Equity | India | Integrated Oil & Gas

RBS The Royal Bank of Scotland

17 February 2010

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Reliance Industries

Tempering E&P expectations

We reduce our expectations on volumes and profitability of KG-D6 oil/gas and, thus, marginally lower our net profit estimates for RIL despite some upside to its refining and petrochemical margins. Net debt has also remained well above our estimates despite lower capex. We maintain Sell, with a Rs815 target price.

Sell

Target price
Rs815.00 (from Rs812.50)

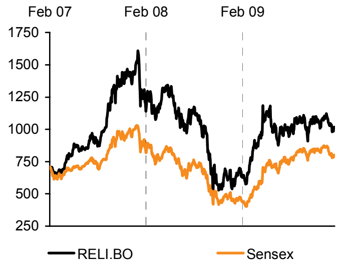
Price
Rs1017.75

Short term (0-60 days)
n/a

Market view
Underweight

Price performance

	(1M)	(3M)	(12M)
Price (Rs)	1111	1077	660.1
Absolute (%)	-8.4	-5.5	54.2
Rel market (%)	-0.9	-0.8	-11.6
Rel sector (%)	0.6	-7.3	3.0



Market capitalisation
Rs3.33t (US$72.06bn)

Average (12M) daily turnover
Rs9624.92m (US$200.83m)

Sector: BBG AP Chemicals
RIC: RELI.BO, RIL IN
Priced Rs1017.75 at close 16 Feb 2010.
Source: Bloomberg

Key forecasts

	FY08A	FY09A	FY10F	FY11F	FY12F
Revenue (Rsm)	1,334,430	1,418,475	2,579,267	2,945,714	3,219,622
EBITDA (Rsm)	223,191	238,087	300,803	373,986	428,480
Reported net profit (Rsm)	194,584	153,094	165,008	194,674 ▼	230,127
Normalised net profit (Rsm)¹	152,650	153,094	165,008	194,674	230,127
Normalised EPS (Rs)	60.8	55.3	56.6	65.4 ▼	77.3
Dividend per share (Rs)	6.5	6.5	6.5	8	8
Dividend yield (%)	0.64	0.64	0.64	0.79	0.79
Normalised PE (x)	16.7	18.4	18	15.6	13.2
EV/EBITDA (x)	16.7	16	12.6	10.1	8.6
Price/book value (x)	3.8	2.87	2.65	2.36	2.04
ROIC (%)	13.3	10.4	8.39	9.68	10.8

Use of ▲ ▼ indicates that the line item has changed by at least 5%.
year to Mar, fully diluted
1. Post-goodwill amortisation and pre-exceptional items
Accounting standard: Local GAAP
Source: Company data, RBS forecasts

KG-D6's lower profitability leads to earnings cut

We have reduced our KG-D6 gas volume assumptions over FY10-11 by 10%, and our oil volume assumptions by a sharper 30-50%. We expected full cost accounting in E&P to lead to higher depletion rates, but the actual rates have been even higher than we estimated. The effective interest rate in 3QFY10 was just 3.7%, which we expect to rise to 6.3% by FY12 as global interest rates normalise. Given RIL's rising net debt, its recent sale of treasury stocks seems a logical move to reduce gearing, even without considering any potential acquisitions. Overall, we have reduced our FY10-12 EPS estimates by 2-7%.

Caution on margin cycles

Singapore Complex gross refining margins (GRMs) have strengthened in 4QFY10 to date, to US$5/bbl, from US$1.92/bbl in 3QFY10, and most of the upside has been driven by petrol. We maintain that the current uptick is unsustainable, given the low levels of global capacity utilisation. Petrochemical margins have also been stronger than we anticipated, but we expect them to weaken post 1QFY11 as new capacity comes online.

We maintain Sell, with a target price of Rs815

We maintain our Sell rating on RIL with a sum-of-the-parts target price of Rs815 (up from Rs812.50). Our FY11-12 EPS estimates are 20% below Bloomberg consensus, and we see a drop in refining and petrochemical margins as the key trigger to achieve our target price. Positive exploration news may provide upside, but our valuation already factors in significant exploration upside.

Analyst

Avadhoot Sabnis
India
+91 22 6715 5302
avadhoot.sabnis@rbs.com

83/84 Sakhar Bhawan, Nariman Point,
Mumbai 400 021, India

http://research.rbsm.com

Tempering E&P expectations

RIL's stock underperformance over the last 12 months (-12% vs the Sensex) reflects the disappointment over its E&P profitability and rising net debt. The stock price now seems to assume the current refining and petrochemical margins are sustainable (we see downside).

KG-D6's lower profitability leads to earnings cut

Slower ramp-up of KG-D6 volumes

We had earlier assumed that the KG-D6 block would achieve peak production of 89mmscmd of gas and 40kbd of oil from 1 April 2010. We now cut our estimates on both counts.

In the case of oil, production during 9MFY10 averaged 8-10kbd and RIL is providing no guidance on how soon this would be ramped up to peak capacity (and also what the peak capacity level would be). Production in 3QFY10 was from three producing wells, while an additional two are due to come online by end-February 2010. RIL's partner in the block, Niko Resources, has reduced its peak oil production guidance from 40kbd to 35kbd.

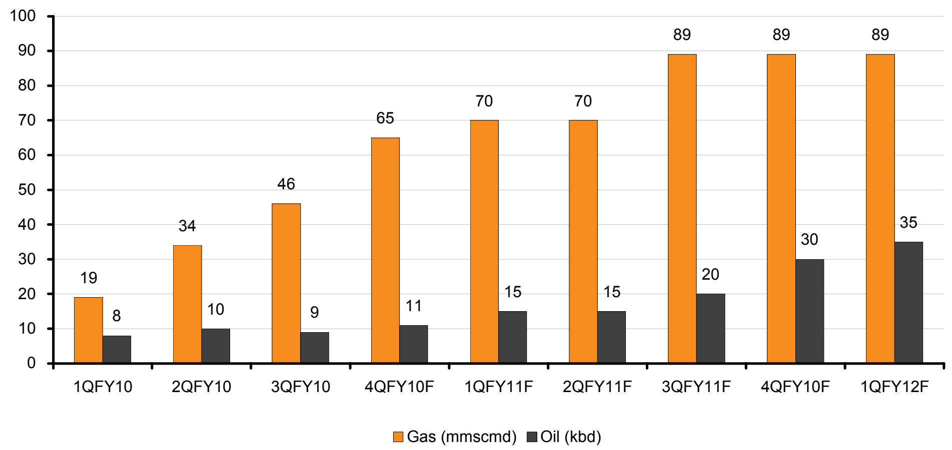
Consequently, we lower our peak oil production estimate from 40kbd to 35kbd and expect this to be achieved only from FY12. We reduce our FY10 and FY11 estimates, from 14kbd to 10kbd and from 40kbd to 20kbd, respectively.

In relation to gas, RIL achieved a production of 46mmscmd in 3QFY10 and is currently producing at the rate of 60mmscmd. The Indian government (GOI) has allocated gas to customers to the extent of 60mmcmd on a firm basis with additional fallback allocation of 30mmscmd. Following this allocation, RIL has current gas sales contracts for 61mmscmd.

RIL now believes that additional gas demand is mainly along GAIL's HVJ pipeline, where there is a capacity constraint. All customers who have pipeline connections with RIL gas (other than those on HVJ) are drawing their maximum quantity. In fact, RIL's own plants are consuming 9mmscmd as against a GOI allocation of 4mmscmd. So, peak production capacity is unlikely to be achieved until the HVJ pipeline is fully expanded (which GAIL has estimated by October 2010).

