Reliance Industries RIL IN

OIL & GAS/CHEMICALS | INDIA

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From Neutral

BUY

NOMURA
NOMURA FINANCIAL ADVISORY AND SECURITIES (INDIA) PRIVATE LIMITED

Closing price on 31 Mar	Rs1,074
Price target	**Rs1,275**
	(from Rs1,020)
Upside/downside	18.7%
Difference from consensus	**18.2%**
FY11F net profit (Rsbn)	242.2
Difference from consensus	**-1.3%**

Source: Nomura

Action

Reliance Industries (RIL) underperformed the Sensex by 22% in FY10 (it outperformed the index in each of the previous four years) mainly on uncertainties over gas litigation, potential acquisition of LyondellBasell, and weakness in refining margins, in our view. With concerns mostly abating, the focus, in our view, should now shift to large earnings growth (on a very large base) and on significant potential E&P upside. We upgrade the stock to BUY with a PT of INR1,275.

Catalysts

A Supreme Court judgment on the gas dispute is expected soon, which should remove the lingering uncertainty, in our view. After the judgment, we would expect more news flows on RIL's plans to monetise its large inventory of discoveries.

Anchor themes

We expect RIL's earnings to rise 44% in FY11F, helped by refining (the first year of full capacity at its new refinery) and KG-D6, whose output will reach its initial peak.

Nomura vs consensus

We are more optimistic than ever on the exploration upside from the 41 discoveries of RIL, hence our PT is about 18% ahead of consensus.

Better days ahead

① Dawn replacing darkness — better days ahead

In our note, *Increased darkness before dawn?* on 27 November, 2009, we highlighted that RIL's offer to acquire LyondellBasell (LB) added to near-term uncertainties. Refining margins were also among the lowest then. Reliance is now nearly out of the LB race. Refining margins have sharply improved from lows in 4Q09. The Supreme Court verdict on the long pending gas litigation is expected soon. The period of darkness is abating, in our view.

② Focus to shift on earnings growth in FY11F

Despite the large base, we expect RIL's earnings to grow 44% in FY11F (consensus is marginally lower at 39%). Growth will be driven by refining (the new refinery will see its first full year of operations and margins have recovered sharply) and exploration and production (KG-D6 gas volumes will reach initial peaks in 2H FY11F).

③ Large E&P upsides remain

With the group focused on KG-D6 (both development and litigation), there has been relatively less exploration effort in other blocks and little news flow on RIL's plans for its large inventory of discoveries. Exploration is scaling up and after the Supreme Court ruling the company could surprise with more concrete plans for other KG-D6 discoveries and other discovered blocks, in our view.

④ Upgrade to BUY with price target of INR1,275

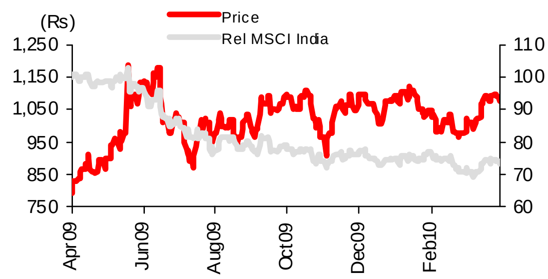
We have rolled forward valuations to end-FY12F. Valuations for core refining, petrochemical and currently producing E&P assets (PMT, KG-D6) are largely unchanged. We are more optimistic than ever on E&P upside and assign a significantly higher value of INR421 (earlier INR167) for other discovered blocks and exploration upsides.

Key financials & valuations

31 Mar (Rsbn)	FY09	FY10F	FY11F	FY12F
Revenue	1,512	2,253	2,450	2,597
Reported net profit	149.7	253.1	242.2	278.8
Normalised net profit	149.7	167.1	242.2	278.8
Normalised EPS (Rs)	47.3	50.6	72.9	83.4
Norm. EPS growth (%)	(10.2)	6.9	44.2	14.3
Norm. P/E (x)	22.7	21.2	14.7	12.9
EV/EBITDA (x)	17.3	12.3	8.9	7.6
Price/book (x)	2.7	2.4	2.1	1.8
Dividend yield (%)	0.6	0.7	0.7	0.7
ROE (%)	14.5	18.6	15.2	15.2
Net debt/equity (%)	43.0	30.4	12.2	net cash
Earnings revisions				
Previous norm. net profit		166.0	253.2	284.3
Change from previous (%)		0.7	(4.3)	(1.9)
Previous norm. EPS (Rs)		50.2	76.3	85.0

Source: Company, Nomura estimates

Share price relative to MSCI India



	1m	3m	6m
Absolute (Rs)	4.8	(1.5)	(1.2)
Absolute (US$)	7.5	2.0	5.8
Relative to Index	2.0	(2.9)	(6.9)
Market cap (US$mn)			78,205
Estimated free float (%)			56.0
52-week range (Rs)			1,184/791
3-mth avg daily turnover (US$mn)			150.3
Stock borrowability			Hard
Major shareholders (%)			
Promoter Group			46.6
FIIs			16.8

Source: Company, Nomura estimates

Any authors named on this report are research analysts unless otherwise indicated.
See the important disclosures and analyst certifications on pages 18 to 21.

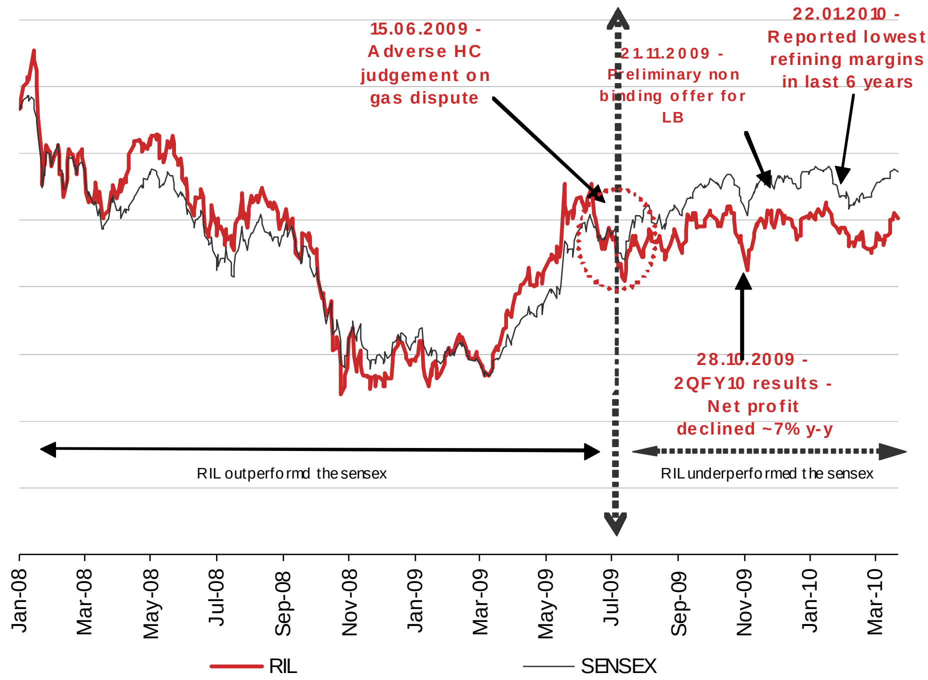
Drilling down

Dawn replacing darkness — better days ahead

Reliance Industries underperformed the Sensex by 22% in FY10, after four straight years of outperformance ranging from 8% to 49% (an average of 26% for the last four years), due mainly to uncertainties brought about by the KG-D6 gas litigation, potential acquisition of LyondellBasell, and weakness in refining margins, in our view.

