

## Company Flash

10 September 2007 | 7 pages

# Reliance Industries (RELI.BO)

## Hualon Acquisition: Meaningful Size, Timing of Sale Indicates Good Value

- RIL acquires Hualon's assets** — RIL acquired polyester manufacturing capacities of Hualon in Malaysia in an asset sale. The asset was under receivership since end-2006 after loan defaults. Though RIL has not disclosed the deal value, the timing of the distressed asset sale during the present lackluster stage in the polyester cycle implies good chances of it being cheap relative to replacement costs.
- Meaningful in size, good fit** — Hualon has PTA based polyester capacity of 0.5MMTPA, ~25% of RIL's capacity incl. IPCL. This fits well with RIL's surplus PTA production estimated at 0.7MTPA in FY07 (excl. captive consumption). About 95% of Hualon's US\$800m revenues (6.3% of RIL's FY07 petrochem revenues) are from exports. Hualon is also forward integrated into spun yarn (250,000 spindles) and significant fabric capacity (360-450m mtrs p.a.).
- Opportunities for cost-cutting**— Hualon has been loss-making for the past few years on account of being a non-integrated player, with high receivables, high debt (US\$1bn), and large employee base (7,000). The contribution to profitability would be contingent on RIL's ability to optimize feedstock costs and cut overheads.
- Maintain Buy (1L)** — Slower ramp-up in gas production, lower than market price for gas, and delay in exploratory drilling in non-D6 blocks (due to rig shortage) are key risks.

<b>Buy/Low Risk</b>	<b>1L</b>
Price (10 Sep 07)	Rs1,987.20
Target price	Rs2,005.00
Expected share price return	0.9%
Expected dividend yield	0.7%
<b>Expected total return</b>	<b>1.5%</b>
Market Cap	Rs2,769,179M US\$68,375M

### Statistical Abstract

Year to	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
31 Mar							
2005A	75,717	54.34	43.0	36.6	6.9	20.3	0.4
2006A	90,693	65.10	19.8	30.5	9.7	26.4	0.5
2007E	109,184	78.37	20.4	25.4	7.3	32.9	0.6
2008E	118,564	85.11	8.6	23.3	5.8	27.8	0.7
2009E	129,139	92.70	8.9	21.4	4.8	24.4	0.8

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

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**Figure 1. Hualon's Financial performance**

Year to 31-Dec (US\$m)	FY01	FY02	FY03	FY04	FY05	FY06
Revenue	787	686	693	853	989	823
Pre-tax Loss	187	266	182	45	70	92
Net Loss	130	173	140	45	71	63
Total Borrowings	848	850	853	1048	1036	1031
Total Receivables	279	204	174	177	188	184
Total Payables	424	489	553	338	371	191

Source: Bloomberg, The Edge, Citigroup Investment Research

**Figure 2. Hualon's Capacity is Meaningful**

'000 MTPA	RIL	Hualon
PFY/PSF	1565	500
PET	300	150
Others	188	
<b>Total</b>	<b>2053</b>	<b>650</b>

Source: Company Reports and Citigroup Investment Research

## Reliance Industries

### Company description

Reliance Industries is a conglomerate with interests in upstream oil & gas (E&P), refining, and petrochemicals. It is building a super-size refinery project through its 75% subsidiary (RPL) and is now undertaking development of a large gas find in KG basin. RIL is foraying into organized retailing and has plans to undertake SEZ projects over the medium to long term.

### Investment thesis

We rate RIL Buy/Low Risk with a target price of Rs2,005. We expect regional refining margins to remain robust due to project delays in the Middle East, with RIL enjoying an enhanced premium for its superior complexity. E&P business has delivered positive surprise and looks set to become more meaningful in the next 3-4 years as KG D6 field commences production and new discoveries are brought on stream. Upgrade of reserves in KG basin adds to the value, although the NAV of the gas find depends on development capex and the demand profile from anchor customers. Given the track record of exploratory success and the evolving portfolio (much beyond KG D6), RIL's E&P business needs to be valued as a going concern rather than a combination of assets. We have therefore valued E&P business (Rs631/share) on more traditional EV/FCF multiple rather than the consensus NAV approach. While petrochemicals will likely face pressure in FY09E, this will be offset by diversity of products to some extent. Factors such as diversity of revenues, integration across product chains, and volume growth should help RIL tide over downturns in product cycles.

### Valuation

Our target price of Rs2,005 is based on a sum-of-the-parts value: 1) RIL's core petrochem and downstream oil business is valued on an EV/EBITDA of 6.5x mid-FY09E, in line with the regional chemicals and refining peers; 2) Total E&P assets including oil & gas prospects and other blocks are valued at Rs631/share based on 10x steady state (FY11E) FCF; 3) Investment in IPCL and RPL valued at 8x profit contribution to consolidated profits; 4) Organized retail business value is rolled forward to Mar-08E and factored in at Rs125/share, as per

Citigroup's Retail Analyst, Princy Singh; and 5) Treasury stock is valued at RIL's target price.

### **Risks**

We rate RIL Low Risk, as opposed to the Medium Risk suggested by our quantitative risk-rating system, which tracks 260-day historical share-price volatility. Diversified earnings and significant value contribution from the emerging E&P business and investment in listed subsidiaries have led to qualitative changes in the value constituents of the stock. Risks that could impede the stock from reaching our target price are: RIL's margins are exposed to the global petrochemical and refining cycles; the group could be asked to offer larger discounts on products sold to oil public sector units; delays in the key KG-D6 gas development and RPL refinery project; delays in the drilling programme for the new blocks (D9, D3, D4); and the organized retail business would call for significant investment in non-core areas.

## Appendix A-1

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Analyst: Rahul Singh (covered since October 6 2005)



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