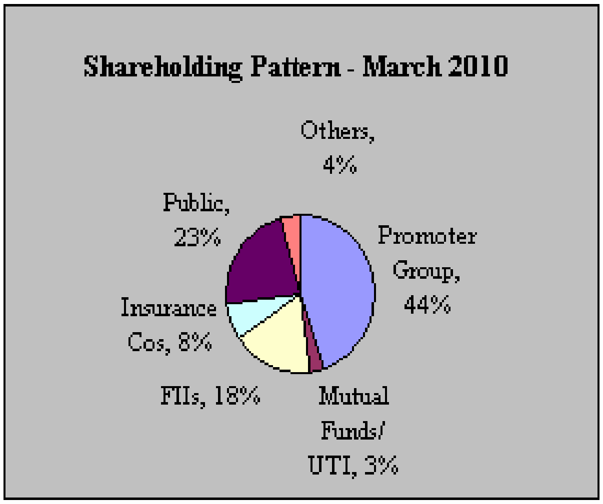
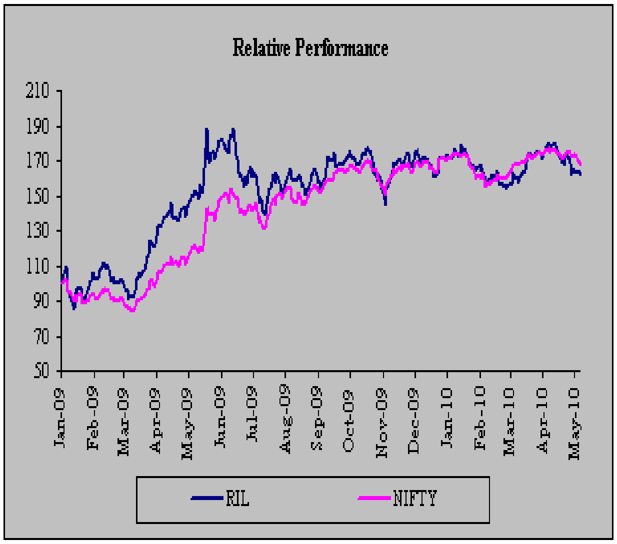
6th MAY. 2010

RELIANCE INDUSTRIES LTD. – Downside Limited…..Court Verdict to decide Upside Potential

KEY DATA	
CMP (Rs.)	1007.00
Bloomberg code	RIL IN
Bloomberg Sector	Oil Refining & Marketing
Current shares O/S (mn)	3270.4
Mkt Cap (INR bn)	3296.04
52 Wk H/L	1267.50 - 858.55
Daily Volume (3M NSE avg)	5.02 mn
1 Yr Total Return	7.76%



Source:NSE

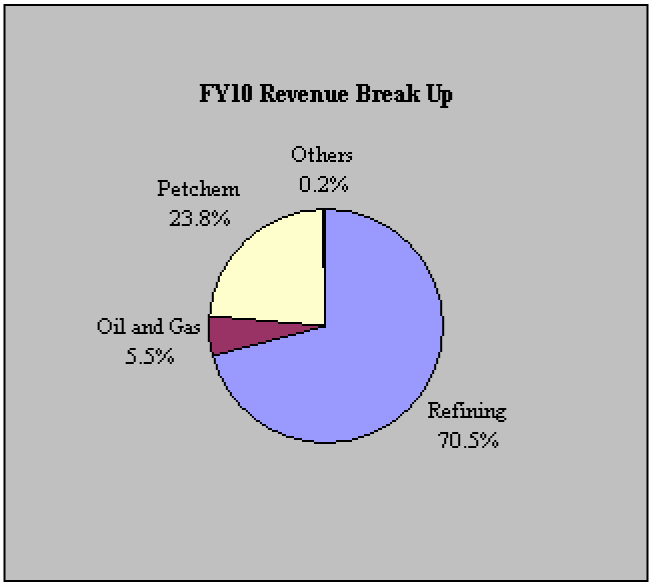


Reliance Industries Ltd. (RIL) appears to be going through an unusually tough period, facing headwinds in all businesses and in new initiatives, which has rarely occurred in its business history. In a normal business environment, which we expect over the next three years, we expect the company's profitability to pick up significantly. RIL has a long track record of creating shareholder value through expansion and new business.