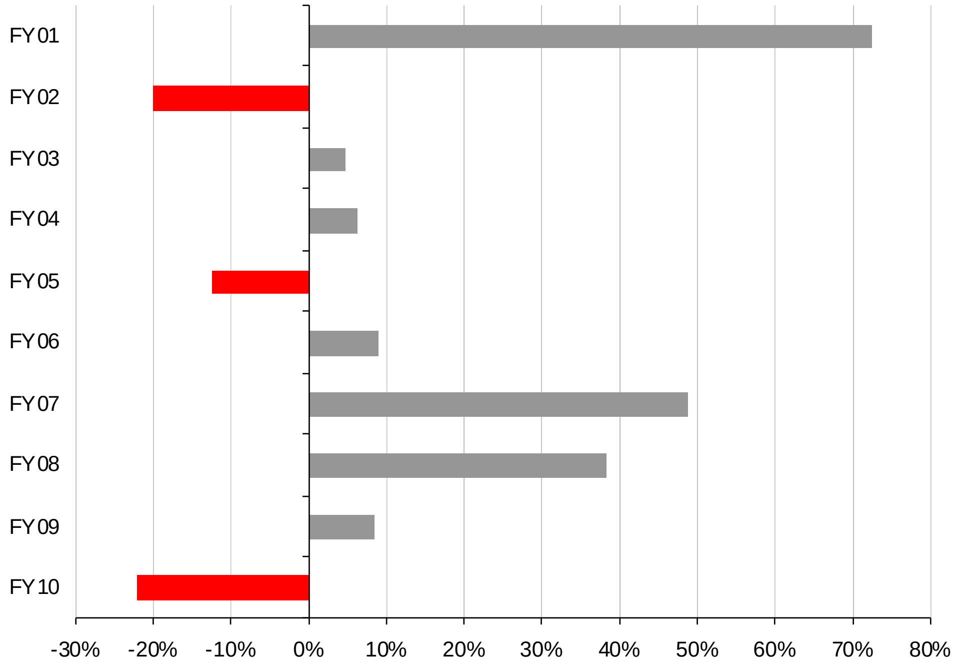
Since the adverse High Court judgment on the KG-D6 litigation on 15 June, 2009, RIL has underperformed the Sensex by 21%. In our note, *Increased darkness before dawn?,* on 27 November, 2009, we highlighted that RIL's offer to buy LB had increased near-term uncertainties and would open up another challenging frontier. Refining margins were also among the lowest at that time, and 3Q FY10 gross refining margin of US$5.90 was RIL's lowest reported GRM in the past six years.

Exhibit 1. RIL vs Sensex — significant underperformance since High Court ruling



Source: Bloomberg, Nomura research

Exhibit 2. RIL's relative performance vs Sensex



Source: Bloomberg, Nomura research

RIL has outperformed in four of past five fiscal years and in seven of last 10 fiscal years

Reliance is now nearly out of the LB acquisition race. Refining margins have sharply improved from lows of 4Q09 (compared with US1.9/bbl in 3Q FY10, Singapore complex margins bounced back to an average of US$5/bbl in 4Q FY10). The Supreme Court verdict on the long pending litigation between RIL and Reliance Natural Resources Limited (RNRL is also expected soon. More important than the positive or negative judgment per se, the SC verdict would end the drawn-out litigation and remove the lingering uncertainty on this count, in our view.

LB acquisition: the race is likely over for RIL

In our view, RIL's likely exit from the LyondellBasell acquisition process would reduce near-term risks

RIL had made a cash offer to acquire a controlling interest in LyondellBasell contemporaneously with LB's emergence from Chapter 11 reorganisation. RIL's offer was a potential alternative to the reorganisation plan filed by LB's management.

Despite RIL's several attempts to better the management plan, LB's management, in its third amended reorganisation plan and disclosure statement filed with the bankruptcy court, categorically rejected RIL's offer, concluding that the non-binding offer was not higher and better than management's own reorganisation plan.

With LB's management able to secure US bankruptcy court approval of its reorganisation plan, and given that unsecured creditors who were earlier supporting RIL are now in favour of management, RIL is likely out of the race now, in our view.

In our note, *Increased darkness before dawn?*, on 27 November, 2009, we highlighted: "Given that LB is in distress, Reliance could get a good deal, which would be positive in the long term. However, in the short term it would open up another challenging frontier."

RIL's decision not to overbid, thus its likely exit from the LB acquisition process, is positive, in our view, especially as it reduces near-term risks, in our view.

KG-D6 gas litigation — judgment day not far away

The Supreme Court judgment would end the long-drawn litigation and remove lingering uncertainty

With the Supreme Court hearing already over at the end of January this year and judgment day not far away, we believe that the KG-D6 litigation is at an end-game stage. The KG-D6 litigation has been an overhang for several years now. The adverse

Mumbai High Court ruling in June 2009 was a key trigger for RIL's stock underperformance over the past few months, in our view.

We believe that the negative judgment scenario (RIL supplies 40mmscmd of KG-D6 gas at US$2.34/mmbtu to RNRL/NTPC for 17 years) is already priced in the stock following its significant underperformance after the High Court ruling. Our KG-D6 gas valuation has also built in an adverse impact of INR80/share. More important than the positive or negative judgment itself, the final decision would end the drawn-out litigation and remove lingering uncertainty, in our view.

After the judgment, we would also expect increased news flow on plans for developing RIL's large inventory of discoveries. In our view, given the ongoing litigation, there has been relatively less disclosure on the size of resources in most of the discoveries in last few years, and information flow on some of the discovered blocks has been sketchy and mostly from minority partners (like Hardy and Niko Resources).

Refining margins up sharply from October 2009 lows

Singapore complex margins had rebounded from low of US$1.9/bbl in 3Q FY10 to US$5/bbl in 4Q FY10

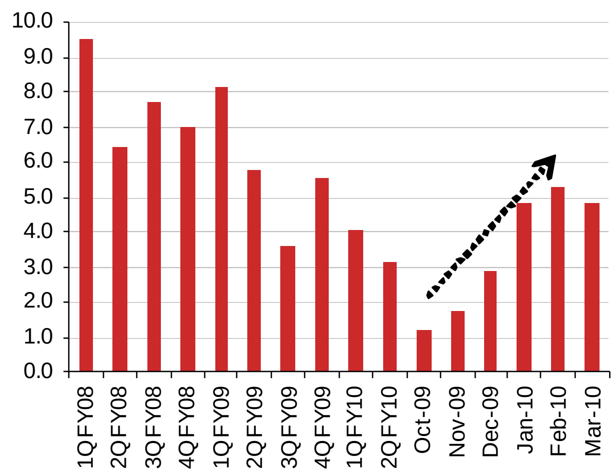
Asian refining margins deteriorated sharply in 2H09. After a low of US$3.2/bbl in 3Q09, the margins fell further to just US$1.9/bbl in 4Q09, the lowest quarterly average over the last six years. In our view, this decline was due to an increase in capacity from new refinery start-ups (1.2mb/d in 2H09 vs 0.6mb/d in 1H09) that outweighed the improvement in global oil demand (+1.1mb/d in 2H09 from 1H09).

Also, gasoline margins, which had been the main support for refining margins in 1H09 (at an average of US$15/bbl), declined to US$10/bbl in 2H09 as the US driving season wound down. Upgrading margins also suffered as a result of: 1) the narrowing of the light-heavy crude differentials — for example, the discount of Arab heavy to Dubai crude narrowed from US$6.1/bbl in 2008 to US$1.7/bbl in 2009, and; 2) an improvement in the quality of global crude supplies, which reduced demand for plant upgrading to produce light and middle distillates.