We now assume that 4QFY10 production will average 65mmscmd, resulting in an FY10 average of 41mmscmd (earlier estimate: 45mmscmd). We reduce our FY11 estimate from 89mmscmd to 80mmscmd, while maintaining our FY12 estimate at 89mmscmd.

Chart 1 : KG-D6 oil/gas production



Source: Company data, RBS forecasts

Table 1 : EPS sensitivity to changes in oil prices and KG-D6 oil production

Year to 31 March	2010F	2011F	2012F
Current estimates			
KG-D6 oil production (gross) -000 bbls/d	10	20	35
Crude oil (Brent) price US$/bbl	69.00	74.00	82.00
EPS (Rs)	56.6	65.4	77.3
EPS sensitivity for US$5/bbl change in oil price	1.41%	1.21%	1.37%
EPS sensitivity for 10% change in output	0.67%	0.86%	1.37%

Source: RBS forecasts

Table 2 : EPS sensitivity to changes in gas prices and KG-D6 gas output

Year to 31 March	2010F	2011F	2012F
Current estimates			
KG-D6 gas production (gross)- mmscmd	41.0	80.0	89.0
KG-D6 gas price (US$/mmbtu)	4.20	4.20	4.20
EPS (Rs)	56.6	65.4	77.3
EPS sensitivity for US$0.5/mmbtu change in gas price	4.93%	7.59%	7.06%
EPS sensitivity for 10% change in output	2.84%	5.94%	5.54%

Source: RBS forecasts

Higher depletion rates depressing bottom-line numbers

RIL follows the full-cost method of accounting, under which all costs incurred in E&P (including the cost of seismic surveys and dry wells) are capitalised, considering the country as a cost centre. These are then charged to the P&L via a depletion charge (included in depreciation costs), which is based on the ratio of oil/gas production to total proved reserves at beginning of the year. Other larger E&P players like ONGC/OIL/Cairn follow the successful-efforts method under which the cost of seismic surveys and dry wells is charged to the P&L in the year when they are incurred (or when the results of well drilling are known).

The full-cost method has allowed RIL to capitalise the cost of all its E&P spending. Since the KG-D6 reserves had been added to total proved reserves category, but were not producing, the depletion charge till FY09 was relatively low. With the commencement of production from KG-D6, the depletion charge will now rise sharply. So what is now getting included in the depletion charge is not just the cost of developing the entire KG-D6 block, but also the spending on other E&P blocks in the country.

The impact in simplistic terms can be gauged by looking at the production to reserve numbers (see table below). Historical numbers show that RIL's oil/gas production to opening proved reserve ratio was in the 1-1.2% range in the last five years. Based on our estimates of production, this ratio will rise to 7% in FY10 and 13.6% in FY11, causing a sharp rise in depletion rates as production increases.
The depletion rate in 9MFY10 appears to be in line with the 7% rate projected for FY10. For FY11, we have assumed a lower rate of 9% (compared to the 13.6% indicated above), by assuming additions to proved reserves by end-FY10.

So, while in the petrochemical and refining business the depreciation charge kicks in upfront as the plant starts commercial operations (providing operational gearing as capacity utilisation increases), in RIL's E&P business, the absolute depletion charge will keep moving up in line with the rise in production.

Table 3 : RIL changes in proved reserves and E&P depletion rate

Year to 31 March	2005	2006	2007	2008	2009	2010F	2011F
Oil (mt)							
Opening balance	5.18	5.70	6.71	12.47	11.64	11.02	9.79
Additions	0.95	1.53	6.33		0.12		
Deletion				-0.16			
Production	-0.43	-0.52	-0.57	-0.67	-0.74	-1.23	-1.50
Closing balance	5.70	6.71	12.47	11.64	11.02	9.79	8.29
Natural gas (bcm)							
Opening balance	136.44	172.63	178.67	222.15	222.19	220.47	205.44
Additions	37.23	7.17	44.68	1.71	0.17		
Deletion							
Production	-1.04	-1.12	-1.21	-1.66	-1.89	-15.03	-27.83
Closing balance	172.63	178.67	222.15	222.19	220.47	205.44	177.61
Gas reserves in terms of tcf	6.10	6.31	7.85	7.85	7.79	7.26	6.27
Gas reserves in terms of mtoe	155.36	160.80	199.93	199.97	198.42	184.89	159.85
Total oil/gas reserves m toe	161.06	167.51	212.40	211.61	209.44	194.68	168.14
Depletion rate based on current proved reserves	**1.1%**	**1.0%**	**1.0%**	**1.0%**	**1.2%**	**7.0%**	**13.6%**

Source: Company data, RBS forecasts

The financial impact of the depletion rates has been evident in quarterly results, as rising depreciation charges have reduced the EBIT contribution of the E&P segment. 3QFY10 depreciation charge of Rs27.95bn would call for an annual figure of Rs112bn, assuming gas production at the 3QFY10 level of 46mmscmd. With production forecast to rise, depreciation charges will also rise in tandem, unless there is a substantial addition to the proved reserves number. We have accordingly raised our total depreciation estimates by 7-10%.

Even after considering the enhanced depletion rate, the lifting costs for the KG-D6 block appear unusually high. RIL's management has not disclosed specific lifting cost numbers and we assume these costs will fall in FY11 and beyond, as plateau production numbers are achieved.

Table 4 : RIL standalone quarterly results (Rs m)

	3QFY09	4QFY09	1QFY10	2QFY10	3QFY10	yoy	qoq
Net sales	**315,630**	**283,620**	**311,870**	**468,480**	**568,560**	**80.1%**	**21.4%**
Expenditure							
Inc/dec in stock	39,340	20,770	(31,560)	(28,040)	17,880	-54.6%	-163.8%
Raw materials	162,610	123,840	247,150	375,050	426,190	162.1%	13.6%
Purchases	26,200	58,070	3,970	11,980	7,940	-69.7%	-33.7%
Staff cost	6,050	5,140	5,570	5,960	5,760	-4.8%	-3.4%
Other expenditure	27,800	21,430	22,900	31,360	32,350	16.4%	3.2%
Total	262,000	229,250	248,030	396,310	490,120	87.1%	23.7%
EBITDA	**53,630**	**54,370**	**63,840**	**72,170**	**78,440**	**46.3%**	**8.7%**
EBITDA margins	*17.0*	*19.2*	*20.5*	*15.4*	*13.8*		
Interest	(4,840)	(4,770)	(4,600)	(4,620)	(5,500)	13.6%	19.0%
Depreciation	(13,170)	(13,270)	(18,780)	(24,320)	(27,950)	112.2%	14.9%
Non-op income	6,630	6,230	7,090	6,280	5,080	-23.4%	-19.1%
Profit before tax	42,250	42,560	47,550	49,510	50,070	18.5%	1.1%
Current tax	(4,990)	(4,850)	(7,910)	(8,000)	(6,990)	40.1%	-12.6%
Deferred tax	(2,250)	(2,250)	(2,980)	(2,990)	(3,000)	33.3%	0.3%
Net profit	**35,010**	**35,460**	**36,660**	**38,520**	**40,080**	**14.5%**	**4.0%**
Total tax (current + deferred)	*17.1%*	*16.7%*	*22.9%*	*22.2%*	*20.0%*		
Debt Position (RPET merged from 4QFY09)							
Gross debt	560,000	739,040	728,350	713,490	700,080	25.0%	-1.9%
Cash	285,000	250,520	220,840	194,210	159,590	-44.0%	-17.8%
Net debt	275,000	488,520	507,510	519,280	540,490	96.5%	4.1%
Segment-wise revenue							
Petrochemicals	126,230	97,240	117,070	133,400	147,560	16.9%	10.6%
Refining	217,400	216,310	244,340	395,640	480,000	120.8%	21.3%
Oil & gas	10,310	7,360	18,640	29,370	35,300	242.4%	20.2%
Others	1,710	2,100	830	920	950	-44.4%	3.3%
Gross turnover	355,650	323,010	380,880	559,330	663,810	86.6%	18.7%
Segment EBIT							
Petrochemicals	16,570	17,220	21,090	21,950	20,550	24.0%	-6.4%
Refining	18,810	19,530	12,990	13,470	13,790	-26.7%	2.4%
Oil & gas	6,050	4,730	10,080	12,260	14,770	144.1%	20.5%
Others	70	120	90	110	110	57.1%	0.0%
Total	**41,500**	**41,600**	**44,250**	**47,790**	**49,220**	**18.6%**	**3.0%**

