

INDIA

# Reliance Industries

3 September 2009

**RIL IN** **Outperform**

Stock price as of 02 Sep 09	Rs	1,971.75
12-month target	Rs	2,350.00
Upside/downside	%	+19.2
Valuation	Rs	2,350.00
- Sum of Parts		

GICS sector		energy
Market cap	Rs bn	3,103
30-day avg turnover	US\$m	180.0
Market cap	US\$m	63,281
Number shares on issue	m	1,574

**Investment fundamentals**

Year end 31 Mar		2009A	2010E	2011E	2012E
Total revenue	bn	1,492.6	1,639.3	2,145.5	2,291.6
EBITDA	bn	234.3	349.2	401.3	446.1
EBITDA growth	%	1.3	49.0	14.9	11.2
EBIT	bn	183.3	266.5	314.7	355.7
EBIT Growth	%	1.0	45.4	18.1	13.0
Reported profit	bn	152.2	210.7	258.6	308.4
Adjusted profit	bn	155.5	210.7	258.6	308.4
EPS rep	Rs	92.65	128.28	157.41	187.76
EPS adj	Rs	94.65	128.28	157.41	187.76
EPS adj growth	%	0.7	35.5	22.7	19.3
PE adj	x	20.8	15.4	12.5	10.5
Total DPS	Rs	12.60	17.45	21.41	25.54
Total div yield	%	0.6	0.9	1.1	1.3
ROE	%	14.6	16.4	18.3	18.6
EV/EBITDA	x	15.8	10.6	9.2	8.3
Net debt/equity	%	36.5	34.9	18.8	2.1
Price/book	x	2.5	2.5	2.1	1.8

**RIL IN rel SENSEX performance, & rec history**



Source: FactSet, Macquarie Research, September 2009 (all figures in INR unless noted)

**Analyst**

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## KGD9 drilling starts - Next big thing

**Event**

- According to media reports, RIL has spudded its first well in the KG-D9 block. Exploratory well KG-D9-A1 was spudded on 31 August at a water depth of 2,754 metres. RIL has 90% stake in KG-D9, while Hardy Oil (HDY LN, GBp355, not rated) has a 10% stake. Our discussions with industry experts suggest that KG-D9 could potentially bear more hydrocarbons than KG-D6. We expect the KG-D9 drilling program to confirm the high potential. We reiterate our Outperform rating.

**Impact**

- Drilling commenced in KG-D9 block.** RIL is committed to a four-well drilling programme in the KG-D9 block, which is an 11,605sq km block. RIL will spud the wells in two different stages. RIL has already shot and processed a much higher volume of 4,000sq km of 3D seismic data against commitment of 1,650sq km.
- East coast of India is highly prospective.** During our Oil & Gas *Next Generation Yatra (Tour)*, the Director General of Hydrocarbons (DGH) highlighted that the production from KG-D6 block, which will be about one-quarter of Brazil's current production, is only the tip of the iceberg and there is a lot of potential on the east coast. The DGH ascribes a record-breaking 70%+ drilling success potential in KG basin as ultra-modern high-resolution electromagnetic seismic studies show clear hydrocarbon signatures.
- KG-D9 – the next big thing.** Both Hardy Oil and DGH believe that KG-D9 could be larger than KG-D6 and is likely to be more oil-bearing, and four-way closures suggest higher recovery potential. Recent gas discoveries suggest that the biogenic gas corridor on India's east coast may extend to a much larger area than was earlier expected.
- Industry experts estimate large oil & gas potential.** The latest technical report by the industry experts, GCA, further underlines the findings that KG-D9 could be larger than KG-D6 and is likely to be more oil-bearing. GCA estimates the gross risked best estimate prospective resources for KG-D9 at 10.8 TCF of gas and 143m bbl of oil.

**Earnings and target price revision**

- No change.

**Price catalyst**

- 12-month price target: Rs2,350.00 based on a Sum of Parts methodology.
- Catalyst: New Oil & Gas finds, resolution of court case with RNRL.

**Action and recommendation**

- Reiterate Outperform.** RIL has a large portfolio of highly prospective blocks and its exploratory success rate is the best amongst peers. We estimate RIL's profits to rise 35% in FY10E, purely from volume growth, despite an assumed cyclical downturn.

