

Reliance Industries (RIL IN)

Rating: **2**

BP puts its stamp of faith on RIL's E&P portfolio; we see this as very positive

Energy: India

Target price: **Rs1,056.00**

Atul Rastogi/Nirmal Raghavan, CFA (91) 22 6622 1020 (atul.rastogi@in.daiwacm.com)

Price (21 Feb)	Rs956.35
Reuters code	RELI.NS
ADR/GDR code	nm
Shares per ADR/GDR	0.00

Market data

SENSEX Index	18,438.31
Market cap	(US\$b) 69.70
EV	(US\$b; 11E) 75.46
3-mth avg daily T/O	(US\$m) 124.28
Shares outstanding	(m) 3,279
Free float	(%) 53.5
Major shareholder	Mukesh Ambani & associates (46.5%)
Exchange rate	Rs/US\$ 44.993

Performance (%)*	1M	3M	6M
Absolute	(3.1)	(4.0)	(3.3)
Relative	(0.1)	1.9	(3.5)

Source: Daiwa

Note: *Relative to SENSEX Index

Investment indicators

	2011E	2012E	2013E
PER (x)	15.3	13.6	11.4
PCFR (x)	11.6	8.6	7.7
EV/EBITDA (x)	8.6	7.6	6.3
PBR (x)	2.0	1.8	1.6
Dividend yield (%)	0.8	0.9	1.1
ROE (%)	14.0	13.9	14.7
ROA (%)	8.0	8.6	9.4
Net debt equity (%)	30.0	17.2	5.8
Relative to peers			Above
Relative to history			Below

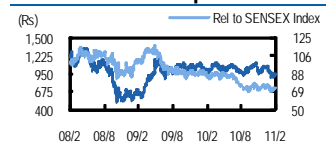
Source: Daiwa forecasts

Income summary (Rs m)

Yr to 31 Mar	2010	2011E	2012E	2013E
Revenue	1,924,610	2,270,226	2,328,962	2,729,502
YoY (%)	35.7	18.0	2.6	17.2
EBITDA	330,412	395,937	427,728	485,126
YoY (%)	30.2	19.8	8.0	13.4
Net profit	162,357	205,015	231,547	276,409
YoY (%)	6.1	26.3	12.9	19.4
EPS (Rs)	49.645	62.524	70.369	84.003
YoY (%)	(49.0)	25.9	12.5	19.4
CFPS (Rs)	62.654	82.707	111	124
DPS (Rs)	6.374	8.016	9.022	10.770

Source: Company, Daiwa forecasts

Price and relative performance



Source: Bloomberg, Daiwa

Forecasts revisions (%)

	FY11E	FY12E	FY13E
Revenue change	0.0	0.0	0.0
Net profit change	0.0	0.0	0.0
EPS change	0.0	0.0	0.0

Source: Daiwa forecasts

Fair value

Valuation (Rs/shr)	1,056.00
Methodology	SOTP
Key assumption	Refining margin

Source: Daiwa forecasts

What has changed?

- Reliance Industries (RIL) has announced a partnership with the UK's BP involving: a) 30% stake sale in 23 oil and gas blocks including *KGD6* for US\$7.2bn, and b) a joint venture for the sourcing & marketing of gas in India.

Impact

- Unlocking value.** British Petroleum (BP) (BP/ LN, GBp491.55, 3) has agreed to pay US\$7.2bn for a 30% stake in 23 oil and gas blocks including *KGD6*, which effectively values those blocks at US\$24bn. Our valuation for RIL's oil and gas segment including currently producing blocks and 'exploration upside' is US\$23bn and is in line with the valuation of the deal. BP has also agreed to pay future performance payments of up to US\$1.8bn based on future exploration success. This could raise the valuation of the 23 blocks to US\$30bn.
- Deal has a signalling effect.** This is BP's single largest investment in any basin anywhere in the world. Coming from BP, which is one of world's leading deepwater explorers, we believe this is a significant indicator of the immense potential of India's east coast, including the KG Basin, as a world-class gas reservoir base. RIL should be able to now share the risk of exploration with BP while simultaneously benefiting from its deepwater exploration and development expertise.
- Well-positioned for capex.** We estimate that RIL had net debt of about US\$8bn as at 31 December 2010. We believe the consideration of US\$7.2bn, which will be received over FY12, should help RIL to further reduce its net debt or provide the cash for further capital expenditure. We believe RIL has capex plans of US\$20-22bn mainly for the petrochemical segment over the next 3-4 years. Besides this, RIL has been investing in shale-gas joint ventures and also has capex plans for the telecom sector. Exploration and commercial development in its E&P blocks would also require investments.
- Downstream investments indicative of the gas demand potential.** The partnership also involves the setting up of a joint venture concerning the sourcing and marketing of gas primarily into India. We believe this downstream investment with a potential involvement of US\$11bn would involve setting up LNG receiving terminals and oil and gas transportation and distribution infrastructure in the country. In our view, this investment plan is indicative of India's potential to emerge as a major gas importing country.