Source: Company data

Rising net debt despite commissioning of projects

As shown in the above table, net debt has been rising in the last three quarters, from Rs488bn as on 31 March 2009 to Rs540bn as on 31 December 2009. This rise is despite commissioning of all major projects (RPET refinery, KG-D6 gas production), sale of treasury shares of Rs31.9bn and after positive adjustment of forex gains of Rs37bn.

In the current quarter, RIL has sold additional treasury shares raising Rs61bn, and there is market expectation that this fund-raising is in view of possible acquisition opportunities around the globe (note that RIL has officially made a non-binding bid for LyondellBasell). However, given the point of rising net debt, we believe that sale of treasury shares is a logical move to reduce gearing, even without considering potential acquisitions.

Table 5 : RIL sale of treasury shares

Date	No of shares (m)	Price (Rs)	Amount (Rs m)	Amount (US$m)	Previous day closing price	Discount
17-Sep-09	30.0*	1062.5*	31,875	661.96	1092.00	-2.7%
4-Jan-10	25.9	1035.0	26,755	577.78	1090.55	-5.1%
11-Jan-10	33.0	1050.0	34,661	763.70	1103.15	-4.8%
Total	**88.9**		**93,290**	**2,003**		

*adjusted for subsequent 1:1 bonus issue
Source: Company data, Bloomberg

Based on RIL's press release, capex in 3QFY10 would work out to just Rs0.26bn (based on capex for 9M less 1H). RIL has clarified that till FY09 the capex numbers disclosed reflected actual cash spending on fixed assets. From FY10 onwards, the capex figures will be based on the balance sheet figures and would include adjustments for interest capitalisation and forex gains/losses. Note that RIL follows Indian GAAP, which allows forex differences on loans taken for purchase of fixed assets to be adjusted against the cost of the asset.

We have obtained full details from management on quarterly numbers. During 9MFY10, the cash spending on assets was Rs107.7bn. The disclosed capex figure was Rs78.6bn, which was the balance sheet figure after adjusting for interest capitalised of Rs8.6bn and forex gain of Rs37.7bn. In addition to this asset spending, RIL has paid Rs53.75bn to creditors for capex, reducing their balance from Rs167.9bn at end-FY09 to Rs114bn at end-December 2009. These creditors (who are not part of the normal working capital cycle creditors) would need to be paid over the next few quarters, reducing the ability to cut net debt levels sharply.

The cash spending on assets has been below our estimates, but appears logical given the slower ramp-up of KG-D6 gas production. Management estimates total KG-D6 gas capex for D1/D3 fields at US$8.9bn, out of which first phase to reach 80mmscmd was estimated at US$5.2bn and another US$3.7bn was estimated in phase 2 to maintain plateau levels. Given the delayed ramp-up, we now estimate phase 2 capex will start only from FY11 (FY10 assumed earlier).

Using the above figures on cash spending, we have attempted a cash flow reconciliation. The cash flow from operations works out to Rs186.7bn for 9MFY10. After considering cash outflow on creditors and fixed assets and sale of treasury shares (no dividend was payable during 9MFY10), net debt before working capital should have reduced by Rs57bn. Since actual net debt has risen by Rs52bn over this period, we estimate that working capital would have increased Rs109bn. Our estimate of working capital as at end-FY09 is Rs57bn (note that this excludes creditors for capex and the loans given to subsidiaries, which we classify as investments).

Table 6 : Fixed assets and net debt reconciliation (Rs bn)

	1Q	2Q	3Q	9MFY10
(a) Actual cash spending on fixed assets	37.66	55.82	14.24	107.72
Interest capitalised	4.35	3.23	1.02	8.60
Forex capitalised/(decapitailsed)	(26.31)	3.61	(15.00)	(37.70)
Disclosed capex	15.70	62.66	0.26	78.62
(b) Creditors for capex (increase)/decline	9.14	3.95	40.66	53.75
Cash outgo on fixed assets and creditors reduction (a+b)	**46.80**	**59.77**	**54.90**	**161.47**
EBITDA	63.84	72.17	78.44	214.45
Other income	7.09	6.28	5.08	18.45
Interest paid (including capitalised)	(8.95)	(7.85)	(6.52)	(23.32)
Cash tax paid	(7.91)	(8.00)	(6.99)	(22.90)
Cash flow from operations	54.07	62.60	70.01	186.68
Cash outgo on fixed assets and creditors reduction	(46.80)	(59.77)	(54.90)	(161.47)
Dividends paid (FY09 paid as interim dividend in FY09 itself)				
Sale of treasury stock		31.88		31.88
Increase/(decrease) in net debt before working capital	(7.27)	(34.71)	(15.11)	(57.09)
Actual increase/(decrease) in net debt qoq	18.99	11.77	21.21	51.97
Implied increase in working capital (excluding creditors for capex)	**26.26**	**46.48**	**36.32**	**109.06**

Source: Company data, RBS estimates

Interest rates expected to rise

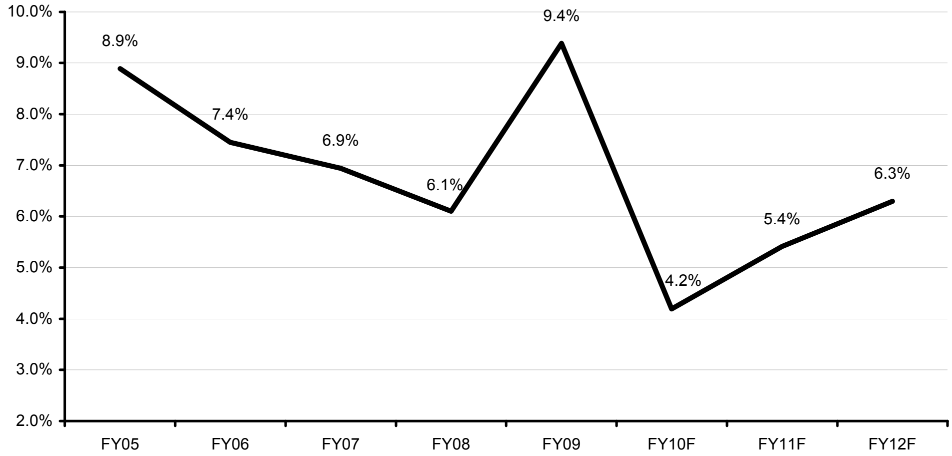
We estimate that, after considering the figures on interest capitalised, the average interest cost on RIL debt has shrunk dramatically from over 10% in 3QFY09 to just 3.7% in 3QFY10. This is partly in line with the reduction in Libor, as nearly 80% of RIL's debt is in foreign currency. Going forward, we expect a partial reversion to mean as interest rates move up. We forecast the average interest cost will go up to 6.3% in FY12, from 4.2% in FY10F. This would result in a sharp 50% rise in interest costs, as the interest capitalised figures would also come down substantially.