In our opinion, the refining cycle is likely to have troughed, with margins bottoming in 4Q09 to US$1.9/bbl. Margins have already sharply recovered in 1Q10 to US$5/bbl.

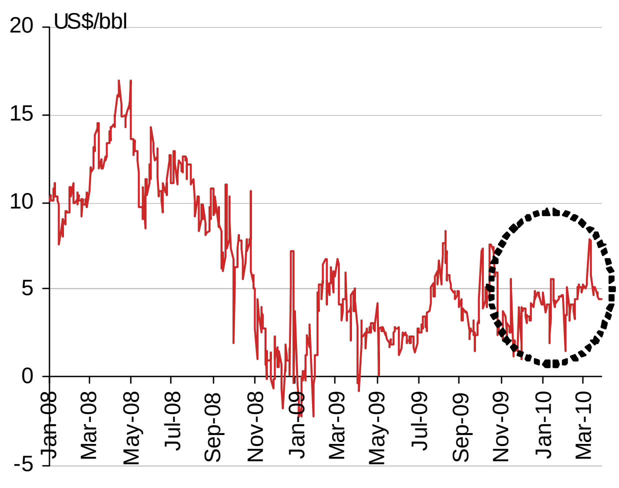
With decreasing OPEC compliance and an increasing amount of heavier crude coming back into production, the light-heavy differentials have also improved over the past few months (see Exhibit 4).

Exhibit 3. Sharp rebound in Singapore complex



Source: Reuters, Nomura research

Exhibit 4. Light-heavy differentials are increasing



Source: Bloomberg, Nomura research Note: Light – Tapis, Heavy – Dubai

While the refining industry remains in oversupply, we believe the outlook for margins is likely to improve gradually due to capacity rationalisation (78/kbd has been mothballed so far), slowing capacity additions (1.9mb/d over 2010-11F) and rising oil demand (2.6mb/d over 2011-11F).

We expect gradual improvement in refining margins

We forecast Singapore complex margins of US$4/bbl for 2010F and US$4.70/bbl for 2011F (lowered from US$4.80/bbl and US$5.10/bbl previously). We introduce a refining margin of US$4.30/bbl for 2012F, as we expect supply growth will slightly outpace demand growth, although we do not discount the possibility of further project delays or cancellations.

(For more details, please refer to our note *Window of opportunity*, dated 4 February, 2010, by Yong Liang Por, Cindy Park and Cheng Khoo).

Exhibit 5. Key changes to refining margin assumptions

US$/bbl	Old			New		
	2010F	2011F	2012F	2010F	2011F	2012F
Gasoline	11.3	12.0	-	13.0	13.5	11.0
Jet	14.0	14.0	-	9.0	11.0	11.5
Diesel	13.0	13.0	-	8.5	10.0	11.0
Fuel oil	-9.0	-9.0	-	-7.0	-6.0	-7.0
Naphtha	-2.0	-1.0	-	0.5	-1.0	1.0
LPG	-10.0	-10.0	-	-14.0	-14.0	-14.0
Singapore complex	**4.8**	**5.1**	**-**	**4.0**	**4.7**	**4.3**
Singapore simple	**0.1**	**0.2**	**-**	**0.1**	**0.7**	**0.6**

Source: Nomura estimates

Exhibit 6. Singapore refining margin trend and forecasts

US$/bbl	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010F	2011F	2012F
Gasoline	7.6	6.1	4.5	7.7	15.7	15.2	13.5	17.0	13.7	12.5	13.0	13.5	11.0
Jet	8.3	5.6	4.3	6.0	13.5	17.4	18.4	18.5	27.7	8.2	9.0	11.0	11.5
Diesel	6.4	4.7	3.7	5.4	11.6	14.2	15.3	16.7	25.9	7.3	8.5	10.0	11.0
Fuel oil	-1.2	-1.8	-1.8	-1.0	-3.8	-6.2	-11.2	-8.3	-14.7	-7.5	-7.0	-6.0	-7.0
Naphtha	2.2	1.3	1.1	2.5	7.0	2.2	0.8	6.2	-4.2	-1.6	0.5	-1.0	1.0
LPG	1.4	-0.2	-1.8	0.2	0.0	-7.6	-14.6	-14.0	-27.2	-15.3	-14.0	-14.0	-14.0
Singapore complex	**3.2**	**2.1**	**1.6**	**3.4**	**6.7**	**6.9**	**5.5**	**7.6**	**6.2**	**3.7**	**4.0**	**4.7**	**4.3**
Singapore simple	**1.2**	**0.2**	**0.2**	**1.4**	**2.1**	**1.8**	**-0.3**	**1.7**	**0.4**	**0.7**	**0.1**	**0.7**	**0.6**

Source: Reuters, Nomura estimates

We have slightly cut our refining margin assumptions

In line with the revision of our regional refining margin forecasts, we have slightly reduced our assumptions of the Singapore complex margins. Our revised Singapore complex margin assumptions are US$3.50/bbl for FY10F, US$4.20/bbl for FY11F, and US$4.60/bbl for FY12F.

We continue to believe that RIL enjoys a premium advantage of US$5/bbl for its complex refineries capable of processing difficult crudes and superior product slates. Our revised assumptions for RIL's overall GRMs for its two refineries are US$6.80/bb for FY10F, US$9.20/bbl for FY11F and US$9.60/bbl for FY12F.

Exhibit 7. Change in RIL's GRM assumptions

US$/bbl	FY08	FY09	FY10F		FY11F		FY12F	
Refining Margins (US$/bbl)			Old	New	Old	New	Old	New
Singapore Complex	7.6	5.8	4.0	3.5	4.9	4.2	5.1	4.6
Premium over Singapore GRM	7.3	6.5	2.2	3.3	5.0	5.0	5.0	5.0
Avg GRM of RIL	15.0	12.3	6.2	6.8	9.9	9.2	10.1	9.6
Change %				9%		-7%		-5%

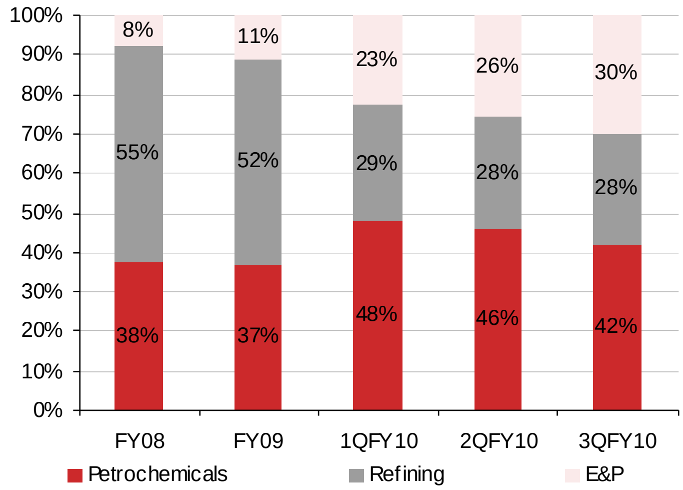
Source: Reuters, Company data, Nomura estimates

Petrochemicals the key surprise in FY10F

The sustained petrochemical cycle has offset the weakness of refining business. RIL has reported very strong earnings for its petrochemicals business in recent quarters. Despite the addition of new refineries and start-up of KG-D6 production, the petrochemical business' share in EBIT increased to 45% in the fist nine months of FY10, versus 37-38% share in FY08 and FY09.

