

PO cut by 15% to Rs1,555; still 45% potential upside



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Cut PO by 15% but still 45% potential upside; Retain Buy

We have steeply cut Singapore complex refining margins forecast for FY10-FY11E. Consequently refining margins of Reliance Industries (RIL) and refining subsidiary Reliance Petroleum (RPL), too, have been steeply cut. The cut in FY10-FY11E EPS at 1-17% is relatively modest as a weaker rupee is assumed (9-24% cut otherwise). RIL's presence in E&P and petrochemicals also helped dilute impact of refining margin cut on RIL. RIL's PO has been cut by 15% to Rs1,555/share, which still implies 45% potential upside. Retain Buy on RIL.

PO cut to Rs1,555/share; E&P 58% of revised PO

RIL's PO has been cut by 15% from Rs1,825/share to Rs1,555/share. The PO cut is due to cut in value of its refining business and value of its investment in RPL. The former has been cut by 56% to Rs168/share and the latter by 39% to Rs137/share. Refining including investment in RPL is now 20% of RIL's PO (33% earlier). E&P is now 58% (49%) and petrochemicals 16% (12%) of RIL's PO.

FY10E EBIT cut by US\$1.7bn and EPS by 17%

We have cut FY10E Singapore complex refining margins by 41% to US\$4.2/bbl. RIL's FY10E refining margin is cut by 37% to US\$6.3/bbl. FY10E EBIT is consequently cut by US\$1.7bn and EPS by 17%. FY10E EBIT from RIL's existing refinery at US\$530m is US\$2bn (79%) lower than in FY08. FY10E existing refinery and petrochemical EBIT is US\$3.4bn (77%) lower than in FY08.

FY10E EPS growth now at 25% YoY; FY11E at 26% YoY

RIL's FY10E EPS is now expected to rise by 25% YoY and FY11E EPS by 26% YoY vis-à-vis 6% earlier. KG D6 oil & gas and RPL are the main growth drivers.

Estimates (Mar)

(Rs)	2007A	2008A	2009E	2010E	2011E
Net Income (Adjusted - mn)	125,476	153,244	168,183	209,555	264,796
EPS	86.34	105.44	106.90	133.19	168.30
EPS Change (YoY)	26.6%	22.1%	1.4%	24.6%	26.4%
Dividend / Share	9.91	11.00	12.00	15.00	15.00
Free Cash Flow / Share	(105.18)	(68.52)	16.48	75.57	85.26
GDR EPS (US\$)	3.82	5.24	4.25	5.30	6.70
GDR Dividend / Share (US\$)	0.438	0.546	0.477	0.597	0.597

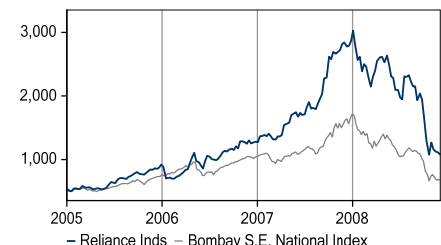
Valuation (Mar)

	2007A	2008A	2009E	2010E	2011E
P/E	12.44x	10.19x	10.05x	8.06x	6.38x
Dividend Yield	0.923%	1.02%	1.12%	1.40%	1.40%
EV / EBITDA*	10.64x	9.47x	8.60x	6.72x	5.48x
Free Cash Flow Yield*	-9.05%	-5.89%	1.53%	7.04%	7.94%

* For full definitions of *iQmethod*SM measures, see page 12.

Stock Data

Price (Common / GDR)	Rs1,074 / US\$43.00
Price Objective	Rs1,825 to Rs1,555/ US\$93.59 to US\$79.72
Date Established	3-Dec-2008 / 3-Dec-2008
Investment Opinion	B-1-7 / B-1-7
Volatility Risk	MEDIUM / MEDIUM
52-Week Range	Rs930.00-Rs3,298
Market Value (mn)	US\$33,609
Shares Outstanding (mn)	1,573.4 / 786.7
Average Daily Volume	10,867,610
ML Symbol / Exchange	XRELF / BSE
ML Symbol / Exchange	RLNIY / LIN
Bloomberg / Reuters	RIL IN / RELI.BO
ROE (2009E)	16.8%
Net Dbt to Eqty (Mar-2008A)	52.3%
Est. 5-Yr EPS / DPS Growth	0.2% / 0.1%
Free Float	45.0%



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Refer to important disclosures on page 13 to 15. Analyst Certification on Page 11. Price Objective Basis/Risk on page 11.

iQprofileSM Reliance Industries Ltd.