Valuation

- Additional cash on the balance sheet could lead to an increase in other income for the company, but at present we maintain our EPS forecasts for RIL. We reiterate our **2 (Outperform)** rating and SOTP-based six-month target price of Rs1,056. We value the petrochemical, refining and oil & gas businesses at FY12 EBITDA multiples of 7x, 8x and 7x, respectively.

Catalysts and action

- We believe the current transaction is a significant positive for the stock, as it provides a benchmark for the valuation of the E&P business. We think the next positive catalyst for the stock lies in further clarity on the gas output ramp-up strategy. We see the key risk as lower-than-expected gross refining margins.

Company background

The Reliance Group, founded by Dhirubhai H. Ambani, is India's largest private-sector enterprise, with businesses in the energy and materials value chain. The group's activities span the exploration and production of oil and gas, petroleum refining and marketing, petrochemicals (polyester, fibre intermediates, plastics and chemicals), textiles, retail and special economic zones.

Reliance Industries – financial summary

Profit and loss (Rs m)

Year to 31 Mar	2009	2010	2011E	2012E	2013E
Petrochemicals	564,497	591,540	533,052	541,173	635,662
Refining	1,098,865	1,751,197	1,942,818	2,002,146	2,371,716
Others	(244,887)	(418,127)	(205,644)	(214,357)	(277,876)
Total revenue	1,418,475	1,924,610	2,270,226	2,328,962	2,729,502
Other income	20,599	24,605	18,058	19,681	29,911
COGS	(1,138,257)	(1,543,222)	(1,816,216)	(1,846,627)	(2,198,674)
SG&A	(47,079)	(75,581)	(76,130)	(74,287)	(75,613)
Other op. expenses	(51,953)	(104,965)	(130,842)	(129,338)	(135,390)
EBIT	201,785	225,447	265,095	298,391	349,737
Net-interest inc./(exp.)	(17,452)	(19,972)	(16,725)	(17,358)	(16,840)
Assoc/forex/extraord./others	0	0	0	0	0
Pre-tax profit	184,332	205,474	248,370	281,033	332,897
Tax	(31,239)	(43,118)	(43,355)	(49,486)	(56,488)
Min. int./pref. div./others	0	0	0	0	0
Net profit (reported)	153,093	162,357	205,015	231,547	276,409
Net profit (adj.)	153,093	162,357	205,015	231,547	276,409
EPS (reported) (Rs)	97.293	49.645	62.524	70.369	84.003
EPS (adj.) (Rs)	97.293	49.645	62.524	70.369	84.003
DPS (Rs)	0.000	6.374	8.016	9.022	10.770
EBIT (adj.)	201,785	225,447	265,095	298,391	349,737
EBITDA (adj.)	253,738	330,412	395,937	427,728	485,126

Balance sheet (Rs m)