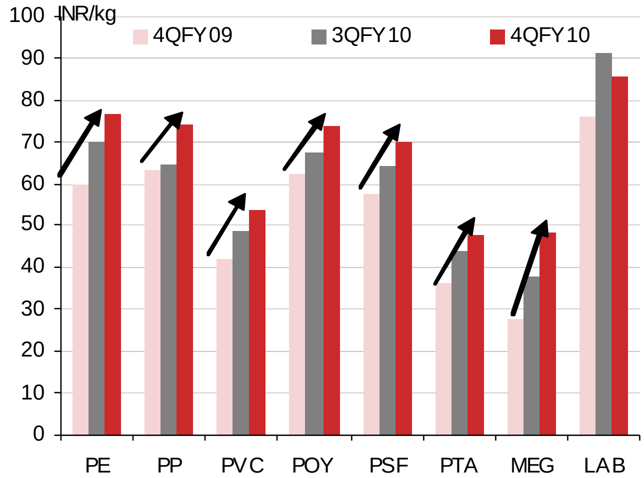
Petrochemical prices in 4Q FY10 remained firm and we believe this segment can surprise positively in coming quarters, if the expected new capacity additions are delayed further.

Exhibit 8. Petrochem — strong earnings in FY10F



Source: Company data, Nomura research

Exhibit 9. Petrochem prices remain firm in 4Q FY10



Source: Company data, Nomura research

Focus to shift on large earnings growth …

Despite the large base, we expect RIL's earnings will grow 44% (the consensus expectation is marginally lower at 39%), driven by both refining (the new refinery will see its first full year of operations and margins have recovered sharply) and exploration and production (after a fast ramp-up to 60mmscmd, the gas volumes will reach an initial peak in 2H FY11).

We expect earnings growth of 38% in FY11F rising another 15% in FY12F

Minor changes in earnings assumptions

We have revised our earnings estimates by 1% in FY10F, -4% in FY11F and -2% in FY12F. Following are key changes in our assumptions:

- Revision in GRM assumptions: our revised GRM assumptions are US$6.80/bbl for FY10F, US$9.20/bbl for FY11F and US$9.60/bbl for FY12F (from US$6.20 for FY10F, US$9.90 for FY11F and US$10.10 for FY12F).
- Driven by the sharper rebound in petrochemical prices, we increase our EBIT estimates by 11% for FY11F and 5% in FY12. Still, we expect petrochemical earnings to decline 36% in FY11F and a further 9% in FY12F.
- An increase in the MAT rate after the Union Budget 2010 (the effective MAT rate increases to 20% from 17%).

Exhibit 10. Changes in earnings estimates

INR Bn		FY08	FY09	FY10F		FY11F		FY12F	
				Old	New	Old	New	Old	New
EBIT		185	178	212	214	323	315	353	353
	% Change				*1%*		*-2%*		*0%*
Net Profit		153	150	166	167	253	242	284	279
	% Change				*1%*		*-4%*		*-2%*
EPS		53	47	50	51	76	73	85	83
	% Change				*1%*		*-4%*		*-2%*

Source: Nomura estimates

Exhibit 11. Earnings breakdown by segment

	FY08A	FY09A	FY10F	FY11F	FY12F
EBIT breakdown (INRbn)					
E&P	15	21	64	143	173
Refining	103	98	69	119	128
Petrochemicals	71	69	85	54	49
Unallocated	-3	-6	-4	-4	-4
Total	187	183	214	313	347
EBIT breakdown (%)					
E&P and others	8%	11%	29%	45%	49%
Refining	55%	52%	32%	38%	37%
Petrochemicals	38%	37%	39%	17%	14%

Source: Nomura estimates

Exhibit 12. Sensitivity of earnings to key variables

	FY11		FY12	
Base EPS	72.9		83.4	
EPS change	**INR/shr**	**%**	**INR/shr**	**%**
Refining GRM				
Base Case (US$/bbl)	9.2		9.6	
+1 US$/bbl	4.9	6.7%	5.1	6.1%
-1 US$/bbl	-4.9	-6.7%	-5.1	-6.1%
KG-D6 gas production				
Base Case (mmscmd)	74		85	
+ 5 mmscmd	2.0	2.8%	2.2	3.3%
- 5 mmscmd	-2.0	-2.8%	-2.2	-3.3%
KG-D6 gas prices				
Base Case (US$/mmbtu)	4.34		4.34	
-0.5 US$/mmbtu	-4.0	-5.5%	-4.3	-5.2%
-1 US$/mmbtu	-8.0	-10.9%	-8.6	-10.3%
KG-D6 Oil Production				
Base Case (kbpd)	20		30	
+ 5 kbpd	1.1	1.5%	1.1	1.3%
- 5 kbpd	-1.1	-1.5%	-1.1	-1.3%
KG-D6 oil prices Realisation				
Base Case (US$/bbl)	72.0		75.0	
+5 US$/bbl	0.3	0.5%	0.5	0.6%
- 5 US$/bbl	-0.3	-0.5%	-0.5	-0.6%
Exchange Rate				
Base Case (INR/US$)	45.0		45.0	
INR 1 depreciation	2.8	3.9%	3.2	3.8%
INR 2 depreciation	5.7	7.8%	6.3	7.6%
INR 1 appreciation	-2.8	-3.9%	-3.2	-3.8%
INR 2 appreciation	-5.7	-7.8%	-6.3	-7.6%

Source: Nomura estimates

… and on large E&P upsides

Largest private sector E&P player in India

RIL holds the largest E&P acreage in the private sector in India. Its domestic portfolio comprises a 30% interest in the Panna-Mukta/Tapti (PMT) block and stakes in 32 other New Exploration Licensing Policy (NELP) blocks. More importantly, nearly 82% of the acreage is in deepwater areas that are largely under-explored and believed to be highly prospective. The company has already made 41 discoveries in NELP blocks with overall success rate of about 53% (it has a higher 63% success rate in deep water). (See detailed list of key blocks of RIL in Annex1.)

RIL has a large deep-water exploration acreage in India and has a high exploration success rate

RIL also has interests in 14 international blocks with acreage of over 99,000 sq km.

Exhibit 13. Large E&P acreages

	Blocks	Area '000SqKm	Deep water
- Domestic	34	315	82%
- International	14	99	70%
Total no of blocks	48	414	79%

Source: Company data, Directorate General of Hydrocarbons (DGH)

Exhibit 14. 63% success rate in deep water

	Drilled	Discoveries	Success %
- KG-D6	25	19	76%
- Other Deepwater	13	5	38%
Deepwater	**38**	**24**	**63%**
Shallow Water	26	15	58%
Onshore	4	2	50%
Relinquished	9		
Total	77	41	53%

Source: Company data, Nomura estimates

Large inventory of 41 discoveries

RIL has made 41 discoveries in NELP blocks. Of these, 24 are in deep water and 34 are gas discoveries. KG-D6 block with 19 discoveries is the most prospective block. Of these discoveries, two gas and one oil discoveries are under development and production. RIL had submitted field development plan (FDP) for nine satellite discoveries in July 2008. However, on the advice of Directorate General of Hydrocarbons, the FDP was revised in December 2009 to begin with only four discoveries.