## Summary of resource estimates for the KG-D9 block

Fig 1 KG-D9: summary – gross prospective gas resources

Prospects/Leads Summary (TCF)	Play	Gross Prospective Resources			GCoS
		Low	Best	High	
Channel 2 (Near #B3)	Lower Pliocene	0.30	0.90	1.80	30%
Channel 1 (Near #B3)	Upper Pliocene	0.20	0.70	1.50	30%
Central Anticline (near #A1)	Upper Miocene	1.40	3.60	7.60	20%
Northern Anticline (NW flank B1)	Upper Miocene	0.80	2.50	5.60	20%
Central Anticline (near #B3)	Upper Miocene	1.00	2.50	5.30	25%
Southern Anticline (SE flank C1)	Upper Miocene	1.10	2.90	6.20	10%
Central Anticline (A1 and B2)	Mid Miocene	1.20	2.80	5.60	25%
Northern Anticline (B1)	Mid Miocene	2.70	5.20	12.00	25%
Central Anticline (A1 and B2)	Mid Miocene	2.90	6.60	12.90	25%
Southern Anticline (C1)	Mid Miocene	1.80	5.20	12.00	15%
Northern Anticline (near #B1)	Lower Miocene	1.80	6.30	15.00	15%
Central Anticline (near #A1)	Lower Miocene	1.50	4.00	8.70	15%
Central Anticline (near #B2)	Lower Miocene	1.30	2.80	5.50	25%
Central Anticline (near #A2)	Lower Miocene	0.80	2.30	4.90	15%
Central Anticline #A1 Channel	Lower Miocene	1.40	4.20	9.20	15%
Central Anticline #A2 Channel	Lower Miocene	0.80	2.30	5.00	15%
<b>Gross Aggregate Risked Prospective Resources</b>		<b>4.10</b>	<b>10.80</b>	<b>23.00</b>	

Source: Company data, Macquarie Research, September 2009

Fig 2 KG-D9: summary – gross prospective oil resources

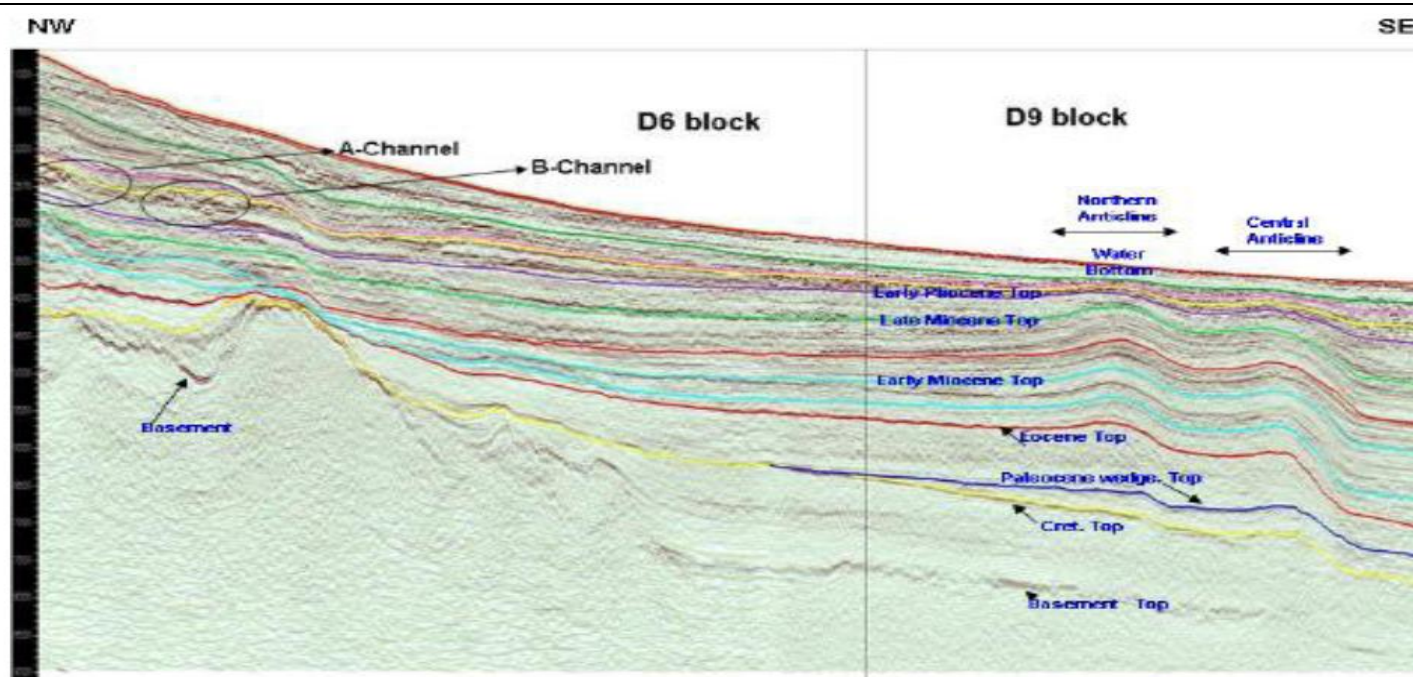
Prospects/Leads Summary (mn bbl)	Play	Gross Prospective Resources		
		Low	Best	High
Central Anticline (four-way fault closure B2)	Palaeocene	142	420	961
Wedge	Palaeocene	156	456	1,040
Central Anticline (A1-B2) - (Hardy Wedge)	Palaeocene	15	47	107
Central Anticline (Fault Closure B2)	Cretaceous	44	122	260
<b>Gross Aggregate Risked Prospective Resources</b>		<b>49</b>	<b>143</b>	<b>322</b>