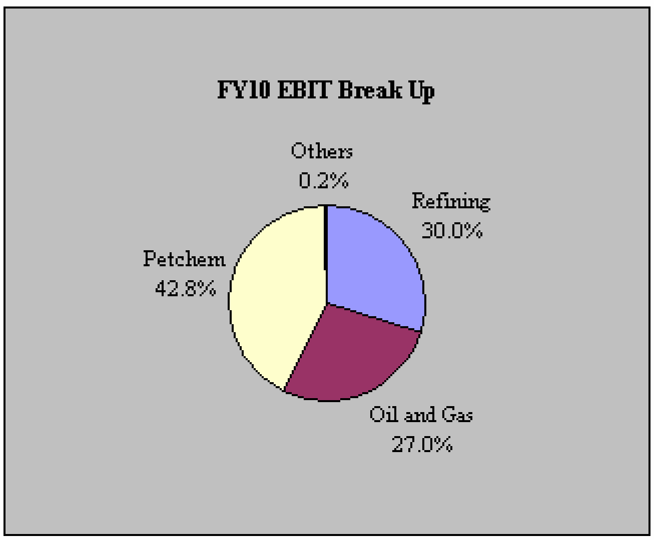
Recovery in the benchmark gross refining margin (GRM) is a key trigger for RIL's earnings over the next 2 years. RIL is positioned as an ideal long-term play on global economic recovery through its refining and petrochemical businesses, and participation in India's robust domestic consumption story through its oil & gas and retail businesses.

RIL's ongoing litigation with RNRL and NTPC for supply of 40 mmscmd volumes of gas at US$2.34/mmbtu could have a major impact on its valuation. The worst-case scenario for RIL would be if it would have to supply RNRL gas at a price of US$2.34/mmbtu and also the Government will continue to charge its levies at the price of $4.2/mmbtu, which would be a double blow on the earnings of RIL. This would have a negative impact of around 5-8% on RIL's FY12 EPS. The stock has corrected significantly (more than Rs. 100/share) post the speculation over the outcome of the case. We thus believe the market participants have already priced in the negative outcome and any correction beyond the current level offers a strong investment opportunity.

If the Court verdict goes in favor of RIL, we give the Company a 1 year price target of ***Rs.1190/share***. Any verdict against RIL, will make our target price reduced by 10% to Rs.***1070/share***. However, we feel, at a range of Rs.960-980, the stock offers a perfect long term buy.



Source: Company



Source: Company

Company Overview

RIL is a conglomerate with interests in upstream oil & gas (E&P), refining, and petrochemicals. It is India's largest private sector company on all major financial parameters. It has commissioned a super-size refinery project through Reliance Petroleum Ltd.(RPL) and has also commenced gas production at its large gas find in the D6 block in KG basin. RIL is foraying into organized retailing and has plans to undertake SEZ projects over the medium to long term. Further, it has also entered into a JV with US-based Atlas Energy for its Marcellus Shale acreage.

Business Segments

Oil and Gas segment which includes exploration, development and production of crude oil and natural gas.

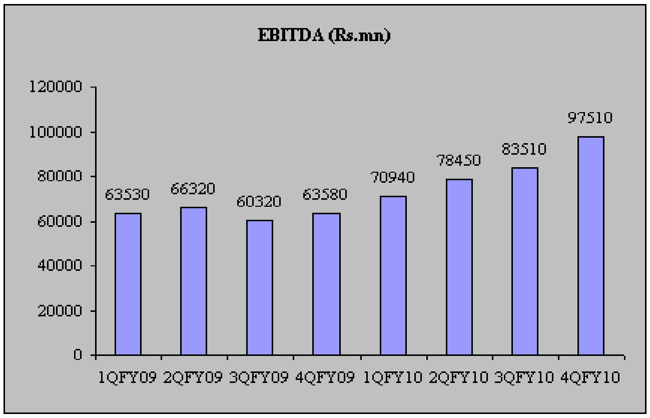
The ***Refining*** segment which includes production and marketing of petroleum products.