The other key block is NEC-25, where eight discoveries (Ex AJ area) have been made. A six-well drilling programme in the AJ area of the block is under way. Of the six wells being drilled, the first three were successful and confirmed the significant hydrocarbon potential of NEC-25 block. A separate commerciality report for successful AJ wells will be prepared when drilling is completed, as per the Niko Resources, the 10% partner in the block. (See detailed list of the 41 discoveries in Annex 2)

Exhibit 15. Large inventory of 41 discoveries in NELP blocks

Block wise discoveries		Area wise discoveries	
KG-DWN-98/3 (KG-D6)	19	Onshore	2
NEC-OSN-97/2 (NEC-25)	8	Shallow water	15
KG-OSN-2001/1	3	**Deepwater**	**24**
KG-DWN-2003/1 (KG-D3)	3		**41**
KG-OSN-2001/2 (KG-III-6)	2		
CB-ONN-2003/1	2		
CY-DWN-2001/2 (CY-III-D5)	1	**Nature of discoveries**	
KG-DWN-98/1	1	Oil	3
SR-OS-94/1	1	**Gas**	**34**
GS-OSN-2000/1	1	Oil/Gas	4
	41		**41**

Source: Company data, DGH, Nomura research

Holds 5 CBM blocks with resources of 10.7tcf

RIL has five coal bed methane (CBM) blocks (two awarded in CBM round I, three in CBM round II) with a total area of 3,885 sq km and 10.7 trillion cubic feet (tcf) of potential resources. Development plan has already been submitted for approval.

Exhibit 16. Stake in 5 CBM blocks with resources of 10.7tcf

Coal Field	State	Round	Block Name	RIL Interest	Area (Sq.Km)	Resource (TCF)
Sohagpur East	MP	CBM I	SP(W)-CBM-2001_1	100%	500	1.3
Sohagpur East	MP	CBM I	SP(E)-2001_1	100%	495	1.7
Barmer	Rajasthan	CBM II	BS(1)-CBM-2003_II	100%	1045	3.4
Barmer	Rajasthan	CBM II	BS(2)-CBM-2003_II	100%	1020	3.1
Sonhat	MP	CBM II	SH(NORTH)-CBM-2003_II	100%	825	1.2
					3885	**10.7**

Source: DGH, Nomura research

KG-D6 — Gas ramp-up limited by pipeline bottlenecks

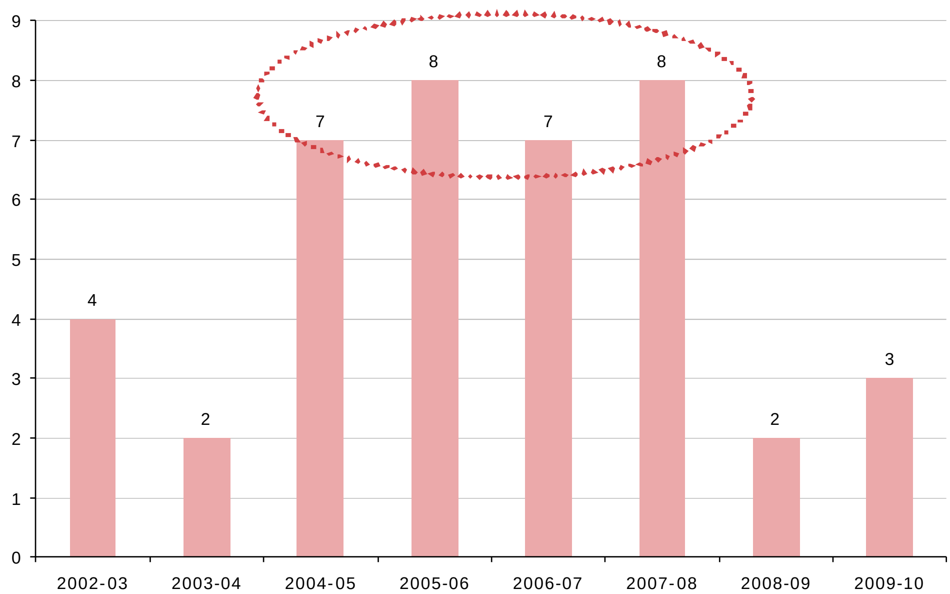
The KG-D6 gas production volume has seen a fast ramp-up to 60mmsmcd in nine months, despite significant delays in increasing the government gas allocation. As at end- December, RIL had assessed the design capacity and achieved the initial peak rate of 80 mmscmd. Despite the capacity of 80mmscmd, current production is limited to about 60mmscmd due to low demand/offtake and, more importantly, pipeline bottlenecks in GAIL's (GAIL IN, BUY) Hazira-Vijaipur-Jagdishpur (HVJ) network.

We believe that complete expansion of GAIL's HVJ network, expected by end-2010F, is critical for KG-D6 volumes to reach initial peak levels. We continue to assume gas volumes of 74/85mmscmd for FY11F and FY12F.

KG-D6 development focus sees E&P news flow drying up in recent years

With RIL's focus on KG-D6 (both development and litigation), the past two years have seen relatively less exploration and little news flow on plans for a large inventory of discoveries. Compared with an average of seven-eight discoveries per year over FY05-FY08, only two discoveries were announced in FY09 and three in FY10F.

Exhibit 17. New discovery announcements have dried up



Source: Company data, DGH, Nomura research

- **Exploration efforts stepped up, news flow could surprise positively**

With the initial development work at KG-D6 nearing completion, RIL's focus seems to have increased in recent quarters on exploration and appraisal efforts in KG-D6 and other blocks, in our view. The company has already drilled three exploratory deepwater wells — one each in KG-D9, CY-D5 and KG-D3 — and four onshore wells in CB-ONN-2003/1. Of these, RIL had one gas discovery in the KG-D3 block and two oil discoveries in the CB-ONN-2003/1 block.

Post the Supreme Court judgment on gas litigation, we would expect increased news flow on plans for developing large inventory of discoveries

After the Supreme Court judgment on the gas dispute, we would expect increased news flow on plans for developing RIL's large inventory of discoveries. In our view, given the ongoing litigation, there has not been much disclosure by the company itself on the size of resources in most of its discoveries over the last few years, and information flow has been sketchy and mostly from minority partners (like Hardy, Niko Resources) in few of the discovered blocks.

SOTP valuation

Upgrade to BUY; price target increased 25 to INR1,275

We have made the following changes to our sum-of-the-parts valuation of RIL:

- We roll forward our valuation to end-FY12F. Our valuation for core refining, petrochemicals and currently producing exploration and production assets (PMT and KG-D6) is largely unchanged.
- We are now more optimistic on RIL's large exploration acreage and inventory of discoveries, and expect increased news flow and information about the company's plans for its large inventory of discoveries, post the Supreme Court Judgement on gas litigation. We now assign a significantly higher upside of INR421/share (from INR167 previously) for other discovered blocks/explorations.

Our price target increases 25% from INR1,020/share to INR1,275, implying potential upside of 19%. We upgrade our rating on the stock to BUY from Neutral.

Exhibit 18. RIL — SOTP valuation

	INR Bn	$ bn	INR / Share	Comments	INR /share (old)
1 Refining	1,147	25.5	381	7x FY12 EBITDA	395
2 Petrochemicals	547	12.2	182	7x FY12 EBITDA	184
3 E&P	2,053	45.6	682		421
Producing Assets	785	17.4	261		254
PMT	169	3.8	56	7x FY12 EBITDA	56
KG-D6 Gas	481	10.7	160	DCF, factors downside of INR80/sh for HC judgement	158
KG-D6 Oil	134	3.0	45	DCF of 160mmbbl of 2P reserves	40
Exploration Assets	1,268	28.2	421		167
NEC-25	235	5	78	8.3 tcf of gas in place, 70% recovery @ $1/mcf	36
CBM Blocks	240	5	80	10.7 tcf of gas in place, 50% recovery @ $1/mcf	21
KG-D3	115	3	38	9.5 tcf of gas in place, 30% recovery @ $1/mcf	-
KG-D9	149	3	49	10.8 tcf of gas/143 mmboe of oil, 30% recovery @ $1/mcf / $10/bbl	-
Others	529	12	175	Exploration upsides from other discoveries	110
4 Investments	300	7.0	100		71
Enterprise Value	4,047	90.3	1,344		1,071
Less: Net Debt	208	4.6	69	FY11E end	56
Equity Value	3,839	85.7	1,275	Ex-treasury shares of 3,012mn	1,015
Target Price			1,275		1,020