As at 31 Mar	2009	2010	2011E	2012E	2013E
Cash & short-term investment	250,500	218,902	155,610	312,398	469,777
Inventory	148,367	269,816	247,877	251,561	294,832
Accounts receivable	45,714	116,602	95,222	97,654	114,499
Other current assets	131,276	102,746	182,746	182,746	182,746
Total current assets	575,858	708,067	681,455	844,358	1,061,854
Fixed assets	1,693,869	1,653,987	1,695,956	1,749,110	1,791,211
Goodwill & intangibles	0	0	0	0	0
Other non-current assets	187,329	148,011	208,251	208,251	208,251
Total assets	2,457,056	2,510,064	2,585,662	2,801,719	3,061,316
Short-term debt	632,066	508,242	506,492	499,942	469,505
Accounts payable	147,824	272,381	201,984	227,642	285,278
Other current liabilities	209,196	131,767	87,680	65,636	54,614
Total current liabilities	989,085	912,390	796,156	793,220	809,397
Long-term debt	106,979	116,705	116,705	116,705	116,705
Other non-current liabilities	97,263	109,263	115,766	123,189	131,662
Total liabilities	1,193,327	1,138,358	1,028,627	1,033,115	1,057,764
Share capital	16,428	32,704	32,790	32,905	32,905
Reserves/R.E./others	1,247,302	1,339,002	1,524,245	1,735,699	1,970,647
Shareholders' equity	1,263,730	1,371,706	1,557,035	1,768,604	2,003,551
Minority interests	0	0	0	0	0
Total equity & liabilities	2,457,057	2,510,064	2,585,662	2,801,719	3,061,316
Net debt/(cash)	488,545	406,045	467,587	304,249	116,433

Cash flow (Rs m)

Year to 31 Mar	2009	2010	2011E	2012E	2013E
Profit before tax	184,332	205,474	248,370	281,033	332,897
Depreciation and amortisation	51,953	104,965	130,842	129,338	135,390
Tax paid	(18,955)	(30,833)	(36,852)	(42,063)	(48,015)
Change in working capital	(37,983)	(53,015)	(71,165)	(2,501)	(13,504)
Other operational CF items	3,111	(21,690)	0	0	0
Cash flow from operations	182,459	204,902	271,195	365,807	406,768
Capex	(246,644)	(218,295)	(172,811)	(182,491)	(177,491)
Net (acquisitions)/disposal	(10,392)	14,206	(140,240)	0	0
Other investing CF items	16,195	22,043	0	0	0
Cash flow from investing	(240,842)	(182,045)	(313,051)	(182,491)	(177,491)
Change in debt	150,695	(53,024)	(1,750)	(6,550)	(30,437)
Net share issues/(repurchases)	151,648	535	11,066	14,755	0
Dividends paid	(19,085)	(22,195)	(30,752)	(34,732)	(41,461)
Other financing CF items	(45,933)	(35,313)	0	0	0
Cash flow from financing	237,326	(109,996)	(21,436)	(26,527)	(71,898)
Forex effect/others	0	0	0	0	0
Change in cash	178,942	(87,139)	(63,293)	156,788	157,379

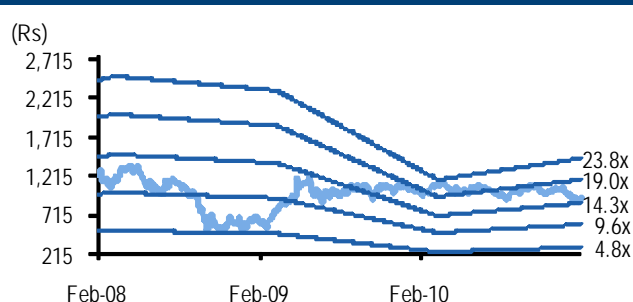
Key ratios

Year to 31 Mar	2009	2010	2011E	2012E	2013E
Sales – YoY %	6.3	35.7	18.0	2.6	17.2
EBITDA (adj.) – YoY %	4.8	30.2	19.8	8.0	13.4
Net profit (adj.) – YoY %	0.3	6.1	26.3	12.9	19.4
EPS (adj.) – YoY %	(7.3)	(49.0)	25.9	12.5	19.4
EBITDA margin % (adj.)	17.9	17.2	17.4	18.4	17.8
EBIT margin % (adj.)	14.2	11.7	11.7	12.8	12.8
Net-profit margin % (adj.)	10.8	8.4	9.0	9.9	10.1
ROAE (%)	14.7	12.3	14.0	13.9	14.7
ROAA (%)	7.7	6.5	8.0	8.6	9.4
ROCE (%)	12.7	11.3	12.7	13.1	14.1
ROIC (%)	11.9	10.1	11.5	12.0	13.9
Net debt to equity (%)	38.7	29.6	30.0	17.2	5.8
Effective tax rate (%)	16.9	21.0	17.5	17.6	17.0
Accounts receivable (days)	13.9	15.4	17.0	15.1	14.2
Payables (days)	42.6	39.8	38.1	33.7	34.3
Net interest cover (x)	11.6	11.3	15.9	17.2	20.8
Net dividend payout (%)	0.0	12.8	12.8	12.8	12.8

