

**RIL -----Maintain OUTPERFORM**
**BP helps underscore RIL's E&P valuations**

EPS: ◀▶ TP: ▶▶

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- BP, on 21 Feb, agreed to pay \$7.2 bn to RIL for a 30% stake in most of the latter's Indian E&P acreage (incl. KG D6, NEC 25, D3, D9 and the MN D4 blocks); with another \$1.8 bn linked to E&P successes. RIL/BP also now have a JV for sourcing/selling of gas.
- The \$7.2 bn is almost exactly in line with our numbers. The \$1.8 bn represents upside, but current value should be low. RIL's tax obligations on money received are yet unclear. Near-term EPS estimates can fall; the extent of which will depend on use of cash.
- BP/RIL have discussed this deal for 2 years. BP will have looked at geological data and production issues at D6. BP's investment is then a vote of confidence in the longer term prospects of RIL's E&P; that will help provide support to RIL's E&P valuations. Near-term volatility in E&P volumes may not matter that much now.
- This shifts focus on RIL's refining, petchem businesses; both of which are currently doing well; and valuations for which are easier to benchmark. This can help RIL get closer to our target price. Use of cash now becomes a larger medium-term issue. Maintain OUTPERFORM.

announced. While they make time, approvals from the Government of India should come through.

**De-risking E&P valuations**

- In our SOTP, we have RIL's E&P (KG D6 oil and gas, NEC 25 and exploration upsides) at Rs336/share. BP's US\$7.2 bn payment for 30% is almost exactly in line.
- RIL's tax obligations on the money received are yet unclear.
- The US\$1.8 bn upside payments are likely to happen over an extended time period; present value (upside to our TP) should be relatively small. The few blocks that BP has not taken stakes in are, by implication, unlikely to have much E&P promise.
- BP and RIL have been in discussion for two years: BP would have looked at geological data in detail, and analysed current output issues at D6. Our valuations for D6 oil and gas assume 80 mmscmd production by FY14. The fact that BP is 1) willing to take on current reservoir uncertainties, and 2) pay valuations that imply higher volumes, will de-risk RIL's upstream portfolio valuations (and allow stock to get closer to our target price), we think.
- As the deal closes, RIL EPS numbers should see cuts; the extent of which will depend on RIL's use of cash.
- RIL has not specified any use for its now approximately US\$15 bn cash. The drag on returns can make the imperative for inorganic growth stronger.
- RIL shall now be able to access BP's technical expertise in deep water exploration and in fixing D6 gas volumes; and potentially look at a LNG terminal / business in India.
- BP believes this purchase allows it to partner a strong company, enter a promising basin and access a growing energy market. Given the deep water exploratory risks, we presume BP has used a reasonably high IRR for its valuation of RIL's E&P assets. BP has about US\$18 bn in cash and a plan to divest US\$22 bn in assets.

Bbg/RIC	RIL IN / RELI.BO	Price (18 Feb 11, Rs)	938.00		
Rating (prev. rating)	O (O)	TP (Prev. TP Rs)	1,132 (1,132)		
Shares outstanding (mn)	3,272.98	Est. pot. % chg. to TP	21		
Daily trad vol - 6m avg (mn)	0.95	52-wk range (Rs)	1132.00 - 894.60		
Daily trad val - 6m avg (US\$ mn)	19.8	Mkt cap (Rs/US\$ bn)	3,070.1/ 68.0		
Free float (%)	51.0	<b>Performance</b>	<b>1M 3M 12M</b>		
Major shareholders	Promoter - 45%	Absolute (%)	(5.9) (9.0) (6.0)		
		Relative (%)	(1.4) (0.4) (15.7)		
<b>Year</b>	<b>3/09A</b>	<b>3/10A</b>	<b>3/11E</b>	<b>3/12E</b>	<b>3/13E</b>
Revenues (Rs mn)	1,513,355	2,033,706	2,808,769	2,772,218	2,874,927
EBITDA (Rs mn)	234,222	308,939	382,231	416,523	480,317
Net profit (Rs mn)	149,687	245,031	203,042	223,808	266,691
EPS (Rs)	47.6	74.9	62.1	68.4	81.5
- Change from prev. EPS (%)	n.a.	n.a.	0	0	0
- Consensus EPS (Rs)	n.a.	n.a.	63.6	74.1	85.9
EPS growth (%)	(26.7)	57.5	(17.1)	10.2	19.2
P/E (x)	19.7	12.5	15.1	13.7	11.5
Dividend yield (%)	1.4	0.7	1.0	1.5	2.1
EV/EBITDA (x)	15.4	11.6	9.5	8.1	6.5
P/B (x)	2.7	2.3	2.1	1.9	1.7
ROE (%)	15.5	20.3	14.5	14.2	15.2
Net debt (net cash)/equity (%)	49.0	38.3	37.2	18.1	1.7