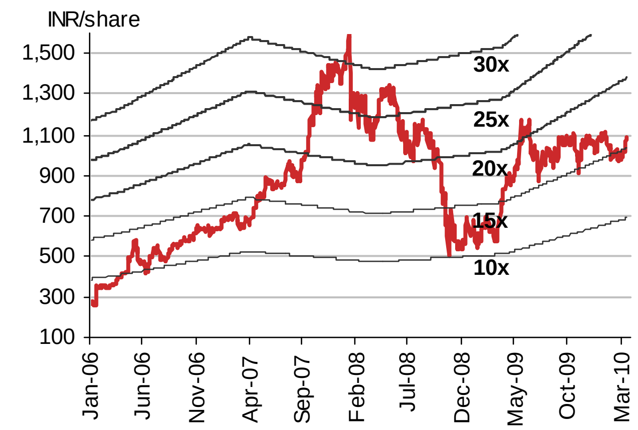
Source: Nomura estimates

Exhibit 19. Sensitivity of NAV to exchange rate and GRM (FY12F)

NAV (INR/share)		FY12 Exhange Rate (INR/US$)				
		40	42	45	48	50
GRM (US$/bbl)	8.0	1,071	1,117	1,187	1,256	1,303
	9.0	1,120	1,169	1,242	1,315	1,364
	9.6	1,149	1,199	**1,275**	1,350	1,400
	10.0	1,169	1,220	1,297	1,374	1,425
	11.0	1,218	1,271	1,352	1,432	1,486

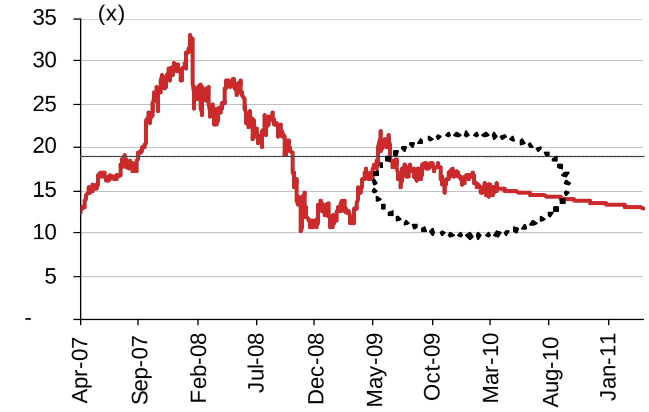
Source: Nomura estimates

Exhibit 20. Historical 1-yr forward P/E band



Source: Datastream, Nomura estimates

Exhibit 21. CMP suggests de-rating on P/E chart



Source: Datastream, Nomura estimates

Exhibit 22. Comparative valuation

	M cap	P/E (x)			EV/EBITDA (x)			P/B (x)		
	US$mn	2009	2010	2011	2009	2010	2011	2009	2010	2011
Refining										
Formosa Petrochemical	25,293	16.6	21.8	17.4	10.2	12.9	11.5	3.1	3.4	3.2
S-Oil	5,658	26.3	14.8	9.3	8.4	8.5	6.3	1.7	1.6	1.5
SK Energy	9,900	16.3	11.8	10.0	9.6	9.2	7.8	1.4	1.3	1.2
GS Holding	3,260	7.5	8.0	6.3	9.1	8.7	6.4	1.1	1.0	0.9
ERG	2,113	NA	72.2	17.3	25.3	12.7	8.9	0.9	0.9	0.9
Hellenic Pet	3,597	11.8	16.5	12.5	11.5	11.2	9.6	1.1	1.1	1.1
Motor Oil	1,559	19.0	16.7	8.0	16.1	12.5	8.2	3.3	3.4	2.8
Neste Oil	4,455	45.0	29.0	9.1	16.8	13.4	7.9	1.5	1.4	1.2
Saras	2,448	NA	23.0	12.4	17.1	9.1	7.4	1.5	1.4	1.2
Average		**20.4**	**23.8**	**11.4**	**13.8**	**10.9**	**8.2**	**1.7**	**1.7**	**1.6**
Petrochemicals										
Formosa Chemical & Fibre	13,427	10.1	13.0	11.6	8.1	12.0	11.2	1.3	1.8	1.7
PTT Chemical	4,514	14.9	14.8	16.1	7.1	7.9	7.6	0.8	1.3	1.2
Nanya Plastics	15,983	21.5	15.4	12.5	13.5	15.3	12.6	1.4	1.9	1.8
Formosa Plastics	13,614	12.3	14.3	11.8	10.2	12.3	11.0	1.6	1.9	1.8
LG Chem	14,044	11.1	10.5	9.1	7.9	7.9	6.7	4.1	2.9	2.2
Cheil Industries	2,809	25.0	15.2	11.3	8.1	8.1	7.0	1.6	1.7	1.5
Average		**15.8**	**13.9**	**12.1**	**9.1**	**10.6**	**9.4**	**1.8**	**1.9**	**1.7**

Source: Thomson Reuters Datastream, Nomura estimates, Pricing as of 30 March, 2010

Valuation methodology and investment risks

We use the SOTP method to value RIL's different businesses. For its core businesses, we use EV/EBITDA multiples. We apply a 7x FY12F EV/EBITDA multiple to its refining and petrochemical business. We use DCF to value the company's new E&P business.

Key risks

- Deterioration in refining margins and sharper-than-expected decline in petrochemical margins.
- Delays in ramp-up of KG-D6 volume.
- A delay in the announcement of the Supreme Court judgment. Such a delay, apart from extending the current uncertainty, could also hold back likely news flows on company's plans for other discoveries on which we are now more optimistic.
- Rupee appreciation against the US dollar.