The **Petrochemicals** segment which includes production and marketing operations of petrochemical products namely, High and Low density Polyethylene, Polypropylene, Polyvinyl Chloride, Polyester Yarn, Polyester Fibres, Purified Terephthalic Acid, Paraxylene, Ethylene Glycol, Olefins, Aromatics, Linear Alkyl Benzene, Butadiene, Acrylonitrile, Poly butyl Rubber, Caustic Soda and Polyethylene Terephthalate.

RIL also has operations in ***Textile, Retail business and SEZ development.***

International Operations:

The International business of RIL comprises of 13 blocks with acreage of over 93,526 square kilometers – 2 in Peru, 3 in Yemen (1 producing and 2 exploratory), 2 each in Oman, Northern part of Iraq i.e. Kurdistan Region and Colombia, 1 each in East Timor and Australia. Average production for the quarter ended 31st March 2010 at the Yemen Block 9 was about 4,600 barrels per day. Reliance has farmed-out 30% of its Participating Interest (PI) in Oman-Block 18 and 25% in Oman- Block 41 to Oman Oil Company Exploration and Production. RIL through its Subsidiary, Reliance Marcellus LLC, has executed definitive agreements to enter into a joint venture with United States based Atlas Energy, Inc., of Pittsburgh, Pennsylvania under which Reliance will acquire a 40% interest in Atlas's core Marcellus shale acreage position. Reliance becomes a partner in approximately 300,000 net acres of undeveloped leasehold in the core area of the Marcellus Shale in southwestern Pennsylvania for an acquisition cost of US$ 339 million and an additional US$ 1.36 billion capital costs under a carry arrangement for 75% of Atlas's capital costs over an anticipated seven and a half year development program. Low operating costs and proximity to U.S. northeast gas markets combine to make the Marcellus one of the most economically attractive unconventional natural gas resource plays. The acreage will support the drilling of over 3,000 wells with a net resource potential of approximately 13.3 TCFe (5.3 TCFe net to Reliance). While Atlas will serve as the development operator, Reliance is expected to begin acting as development operator in certain regions in the coming years as part of the joint venture.



Source:Company

Financials

The Company's Top line increased 36% to Rs.1924610mn from Rs.1418470mn in FY09 while the bottom line increased 4% to Rs.162360mn. from Rs.156370mn of FY09. **EPS of the company for the year stood at Rs.49.65 per share.** Expenditure of the company for the year stood at Rs.1618800mn, which is around 37% higher than FY09. Consumption of raw materials and purchase of traded goods increased by 44% to Rs. 1509150mn mainly on account of higher crude oil processed in the SEZ refinery. Volumes accounted for 51% increase in value of consumption of raw materials which were partially offset by 7% reduction in prices, primarily of crude, naphtha and propane. Interest increased 14%YoY to Rs.19970mn. Depreciation (including depletion and Amortization) was higher by 102% at Rs. 104970mn against Rs. 51950mn in the previous year primarily on account of higher depletion charge in Oil & Gas and increased depreciation in the Refining business segment. Outstanding debt as on 31st March 2010 was Rs. 624950 compared to Rs. 739040mn as on 31st March 2009. **RIL has cash and cash equivalents of Rs. 218740mn (US$ 4.9 billion).** These are in fixed deposits, certificate of deposits with banks and Government securities and bonds. The net Capex towards projects for the year ended 31st March 2010 was Rs. 93310mn.

Operational: During the financial year the Company's KG D6 completed 365 days of 100% uptime and zero-incident production. **Production from KG D6 was 507,700 tonnes of crude oil and 14,397 MMSCM of natural gas.** Production from Panna-Mukta was 1,965 mmscm of natural gas and 1.8 million tonnes of crude oil, a growth of 18% and 9% respectively as compared to the previous year.

SEGMENTAL PERFORMANCE FY10			
(in Rs. mn)	FY10	FY09	% Change
REFINING			
Revenues	163249	107994	51%
EBIT	6011	9790	-39%
EBIT(%)	3.7%	9.1%	
PETROCHEMICALS			
Revenues	55251	52758	5%
EBIT	8581	6848	25%
EBIT(%)	15.5%	13.0%	
OIL AND GAS			
Revenues	12649	3489	263%
EBIT	5413	2224	143%
EBIT(%)	42.8%	63.7%	

Source: Company

Segment Results: FY10 Refining EBIT fell 39% in FY10 primarily on decline in **GRM from $ 12.2/bbl to $ 6.6/bbl** and higher depreciation. The Petrochemicals Business posted highest ever EBIT due to margin expansion and strong domestic growth. The higher oil & gas EBIT is mainly due to higher gas production from KG-D6.