Key Income Statement Data (Mar)

	2007A	2008A	2009E	2010E	2011E
(Rs Millions)					
Sales	1,137,701	1,371,467	1,311,861	1,477,828	1,792,184
Gross Profit	347,532	373,835	408,926	494,087	597,530
Sell General & Admin Expense	(141,526)	(142,389)	(154,033)	(167,707)	(197,336)
Operating Profit	157,011	181,404	203,816	243,176	312,835
Net Interest & Other Income	(5,814)	1,369	(303)	(172)	4,671
Associates	NA	NA	NA	NA	NA
Pretax Income	151,198	182,773	203,513	243,003	317,506
Tax (expense) / Benefit	(25,723)	(29,511)	(35,329)	(23,341)	(35,828)
Net Income (Adjusted)	125,476	153,244	168,183	209,555	264,796
Average Fully Diluted Shares Outstanding	1,453	1,453	1,573	1,573	1,573

Key Cash Flow Statement Data

Net Income	125,476	153,244	168,183	209,555	264,796
Depreciation & Amortization	48,995	50,042	51,077	83,204	87,358
Change in Working Capital	(42,218)	(108,528)	56,228	(499)	(36,681)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	15,469	50,067	10,054	14,776	24,048
Cash Flow from Operations	147,722	144,824	285,542	307,035	339,521
Capital Expenditure	(300,591)	(244,405)	(259,613)	(188,137)	(205,370)
(Acquisition) / Disposal of Investments	13,988	(42,548)	(13,381)	0	(5,000)
Other Cash Inflow / (Outflow)	NA	NA	NA	NA	NA
Cash Flow from Investing	(286,603)	(286,953)	(272,994)	(188,137)	(210,370)
Shares Issue / (Repurchase)	59,248	(181)	168,240	0	0
Cost of Dividends Paid	(30,247)	(2,764)	(17,016)	(21,529)	(26,911)
Cash Flow from Financing	132,088	167,500	57,684	(158,529)	(98,911)
Free Cash Flow	(152,870)	(99,580)	25,930	118,898	134,151
Net Debt	317,144	462,219	298,447	201,078	98,838
Change in Net Debt	109,881	145,075	(163,772)	(97,369)	(102,240)

Key Balance Sheet Data

Property, Plant & Equipment	911,669	1,127,466	1,336,001	1,440,934	1,558,946
Other Non-Current Assets	52,680	95,229	108,610	108,610	113,610
Trade Receivables	38,314	60,683	58,046	85,706	100,508
Cash & Equivalents	19,370	44,742	114,974	75,343	105,583
Other Current Assets	273,475	409,464	344,640	254,849	330,010
Total Assets	1,295,508	1,737,583	1,962,271	1,965,442	2,208,657
Long-Term Debt	252,288	390,744	306,561	194,561	147,561
Other Non-Current Liabilities	69,905	77,983	88,037	92,705	99,871
Short-Term Debt	84,227	116,217	106,860	81,860	56,860
Other Current Liabilities	202,516	268,667	261,947	204,699	257,981
Total Liabilities	608,936	853,611	763,405	573,825	562,273
Total Equity	686,572	883,972	1,198,866	1,391,617	1,646,384
Total Equity & Liabilities	1,295,508	1,737,583	1,962,271	1,965,442	2,208,657

iQmethodSM - Bus Performance*

Return On Capital Employed	14.4%	12.2%	10.9%	12.9%	15.2%
Return On Equity	22.6%	20.5%	16.8%	16.8%	18.1%
Operating Margin	13.8%	13.2%	15.5%	16.5%	17.5%
EBITDA Margin	18.1%	16.9%	19.4%	22.1%	22.3%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	1.2x	0.9x	1.7x	1.5x	1.3x
Asset Replacement Ratio	6.1x	4.9x	5.1x	2.3x	2.4x
Tax Rate (Reported)	17.0%	16.1%	17.4%	9.6%	11.3%
Net Debt-to-Equity Ratio	46.2%	52.3%	24.9%	14.4%	6.0%
Interest Cover	12.7x	16.7x	16.2x	18.6x	27.6x

Key Metrics

* For full definitions of iQmethodSM measures, see page 12.

Company Description

India's largest petchem and second largest refining company, Reliance, owns a 660kbpd refinery. Along with RPL, its total refining capacity would be 1.2mbpd by 2009. It also has a 900ktpa cracker, 1mtpa polyester, 1.9mtpa polymer and over 3mtpa of fibre intermediate capacities. Refining contributes 55% to revenues with petchem contributing 43%. The company has discovered gas with initial inplace reserves of over 40tcf on the East Coast.

Investment Thesis

Share price drivers are (1) Very strong earnings growth in FY10E, (2) large reserve accretion potential, and (3) upside to valuation on diversification into organized retail (valued at Rs102/share) and SEZ (not valued). RIL's 2P reserves and resources of 4.7bn boe are from exploration of just 5pct of its Indian acreage. It is embarking on a US\$4bn exploration program of its highly prospective acreage. We believe positive news flow by way of more discoveries and reserve accretion will continue.