Annex 1: RIL's key E&P blocks

Exhibit 23. Key blocks of RIL

Blocks	Regime	Type	RIL (%)	JV Partners	Discoveries	Comments
KG Offshore, AP						
KG-DWN-98/1(KG-D4)	NELP I	Deepwater	100%	-	1	> Appraisal of discovery D-36 is currently underway
KG-DWN-98/3 (KG-D6)	NELP I	Deepwater	90%	NIKO (10)	19	> Current production - Gas ~60mmscmd, Oil ~ 20kbpd > Phase I of gas development (18 wells) is complete. > Commerciality proposal filed for R series fields / integrated development of all gas discoveries is being conceptualised. > Satellite fields - Amendment in development plan (include 4 discoveries as against 9 discoveries earlier)
KG-DWN-2001/1 (KG-D9)	NELP III	Deepwater	90%	HEPI (10)	0	> The first exploratory well KGD9-A1 was plugged and abandoned. > Commitment to drill 3 more wells (2010-11). > Study 1st well data underway, further drilling expected in 2H 2010. > Total gross risked best estimate prospective resources of 10.8tcf of gas and 143mmbbls of oil (Source - Hardy Exploration, May 2009)
KG-OSN-2001/1	NELP III	Shallow Water	100%	-	3	> Three gas discoveries (Dhirubhai -28, 37, 38) > Declaration of Commerciality (DoC) filed with the DGH
KG-OSN-2001/2 (KG-III-6)	NELP III	Shallow water	100%	-	2	> Two oil/gas discoveries (Dhirubhai -24, 25) > DoC filed with the DGH
KG-DWN-2003/1 (KG-D3)	NELP V	Deepwater	90%	HEPI (10)	3	> Three consecutive gas discoveries - Dhirubhai 39, 41 and 44. > Appraisal program for D-39/41 submitted to DGH > 3 additional exploration / 1 appraisal wells are planned before end 2010. > Total gross risked best estimate prospective resources of 9.5tcf (Source - Hardy Exploration, May 2009)
Mahanadi - NEC, Orissa						
NEC-OSN-97/2 (NEC - 25)	NELP I	Shallow Water	90%	NIKO (10)	8	> 11 gas discoveries so far. 8.3tcf gas in place based on first 8 discoveries. > Commerciality approved and FDP submitted (for six discoveries). > 6 wells drilling program in AJ area ongoing (first 3 wells were success and confirmed the significant further hydrocarbon potential). > Separate commerciality report for successful AJ wells will be prepared when drilling is completed.
MN-DWN-2003/1 (D4 block)	NELP V	Deepwater	85%	NIKO(15)	0	> Niko seems highly optimistic on this block. > Seismic completed. 4500km/3600sq km of 2D/3D seismic being integrated. > Commitment to drill 3wells, one is planned for 3Q 2010
Cambay, Gujarat						
CB-ONN-2003/1 (Pt.A&B)	NELP V	Onshore	100%	-	2	> Phase I of exploration is currently underway. > Drilling of nine exploratory wells committed under Phase-I. > Oil discovery was made in the two wells (Dhirubhai-43 and 45). > Reserves potential in both the discoveries is yet to be established. > Committed to further drill 4 exploratory wells in each Phase-II and III
Cauveri, Tamilnadu						
CY-DWN-2001/2 (CY-III-D5)	NELP III	Deepwater	100%	-	1	> Completed Ph-I MWP in Dec2007 with drilling of third well. > Dhirubhai-35 discovery is under appraisal. > Seeking 3 yrs drilling moratorium.
Saurashtra, Gujarat						
SR-OS-94/1	Pre-NELP	Shallow Water	100%	-	1	> One gas discovery Dhirubhai - 27 > Opted to relinquish the block due to sub-economic nature
GS-OSN-2000/1	NELP II	Shallow Water	90%	HEPI (10)	1	> Appraisal of gas discovery Dhirubhai- 33 underway. > Extension of appraisal period was granted upto May, 2010.
Mumbai Offshore						
Mid & South Tapti	Pre-NELP	Shallow Water	30%	BG(30), ONGC(40)		> On natural decline. > 3 infill wells (2 in south Tapti and 1 in mid Tapti) are planned to be drilled in 2HFY10 to inc prod to 10mmscmd from current 8mmscmd.
Panna Mukta	Pre-NELP	Shallow Water	30%	BG(30), ONGC(40)		> Panna-K(PK) platform/pipeline installation work and drilling of five wells have been completed.
Total discoveries					**41**	

Source: Company data, DGH, Nomura research

Annex 2: List of RIL's 41 discoveries

Exhibit 24. List of RIL's 41 discoveries

Block	RIL %	JV Partner	Regime	Name	Find	Month	Comment
KG-DWN-98/3	**90%**	**NIKO (10)**	**NELP-I**				
				Dhirubhai-1	Gas	Oct-02	Under production since April 2009, Current production-60mmscmd
				Dhirubhai-3	Gas	Oct-02	
				Dhirubhail-26	Oil/Gas	Jun-06	Oil prod commenced in Sept 2008, Current production is ~20kbpd
				Dhirubhai-2	Gas	Oct-02	> FDP for these 9 satellite discoveries was submitted to DGH in July, 2008. > In Dec 2009, on DGH advise, plan was modified to include only 4 discoveries. > Development plan for other 5 discoveries to be submitted separately.
				Dhirubhai-4	Gas	Jan-03	
				Dhirubhai-6	Gas	Jul-03	
				Dhirubhai-7	Gas	May-04	
				Dhirubhai-8	Gas	May-04	
				Dhirubhai-16	Gas	Aug-04	
				Dhirubhai-19	Gas	Apr-05	
				Dirubhai-22	Gas	Aug-05	
				Dhirubhai-23	Gas	Oct-05	
				Dhirubhai-5	Gas	Jul-03	Yet to submit DOC.
				Dhirubhai-18	Gas	Apr-05	
				Dhirubhai-29	Gas	Feb-07	Under appraisal
				Dhirubhai-30	Gas	Feb-07	
				Dhirubhai-31	Gas	Mar-07	
				Dhirubhai-34	Gas	May-07	
				Dhirubhai-42	Gas	Jul-08	Appraisal programme submitted
NEC-OSN-97/2	**90%**	**NIKO (10)**	**NELP-I**				
				Dhirubhai-9	Gas	Jun-04	> In-place gas estimates for first 8 discoveries at 8.3tcf > Commerciality approved and FDP submitted for six discoveries. > 3 more discoveries in ongoing 6 well AJ area program
				Dhirubhai-10	Gas	Jun-04	
				Dhirubhai-11	Gas	Jun-04	
				Dhirubhai-15	Gas	Aug-04	
				Dhirubhai-20	Gas	Apr-05	
				Dhirubhai-21	Gas	Apr-05	
				Dhirubhai-32	Gas	Mar-07	
				Dhirubhai-40	Gas	Feb-08	
KG-DWN-2003/1	**90%**	**HEPI (10)**	**NELP-V**				
				Dhirubhai-39	Gas	Mar-08	Well flowed gas @ 38.1mmscfd. Discovery is under appraisal.
				Dhirubhai-41	Gas	Mar-09	Discovery is under appraisal.
				Dhirubhai-44	Gas	Dec-09	Commerciality of the discovery is being ascertained.
KG-OSN-2001/1	**100%**	**-**	**NELP-III**				
				Dhirubhai-28	Gas	Sep-06	First discovery in the block.
				Dhirubhai-37	Gas	Nov-07	Well encountered gross hydrocarbon columns of 32 meters and 4 meters in two payzones
				Dhirubhai-38	Gas	Jan-08	Well encountered gross hydrocarbon column of 105 meters.
KG-OSN-2001/2	**100%**	**-**	**NELP-III**				
				Dhirubhai-24	Oil/Gas	Dec-05	Appraisal programme submitted for approval.
				Dhirubhai-25	Oil/Gas	Dec-05	
CB-ONN-2003/1	**100%**	**-**	**NELP V**				
				Dhirubhai-43	Oil	Nov-09	Gross reservoir thickness of ~15m encountered; well flowed @ 500 bopd; Commerciality of discovery is being ascertained.
				Dhirubhai-45	Oil	Feb-10	2nd oil discovery in same block in 3 months
Others							
CY-DWN-2001/2	100%	-	NELP-III	Dhirubhai-35	Oil/Gas with Condensate	Jul-07	First discovery in Cauvery deep-water basin; Main zone produced 31 mmscfd gas and 1,200 bpd condensate.
KG-DWN-98/1	100%	-	NELP-I	Dhirubhai-36	Oil	Sep-07	Well flowed @ 570bpd
SR-OS-94/1	100%	-	Pre-NELP	Dhirubhai - 27	Gas	Sep-06	Due sub-economical potential of the Discovery, the operator has opted to relinquish this block.
GS-OSN-2000/1	90%	HEPI (10)	NELP-II	Dhirubhai-33	Gas	May-07	Appraisal is underway.