Table 7 : RIL quarterly interest rates

	1QFY09	2QFY09	3QFY09	4QFY09	1QFY10	2QFY10	3QFY10
Total debt (Rs m)	374,000	380,000	560,000	534,570	728,350	713,490	700,080
Interest expensed (Rs m)	2940	4370	4840	4770	4600	4620	5500
Interest capitalised (Rs m)	4800	7000	7350	6170	4350	3230	1020
Total interest paid (Rs m)	7740	11370	12190	10940	8950	7850	6520
Weighted average interest cost	8.4%	12.1%	10.4%	8.0%	4.9%	4.4%	3.7%
12m daily Libor	3.1%	3.3%	3.0%	2.0%	1.8%	1.4%	1.1%

Note: Figures for 1QFY10 onwards reflect the impact of RPET merger
Source: Company data, RBS forecasts

Chart 2 : RIL annual interest rates



Source: Company data, RBS forecasts

EPS estimates cut by 2-7%

The decline in E&P profitability arising from lower oil/gas volumes and the higher depletion rate has more than offset the upside from the delayed downtrend in petrochemical margins that we were anticipating. Our earnings assumptions at the EBITDA level have hardly changed over FY10-12.

Note that we calculate our EPS and target price based on net shares outstanding (excluding treasury stock). Hence, we have increased our shares outstanding to consider the three tranches of the treasury stock sale. Bloomberg consensus EPS estimates, on the other hand, are based on gross shares outstanding, so we adjust our EPS numbers for gross shares when comparing with consensus estimates.

Table 8 : Changes in estimates

Year to 31 March	2010F	2011F	2012F
Net profit (Rs m)			
Revised	165,008	194,674	230,127
Previous	167,429	205,767	236,019
Change	*-1.4%*	*-5.4%*	*-2.5%*
EPS (Rs)			
Revised	56.6	65.4	77.3
Previous	57.7	70.5	80.9
Change	*-2.0%*	*-7.2%*	*-4.4%*
EPS (based on gross shares)			
RBS current estimate	50.2	59.2	70.0
Consensus	52.9	75.2	87.8
RBS vs consensus	*-5%*	*-21%*	*-20%*

Source: RBS forecasts, Bloomberg consensus

Table 9 : RIL earnings

Year to 31 March (Rs m)	2008	2009	2010F	2011F	2012F
Segmental EBITDA					
Petrochemicals	79,926	95,386	109,511	60,252	51,996
Old refinery	119,116	113,302	48,732	52,927	61,628
RPET			46,480	67,768	87,680
PMT	24,149	29,399	26,015	26,599	27,187
KG D6			70,064	166,440	199,989
Total	223,191	238,087	300,803	373,986	428,480
EBITDA share %					
Petrochemicals	36%	40%	36%	16%	12%
Refining & Marketing	53%	48%	32%	32%	35%
E&P	11%	12%	32%	52%	53%
Depreciation	(48,471)	(51,953)	(102,765)	(125,629)	(127,791)
Interest	(10,774)	(17,452)	(20,193)	(31,918)	(35,692)
Forex gains/(losses)	9,868	(4,947)	7,000	7,000	6,000
Non-op income	8,953	20,599	25,627	21,434	18,471
Exceptional item-sale of RPL shares	47,335				
Profit before tax	230,103	184,333	210,473	244,873	289,468
Tax	(35,519)	(31,239)	(45,465)	(50,199)	(59,341)
Effective tax rate	15%	17%	22%	21%	21%
Net profit	**194,584**	**153,094**	**165,008**	**194,674**	**230,127**
EPS (Rs)	77.5	55.3	56.6	65.4	77.3
EPS (excluding exceptionals) (Rs)	60.8	55.3	56.6	65.4	77.3

Source: Company data, RBS forecasts

Table 10 : Key assumptions

Year to 31 March	2008	2009	2010F	2011F	2012F
Exchange rate year average (Rs/USD)	40.27	46.03	47.50	46.00	45.00
Refining & Marketing					
RIL consolidated throughput (mt)	31.80	32.01	60.86	65.55	65.55
RIL consolidated GRM (US$/bbl)	15.0	12.2	6.7	7.2	8.7
E&P					
PMT oil production (gross) - bbls/d	44,770	39,439	41,808	41,808	41,808
PMT gas production (gross)- mmscmd	14.8	16.1	14.0	14.5	14.0
KG-D6 gas production (gross)- mmscmd			41.0	80.0	89.0
KG-D6 gas price (US$/mmbtu)			4.20	4.20	4.20
KG-D6 oil production (gross) -000 bbls/d			10	20	35
Crude oil (Brent) price US$/bbl	82.4	84.80	69.00	74.00	82.00
Petrochemicals					
Production key segments					
Polyester 000t (PFY, PSF, PET)	1,572	1,534	1,582	1,618	1,618
Fiber Intermediates 000t (PX, PTA, MEG)	4,714	4,583	4,573	4,573	4,573
Polymers 000t (PE, PP, PVC)	3,374	3,076	4,054	4,274	4,274
Cracker (ethylene production) 000t	1,889	1,757	1,760	1,744	1,744
Margins (US$/t) key products					
PP less naphtha	611	566	535	390	380
PE less naphtha	671	593	615	435	400
PX less naphtha	352	345	420	320	300
PTA less naphtha	400	390	501	394	401
MEG less naphtha	717	317	386	336	305
PFY less naphtha	972	828	894	873	850
PSF less naphtha	590	492	584	508	485

Source: Company data, RBS forecasts

Table 11 : Changes in key assumptions, margins (US$/t)

Year to 31 March	2010F	2011F
PP less naphtha		
New	535	390
Old	470	300
PE less naphtha		
New	615	435
Old	550	350
PX less naphtha		
New	420	320
Old	370	250
PTA less naphtha		
New	501	394
Old	448	348
MEG less naphtha		
New	386	336
Old	314	286
PFY less naphtha		
New	894	873
Old	835	820
PSF less naphtha		
New	584	508
Old	535	455
GRM (US$/bbl)		
New	6.7	7.2
Old	6.1	6.9
KG-D6 gas production (gross)- mmscmd		
New	41.0	80.0
Old	45.0	89.0
KG-D6 oil production (gross) -000 bbls/d		
New	10	20
Old	14	40

Source: RBS forecasts

Caution on margin cycles

Recent GRM uptick not sustainable

Regional GRMs have improved substantially in the current quarter, after a sharp dip in 3QFY10. While we were expecting some bounce on a qoq basis, most of the upside has come from gasoline where margins have been very strong. Improvements in middle distillate (diesel/jet fuel) margins and in crude differentials have not been very significant (see table below).

We believe margins will weaken going forward, and remain at around US$4/bbl (Singapore Complex) over the next four quarters, given continued overcapacity in the industry.

There has been a significant divergence in oil demand trends. The International Energy Agency (IEA) estimates that, over CY08-09, oil demand fell 3.7m b/d in OECD countries whereas it grew 2.12m b/d in non-OECD countries, with India and China recording robust growth rates. Demand appears to have peaked in OECD, and hence refineries are facing structural over-capacity and several closures have already been announced. However, the IEA estimates that OECD refinery utilisation rates averaged 77.6% in November 2009. Hence, we believe refinery closures need to be far more significant to cause any sustainable uptick in GRMs.