Stock Data

Shares / GDR	2.00
Price to Book Value	1.5x

RIL's earnings and PO cut

Singapore margin cut prompts RIL margin cut FY10-FY11E Singapore refining margin cut by 23-41%

The Singapore complex refining margins forecast for FY10E and FY11E has been cut by 23-41% to US\$4.2-5.4/bbl from US\$7.2-6.9/bbl. The cut in refining margin forecast is mainly due to expected decline in oil Asian demand and large refining capacity addition in 2009-2010E.

Table 1: Singapore refining margins cut

US\$/bbl	Revised	Old	Change
Singapore complex refining margins forecast			
FY10E	4.2	7.2	-41%
FY11E	5.4	6.9	-23%

Source: DSP Merrill Lynch

Long term refining margin unchanged at US\$6.75/bbl

Long term refining margin from FY12E has been kept unchanged at US\$6.75/bbl.

21-37% cut in RIL's FY10-FY11E refining margin forecast

RIL's FY10E margin cut to US\$6.3/bbl and FY11E margin to US\$7.8/bbl

The 23-41% cut in Singapore complex refining margin forecast has prompted a cut in RIL's FY10-FY11E refining margin forecast by 21-37%. RIL's FY10-FY11E refining margin has been cut to US\$6.3-7.8/bbl from US\$9.8-10.1/bbl.

Table 2: RIL's refining margins cut

US\$/bbl	Revised	Old	Change
RIL's refining margins forecast			
FY10E	6.3	10.1	-37%
FY11E	7.8	9.8	-21%

Source: DSP Merrill Lynch

RIL's premium to Singapore margins at US\$2.1-2.4/bbl

Table 3 gives RIL's FY10-FY11E refining margin build-up. We expect RIL's premium to benchmark Singapore margins to be US\$2.1 in FY10E and US\$2.4 in FY11E.

Table 3: RIL's refining margin build-up

US\$/bbl	FY10E	FY11E
Singapore complex refining margin forecast		
	4.2	5.4
Premium to Singapore margin due to		
RIL's ability to use heavier crude than Dubai	1.2	1.6
Cost saving from D6 gas use in place of liquid fuels	0.8	0.8
RIL's refining margin premium to Singapore complex margins	2.1	2.4
RIL's refining margin	6.3	7.8

Source: DSP Merrill Lynch

Drivers of RIL's premium to Singapore margins

Ability to process heavier crude and gain from use of gas

We have broken up the premium RIL can achieve to Singapore margins in to

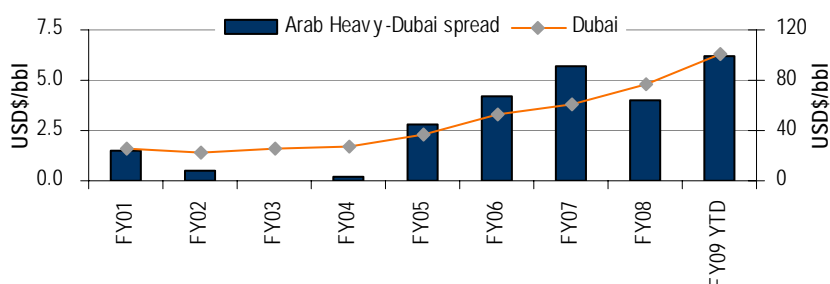
- Ability to process heavier and cheaper crude than Dubai:** RIL has ability to process crude heavier and cheaper than Dubai crude, on which benchmark Singapore complex margin is calculated

- **Gain from use of gas in place of liquid fuels:** RIL plans to use cheaper gas in place of liquid fuels to generate power, steam and hydrogen. This will mean significant cost savings and boost refining margins

RIL can use crude similar to Arab heavy, which is cheaper than Dubai
RIL can process crude with average API of 28, which is heavier than Dubai (API of 31-32), on which Singapore margin is based. The API of Arab heavy crude is 27. Thus RIL can use crude similar to Arab heavy crude.

Average premium of Arab heavy to Dubai at US\$2.8/bbl since FY01
Arab heavy crude, which RIL can process, has traded at average discount of US\$2.8/bbl to Dubai crude since FY01. The average Arab heavy-Dubai spread was at US\$1.0/bbl during FY01-FY05 and at US\$5.0/bbl during FY06-FY09 YTD.

Chart 1: Arab Heavy-Dubai crude spread trend



Source: DSP Merrill Lynch, Bloomberg

Arab heavy-Dubai spread sustained above US\$5/bbl despite oil price fall
The Arab heavy-Dubai spread averaged just US\$1/bbl in FY01-FY05 when Dubai crude price averaged US\$27.4/bbl. The spread has averaged US\$5/bbl when Dubai crude price averaged US\$71.2/bbl. Dubai crude price has declined to US\$51.4/bbl in November 2008 but the Arab heavy-Dubai spread has remained high at US\$5.8/bbl.