Source: Company data, DGH, Infraline, Nomura research

Financial statements

Income statement (Rsbn)					
Year-end 31 Mar	**FY08**	**FY09**	**FY10F**	**FY11F**	**FY12F**
Revenue	1,334	1,512	2,253	2,450	2,597
Cost of goods sold	(1,069)	(1,244)	(1,883)	(1,980)	(2,083)
Gross profit	**265**	**268**	**370**	**470**	**514**
SG&A	(81)	(90)	(157)	(155)	(161)
Employee share expense	-	-	-	-	-
Operating profit	**185**	**178**	**214**	**315**	**353**
EBITDA	**233**	**234**	**321**	**417**	**460**
Depreciation	(48)	(57)	(108)	(102)	(107)
Amortisation	-	-	-	-	-
EBIT	**185**	**178**	**214**	**315**	**353**
Net interest expense	(11)	(18)	(23)	(28)	(28)
Associates & JCEs	-	-	-	-	-
Other income	9	19	23	33	45
Earnings before tax	**183**	**179**	**214**	**320**	**369**
Income tax	(30)	(29)	(47)	(78)	(90)
Net profit after tax	**153**	**150**	**167**	**242**	**279**
Minority interests	-	0	0	(0)	(0)
Other items	-	-	-	-	-
Preferred dividends	-	-	-	-	-
Normalised NPAT	**153**	**150**	**167**	**242**	**279**
Extraordinary items	42	-	86	-	-
Reported NPAT	**195**	**150**	**253**	**242**	**279**
Dividends	(19)	(22)	(29)	(29)	(29)
Transfer to reserves	**176**	**127**	**224**	**213**	**250**
Valuation and ratio analysis					
FD normalised P/E (x)	20.4	22.7	21.2	14.7	12.9
FD normalised P/E at price target (x)	24.2	27.0	25.2	17.5	15.3
Reported P/E (x)	16.0	22.7	14.0	14.7	12.9
Dividend yield (%)	0.6	0.6	0.7	0.7	0.7
Price/cashflow (x)	17.9	20.9	17.0	9.3	8.7
Price/book (x)	3.8	2.7	2.4	2.1	1.8
EV/EBITDA (x)	16.5	17.3	12.3	8.9	7.6
EV/EBIT (x)	20.8	22.8	18.6	11.8	10.0
Gross margin (%)	19.9	17.7	16.4	19.2	19.8
EBITDA margin (%)	17.5	15.5	14.3	17.0	17.7
EBIT margin (%)	13.8	11.8	9.5	12.9	13.6
Net margin (%)	14.6	9.9	11.2	9.9	10.7
Effective tax rate (%)	16.2	16.3	21.9	24.3	24.4
Dividend payout (%)	9.8	14.8	11.5	12.0	10.5
Capex to sales (%)	14.3	18.3	7.1	4.7	6.9
Capex to depreciation (x)	3.9	4.9	1.5	1.1	1.7
ROE (%)	26.8	14.5	18.6	15.2	15.2
ROA (pretax %)	14.1	9.6	9.3	13.2	14.4
Growth (%)					
Revenue	19.5	13.3	49.0	8.7	6.0
EBITDA	16.3	0.5	37.2	29.8	10.3
EBIT	21.2	(3.7)	20.2	47.5	11.9
Normalised EPS	22.5	(10.2)	6.9	44.2	14.3
Normalised FDEPS	22.5	(10.2)	6.9	44.2	14.3
Per share					
Reported EPS (Rs)	67	47	77	73	83
Norm EPS (Rs)	53	47	51	73	83
Fully diluted norm EPS (Rs)	53	47	51	73	83
Book value per share (Rs)	280	395	448	513	589
DPS (Rs)	7	7	8	8	8

Source: Nomura estimates

Strong earnings growth expected in FY11F

Cashflow (Rsbn)					
Year-end 31 Mar	**FY08**	**FY09**	**FY10F**	**FY11F**	**FY12F**
EBITDA	233	234	321	417	460
Change in working capital	(51)	143	(85)	25	10
Other operating cashflow	(8)	(214)	(28)	(57)	(55)
Cashflow from operations	**174**	**163**	**209**	**385**	**415**
Capital expenditure	(191)	(277)	(159)	(115)	(180)
Free cashflow	**(17)**	**(114)**	**50**	**270**	**235**
Reduction in investments	(58)	156	(25)	(10)	(10)
Net acquisitions	-	-	-	-	-
Reduction in other LT assets	(155)	(508)	(40)	(19)	(52)
Addition in other LT liabilities	9	17	11	16	18
Adjustments	156	382	107	4	34
Cashflow after investing acts	**(65)**	**(68)**	**103**	**260**	**225**
Cash dividends	-	(19)	(29)	(29)	(29)
Equity issue	17	152	11	11	15
Debt issue	92	118	-	-	-
Convertible debt issue	-	-	-	-	-
Others	(19)	2	-	-	-
Cashflow from financial acts	**90**	**252**	**(18)**	**(18)**	**(15)**
Net cashflow	**24**	**184**	**85**	**242**	**210**
Beginning cash	18	43	227	312	555
Ending cash	43	227	312	555	765
Ending net debt	322	535	450	208	(2)

Source: Nomura estimates

Balance sheet (Rsbn)					
As at 31 Mar	**FY08**	**FY09**	**FY10F**	**FY11F**	**FY12F**
Cash & equivalents	43	227	312	555	765
Marketable securities	81	29	29	29	29
Accounts receivable	62	48	64	69	73
Inventories	142	201	235	243	252
Other current assets	181	110	118	118	118
Total current assets	**510**	**616**	**759**	**1,014**	**1,236**
LT investments	140	36	60	70	80
Fixed assets	619	1,070	1,082	1,075	1,096
Goodwill	-	-	-	-	-
Other intangible assets	-	-	-	-	-
Other LT assets	230	738	778	798	850
Total assets	**1,498**	**2,461**	**2,679**	**2,958**	**3,263**
Short-term debt	60	62	62	62	62
Accounts payable	206	316	244	256	269
Other current liabilities	34	41	86	111	122
Total current liabilities	**301**	**419**	**391**	**430**	**452**
Long-term debt	304	701	701	701	701
Convertible debt	-	-	-	-	-
Other LT liabilities	79	96	106	122	141
Total liabilities	**684**	**1,215**	**1,198**	**1,253**	**1,294**
Minority interest	-	1	1	1	1
Preferred stock	-	-	-	-	-
Common stock	15	14	31	31	32
Retained earnings	578	597	805	1,018	1,267
Proposed dividends	-	-	-	-	-
Other equity and reserves	222	632	643	654	669
Total shareholders' equity	**814**	**1,244**	**1,479**	**1,704**	**1,968**
Total equity & liabilities	**1,498**	**2,461**	**2,679**	**2,958**	**3,263**
Liquidity (x)					
Current ratio	1.69	1.47	1.94	2.36	2.73
Interest cover	17.1	9.8	9.3	11.1	12.4
Leverage					
Net debt/EBITDA (x)	1.38	2.28	1.40	0.50	net cash
Net debt/equity (%)	39.5	43.0	30.4	12.2	net cash
Activity (days)					
Days receivable	13.7	13.4	9.1	9.9	10.0
Days inventory	45.2	50.4	42.3	44.1	43.5
Days payable	63.4	76.5	54.2	46.1	46.1
Cash cycle	(4.6)	(12.8)	(2.9)	7.9	7.3

Source: Nomura estimates

Lower net debt-to-equity enables flexibility in capital structure

ANALYST CERTIFICATIONS

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Issuer	Ticker	Price (as at last close)	Closing Price Date	Rating	Disclosures
Reliance Industries	RIL IN	1093.65 INR	01 Apr 2010	Neutral	

Previous Ratings

Issuer	Previous Rating	Date of change
Reliance Industries	Reduce	27 Aug 2009

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• A "**Neutral**" recommendation indicates that upside or downside is less than 10%.
• A "**Reduce**" recommendation indicates that downside is between 10% and 20%.
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