In non-OECD countries, there have been no refinery closures; in fact, bulk of capacity growth is concentrated here. We estimate that over CY09-11, India and China alone will add nearly 2.3m b/d of new refining capacity.

We expect RIL's GRMs to improve, averaging US$7.2/bbl in FY11F and US$8.7/bbl in FY12F, compared to US$6.7/bbl in FY10F. Consensus expectations are much higher, at around US$9/bbl in FY10 already. We believe that for these higher margins to be achieved there have to be further improvements in middle distillate margins and crude differentials.

Table 12 : Quarterly crude and product differentials (US$/bbl)

	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10	1H4Q10*
Singapore Complex GRM	8.17	5.80	3.66	5.56	4.10	3.21	1.92	5.00
Spreads over Dubai crude								
Diesel	34.60	21.07	12.47	6.32	5.49	4.87	3.45	5.67
Jet Fuel	36.25	25.81	18.85	10.17	7.36	7.26	6.64	7.31
Naphtha	(6.27)	(7.72)	(17.29)	(1.94)	(4.27)	(3.12)	(3.48)	(1.12)
Furnace Oil	(32.76)	(19.87)	(13.91)	(8.89)	(9.32)	(6.81)	(8.78)	(7.51)
Gasoline	13.83	6.93	3.47	11.11	9.87	9.40	5.66	12.80
LPG	(42.44)	(42.02)	(16.49)	(8.39)	(22.32)	(22.10)	(16.95)	(16.46)
Arab Light - Heavy Differential	8.28	8.56	4.70	3.68	1.90	1.68	1.54	1.72

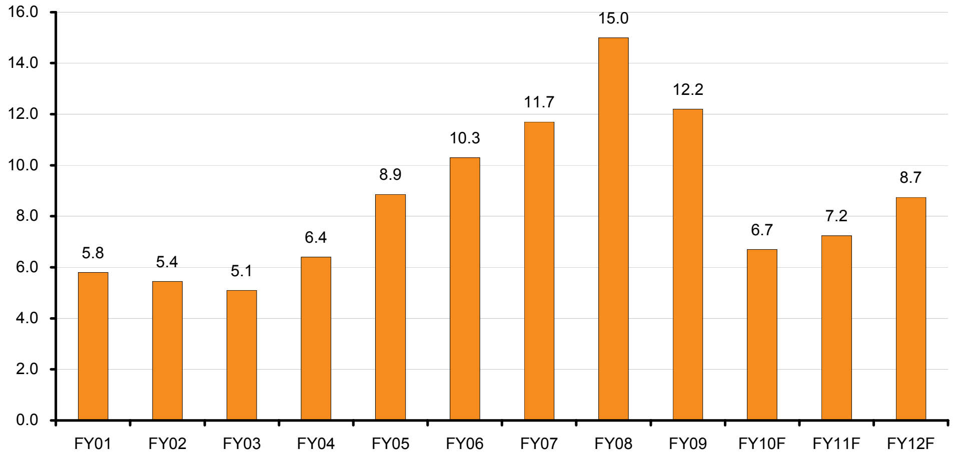
*up to 15 February 2010
Source: Bloomberg, Reuters, RBS estimates

Table 13 : India and China refining capacity additions (kbpd) 2009-11

Company	Location	Capacity addition	Likely commissioning
India			
Reliance Petroleum	Jamnagar	580	1Q 2009
Chennai Petroleum	Manali	30	1Q 2010
Indian Oil Corporation	Haldia	30	1Q 2010
Bharat Petroleum	Kochi	40	2Q 2010
Bharat Petroleum	Bina	120	2Q 2010
Indian Oil Corporation	Panipat	60	2Q 2010
Essar Oil	Vadinar	40	4Q 2010
Hindustan Petroleum	Bhatinda	180	4Q 2011
Mangalore Refinery	Mangalore	106	4Q 2011
India total		**1186**	
China			
Sinopec	Fujian	170	2Q 2009
Sinopec	Tianjin	140	4Q 2009
CNOOC	Huizhou	240	1Q 2009
Petrochina	Dushanzi	80	3Q 2009
Petrochina	Guangxi	200	2Q 2010
Petrochina	Chengdu	200	4Q 2011
Sinochem	Quanzhou	100	4Q 2011
China total		**1130**	
Total		**2316**	

Source: Company data, RBS estimates

Chart 3 : RIL annual GRMs (US$/bbl)



Source: Company data, RBS forecasts

Table 14 : GRM sensitivity to earnings

Year to 31 March	2010F	2011F	2012F
Current estimates			
RIL consolidated GRM (US$/bbl)	6.7	7.2	8.7
EPS (Rs)	56.6	65.4	77.3
EPS sensitivity for US$1/bbl change in GRM	10.7%	8.9%	7.4%

Source: RBS forecasts

Petrochemical capacities set to hit the market in 2010

The downturn in petrochemical margins long anticipated by us is yet to materialise. In fact, petrochemical margins have strengthened in recent weeks (see pricing charts in Appendix). New projects that were due to go on stream in CY08/09 have been delayed, while projects that have been commissioned have taken time to ramp up. On the other hand, demand has been extremely buoyant in India and China, growing 22% and 27% yoy respectively during January-November 2009.

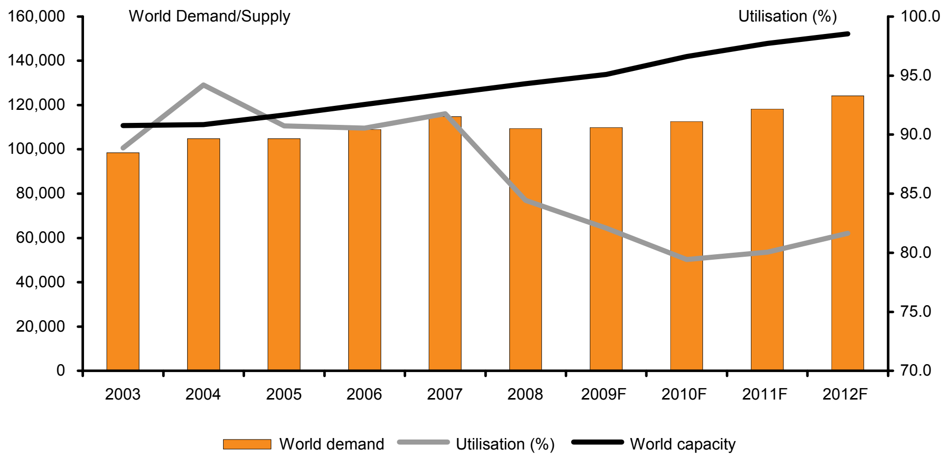
The capacity delays mean that capacity growth is now concentrated in CY10. We estimate that an unprecedented 10mt of new ethylene capacity is set to be commissioned in CY10, which would surely cause margins to contract. We expect a sharp downturn in margins by 3Q/4QCY10. On the demand front, the CY09 demand numbers look very high and it remains to be seen whether there has been any inventory build-up. The Chinese government has launched several measures to curb the sharp growth in bank lending, and its impact on demand growth and more importantly inventory holding remains to be seen.