Note 1: Reliance Industries is India's largest private sector business enterprise in India. It has three business divisions: exploration & production, refining & marketing, and petrochemicals.

**BP buys 30% of RIL's domestic E&P**

In a deal announced 21 Feb, BP has agreed to take a 30% stake in most of RIL's Indian E&P acreage. These include the producing KG D6 (oil and gas) block, the discovered NEC 25 reserves, and other promising acreage on the east coast (D3/D9/MND4) blocks. BP will pay US\$7.2 bn in phases through FY12 (as government approvals come through), and can pay US\$1.8 bn based on commercially exploitable exploratory successes in future. BP and RIL have also formed a 50:50 JV for the sourcing and marketing of natural gas in India. In total, BP expects to invest about US\$20 bn in India over several years. On the call, the companies suggested that both the UK and the Indian governments had been taken on board (the agreement is reportedly being signed at 10 Downing Street) before the deal was

**Figure 1: RIL SOTP valuation**

SOTP	Rs/sh	SOTP	Rs/sh	BP valuation
a) Chemicals	237	d) KGD6+MA	336	331*
b) Refining	469	Oil+NEC25+Exp option		
c) Others	36	e) CBM+US Shale	54	
		<b>Total (a+b+c+d+e)</b>	<b>1,132</b>	<b>1,127</b>

\*Assuming no value for the \$1.8bn potential upside

Source: Company data, Credit Suisse estimates.

We will update our numbers as the deal closes and as we get clarity on taxation. Near-term oil/gas production volumes will continue to cause EPS estimate volatility. With this deal however, RIL has helped 'fix' valuations for almost all of its E&P business. Near-term valuation uncertainties now lie with the commodity petchem/refining businesses; both of which have surprised the market with their recent strength. Lower refining spare capacity and seasonality towards late 2011 can help refining do better. RIL's use of its cash is now a bigger driver of medium-term valuations, we think. Maintain OUTPERFORM.

**Companies Mentioned** (Price as of 18 Feb 11)

Reliance Industries (RELI.BO, Rs938.00, OUTPERFORM, TP Rs1132.00)

BP (BP.L, 493.00 p, OUTPERFORM, TP 585.00 p, MARKET WEIGHT)

**Disclosure Appendix**

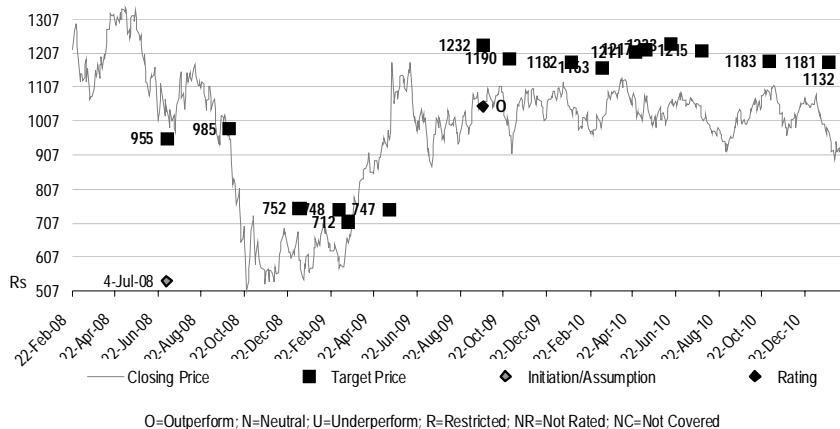
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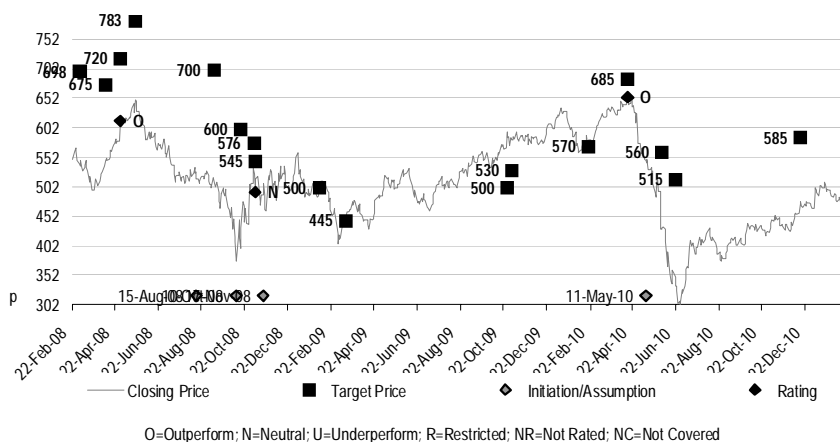
**3-Year Price, Target Price and Rating Change History Chart for RELI.BO**