Table 4: Dubai crude price and Arab heavy-Dubai crude spread

US\$/bbl	Dubai price	Arab Heavy-Dubai spread
FY01-FY05	27.4	1.0
FY06-FY09 Y-t-d	71.1	5.0
4Q 2008 y-t-d	60.3	5.4
November 2008	51.4	5.8

Source: Bloomberg

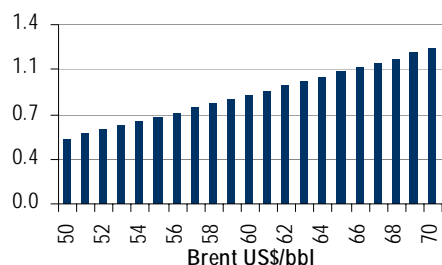
Higher oil prices than in FY01-FY05 to translate in to higher spreads

We expect Arab heavy-Dubai spread to be higher than FY01-FY05 level of US\$1/bbl if Dubai price sustains at level higher than FY01-FY05 average level of US\$27.4/bbl. We do not expect oil prices to decline to below US\$30/bbl. In the next 1-2 years RIL may thus enjoy higher crude spread than in FY01-FY05.

Crude spread may not sustain at US\$5/bbl line in last four years

Arab heavy-Dubai crude spread has sustained at over US\$5/bbl despite the steep oil price decline. However it may not sustain at these high levels in the next 1-2 years. In the past whenever OPEC has cut crude output like it has now light-heavy crude spread has shrunk. We believe this is due to the fact that OPEC countries cut output of cheaper heavier crude, which means supply of heavier crude declines at the margin. Lighter crude supply remains unchanged.

Chart 2: Upside to RIL's refining margin from use of gas at Brent price of US\$50-70/bbl



Source: DSP Merrill Lynch

Thus we expect Arab heavy-Dubai spread to be higher than average of US\$1/bbl seen in FY01-FDY05 but we do not expect it to sustain at US\$5/bbl like in last four years. It is likely to settle somewhere in between.

RIL to also gain from use of gas in place of liquid fuels in refinery

RIL plans to use gas produced from its KG D6 block in the refinery to replace liquid fuels. Liquid fuels are used in the refinery to generate power, steam and hydrogen. Gas is cheaper than liquid fuels used, which will result in cost savings and boost refining margins. Price of liquid fuels, which gas replaces, are highly sensitive to oil prices while price of KG D6 is not very sensitive to oil price. We estimate boost to RIL's refining margin from use of gas at US\$0.5/bbl when oil is at US\$50/bbl and US\$1.2/bbl when oil is at US\$70/bbl.

Weaker rupee assumed

Rupee assumed Rs45-46 (Rs42-43 earlier) in FY10-FY11E

Rupee currently at Rs50.3 vis-à-vis US dollar

We have assumed a weaker rupee in FY10-FY11E vis-à-vis US dollar than we were assuming earlier. We were earlier assuming exchange rate to be Rs42-43 but are now assuming it to be Rs45-46 (see Table 5). The rupee could be weaker than we have assumed given that it is currently at over Rs50.

Table 5: Revision in exchange rate assumption for FY10-FY11E

INR/US\$	Revised	Old	Change
Exchange rate forecast			
FY10E	46.0	43.0	7%
FY11E	45.0	42.0	7%

Source: DSP Merrill Lynch

RIL's FY10-11E earnings cut by 1-17%

Cut in refining margins main reason for earnings cut

RIL's FY10E margins cut by 37% to US\$6.3/bbl

We have cut RIL's FY10E earnings forecast by 17%. The main reason for the earnings cut is the cut in refining margin forecast of RIL by 37% to US\$6.3/bbl and that of its refining subsidiary RPL by 34% to US\$8.3/bbl. -

Table 6: RIL's earnings cut

	Revised	Old	Change
RIL's EPS for			
FY10E	133.2	160.7	-17%
FY11E	168.3	169.8	-1%

Source: DSP Merrill Lynch

EPS cut would have been steeper but for weaker rupee

RIL's FY10-11E earnings cut would have been steeper if a weaker rupee was not assumed. Weaker rupee assumption has meant 7-8% boost to FY10-FY11E earnings.

FY10E EPS cut would have been 24% if not for weaker rupee

RIL's FY10E EPS cut would have been 24% if we had just cut refining margins and not assumed weaker rupee. Assuming a weaker rupee has boosted FY10E EPS by 7% and thereby limited earning decline to 17%.

FY11E EPS cut would have been 9% if not for weaker rupee

RIL's FY11E EPS cut would have been 9% if we had just cut refining margins and not assumed weaker rupee. Assuming a weaker rupee has boosted FY11E EPS by 8% and thereby limited earning decline to just 1%.