Table 15 : Global ethylene demand-supply model ('000 tonnes)

	2003	2004	2005	2006	2007	2008	2009F	2010F	2011F	2012F
World capacity	110,773	111,209	115,561	120,310	125,076	129,670	133,895	141,868	147,798	152,148
Change	1,307	436	4,352	4,749	4,766	4,073	4,225	7,973	5,930	4,350
Change yoy (%)	1.2	0.4	4.1	3.9	4.3	3.7	3.3	6.0	4.2	2.9
World demand	98,444	104,762	104,863	108,944	114,767	109,477	109,915	112,663	118,296	124,211
Change	2,770	6,318	101	4,081	5,823	-5,290	438	2,748	5,633	5,915
Change yoy (%)	2.9	6.4	0.1	3.9	5.3	(4.6)	0.4	2.5	5.0	5.0
Utilisation (%)	88.9	94.2	90.7	90.6	91.8	84.4	82.1	79.4	80.0	81.6

Source: CMAI, RBS forecasts

Chart 4 : Global ethylene capacity utilisation ('000 tonnes)



Source: CMAI, RBS forecasts

Table 16 : Petrochemical capacity additions ('000 tonnes)

Operator	Location	Ethylene	PE	Propylene	PP	MEG	Completion Date
2009							
RIL	Jamnagar, India				900		2Q09
Bandar Imam Petrochemical	Iran	500	300				2Q09
SEPC	Al Jubail, Saudi Arabia	1,000	798	285			2Q09
Quattor	Sau Paulo, Brazil	200	230				2Q09
Laleh Petrochemicals	Mahshahr, Iran		300				2Q09
Mehr Petrochemicals	Bandar Assaluyeh, Iran		300				3Q09
Petro Rabigh	Saudi Arabia	1,300	900		700	600	3Q09
Fujian PC	Fujian, China	800	800	400	400		3Q09
Sabic - Yansab	Yanbu, Saudi Arabia	1,300	900	400	400	700	3Q09
Petrochina Dushanzi PC	Dushanzi, China	1,000	900	550	550		4Q09
Al-Waha Petrochemical	Al-Jubai, Saudi Arabia			450	450		4Q09
		6,100	**5,428**	**2,085**	**3,400**	**1,300**	
2010							
Sinopec Tianjin PC	Tianjin, China	1,000	600			400	1Q10
PTT	Thailand	1,000	700				1Q10
SHARQ	Saudi Arabia	1,200	800			700	4Q09
Siam Cement Co.	Rayong	900	400		400		1Q10
Moravid (Olefins 5)	Iran	500				500	1Q10
Panjin Ethylene (Huajin Tongda Chemicals)	Liaoning, China	450	300		250		1Q10
Shell	Singapore	800		450		750	1Q10
Indian Oil	Panipat, India	900	650	600	600	300	2Q10
Borouge #2	Ruwais, UAE	1,500	540		400		3Q10
Ras Laffein Olefin Co.	Ras Laffan, Qatar	1,300	800				3Q10
Baotuo Shenhua	China		300				3Q10
Sinopec Zhenhai PC	Ningbo, China	1,000	450	650	300		4Q10
		10,550	**5,540**	**1,700**	**1,950**	**2,650**	
2011							
Saudi Kayan	Saudi Arabia	1,325	750				1Q11
Exxon Mobil	Jurong, Singapore	1,000	1,070				1Q11
Saudi Polymers	Al Jubail, Saudi Arabia	1,300	1,100				3Q11
Ilam PC (Olefins 13)	Iran	500	299				3Q11
Taneko	Nizhnekamsk, Russia	600	200				4Q11
		4,725	**3,420**				

Source: CMAI, RBS estimates

Table 17 : RIL petrochemical margin assumptions (US$/t)

Year to 31 March	2002	2003	2004	2005	2006	2007	2008	2009	2010F	2011F	2012F
PP-naphtha	309	386	428	595	569	678	611	566	535	390	380
PE-naphtha	362	319	379	577	538	680	671	593	615	435	400
PX-naphtha	177	222	291	416	388	513	352	345	420	320	300
PTA less naphtha	326	377	395	523	453	509	400	390	501	394	401
MEG less naphtha	307	356	529	735	556	504	717	317	386	336	305
PFY less naphtha	750	796	892	1,026	860	923	972	828	894	873	850
PSF less naphtha	451	533	612	709	596	607	590	492	584	508	485

Source: CMAI, Bloomberg, RBS forecasts

Indian supply constraints also set to ease

The ability to price domestic products at a premium to landed costs was high in recent months, due to shortages arising from shutdowns. Haldia Petrochemicals, the second-largest Indian cracker operator, shut down its cracker for nearly three months to implement capacity expansion from 520,000 tonnes to 670,000 tonnes, and has restarted operations only this month. Mitsubishi has set up a new 800,000 tonne PTA plant in addition to its existing 480,000 tonne plant. The new plant was due to begin trial runs in October 2009, but its start-up was delayed several times and production has stabilised only this month. The older unit had to take a shutdown of more than a month and full production from both units is now expected only from March 2010. The domestic market will also see a new entrant with Indian Oil's 900,000 tonne cracker set to start operations by next quarter. Post these capacities, the domestic supply position will improve significantly, thereby reducing the ability to charge a premium to import parity pricing.

We maintain Sell, target price Rs815

We have marginally adjusted our target price from Rs812.50 to Rs815. Note that this valuation is for end-FY11 and hence considers net debt as on that date. We continue to value the refining, petrochemical and the old oil businesses at 7x FY12F EV/EBITDA. As explained earlier, we assume that KG-D6's phase II capex has been pushed back by a year, which reduces the valuation of the block slightly (since it is based on the net present value as on end-FY11F).

Table 18 : RIL SOTP valuation

			Valuation				Change
Sector	**Base**	**Multiple**	**Rsm**	**US$m**	**New Rs/share**	**Old Rs/share**	**Rs/share**
Existing business valuation on FY12F EV/EBITDA							
Petrochemicals EBITDA on Rsm	51,996	7	363,972	7,827	122	122	1
Refining EBITDA on Rsm	149,308	7	1,045,153	22,476	351	332	19
Oil& gas EBITDA on Rsm	27,187	7	190,312	4,093	64	65	-1
Sub total			1,599,437	34,396	537	519	19
Less: FY11F net debt			(440,627)	(9,476)	(148)	(149)	1
KG-D6 oil/gas reserves on DCF on US$/boe	3991.5	4.3	822,000	17,677	276	287	-10
Sub total			1,980,810	42,598	665	656	10
Option values now considered for target price							
NEC-25 reserves on DCF on US$/boe	455	2.6	67,000	1,185	23	23	-0
Exploration upside: oil reserves on US$/boe	200	11	105,600	2,200	35	36	-1
Exploration upside: gas reserves on US$/boe	1800	2	172,800	3,600	58	59	-1
Reliance Retail at 1x price/book on Rsm	58000	1.0	58,000	1,247	19	20	-0
SEZs at 1x price/book on Rsm	42000	1.0	42,000	903	14	20	-5
Sub total			445,400	9,136	150	157	-8
Total valuation/earlier target price			**2,426,210**	**51,734**	**815**	**813**	**2**

Source: RBS estimates

Limited clarity on additional gas production

The market has been expecting continued rapid growth in RIL's oil/gas business, given guidance from Niko Resources that KG-D6 gas volumes could rise to 120mmscmd. Our DCF valuation for KG-D6 also assumes that gas production will start rising again in FY14, touching a new high of 129mmscmd by FY16. We estimate the peak production from D1/D3 and MA fields at 89mmscmd by FY12, and believe that any increase beyond this is possible only after new fields start producing. To meet our estimate of new production starting FY14, the field development plan to support this increase needs to be approved by the regulator in CY10. There has been considerable delay in getting this approval. Niko in its 3QFY10 result release stated: "a development plan for nine discoveries (called satellite fields) was submitted to the GOI in July 2008. However, based on the GOI's advice, in December 2009, the plan was modified to include four rather than nine discoveries. Additional development plans can be expected in future".