RELI.BO Date	Closing Price (Rs)	Target Price (Rs)	Initiation/ Rating Assumption
4-Jul-08	1,049.5	955	X
30-Sep-08	973.17	984.5	
7-Jan-09	598.4	752	
3-Mar-09	599.52	747.5	
17-Mar-09	650.17	712	
13-May-09	968.95	747	
23-Sep-09	1,050.7	1232	O
30-Oct-09	965.63	1190	
25-Jan-10	1,041.35	1182	
10-Mar-10	1010	1163	
26-Apr-10	1,068.75	1211	
10-May-10	1,080.8	1217	
14-Jun-10	1,063.35	1233	
28-Jul-10	1,020.25	1215	
1-Nov-10	1092	1183	
24-Jan-11	972.55	1181	
18-Feb-11	938	1132	



**3-Year Price, Target Price and Rating Change History Chart for BP.L**

BP.L Date	Closing Price (p)	Target Price (p)	Initiation/ Rating Assumption
3-Mar-08	540.5	697.7	
8-Apr-08	537	675	
29-Apr-08	613	720	O
20-May-08	628	783	
15-Aug-08			X
8-Sep-08	517	700	
10-Oct-08			X
16-Oct-08	397.5	600	
4-Nov-08	533.25	576	
6-Nov-08	493	545	N
17-Nov-08			X
4-Feb-09	499.75	500	
13-Mar-09	450.75	445	
27-Oct-09	594.4	500	
3-Nov-09	580.3	530	
19-Feb-10	581.3	570	
15-Apr-10	653	685	O
11-May-10			X
2-Jun-10	429.75	560	
22-Jun-10	334.2	515	
14-Dec-10	473.1	585	



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<b>Restricted</b>	2%	

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**Price Target:** (12 months) for (RELI.BO)

**Method:** Our target price for Reliance Industries is Rs1,132. We value the company using our discounted cash flow (DCF) based sum-of-the-parts valuation. For our DCF valuation, we use a weighted average cost of capital (WACC) of 9.9%. Our DCF-based valuations for the core business - chemicals and refining - imply an EV/EBITDA (enterprise value/earnings before interest, tax, depreciation, amortisation) of 7.5x and 9.4x, respectively, for 2012. We value the existing known blocks in E&P at US\$22 bn, and the exploration at US\$4 bn for the reserves that have not been discovered. We add US\$2.5 bn for US Shale JVs in our SOTP.

**Risks:** Risks: There are risks on the downside to our Rs1,132 target price for Reliance Industries if: 1) There is a correction in equity valuations 2) lack of re-investment of the surplus cash resulting in lower ROEs; 3) gas reserves are lower than modelled.

**Price Target:** (12 months) for (BP.L)

**Method:** We value BP at a combination of NAV (40% weight) and a 2012E target multiple of 8.0x P/E (60% weight). Our TP is 585 GBP.

**Risks:** Risks to our TP - Short term: Commodities volatility, exchange rate movements, geo-political tensions, delays/issue with plugging the Macondo well. Longer term risks include risks of litigation related to the Macondo oil spill from civil parties and risks of punitive damages, Oil and Gas prices, refining and cracking margins, power supply pricing, Chemical products pricing, increasing tax takes from producing countries, possible (partial) renationalisation of assets in less stable regions, inflationary pressures in external suppliers (such as rig day-rates)

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