Source: Company data, Macquarie Research, September 2009

### Same geological plays extends across the blocks on India's east coast

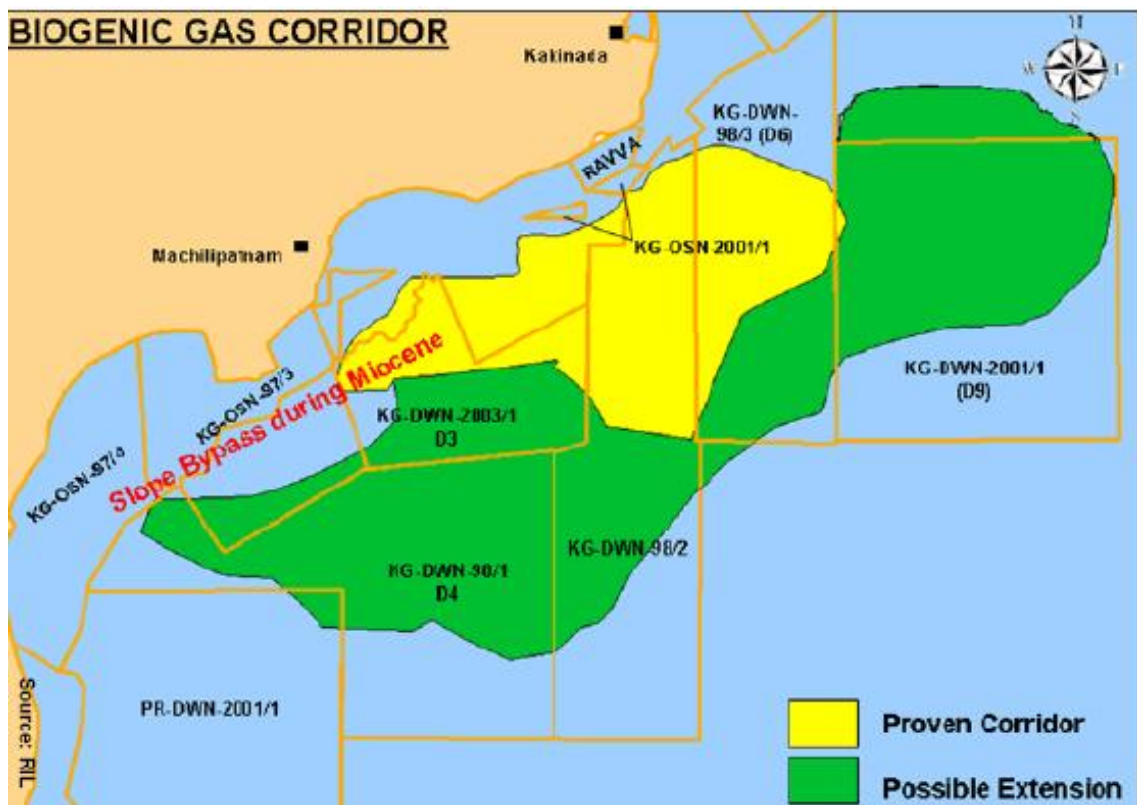
Recent studies carried out by the upstream exploration companies show that the geological plays present in the KG-D6 block extend through to the large area of the KG basin. RIL's partner in KG-D9, Hardy Oil, believes that KG-D9 could be much larger than KG-D6. These views were reaffirmed by the DGH.

Fig 3 Large anticline structures in KG-D9, potentially higher resources than KG-D6