RIL will probably have to change its development plan and possibly include other discoveries (like the R field). Either way, the new development plan needs to be approved soon. Otherwise, production from new fields may coincide with decline from existing fields, resulting in overall production levels being maintained, rather than increasing.

Exploration success: catching up with the industry average

RIL to date has announced 44 discoveries after drilling 89 wells, indicating a success rate of 49%, which is higher than the industry average but much lower than its initial rate. For example, as of 1QFY09, RIL's success rate was 63% after drilling 66 wells, indicating that recent well drilling has not been as successful. We remain optimistic on RIL's ability to grow reserves and our valuation already assumes reserve creation of 2m boe, over and above the higher reserves in KG-D6 and NEC-25.

The initial high success rate was because drilling was concentrated in few highly successful blocks. Out of the 44 discoveries announced to date, just two blocks (KG-D6, NEC-25) have contributed 61% and development plans have been filed only for these two blocks. The rest of the discoveries (some of them made in 2005 and 2006) have not yet progressed to the development stage, when reserves can be recognised. While the stock price tends to react positively to every new discovery, there needs to be continuous success across the blocks to justify a development plan and book reserves.

Table 19 : RIL discoveries to date

Block	No of discoveries
KG-DWN-98/3 (KG D6)	19
NEC-OSN-97/2 (NEC 25)	8
Yemen (Malik Block 9)	4
KG-OSN-2001/1 (KG III 5)	3
KG-OSN-2001/2 (KG-III-6)	2
KG-DWN-2003/1 (KG-V-D3)	3
SR-OS-94/1 (SR-01)	1
KG-DWN-98/1 (KG-D4)	1
GS-OSN-200/1 (GS01)	1
CY-DWN-2001/2 (CYIII D5)	1
CB-ONN-2003/1 Part A&B	1
Total	**44**

Source: Company

Domestic organic growth plans need clarity

We believe RIL's historical valuation premium has been based on its ability to put up new greenfield projects at world-beating low-cost structures every few years, thereby causing a substantial jump in revenue and profit. Post the recent completion of the RPET refinery and KG-D6 gas project, the company is yet to embark on the next stage of its capex plans.

According to the chairman's statement at the annual general meeting on 12 October 2007: "over the next three to four years, Reliance will be investing US$8bn-9bn in the Jamnagar super site…". This capex was to cover the largest petrochemical complex in the world (2mt capacity), the world's largest combined cycle coke gasification complex (6mt) and an expansion of PX capacity from 1.9mt to 4.5mt. However, all of these projects have been put on hold following the global economic downturn. Earlier plans to expand the retail business aggressively also appear to have been curbed and the foray into special economic zones (SEZs) has not progressed as RIL is waiting for a suitable partner to share the risks.

We believe that getting the domestic organic growth story restarted will be critical for stock outperformance. Given RIL's size and scale, it may be forced to look at global acquisition opportunities, but these are likely to be far riskier than the low-cost world-scale projects it has implemented historically.

Update on Lyondell Basell

RIL confirmed in November 2009 that it had made a preliminary non-binding bid for LyondellBasell (LB), the world's third-largest independent chemical company. News reports have suggested that RIL's initial bid value was US$10bn-12bn, which was subsequently raised to US$13.5bn. LB is emerging out of bankruptcy and RIL has declined to comment on the potential timing or value of this transaction, if it were to materialise. For a detailed report on LB, please see our note on RIL, *Eyeing LyondellBasell,* dated 25 November 2009. Meanwhile, LB announced on 16 February that it had reached a settlement with unsecured creditors by raising the amount it would give them by 50%, to US$450m. This move may weaken RIL's bid, as the unsecured creditors had been the bid's strongest backers.

In terms of LB's operations, its core profitability weakened in 4QCY09 with the refining business reporting a loss. The polymers business in the US was a big profit contributor in CY09 as it benefited from using natural gas as feedstock. US natural gas prices in CY09 were exceptionally low compared to crude prices. This allowed LB to export products out of the US (mainly to China), compensating for the persistent downturn in US domestic demand. Hence, these operations remain vulnerable to the capacity increase that is due from the Middle East and Asia over CY10.

LB ended CY09 reporting earnings before interest, tax, depreciation, amortization and restructuring costs (EBITDAR) of US$2264m, about 7% above its forecast. Restructuring costs, however, were nearly US$1,541m compared to its initial estimate of US$300m.

Table 20 : Lyondell Basell current cost EBITDAR (US$m)

	1QCY09	2QCY09	3QCY09	4QCY09	CY09 actuals	CY09 forecasts	CY08 actuals
Fuels	107	48	107	-7	255	710	1,241
Chemicals	128	168	290	275	861	731	1,317
Polymers	76	219	333	141	769	453	411
Technology and R&D	66	101	66	73	306	242	291
Other	-27	43	-39	96	73	-26	134
Total EBITDAR	350	579	757	578	2,264	2,110	3,394
Restructuring cost	226	346	864	105	1,541	300	

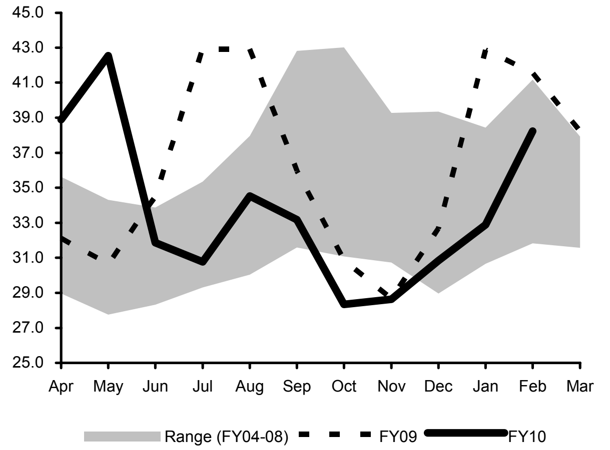
Source: LB

Possible technical upside if GOI disappoints on policy reforms

RIL has significantly underperformed the market since May 2009, ie post election results (a 7% increase for the RIL stock, vs 48% for the BSE Sensex). GOI-owned oil companies, on the other hand, have significantly outperformed on the back of expectations that the new government will provide clarity on subsidy-sharing and carry out reforms on domestic oil pricing. CY10 has started on a negative note for GOI-owned stocks, as the finance ministry appears unwilling to bear the entire cooking fuels subsidy. If the GOI continues to disappoint on the policy front, GOI-owned stocks could still underperform significantly, in our view. This could, by default, lead to an increase in ownership in RIL within the Indian oil/gas universe.