Investment Rationale

Recovery in GRMs

RIL's exposure to refining business has increased sharply post the commissioning and merger with the SEZ refinery (erstwhile RPL) in FY09. The company's overall refining capacity now stands at 62 mmtpa currently. Hence, around 70% of its revenues are from the refining business. Expansion in GRMs therefore is critical for the valuation of the company. Global GRMs have bottomed out in 3QFY10 and are expected to improve with the global economic recovery. According to consensus estimates RIL's GRM are expected to rise from US$5.9/bbl in 3Q FY10 to US$11/bbl in FY11 and further to US$12/bbl in FY12, in tandem with the rise in benchmark Singapore GRMs.

Strong E&P Outlook

RIL successfully commissioned the KG-D6 project in the Krishna-Godavari basin in April 2009. Natural gas production from the D6 block has stabilized at 61 mmscmd and is all set to peak over the next 2-3 quarters to 80 mmsmcd (from D1 and D3 wells). Earnings from this block would continue to be a significant contributor to RIL's overall cash flows over the next 8-10 years. Additionally, there can be significant upside triggers if gas is discovered in other blocks in the KG basin like D9, D3, D4, etc. These blocks have the potential to virtually alter the valuation outlook for RIL going forward. We believe that RIL's next leg of growth would be led by aggressive development and appraisal of its existing discoveries and possible inorganic acquisitions. We believe RIL is the best play in the domestic E&P sector, considering its asset portfolio and proven execution capabilities.

Significant reserves upside potential

RIL has had 22 other discoveries in the D6 block apart from three which are under production currently, which clearly indicates that there's a lot more of reserve upsides to come from this block over the course of time. In the addendum filed to the Directorate General of Hydrocarbons (DGH), RIL has indicated an upside potential of 35tcf to its in-place reserve estimates of 22tcf for the KG-D6 block, based on its recent discoveries in the block. The company had submitted to the DGH the development plan for 9 discoveries in the D6 block, which was later modified in December 2009 to include only four discoveries from nine. The company will be finalizing the development plans over the next few quarters. This could significantly add to the Company's reserves potential.

Strong balance sheet with high liquidity to drive future growth

RIL has cash and cash equivalents of Rs. 21,874 crore (US$ 4.9 billion) as on 31st, March, 2010. The Company's net gearing fell from 27.8% in FY09 to 22.3% in FY10. The Company is in a strong position to take advantage of ant inorganic growth opportunity which comes its way.

CREDIT PROFILE		
	FY10	FY09
Net Debt/Equity	0.31	0.42
Net Gearing	22.3%	27.8%
Gross Interest Coverage	11.1	5.0
ROCE(%)	13.9	20.3
ROE(%) Adjusted	16.6	21.6

Source: Company

Ratings

RIL has domestic credit ratings of AAA from CRISIL and FITCH. RIL has investment grade ratings for its international debt from Moody's and S&P as Baa2 and BBB respectively. S&P has recently revised its outlook on RIL from "negative" to "stable".

Key Strategic Alliances

Marcellus shale joint venture with Atlas Energy

The company announced the closing of its recently announced Marcellus Shale Joint venture transaction with United States based Atlas Energy, Inc. of Pittsburgh, Pennsylvania. Under the terms of the transaction, Reliance will acquire a 40% interest in Atlas' core Marcellus Shale acreage position. Reliance paid Atlas approximately $339 million in cash at closing and will pay an additional $1.36 billion under a carry arrangement by funding 75% of Atlas' capital costs over the development program. Reliance and Atlas have agreed to acquire, in a series of transactions, 42,344 highly prospective Marcellus Shale acres in southwestern Pennsylvania for an average purchase price of $4,532 per acre. Substantially all of the acreage to be acquired is held by production and is either contiguous with the joint venture's existing acreage or in concentrated blocks of acreage. As a result of these transactions, the Atlas/Reliance joint venture will now control approximately 343,000 Marcellus Shale acres, of which approximately 137,000 acres are net to Reliance.