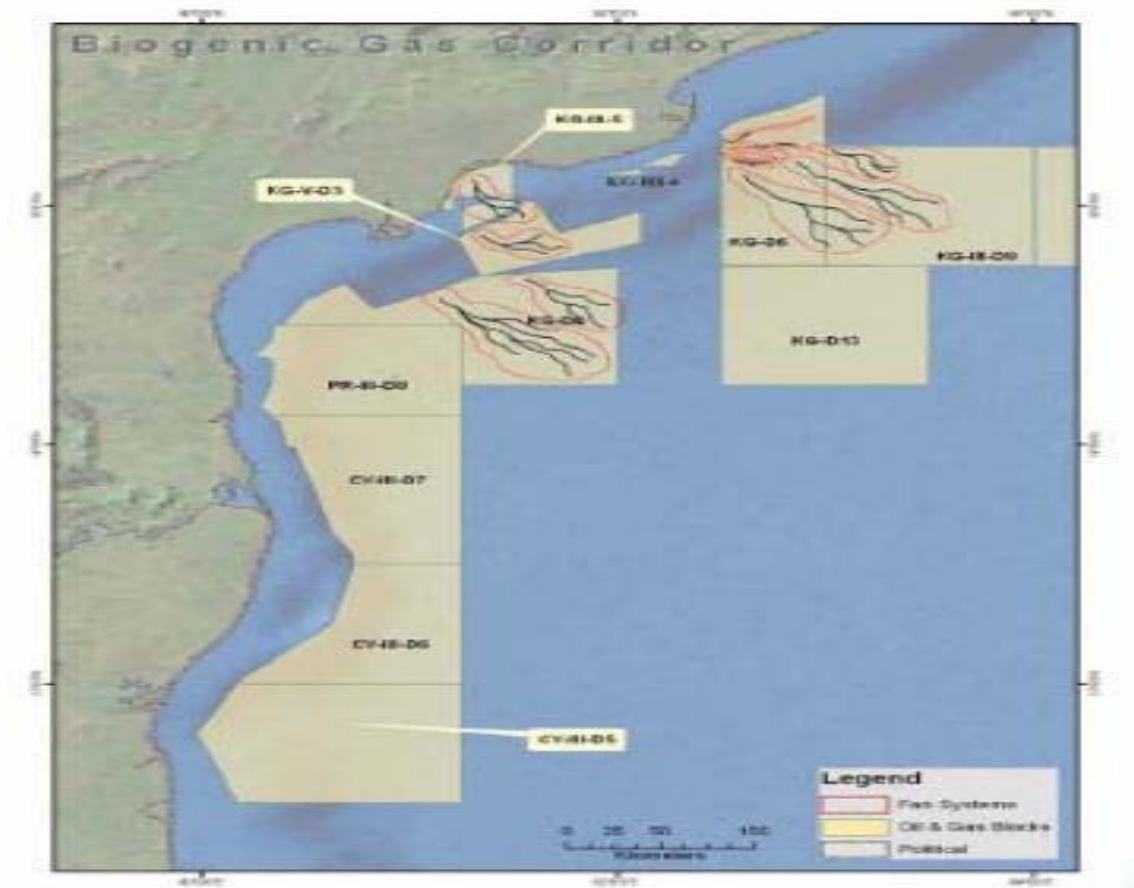
Source: Company data, Macquarie Research, September 2009

Fig 4 Biogenic gas corridor may potentially extend to cover the entire KG basin



Source: Company data, Macquarie Research, September 2009

Fig 5 Across Indian east coast, blocks have same geological plays as KG-D6



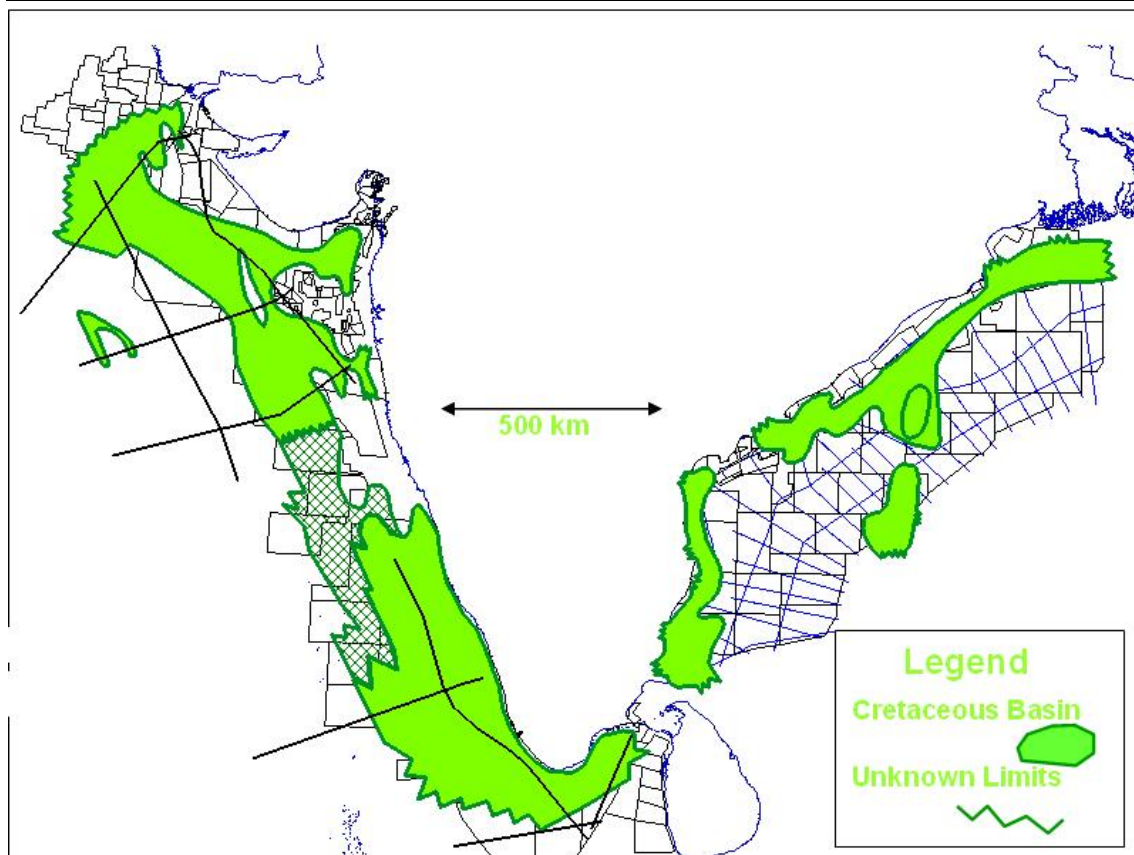
Source: Company data, Macquarie Research, September 2009