Table 7: Break-up of RIL's FY10-FY11E EPS cut

Rs/share	FY10E	FY11E
Earlier EPS forecast	160.7	169.8
Less: Hit from cut in refining margins forecast	38.8	15.0
EPS forecast if only refining margins were cut	122.0	154.8
Add: Gain from assuming weaker rupee	11.2	13.5
Revised EPS forecast	133.2	168.3
EPS decline due to refining margins cut	-24%	-9%
EPS rise due to weaker rupee	7%	8%
Net change in EPS	-17%	-1%

Source: DSP Merrill Lynch

**FY10E EPS growth now at 25% YoY; FY11E at 26% YoY
FY11E EPS growth was 6% YoY earlier**

Based on our revised earnings RIL's FY10E EPS is 25% YoY higher. FY10E EPS growth was 50% YoY on our earlier earnings estimates. RIL's FY11E EPS growth, which was just 6% YoY based on earlier estimates, is now 26% YoY

Table 8: RIL's YoY earnings growth in FY08-FY10E

Rs-m	FY08E	FY09E	FY10E	FY11E
RIL's recurring profit	153,244	168,183	209,555	264,796
YoY change		9.7%	24.6%	26.4%
RIL recurring EPS (Rs/share)	105.4	106.9	133.2	168.3
YoY change		1.4%	24.6%	26.4%

Source: DSP Merrill Lynch

E&P 61-64% of RIL's FY10-FY11E EBIT now

Refining just 26-32% of FY10-FY11E EBIT; 39-45% of EBIT earlier

E&P will be 64% of RIL's FY10E EBIT and 61% of FY11E EBIT based on our revised estimates. It was 49-56% of FY10-FY11E EBIT as per our earlier estimates. Refining & marketing is now are expected to be 26-32% of RIL's FY10-11E EBIT as against 39-45% earlier.

Table 9: RIL's segment wise EBIT break-up

US\$m	FY08	FY09E	FY10E	FY11E
Segment wise EBIT				
Refining & marketing	2,576	2,026	1,437	2,313
Petrochemicals	1,779	1,380	471	462
E&P	375	1,132	3,512	4,492
Others	79	60	50	40
EBIT excluding other income	4,809	4,598	5,470	7,307
Segment wise EBIT break-up				
Refining & marketing	54%	44%	26%	32%
Petrochemicals	37%	30%	9%	6%
E&P	8%	25%	64%	61%
Others	2%	1%	1%	1%
	100%	100%	100%	100%
YoY EBIT growth				
Refining & marketing	51%	-21%	-29%	61%
Petrochemicals	22%	-22%	-66%	-2%
E&P	31%	202%	210%	28%
Total EBIT	39%	-4%	19%	34%

Source: DSP Merrill Lynch

RIL's FY10-FY11E EBIT cut by 2-18% in rupee terms

FY10-FY11E EBIT cut 9-23% in US dollar terms

The net impact of the cut in refining margins and assuming a weaker rupee is 2-18% cut in RIL's FY10-FY11E EBIT in rupee terms. The decline in EBIT in US dollar terms is 23% in FY10E and 9% in FY11E.

Table 10: Cut in RIL's EBIT in rupee and US dollar terms

	Rs-m			US\$m		
	Revised	Old	Change	Revised	Old	Change
RIL's EBIT in						
FY10E	256,108	311,252	-18%	5,568	7,238	-23%
FY11E	328,831	336,293	-2%	7,307	8,007	-9%

Source: DSP Merrill Lynch

FY10-FY11E refining EBIT cut by 26-55%

FY10E refining EBIT cut by US\$1.8bn and FY11E by US\$800m

FY10E refining EBIT has been cut by US\$1.8bn (55%) to US\$1.4bn from US\$3.2bn earlier. FY11E refining EBIT has been cut by US\$796m (26%) from US\$3.1bn to US\$2.3bn.

Table 11: Change in FY10-FY11E segment wise EBIT

US\$m	FY10E			FY11E		
	Revised	Old	Change	Revised	Old	Change
Segment wise EBIT						
Refining & marketing	1,437	3,195	-55%	2,313	3,109	-26%
Petrochemicals	471	372	27%	462	362	28%
E&P	3,512	3,517	0%	4,492	4,496	0%
Others	50	50	0%	40	40	0%
EBIT	5,470	7,134	-23%	7,307	8,007	-9%

Source: DSP Merrill Lynch

Existing refinery EBIT to contract US\$2bn from FY08 peak

FY10E refining EBIT of US\$1.4bn includes RPL's EBIT of US\$0.9bn

RIL's FY10-FY11E EBIT as given in Table 9 includes EBIT of RIL's refining subsidiary RPL. RPL's refining EBIT is US\$0.9-1.4bn in FY10-FY11E. Thus EBIT from RIL's existing refinery is US\$530m in FY10E and US\$880m in FY11E. This means we are assuming EBIT from RIL's existing refinery declining by US\$2.0bn in FY10E from peak level of US\$2.6bn achieved in FY08.

27-28% rise in petrochemical EBIT due to weaker rupee

Petrochemical EBIT rise US\$100m in FY10-FY11E on small base

RIL's FY10-FY11E EBIT has increased by US\$100m due to assumption of weak rupee. On a small EBIT base of US\$362-372m, US\$100m rise works out 27-28%.