Key assumptions

Year to 31 Mar	2009	2010	2011E	2012E	2013E
WTI oil price (US\$/bbl)	84	71	84	86	102
Brent oil price (US\$/bbl)	82	69	82	84	100
Oil production (mmbbl)	5	13	10	11	12
Oil production (bpd)	13,544	36,637	27,978	29,037	31,967
Natural gas production (bcf)	62	570	763	757	817
Natural gas production (mcf/d)	170	1,561	2,090	2,075	2,239
Natural gas production (PJ)					
Gross refining margin (US\$/bbl)	12	7	8	10	10
SG complex refining margin (US\$/bbl)	5	4	5	6	6

PER bands



Source: Company, Daiwa forecasts

DAIWA'S ASIA PACIFIC RESEARCH DIRECTORY

Hong Kong

Regional Research Head: Pan Asia Research	Nagahisa MIYABE	(852) 2848 4971	nagahisa.miyabe@hk.daiwacm.com
Head of Product Management	John HETHERINGTON	(852) 2773 8787	john.hetherington@hk.daiwacm.com
Product Management	Talhgata Guha ROY	(852) 2773 8731	talhgata.guharoy@hk.daiwacm.com
Head of China Research; Chief Economist (Greater China)	Mingchun SUN	(852) 2773 8751	mingchun.sun@hk.daiwacm.com
Macro Economy (Hong Kong, China)	Kevin LAI	(852) 2848 4926	kevin.lai@hk.daiwacm.com
Strategy (Regional)	Colin BRADBURY (Regional Chief Strategist)	(852) 2848 4983	colin.bradbury@hk.daiwacm.com
Strategy (Regional)	Mun Hon THAM	(852) 2848 4426	munhon.tham@hk.daiwacm.com
Property Developers (Hong Kong)	Jonas KAN (Head of Hong Kong Research; Regional Property Co-ordinator: Co-head of Hong Kong and China Property)	(852) 2848 4439	jonas.kan@hk.daiwacm.com
Banking (Hong Kong, China)	Grace WU (Head of Hong Kong and China Banking)	(852) 2532 4383	grace.wu@hk.daiwacm.com
Banking (Hong Kong, China)	Sophia HUO	(852) 2532 4380	sophia.huo@hk.daiwacm.com
Banking (Hong Kong, China)	Queenie POON	(852) 2532 4381	queenie.poon@hk.daiwacm.com
Insurance	Jennifer LAW	(852) 2773 8745	jennifer.law@hk.daiwacm.com
Capital Goods – Electrical Equipment and Machinery (China)	Ole HUI	(852) 2848 4468	ole.hui@hk.daiwacm.com
Consumer/Retail (Hong Kong, China)	Peter CHU	(852) 2848 4430	peter.chu@hk.daiwacm.com
Consumer/Retail (China)	Nicolas WANG	(852) 2848 4963	nicolas.wang@hk.daiwacm.com
Hotels, Restaurants and Leisure – Casinos and Gaming (Hong Kong); Capital Goods – Conglomerate (Hong Kong)	Gavin HO	(852) 2532 4384	gavin.ho@hk.daiwacm.com
IT/Electronics – Semiconductor and Solar (Regional, Taiwan, Singapore, Hong Kong and China)	Pranab Kumar SARMAH (Regional Head of IT/Electronics)	(852) 2848 4441	pranab.sarmah@hk.daiwacm.com
IT/Electronics – Semiconductor/IC Design (Regional)	Eric CHEN (Co-head of Regional IT/Electronics)	(852) 2773 8702	eric.chen@hk.daiwacm.com
IT/Electronics – Tech IT Services (Hong Kong, China)	Joseph HO	(852) 2848 4443	joseph.ho@hk.daiwacm.com
IT/Technology Hardware – PC Hardware (Taiwan)	Calvin HUANG	(852) 2773 8782	calvin.huang@hk.daiwacm.com
IT/Electronics – Semiconductor/IC Design (Taiwan)	Ashley CHUNG	(852) 2848 4431	ashley.chung@hk.daiwacm.com
Materials/Energy (Regional)	Alexander LATZER (Regional Head of Materials)	(852) 2848 4463	alexander.laizer@hk.daiwacm.com
Materials (China)	Felix LAM	(852) 2532 4341	felix.lam@hk.daiwacm.com
Oil & Gas (China, Korea)	Andrew CHAN	(852) 2848 4964	andrew.chan@hk.daiwacm.com
Pan Asia Research, Consumer/Retail (China)	Hongxia ZHU	(852) 2848 4460	hongxia.zhu@hk.daiwacm.com
Pan Asia Research	Kenji SERIZAWA	(852) 2532 4159	kenji.serizawa@hk.daiwacm.com
Property Developers (Hong Kong, China)	Danny BAO (Head of Hong Kong and China Property)	(852) 2773 8715	danny.bao@hk.daiwacm.com
Property (Hong Kong, China)	Yannis KUO	(852) 2773 8735	yannis.kuo@hk.daiwacm.com
Small/Medium Cap (Regional)	Mark CHANG (Regional Head of Small/Medium Cap)	(852) 2773 8729	mark.chang@hk.daiwacm.com
Small/Medium Cap (Regional)	John CHOI	(852) 2773 8730	john.choi@hk.daiwacm.com
Telecommunications (Regional, Greater China); Software (China)	Marvin LO (Regional Head of Telecommunications)	(852) 2848 4465	marvin.lo@hk.daiwacm.com
Transportation – Land/Marine (Regional); Capital Goods – Infrastructure Construction (China)	Jimmy LAM	(852) 2848 4024	jimmy.lam@hk.daiwacm.com
Transportation – Aviation and Expressway (Hong Kong, China, Singapore)	Kelvin LAU	(852) 2848 4467	kelvin.lau@hk.daiwacm.com
Transportation (Hong Kong, China)	Edwin LEE	(852) 2532 4349	edwin.lee@hk.daiwacm.com
Utilities; Power Equipment; Renewables (Hong Kong/China)	Dave DAI	(852) 2848 4068	dave.dai@hk.daiwacm.com
Custom Products Group	Justin LAU (Head of Custom Products Group)	(852) 2773 8741	justin.lau@hk.daiwacm.com
Custom Products Group	Phillip LO	(852) 2773 8714	philip.lo@hk.daiwacm.com
Custom Products Group	Jibo MA	(852) 2848 4489	jibo.ma@hk.daiwacm.com