## Oil potential in cretaceous sections

The mid-Jurassic rifting in the Indian sub-continent resulted in a thinning of the crust and a cretaceous sag basin developed, containing thick (up to 5–12km) sediments. These basins are widely distributed on both the east and west coasts of India and are likely to contain source rocks in the oil window.

Gas resources have been identified in the Miocene and the mid-Pliocene sections. In addition, the KG-D9 block has a potential oil resource in the cretaceous section. Even in the KG-D6 block, oil was discovered in the cretaceous section; however, preliminary data suggests that the oil-bearing structures in KG-D9 could be larger than in KG-D6.

**Fig 6 Potential for oil discoveries in the cretaceous sections**

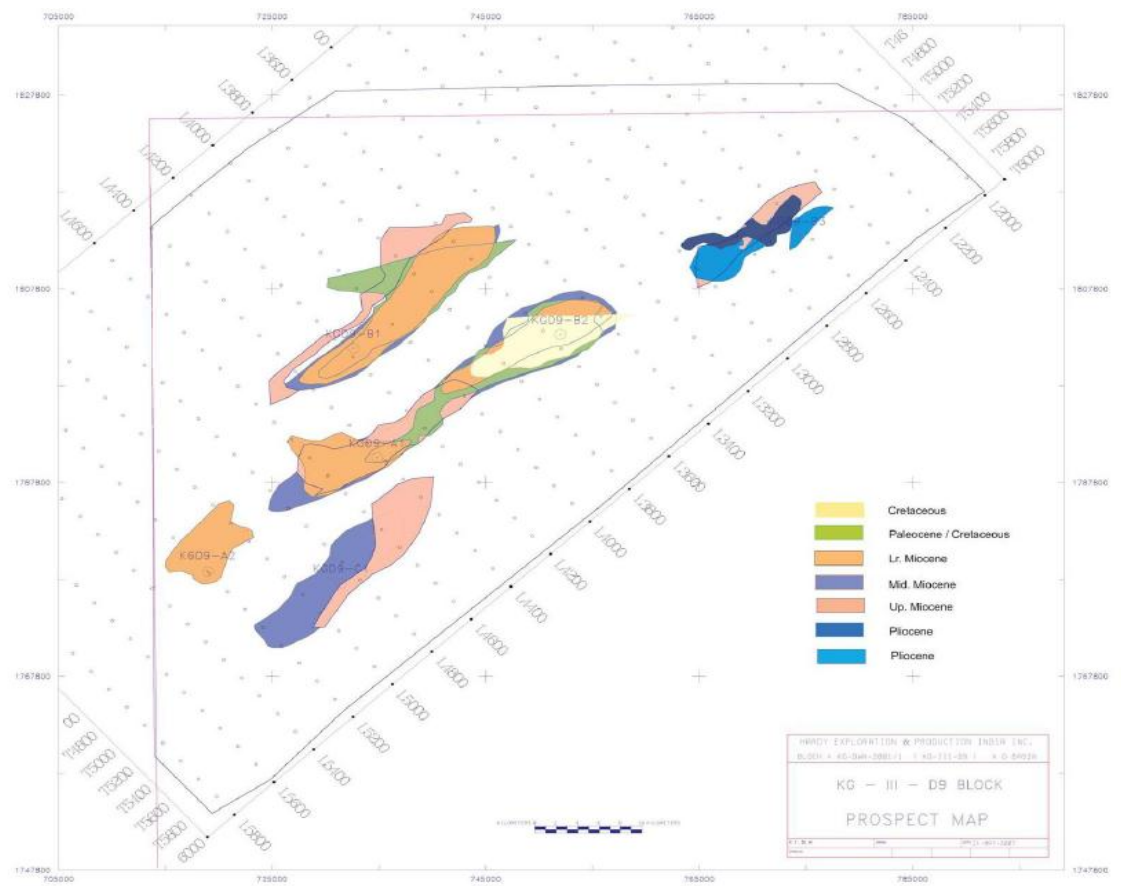


Source: DGH

## Drilling in KG-D9 block has commenced

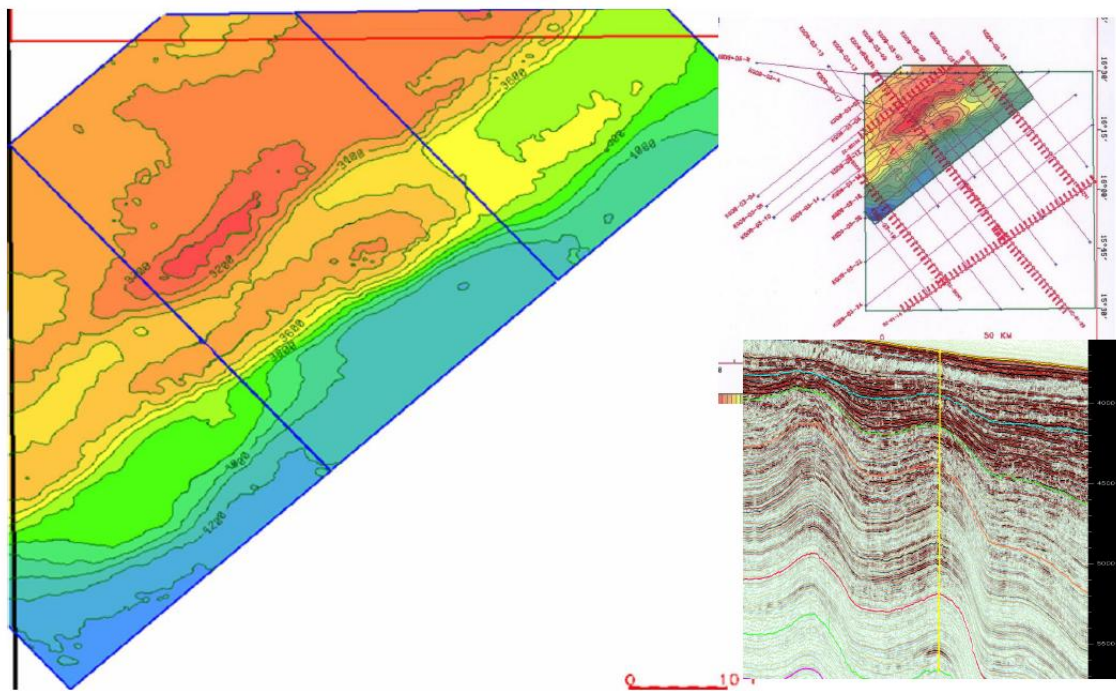
The deepwater rig 'Deepwater Expedition', which was drilling exploratory wells in KG-D6 block, has moved to the KG-D9 block. Drilling locations target stacked sands in the Miocene, Oligocene and Pliocene. Two locations were identified for drilling – one in the shallower part and another in the deeper section (~2,700 metre water depth) up to the Cretaceous section.