RIL's PO cut by 15% to Rs1,555/share

Cut in value of refining business and investment in RPL

Refining business and RPL shares both valued on FY10E EV/EBITDA

We have cut PO of RIL by 15% to Rs1,555/share from Rs1,825/share. The cut in RIL's PO is mainly due to cut in

- Value of RIL's refining business by 56% from Rs385/share to Rs168/share. RIL's refining business is valued at 7x FY10E EBITDA
- Value of RIL's 70% stake in RPL by 39% from Rs225/share to Rs137/share. RPL has been valued at 7x FY10E EBITDA

Table 12: RIL's sum of parts valuation

INR/share	Valuation measure used	Valuation			
		USDbn	Rs-bn	Rs/share	Break-up
Business/Investment					
Petrochemicals	EV/EBITDA	7.4	339	247	16%
Refining & Marketing	EV/EBITDA	5.0	231	168	11%
Value of investment in RPL (Rs59/share)	EV/EBITDA	4.1	187	137	9%
Exploration & production	DCF	27.4	1,235	900	58%
Retail	DCF	3.0	140	102	7%
Sum of parts valuation		47.0	2,133	1,555	100%
No of shares (excluding treasury shares)				1,372	

Source: DSP Merrill Lynch

Petrochemical valuation up by 12% due to weaker rupee
Weaker rupee boosted EBITDA; still valued on 8x FY10E EBITDA
RIL's petrochemical business valuation is up 12% to Rs247/share from Rs220/share. The rise in valuation is due to assuming weaker rupee, which boosted FY10E petrochemical EBITDA of RIL. We continue to value the petrochemical business on 8x FY10E EBITDA.

Table 13: RIL's revised PO and sum of parts valuation

Rs/share			
Business/Investment	Revised	Old	Change
Petrochemicals	247	220	12%
Refining & Marketing	168	385	-56%
Value of investment in RPL (Rs103/share)	137	225	-39%
Exploration & production	900	893	1%
Retail	102	102	0%
Sum of parts valuation	1,555	1,825	-15%

Source: DSP Merrill Lynch

E&P is 58% of RIL's revised PO; refining including RPL 20%
Refining including was 33% of RIL's earlier PO
Refining including value of RPL investment is now just 20% of RIL's PO. It was earlier 33% of RIL's PO. E&P is now 58% (49% earlier) while petrochemicals is 16% (12% earlier) of RIL's PO. Retail is 7% of RIL's revised PO.

Sensitivity analysis

Sensitivity of PO and FY10E EPS to refining margins

FY10E EPS to change Rs13.6 for US\$1/bbl change in Singapore margins

RIL continues to be highly sensitive to refining margin assumption. The change in FY10E EPS is Rs13.6 for every US\$1/bbl change in Singapore complex refining margin. It is US\$4.2/bbl in the base case.

Table 14: Sensitivity of RIL's FY10E EPS and fair value to Singapore complex refining margins

Rs/share	FY10E EPS	Fair value
Singapore complex refining margin (US\$/bbl)		
4.0	130.1	1,525
4.2 (base case)	133.2	1,555
5.0	143.7	1,655
6.0	157.3	1,786
7.0	170.9	1,916

Source: DSP Merrill Lynch

PO to change by Rs130/share for US\$1/bbl change in Singapore margins

The change in RIL's fair value to every US\$1/bbl change in Singapore complex refining margin is Rs130/share.

Sensitivity of PO and FY10E EPS to exchange rate

Table 15 gives sensitivity of RIL's FY10E earnings to exchange rate. Exchange rate is Rs46 vis-à-vis US dollar in base case.

Table 15: Sensitivity of RIL's FY10E EPS to exchange rate

INR/US\$	FY10E EPS (Rs/share)	Change vis-à-vis base case
42	118.2	-11%
43	122.0	-8%
44	125.7	-6%
45	129.5	-3%
46 (base case)	133.2	0%
47	136.9	3%
48	140.6	6%
49	144.3	8%
50	148.0	11%

Source: DSP Merrill Lynch

Table 16 gives sensitivity of RIL's fair value to exchange rate. Exchange rate is Rs46 vis-à-vis US dollar in base case.

Table 16: Sensitivity of RIL's fair value to exchange rate

INR/US\$	Fair value (Rs/share)	Change vis-à-vis base case
42	1,403	-10%
43	1,441	-7%
44	1,479	-5%
45	1,517	-2%
46 (base case)	1,555	0%
47	1,592	2%
48	1,629	5%
49	1,667	7%
50	1,704	10%

Source: DSP Merrill Lynch

Downside to PO of Rs40/share if long term oil at US\$50/bbl

Our PO continues to be based on assumption of long term oil price to be US\$90/bbl. FY10-FY11E oil price is assumed to be US\$50/bbl and US\$70/bbl respectively. The downside to RIL's E&P valuation and PO is Rs40/share if long term oil price is assumed to be US\$50/bbl.