South Korea

Strategy; Banking/Finance	Chang H LEE (Head of Research)	(82) 2 787 9177	chlee@kr.daiwacm.com
Automobiles; Shipbuilding; Steel	Sung Yop CHUNG	(82) 2 787 9157	sychung@kr.daiwacm.com
Banking/Finance	Anderson CHA	(82) 2 787 9185	anderson.cha@kr.daiwacm.com
Capital Goods (Construction and Machinery)	Mike OH	(82) 2 787 9179	mike.oh@kr.daiwacm.com
Consumer/Retail	Sang Hee PARK	(82) 2 787 9165	sanghee.park@kr.daiwacm.com
IT/Electronics (Tech Hardware and Memory)	Jae H LEE	(82) 2 787 9173	jhlee@kr.daiwacm.com
IT Electronics (Tech Hardware)	Steve OH	(82) 2 787 9195	steve.oh@kr.daiwacm.com
Materials (Chemicals)	Daniel LEE	(82) 2 787 9121	daniel.lee@kr.daiwacm.com
Pan Asia Research; Small/Medium Caps	Yumi KIM	(82) 2 787 9838	yumi.kim@kr.daiwacm.com
Telecommunications; Software (Internet/Online Games)	Thomas Y KWON	(82) 2 787 9181	yskwon@kr.daiwacm.com

