

## Reliance Industries Ltd

### Amalgamation of RPL with RIL - ALERT

### Overweight

RELI.BO, RIL IN

Price: Rs1,265.05

27 February 2009

- **RPL to amalgamate with RIL:** RIL announced that it will hold a meeting of its Board on 2nd March to consider amalgamation of RPL with RIL. This is similar to the RIL-old RPL amalgamation in 2002, however the timing (pre-commercial production) has come as a surprise.
- **More efficient use of RPL's cash flows:** Though the amalgamation does not impact operations the deal helps: (1) simplify holding of the group's refining business – RIL's refining capacity will be 1.2mnbl/day; (2) will ensure efficient use of RPL's operating cash flows (US\$1.5bn p.a) and tax exemptions (SEZ benefits are for a unit and not RPL entity).
- **Share swap ratio:** The swap ratio would be announced on March 2nd. Likely swap ratio could range from 16.6x (1 share of RIL: 16.6 shares of RPL) considering current price, 15.2x considering last 3 months avg. closing price and 17.0x considering our fair valuation for RIL and RPL. The 2002 RIL RPL merger at a share swap ratio of 11x was inline with ratio of last mnt average closing price. *Considering current share price and valuations share swap of 16x or lower would favor RPL shareholders and 18x or greater would favour RIL shareholders.*
- **EPS accretive:** We believe the deal would be EPS accretive for RIL due to higher current and fair valuation multiple for RIL (on account of diversified earnings profile). We expect management to extinguish treasury shares that are direct holdings and creating treasury stock would be EPS dilutive. With extinguished treasury shares, equity would expand by 4% and the deal would be 3-5% EPS accretive.
- **Stock implications:** We believe the deal would be positive for RIL and potentially negative for RPL (N). The merger would have marginal impact on consolidated earnings, but treatment of minorities will be closely watched.

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#### Integrated Oils

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Swap ratio based on current price could be 16.6x, 14-16x considering 6 month trading history and 17.0x considering our fair valuation for RIL and RPL.

2002 RIL-RPL amalgamation at 11:1 share sway ratio was inline with 6 month trading history.

Figure 1: Share swap ratios

	RIL	RPL	Ratio
Current Price	1266	76	16.6
1 mnt average price	1,313	83	15.8
3 mnt average price	1,248	82	15.2
6 mnt average price	1,419	99	14.3
FY08 EPS	105	N/A	N/A
FY09E EPS	98	N/A	N/A
FY11E EPS	159	14	11.5
FY08 Book	588	30	19.6
FY09E Book	732	30	24.4
FY11E Book	956	52	18.5
RIL- Old RPL merger at 11:1			
1 mnt average price	311	29	10.5
3 mnt average price	312	30	10.5
6 mnt average price	291	31	9.6

Source: Company, Bloomberg, J.P.Morgan estimates

We estimate Ebitda to grow at a 29% CAGR over FY09-11E and net profit to grow 32% CAGR over FY09-11E for the merged entity.

Figure 2: P&L of RIL+RPL

Profit and Loss statement				
Rs in millions, year-end Mar	FY08	FY09E	FY10E	FY11E
Revenues	1,334,430	1,533,142	1,582,292	1,960,765
% change Y/Y	19%	15%	3%	24%
EBITDA	223,191	234,343	321,815	390,804
% change Y/Y	10%	5%	37%	21%
EBITDA Margin (%)	17%	15%	20%	20%
EBIT	174,719	186,268	245,552	309,387
% change Y/Y	13%	7%	32%	26%
EBIT Margin (%)	13%	12%	16%	16%
Net financial income	55,383	(4,890)	(15,528)	(11,381)
Earnings before tax	230,102	181,379	230,025	298,006
% change Y/Y	58%	-21%	27%	30%
Tax	(35,519)	(27,566)	(26,783)	(28,575)
Net Income (Rs mn)	152,613	153,813	203,242	269,430

Source: J.P.Morgan estimates

3-5% EPS accretive if treasury shares extinguished.

Figure 3: EPS accretive considering treasury shares to be extinguished

	FY09E	FY10E	FY11E
RIL current EPS estimates	97.6	118.5	159.2
RIL profit post amalgamation	153,813	203,242	269,430
Shares (including treasury)	1839	1839	1839
EPS (including treasury stock)	83.7	110.5	146.5
% earnings dilutive	-14%	-7%	-8%
Shares (extinguishing treasury)	1639	1639	1639
EPS (extinguishing treasury stock)	93.8	124.0	164.4
% earnings accretive	-3.8%	4.6%	3.3%