Retain Buy

FY10-FY11E EPS cut 1-17% despite US\$0.7-1.7bn EBIT cut

Weaker rupee helped to limit earnings cut; 9-24% otherwise

FY10E EBIT of RIL has been cut by US\$1.7bn following the steep cut in refining margin forecast. FY11E EBIT has been cut by US\$700m. The cut in FY10E earnings is 17% while that in FY11E earnings is just 1%. The cut in FY10E earnings would have been 24% in FY10E and 9% in FY11E if it had not been for assumption of a weaker rupee. The exchange rate vis-à-vis US dollar is assumed at Rs45-46 in FY10-FY11E as against Rs42-43 earlier.

25% 2-year EPS CAGR to FY11E despite earnings cut

FY10E EPS to be 25% YoY higher and FY11E 26% YoY higher

We still expect FY10E EPS of RIL to rise by 25% YoY and FY11E EPS by 26% YoY despite the earnings cut. The earnings growth will be driven by

- 0.6m bpoed of oil and gas production in the next 12-18 months from the KG D6 block
- Addition of 0.58m bpd refining capacity of RPL. RPL's refinery is more complex than RIL and it is likely to be more profitable, too

The 2-year EPS CAGR to FY11E is now 25%.

45% potential upside at revised PO of Rs1,555/share

The PO of RIL has been cut by 15% to Rs1,555/share. The revised PO still offers 45% potential upside. We retain Buy on RIL.

Price objective basis & risk

Reliance Inds (XRELF / RLNIY)

Our PO of Rs1,555 (GDR US\$79.72) is based on a sum of parts valuation. The value of the refining and petrochemical business has been calculated on an EV/EBITDA basis using multiple of 7-8x on FY10E EBITDA. The value of its investment in Reliance Petroleum (RPL) is calculated by applying the EV/EBITDA based value of RPL (multiple of 7x FY10E EBITDA) to RIL's holding in RPL. Oil and gas reserves and resources, as well as its retail business, are valued on a DCF basis using WACC of 11.8%. Refining and marketing, including investment in RPL, is 20pct of PO, E&P valuation (Rs900) 58pct, petrochemicals 16pct and organized retail 7pct. Risks are (1) Decline in refining and petrochemical margins being steeper than expected, (2) Lower than expected oil price. (3) huge disappointments on the E&P front as we have valued exploration upside of Rs154/share, (4) failure in the retail business, and (5) changes in government policies (eg, withdrawal of the tax holiday) which may have a direct impact on the business, cash flow and profit.

Analyst Certification

I, Vidyadhar Ginde, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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APR - Energy Coverage Cluster

Investment rating	Company	ML ticker	Bloomberg symbol	Analyst
BUY	Cairn India	XCANF	CAIR IN	Vidyadhar Ginde
	China BlueChem	CBLUF	3983 HK	Timothy Bush
	CNOOC Ltd.	CEO	CEO US	Bin Guan
	CNOOC Ltd.	CEOHF	883 HK	Bin Guan
	COS Limited	CHOLF	2883 HK	Bin Guan

03 December 2008

APR - Energy Coverage Cluster

Investment rating	Company	ML ticker	Bloomberg symbol	Analyst
	Hindustan Petro.	XHTPF	HPCL IN	Vidyadhar Ginde
	IOC	IOCOF	IOCL IN	Vidyadhar Ginde
	ONGC	ONGCF	ONGC IN	Vidyadhar Ginde
	Reliance Inds	XRELF	RIL IN	Vidyadhar Ginde
	Reliance Inds -G	RLNIY	RIGD LI	Vidyadhar Ginde
	Sinofert HLDG	SNFRF	297 HK	Timothy Bush
	SK Energy Co Ltd	XVERF	096770 KS	Sonia Song
	SK Holdings	SKCXF	003600 KS	Sonia Song
NEUTRAL				
	Aban Offshore L	XBWTF	ABAN IN	Vidyadhar Ginde
	BPCL	XBPCF	BPCL IN	Vidyadhar Ginde
	Gushan Environmental Energy	GU	GU US	Bin Guan
	Shell Refining	SRMMF	SHELL MK	Sonia Song
UNDERPERFORM				
	Formosa Chems	XFUMF	1326 TT	Sonia Song
	Formosa Petro	FPTCF	6505 TT	Sonia Song
	Formosa Plastics	FSAPF	1301 TT	Sonia Song
	GS Holdings Corp	GSHDF	078930 KS	Duke Suttikulpanich
	Hanwha Chem Corp	HAYCF	009830 KS	Stephan Han
	Honam Petrochem	HHBHF	011170 KS	Stephan Han
	LG Chem Ltd	LGCLF	051910 KS	Stephan Han
	Nan Ya Plastics	NNYPF	1303 TT	Sonia Song
	Petrochina	PCCYF	857 HK	Bin Guan
	Petrochina - A	PTR	PTR US	Bin Guan
	Petronet LNG Ltd	POLNF	PLNG IN	Vidyadhar Ginde
	RPL	RPLUF	RPET IN	Vidyadhar Ginde
	Sinopec	SNPMF	386 HK	Bin Guan
	Sinopec - A	SNP	SNP US	Bin Guan
	S-Oil Corp	SOOCF	010950 KS	Duke Suttikulpanich
	SPC	SPCJF	SPC SP	Duke Suttikulpanich