Fig 7 KG-D9 prospect map



Source: Company data, Macquarie Research, September 2009

Fig 8 KG-D9 seismic depth structure map



Source: Company data, Macquarie Research, September 2009

**Reliance Industries (RIL IN, Outperform, Target price: Rs2,350.00)**

Balance Sheet		2009A	2010E	2011E	2012E	Profit & Loss		2009A	2010E	2011E	2012E
Cash	m	62,890	120,405	129,751	81,434	<b>Revenue</b>	m	<b>1,492,606</b>	<b>1,639,259</b>	<b>2,145,521</b>	<b>2,291,598</b>
Receivables	m	77,131	79,925	102,232	108,161	<b>Gross Profit</b>	m	<b>345,101</b>	<b>428,317</b>	<b>490,158</b>	<b>537,270</b>
Inventories	m	123,203	113,575	151,274	154,843	Cost of Goods Sold	m	1,147,506	1,210,942	1,655,363	1,754,328
Investments	m	255,636	290,636	325,636	360,636	<b>EBITDA</b>	m	<b>234,347</b>	<b>349,225</b>	<b>401,322</b>	<b>446,107</b>
Fixed Assets	m	1,451,870	1,450,368	1,441,615	1,424,547	Depreciation	m	51,069	82,732	86,652	90,396
Intangibles	m	0	0	0	0	Amortisation of Goodwill	m	0	0	0	0
Other Assets	m	155,246	128,128	162,586	166,749	Other Amortisation	m	0	0	0	0
<b>Total Assets</b>	<b>m</b>	<b>2,125,977</b>	<b>2,183,036</b>	<b>2,313,093</b>	<b>2,296,371</b>	<b>EBIT</b>	<b>m</b>	<b>183,278</b>	<b>266,493</b>	<b>314,670</b>	<b>355,711</b>
Payables	m	196,782	171,479	226,247	230,119	Net Interest Income	m	-17,878	-34,271	-26,551	-14,229
Short Term Debt	m	87,000	87,000	87,000	37,000	Associates	m	0	0	0	0
Long Term Debt	m	440,743	488,629	329,172	82,368	Exceptionals	m	-3,280	0	0	0
Provisions	m	29,926	29,926	29,926	29,926	Forex Gains / Losses	m	0	0	0	0
Other Liabilities	m	97,370	103,438	115,505	125,253	Other Pre-Tax Income	m	20,775	22,695	24,092	25,542
<b>Total Liabilities</b>	<b>m</b>	<b>851,821</b>	<b>880,473</b>	<b>787,850</b>	<b>504,665</b>	<b>Pre-Tax Profit</b>	<b>m</b>	<b>182,896</b>	<b>254,918</b>	<b>312,211</b>	<b>367,025</b>
Shareholders' Funds	m	1,274,156	1,302,563	1,525,243	1,791,706	Tax Expense	m	-30,700	-44,199	-53,639	-58,610
Minority Interests	m	0	0	0	0	<b>Net Profit</b>	<b>m</b>	<b>152,196</b>	<b>210,718</b>	<b>258,572</b>	<b>308,415</b>
Other	m	0	0	0	0	Minority Interests	m	0	0	0	0
<b>Total S/H Equity</b>	<b>m</b>	<b>1,274,156</b>	<b>1,302,563</b>	<b>1,525,243</b>	<b>1,791,706</b>	<b>Reported Earnings</b>	<b>m</b>	<b>152,196</b>	<b>210,718</b>	<b>258,572</b>	<b>308,415</b>