Reliance provides growth capital to Deccan 360 as a strategic investor

The company announced their investment in Deccan 360, India's new delivery and distribution network, an initiative which will provide a remarkable boost in transforming the logistics spectrum in India. This investment will help Deccan 360 to increase the air and surface network coverage across the country. Deccan 360 will introduce world class services & systems to India's express end-to-end supply chain logistics space in both business-to-business and retail sector.

Common Wealth Games 2010 to be 'solar powered' by Reliance

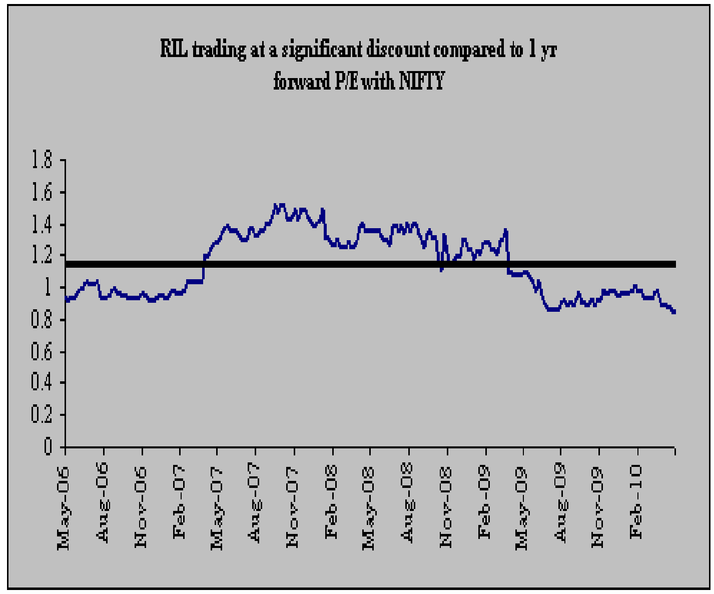
The solar energy initiative of Reliance Industries Ltd. (RIL), RIL Solar Group, has successfully implemented and commissioned India's first 1MW solar plant on the roof of the Thyagaraj Stadium in New Delhi. The Thyagaraj Stadium, developed by the Government of Delhi, is planned to be a model green stadium and will host Netball in the upcoming Common Wealth Games. RIL Solar Group has also implemented power plants in the R K Khanna Tennis Complex as also solar LED street lights and garden lights in the Commonwealth Games Village. With these, RIL Solar Group has installed 100% of the solar PV power generating equipment for the Commonwealth Games 2010. The entire solar initiative is one of the major initiatives to compensate for CO2 emissions to be released through the game.

Reliance Industries and IMG Worldwide forge alliance (IMG Reliance)

RIL and IMG, the world's leading sports marketing and Management Company, announced an equal joint venture to develop market and manage sports and entertainment in India. The venture, IMG Reliance Pvt. Ltd., will have parallel complementary strategies: to provide and operate world class infrastructure and coaching facilities in the country to unlock India's sporting potential and; to create and operate major sports and entertainment assets in the country.

Outlook and Valuation

Currently RIL is trading at 11.9x its consensus FY12 EPS of Rs.85/share compared to Nifty trading at 13.5x FY12 earnings. The discount compared to the market is primarily on account of RIL's uncertainty over gas litigation with NTPC and RNRL. We expect **the discount to narrow down** once this uncertainty clears. Also since RIL is a global commodity play, it is positioned ideally to benefit on global economic recovery through its refining and petrochemical businesses, and participation in India's robust domestic consumption story through its oil & gas and retail businesses. We expect the GRMs to bottom out within the next 1-2 quarters and expect sustained refining recovery going thereafter.



Source: Bloomberg, GSL Research

We value Reliance based on two scenarios:

Base Case: **RIL to sell gas at $4.2/mmbtu - Govt. to charge levies (royalty and profit sharing) on $4.2/mmbtu**. In this scenario we value the Company at Rs.1190/share based on 14x FY12 consensus EPS of Rs.85.

Worst Case: **RIL to sell gas at $2.34/mmbtu - Govt. to charge levies (royalty and profit sharing) on $4.2/mmbtu.** This would be the worst case scenario for RIL and it would lead to a fall of 6-8$ on the Company's FY12EPS. In this case, our 12- month target price gets reduced by 10% to Rs.1070/share. However, the stock has corrected significantly (more than Rs. 100 per share) post the speculation over the outcome of the case. We thus believe the market participants have already priced in the negative outcome and any correction beyond the current level offers a strong investment opportunity.