Taiwan

Co-head of Research; Strategy	Alex YANG	(886) 2 2345 3660	alex.yang@daiwacm-cathay.com.tw
Banking/Diversified Financials	Ling TANG	(886) 2 8789 5158	ling.tang@daiwacm-cathay.com.tw
Consumer/Retail	Yoshihiko KAWASHIMA	(886) 2 8780 5987	y.kawashima@daiwacm-cathay.com.tw
IT/Technology Hardware (PC Hardware); Software (Small/Medium Caps)	Christine WANG	(886) 2 8788 1531	christine.wang@daiwacm-cathay.com.tw
IT/Technology Hardware (PC Hardware - Panels)	Chris LIN	(886) 2 8788 1614	chris.lin@daiwacm-cathay.com.tw
IT/Technology Hardware (PC Components)	Jenny SHIH	(886) 2 8780 1326	jenny.shih@daiwacm-cathay.com.tw
Materials; Conglomerates	Albert HSU	(886) 2 8786 2212	albert.hsu@daiwacm-cathay.com.tw

India

Head of India Equities Strategy	Jaideep GOSWAMI	(91) 22 6622 1010	jaideep.goswami@in.daiwacm.com
Strategy; Banking/Finance	Punit SRIVASTAVA (Deputy Head of Research)	(91) 22 6622 1013	punit.srivastava@in.daiwacm.com
All Industries; Pan Asia Research	Fumio YOKOMICHI	(91) 22 6622 1003	fumio.yokomichi@in.daiwacm.com
Automobiles	Ambrish MISHRA	(91) 22 6622 1060	ambrish.mishra@in.daiwacm.com
Capital Goods; Utilities	Jonas BHUTTA	(91) 22 6622 1008	jonas.bhutta@in.daiwacm.com
Materials	Vishal CHANDAK	(91) 22 6622 1006	vishal.chandak@in.daiwacm.com
Oil & Gas; Construction; Small/Medium Caps	Atul RASTOGI	(91) 22 6622 1020	atul.rastogi@in.daiwacm.com
Pharmaceuticals and Healthcare; Consumer	Kartik A. MEHTA	(91) 22 6622 1012	kartik.mehta@in.daiwacm.com
Real Estate	Amit AGARWAL	(91) 22 6622 1063	amit.agarwal@in.daiwacm.com
Software (Tech IT Services)	R. RAVI	(91) 22 6622 1014	ravi.r@in.daiwacm.com

Singapore

Head of Research; Pan Asia Research	Tatsuya TORIKOSHI	(65) 6321 3050	tatsuya.torikoshi@sg.daiwacm.com
Macro Economy (Regional)	Prasenjit K BASU (Chief Economist, Asia Ex-JP)	(65) 6321 3069	p-k.basu@sg.daiwacm.com
Quantitative Research	Deep KAPUR (Global Director of Quantitative Research)	(65) 6321 3079	deep.kapur@sg.daiwacm.com
Quantitative Research	Josh CHERIAN	(65) 6499 6549	josh.cherian@sg.daiwacm.com
Quantitative Research	Suzanne HO	(65) 6499 6545	suzanne.ho@sg.daiwacm.com
Banking; Property and REITs	David LUM (Regional Head of Banking/Finance)	(65) 6329 2102	david.lum@sg.daiwacm.com
Banking (Southeast Asia)	Srikanth VADLAMANI	(65) 6499 6570	srikanth.vadlamani@sg.daiwacm.com
Conglomerates; Soft Commodities; Energy; Small/Medium Caps	Chris SANDA	(65) 6321 3085	chris.sanda@sg.daiwacm.com
Oil and Gas; Utilities (Southeast Asia)	Adrian LOH	(65) 6499 6548	adrian.loh@sg.daiwacm.com
Small/Medium Cap	Pyari MENON	(65) 6499 6566	pyari.menon@sg.daiwacm.com
Telecommunications (Southeast Asia & India)	Ramakrishna MARUVADA (Head of SE Asia & India Telecommunications)	(65) 6499 6543	ramakrishna.maruvada@sg.daiwacm.com

Australia

Banking/Diversified Financials	Johan VANDERLUGT	(61) 3 9916 1335	johan.vanderlugt@au.daiwacm.com
Resources/Mining/Petroleum	David BRENNAN	(61) 3 9916 1323	david.brennan@au.daiwacm.com

Japan

Industrials (Regional); Pan Asia Research	Taiki KAJI	(81) 3 5555 7174	taiki.kaji@jp.daiwacm.com
Industrials (Regional); Pan Asia Research	Daijiro HATA	(81) 3 5555 7178	daijiro.hata@jp.daiwacm.com