<b>Total Liab &amp; S/H Funds</b>	<b>m</b>	<b>2,125,977</b>	<b>2,183,036</b>	<b>2,313,093</b>	<b>2,296,371</b>	<b>Adjusted Earnings</b>	<b>m</b>	<b>155,476</b>	<b>210,718</b>	<b>258,572</b>	<b>308,415</b>
						EPS (rep)		92.65	128.28	157.41	187.76
						EPS (adj)		94.65	128.28	157.41	187.76
						EPS Growth (adj)	%	0.7	35.5	22.7	19.3
						PE (rep)	x	21.3	15.4	12.5	10.5
						PE (adj)	x	20.8	15.4	12.5	10.5
						Total DPS		12.60	17.45	21.41	25.54
						Total Div Yield	%	0.6	0.9	1.1	1.3
						Weighted Average Shares	m	1,643	1,643	1,643	1,643
						Period End Shares	m	1,643	1,643	1,643	1,643
Profit and Loss Ratios		2009A	2010E	2011E	2012E	Cashflow Analysis		2009A	2010E	2011E	2012E
Revenue Growth	%	8.8	9.8	30.9	6.8	<b>EBITDA</b>	<b>m</b>	<b>234,347</b>	<b>349,225</b>	<b>401,322</b>	<b>446,107</b>
EBITDA Growth	%	1.3	49.0	14.9	11.2	Tax Paid	m	-30,700	-44,199	-53,639	-58,610
EBIT Growth	%	1.0	45.4	18.1	13.0	Chgs in Working Cap	m	82,253	6,741	-37,504	-9,784
Gross Profit Margin	%	23.1	26.1	22.8	23.4	Net Interest Paid	m	-17,878	-34,271	-26,551	-14,229
EBITDA Margin	%	15.7	21.3	18.7	19.5	Other	m	6,462	7,977	9,875	9,741
EBIT Margin	%	12.3	16.3	14.7	15.5	<b>Operating Cashflow</b>	<b>m</b>	<b>274,484</b>	<b>285,473</b>	<b>293,503</b>	<b>373,226</b>
Net Profit Margin	%	10.2	12.9	12.1	13.5	Acquisitions	m	-156,574	0	0	0
Payout Ratio	%	13.3	13.6	13.6	13.6	Capex	m	-363,487	-81,229	-77,900	-73,328
EV/EBITDA	x	15.8	10.6	9.2	8.3	Asset Sales	m	0	0	0	0
EV/EBIT	x	20.2	13.9	11.8	10.4	Other	m	20,775	22,695	24,092	25,542
<b>Balance Sheet Ratios</b>						<b>Investing Cashflow</b>	<b>m</b>	<b>-499,286</b>	<b>-58,534</b>	<b>-53,808</b>	<b>-47,786</b>
ROE	%	14.6	16.4	18.3	18.6	Dividend (Ordinary)	m	-20,699	-28,663	-35,172	-41,952
ROA	%	9.5	12.4	14.0	15.4	Equity Raised	m	692	0	0	0
ROIC	%	11.2	12.7	14.8	16.5	Debt Movements	m	20,782	47,886	-159,457	-296,804
Net Debt/Equity	%	36.5	34.9	18.8	2.1	Other	m	246,008	-153,648	-720	0
Interest Cover	x	10.3	7.8	11.9	25.0	<b>Financing Cashflow</b>	<b>m</b>	<b>246,784</b>	<b>-134,425</b>	<b>-195,349</b>	<b>-338,756</b>
Price/Book	x	2.5	2.5	2.1	1.8	<b>Net Chg in Cash/Debt</b>	<b>m</b>	<b>21,982</b>	<b>92,514</b>	<b>44,346</b>	<b>-13,316</b>
Book Value per Share		775.7	793.0	928.5	1,090.8	<b>Free Cashflow</b>	<b>m</b>	<b>-89,003</b>	<b>204,244</b>	<b>215,603</b>	<b>299,898</b>

All figures in INR unless noted.