Source: J.P.Morgan estimates

Figure 4: Equity change in RIL

	Shares (mn)	Shares (%)
<b>Current RPL shareholding</b>		
RIL	3167	70%
Chevron	225	5%
Others	1108	25%
<b>Total</b>	<b>4500</b>	<b>100%</b>
<b>Chevron would sell its 5% stake in RPL to RIL.</b>		
<b>RPL Shareholding: Post Chevron Sale</b>		
RIL	3392	75%
Chevron	0	0%
Others	1108	25%
<b>Total</b>	<b>4500</b>	<b>100%</b>
<b>Assuming a merger ratio of 17:1, 265mn shares RIL shares will have to be issued</b>		
<b>Assumed Merger Ratio</b>	<b>17</b>	
<b>New RIL shares to be issued</b>		
To RIL (Treasury)	200	
To Others	65	
<b>Total</b>	<b>265</b>	
<b>With treasury shares the equity base would increase by 17% and assuming treasury shares to be extinguished equity base would increase by 4%.</b>		
<b>Current RIL Shareholding</b>		
Promoters	667	42%
Treasury shares	197	13%
Others	709	45%
<b>Total</b>	<b>1574</b>	<b>100%</b>
<b>Shareholding: Post Amalgamation (with Treasury shares)</b>		
Promoters	667	36%
Treasury shares	397	22%
Others	775	42%
<b>Total</b>	<b>1839</b>	<b>100%</b>
<i>(increase in equity base %)</i>	<i>16.8%</i>	
<b>Shareholding: Post Amalgamation (if Treasury shares are extinguished)</b>		
Promoters	667	41%
Treasury shares	197	12%
Others	775	47%
<b>Total</b>	<b>1639</b>	<b>100%</b>
<i>(Increase in equity base %)</i>	<i>4.1%</i>	

Source: NSE, J.P.Morgan estimates

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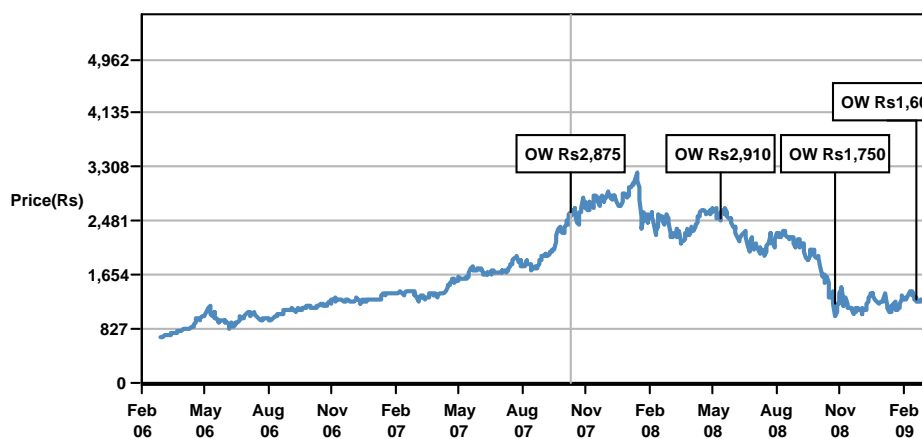
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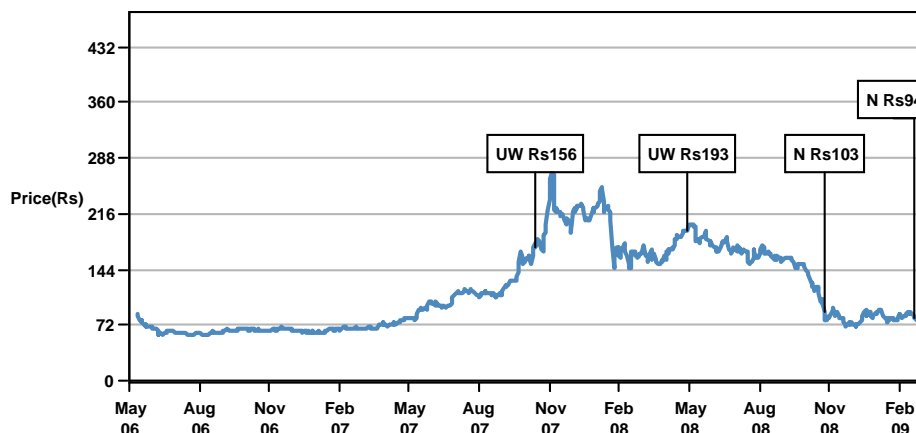
Reliance Industries Ltd (RELI.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
11-Oct-07	OW	2617.35	2875.00
15-May-08	OW	2529.95	2910.00
24-Oct-08	OW	1215.25	1750.00
18-Feb-09	OW	1267.60	1600.00

Source: Reuters and J.P. Morgan; price data adjusted for stock splits and dividends.  
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**Reliance Petroleum Ltd (RPET.BO) Price Chart**



Date	Rating	Share Price (Rs)	Price Target (Rs)
11-Oct-07	UW	172.85	156.00
28-Apr-08	UW	193.95	193.00
24-Oct-08	N	89.75	103.00
18-Feb-09	N	81.90	94.00

Source: Reuters and J.P. Morgan; price data adjusted for stock splits and dividends.  
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