DAIWA SECURITIES GROUP INC

<i>OFFICE / BRANCH / AFFILIATE</i>	<i>ADDRESS</i>	<i>TEL</i>	<i>FAX</i>
HEAD OFFICE	Gran Tokyo North Tower, 1-9-1, Marunouchi, Chiyoda-ku, Tokyo, 100-6753	(81) 3 5555 3111	(81) 3 5555 0661
Daiwa Securities Trust Company	One Evertrust Plaza, Jersey City, NJ 07302, U.S.A.	(1) 201 333 7300	(1) 201 333 7726
Daiwa Securities Trust and Banking (Europe) PLC (Head Office)	5 King William Street, London EC4N 7JB, United Kingdom	(44) 207 320 8000	(44) 207 410 0129
Daiwa Securities Trust and Banking (Europe) PLC (Dublin Branch)	Level 3, Block 5, Harcourt Centre, Harcourt Road, Dublin 2, Ireland	(353) 1 603 9900	(353) 1 478 3469

DAIWA CAPITAL MARKETS LIMITED

<i>OFFICE / BRANCH / AFFILIATE</i>	<i>ADDRESS</i>	<i>TEL</i>	<i>FAX</i>
HEAD OFFICE	Gran Tokyo North Tower, 1-9-1, Marunouchi, Chiyoda-ku, Tokyo, 100-6753	(03) 5555 3111	(03) 5555 0661
Daiwa Capital Markets America Inc	Financial Square, 32 Old Slip, New York, NY10005, U.S.A.	(1) 212 612 7000	(1) 212 612 7100
Daiwa Capital Markets America Inc. San Francisco Branch	555 California Street, Suite 3360, San Francisco, CA 94104, U.S.A.	(1) 415 955 8100	(1) 415 956 1935
Daiwa Capital Markets Europe Limited	5 King William Street, London EC4N 7AX, United Kingdom	(44) 20 7597 8000	(44) 20 7597 8600
Daiwa Capital Markets Europe Limited, Frankfurt Branch	Trianon Building, Mainzer Landstrasse 16, 60325 Frankfurt am Main, Federal Republic of Germany	(49) 69 717 080	(49) 69 723 340
Daiwa Capital Markets Europe Limited, Paris Branch	127, Avenue des Champs-Élysées, 75008 Paris, France	(33) 1 56 262 200	(33) 1 47 550 808
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Daiwa Capital Markets Europe Limited, Dubai Branch	The Gate village Building 1, 1st floor, Unit-6, DIFC, P.O.Box-506657, Dubai, UAE.	(971) 47 090 401	(971) 43 230 332
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Daiwa Capital Markets Australia Limited	Level 34, Rialto North Tower, 525 Collins Street, Melbourne, Victoria 3000, Australia	(61) 3 9916 1300	(61) 3 9916 1330
DBP-Daiwa Capital Markets Philippines, Inc	18th Floor, Citibank Tower, 8741 Paseo de Roxas, Salcedo Village, Makati City, Republic of the Philippines	(632) 813 7344	(632) 848 0105
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Daiwa Securities Capital Markets Co Ltd, Beijing Representative Office	Room 3503/3504, SK Tower, No.6 Jia Jianguomen Wai Avenue, Chaoyang District, Beijing 100022, People's Republic of China	(86) 10 6500 6688	(86) 10 6500 3594
Daiwa SSC Securities Co Ltd	Room 011, 45F HSBC Tower, 1000 Lujiazui Ring Road, Pudong New Area, Shanghai 200120, People's Republic of China	(86) 21 6859 8000	(86) 21 6859 8030
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HEAD OFFICE	15-6, Fuyuki, Koto-ku, Tokyo, 135-8460, Japan	(81) 3 5620 5100	(81) 3 5620 5603
MARUNOUCHI OFFICE	Gran Tokyo North Tower, 1-9-1, Marunouchi, Chiyoda-ku, Tokyo, 100-6756	(81) 3 5555 7011	(81) 3 5202 2021
New York Research Center	11th Floor, Financial Square, 32 Old Slip, NY, NY 10005-3504, U.S.A.	(1) 212 612 6100	(1) 212 612 8417
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