Source: Company data, Macquarie Research, September 2009

**Important disclosures:**

<p><b>Recommendation definitions</b></p> <p><b>Macquarie - Australia/New Zealand</b>  Outperform – return &gt;5% in excess of benchmark return  Neutral – return within 5% of benchmark return  Underperform – return &gt;5% below benchmark return</p> <p><b>Macquarie – Asia/Europe</b>  Outperform – expected return &gt;+10%  Neutral – expected return from -10% to +10%  Underperform – expected return &lt;-10%</p> <p><b>Macquarie First South - South Africa</b>  Outperform – expected return &gt;+10%  Neutral – expected return from -10% to +10%  Underperform – expected return &lt;-10%</p> <p><b>Macquarie - Canada</b>  Outperform – return &gt;5% in excess of benchmark return  Neutral – return within 5% of benchmark return  Underperform – return &gt;5% below benchmark return</p> <p><b>Macquarie - USA</b>  Outperform (Buy) – return &gt;5% in excess of benchmark return (Russell 3000)  Neutral (Hold) – return within 5% of benchmark return (Russell 3000)  Underperform (Sell)– return &gt;5% below benchmark return (Russell 3000)</p> <p><b>Recommendations – 12 months</b></p> <p><b>Note:</b> Quant recommendations may differ from Fundamental Analyst recommendations</p>	<p><b>Volatility index definition*</b></p> <p>This is calculated from the volatility of historical price movements.</p> <p><b>Very high–highest risk</b> – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.</p> <p><b>High</b> – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.</p> <p><b>Medium</b> – stock should be expected to move up or down at least 30–40% in a year.</p> <p><b>Low–medium</b> – stock should be expected to move up or down at least 25–30% in a year.</p> <p><b>Low</b> – stock should be expected to move up or down at least 15–25% in a year.</p> <p>* Applicable to Australian/NZ/Canada stocks only</p>	<p><b>Financial definitions</b></p> <p>All "Adjusted" data items have had the following adjustments made:  Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives &amp; hedging, IFRS impairments &amp; IFRS interest expense  Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends &amp; minority interests</p> <p><b>EPS</b> = adjusted net profit / <i>efpowa</i>*  <b>ROA</b> = adjusted ebit / average total assets  <b>ROA Banks/Insurance</b> = adjusted net profit / average total assets  <b>ROE</b> = adjusted net profit / average shareholders funds  <b>Gross cashflow</b> = adjusted net profit + depreciation  *equivalent fully paid ordinary weighted average number of shares</p> <p>All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).</p>																																
<p><b>Recommendation proportions – For quarter ending 30 June 2009</b></p> <table border="1"> <thead> <tr> <th></th> <th>AU/NZ</th> <th>Asia</th> <th>RSA</th> <th>USA</th> <th>CA</th> <th>EUR</th> <th></th> </tr> </thead> <tbody> <tr> <td>Outperform</td> <td>40.38%</td> <td>48.53%</td> <td>40.00%</td> <td>44.02%</td> <td>57.42%</td> <td>40.20%</td> <td>(for US coverage by MCUSA, 1.54% of stocks covered are corporate advisory clients)</td> </tr> <tr> <td>Neutral</td> <td>39.25%</td> <td>17.08%</td> <td>45.00%</td> <td>37.45%</td> <td>32.90%</td> <td>39.21%</td> <td>(for US coverage by MCUSA, 1.16% of stocks covered are corporate advisory clients)</td> </tr> <tr> <td>Underperform</td> <td>20.38%</td> <td>34.40%</td> <td>15.00%</td> <td>18.53%</td> <td>9.68%</td> <td>20.59%</td> <td>(for US coverage by MCUSA, 0.77% of stocks covered are corporate advisory clients)</td> </tr> </tbody> </table>				AU/NZ	Asia	RSA	USA	CA	EUR		Outperform	40.38%	48.53%	40.00%	44.02%	57.42%	40.20%	(for US coverage by MCUSA, 1.54% of stocks covered are corporate advisory clients)	Neutral	39.25%	17.08%	45.00%	37.45%	32.90%	39.21%	(for US coverage by MCUSA, 1.16% of stocks covered are corporate advisory clients)	Underperform	20.38%	34.40%	15.00%	18.53%	9.68%	20.59%	(for US coverage by MCUSA, 0.77% of stocks covered are corporate advisory clients)
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**Company Specific Disclosures:**

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