Risks

Delay in scale up of production: RIL plans to scale up production from KG D6 to 90 mmscmd from current 61 mmscmd over the next one year, and oil production to reach its peak at 40,000 bbls/day. Currently, although RIL can achieve its peak gas production from D6, delays in expansion of supporting pipeline capacity from GAIL has led to production being restricted at 61 mmscmd. Any further delays from GAIL can lead to RIL achieving the peak production from D6 much later leading to an impact on valuations.

Execution risks: RIL plans to develop new discoveries like the NEC-25, KG D4, KG D9, and CBM over the next 5-6 years. RIL's inability to develop these reserves in the foreseeable future would result in potential threat to the company's valuation upside from these blocks.

PEER COMPARISON									
	P/E			P/BV			EV/EBITDA		
	FY10	FY11	FY12	FY10	FY11	FY12	FY10	FY11	FY12
ONGC	10.96	10.12	9.41	2.16	1.91	1.71	5.05	4.65	4.38
GAIL	18.21	15.47	13.33	3.18	2.79	2.43	11.65	9.56	8.06
Cairns	48.49	12.02	6.93	1.66	1.48	1.26	42.02	8.41	4.86
Reliance	20.28	14.05	11.90	2.38	2.07	1.83	12.39	9.53	8.11

Source: Bloomberg

Income Statement (in Rs. Crores)			
Particulars	**FY10**	**FY09**	**FY08**
Net Sales	192461.00	141847.00	133443.00
Other Operating Income	0.00	0.00	0.00
Other Income	2460.00	2388.00	5628.00
Total Income	194921.00	144235.00	139071.00
Total Expenditure	161880.00	118534.00	114334.00
PBIDT	33041.00	25701.00	24737.00
Interest	1997.00	1745.00	1077.00
PBDT	31044.00	23956.00	23660.00
Depreciation	10497.00	5195.00	4847.00
Tax	3111.00	1206.00	2605.00
Fringe Benefit Tax	0.00	57.00	47.00
Deferred Tax	1200.00	1861.00	900.00
Reported PAT	16236.00	15637.00	15261.00
Extra-ordinary Items	0.00	18.48	-345.79
Adjusted Profit	16236.00	15618.52	15606.79
EPS (Adj)	49.70	50.50	67.10
Dividend (%)	70.00	130.00	130.00
Face Value	10.00	10.00	10.00

Source: CAPITALINE

BALANCE SHEET (in Rs. Crores)		
	FY09	**FY08**
SOURCES OF FUNDS :		
Share Capital	1642.78	1453.39
Reserves Total	124730.19	78312.81
Equity Share Warrants	0.00	1682.40
Equity Application Money	1.42	0.00
Total Shareholders Funds	126374.39	81448.60
Secured Loans	10697.92	6600.17
Unsecured Loans	63206.56	29879.51
Total Debt	73904.48	36479.68
Total Liabilities	200278.87	117928.28
APPLICATION OF FUNDS :		
Gross Block	149628.70	104229.10
Less : Accumulated Depreciation	49285.64	42345.47
Less:Impairment of Assets	0.00	0.00
Net Block	100343.06	61883.63
Lease Adjustment	0.00	0.00
Capital Work in Progress	69043.83	23005.84
Producing Properties	0.00	0.00
Investments	21606.49	22063.60
Current Assets, Loans & Advances		
Inventories	14836.72	14247.54
Sundry Debtors	4571.38	6227.58
Cash and Bank	22176.53	4280.05
Loans and Advances	13127.64	18130.67
Total Current Assets	54712.27	42885.84
Less : Current Liabilities and Provisions		
Current Liabilities	32689.58	21045.47
Provisions	3010.90	2992.62
Total Current Liabilities	35700.48	24038.09
Net Current Assets	19011.79	18847.75
Miscellaneous Expenses not wrt/off	0.00	0.00
Deferred Tax Assets	247.51	310.53
Deferred Tax Liability	9973.81	8183.07
Net Deferred Tax	-9726.30	-7872.54
Total Assets	200278.87	117928.28

Source: CAPITALINE

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Disclaimer