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Sales Other LT Liabilities	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

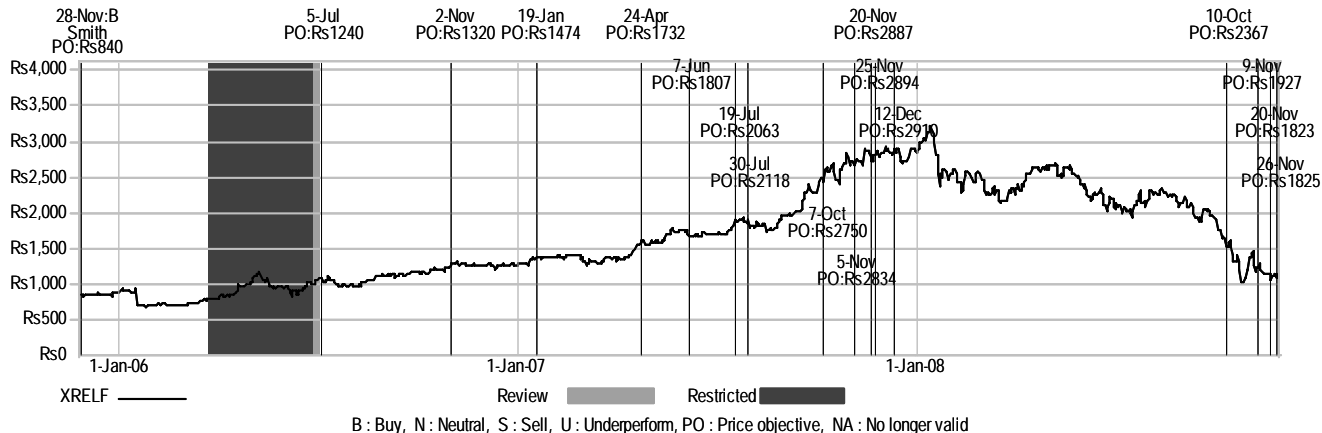
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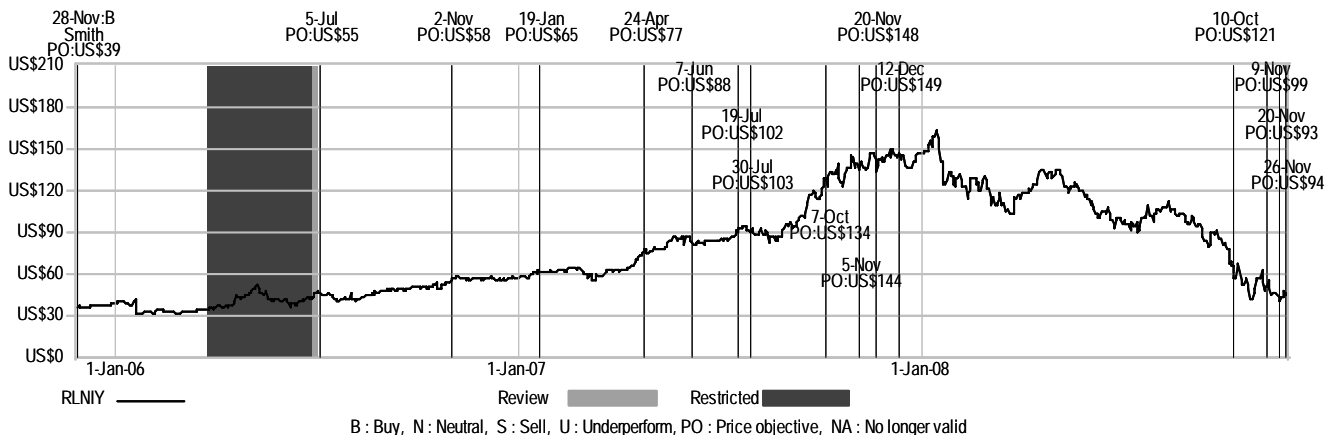
Important Disclosures

XRELF Price Chart



Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of October 31, 2008 or such later date as indicated.

RLNIY Price Chart



Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of October 31, 2008 or such later date as indicated.

Investment Rating Distribution: Chemicals Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	41	45.56%	Buy	10	28.57%
Neutral	23	25.56%	Neutral	4	21.05%
Sell	26	28.89%	Sell	3	12.50%

Investment Rating Distribution: Global Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1647	45.31%	Buy	429	28.83%
Neutral	858	23.60%	Neutral	240	31.41%
Sell	1130	31.09%	Sell	227	22.02%

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