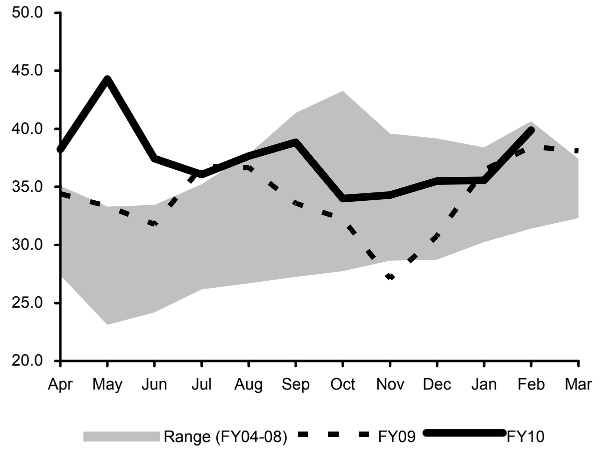
Petrochemical spreads

Chart 5 : PP – Naphtha (Rs/kg)



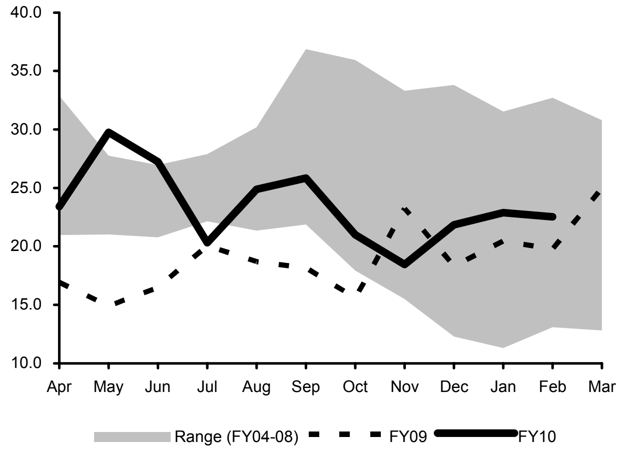
Source: RBS, RIL

Chart 6 : PE – Naphtha (Rs/kg)



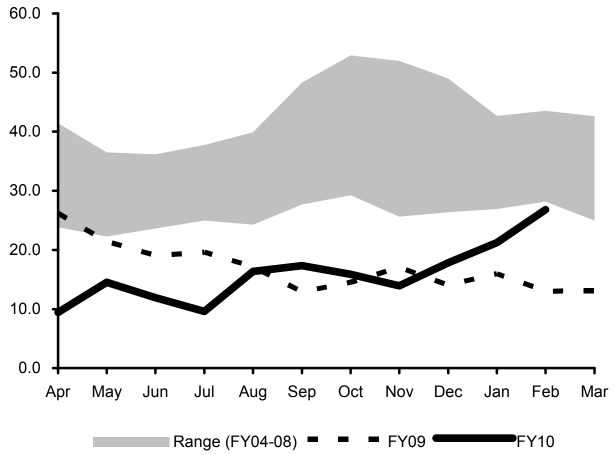
Source: RBS, RIL

Chart 7 : PTA – Naphtha (Rs/kg)



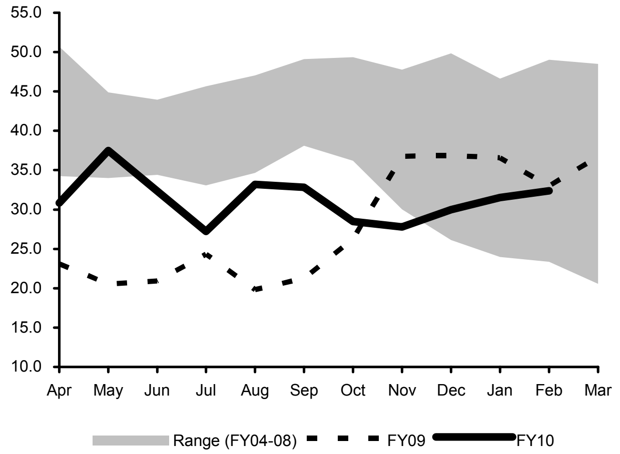
Source: RBS, RIL

Chart 8 : MEG – Naphtha (Rs/kg)



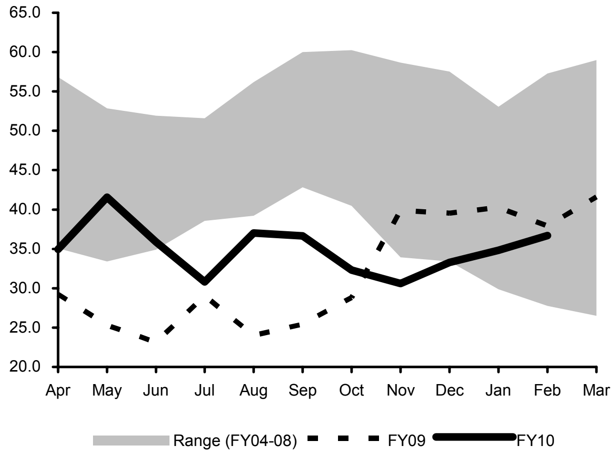
Source: RBS, RIL

Chart 9 : PSF – Naphtha (Rs/kg)



Source: RBS, RIL

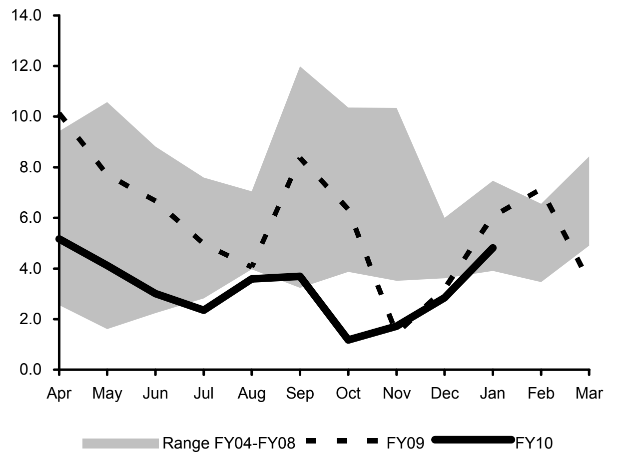
Chart 10 : POY – Naphtha (Rs/kg)



Source: RBS, RIL

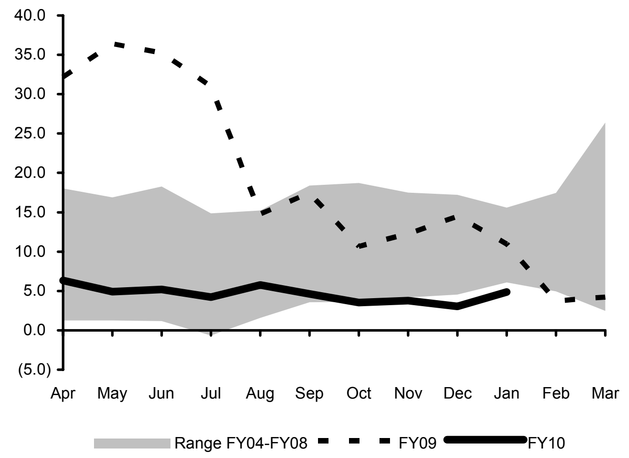
Oil product spreads

Chart 11 : Singapore complex refining margin (US$/bbl



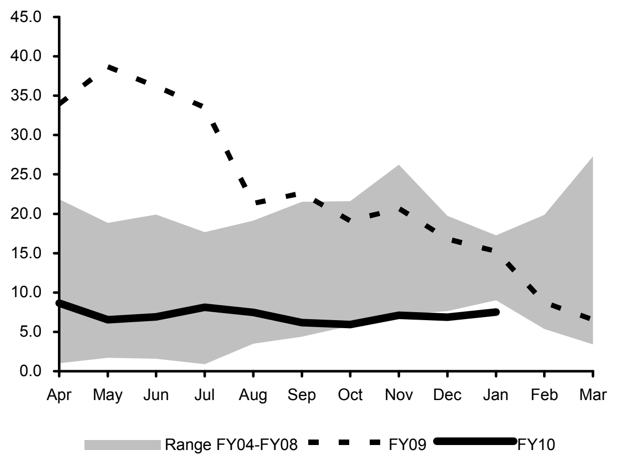
Source: Reuters

Chart 12 : Diesel – Dubai crude (US$/bbl



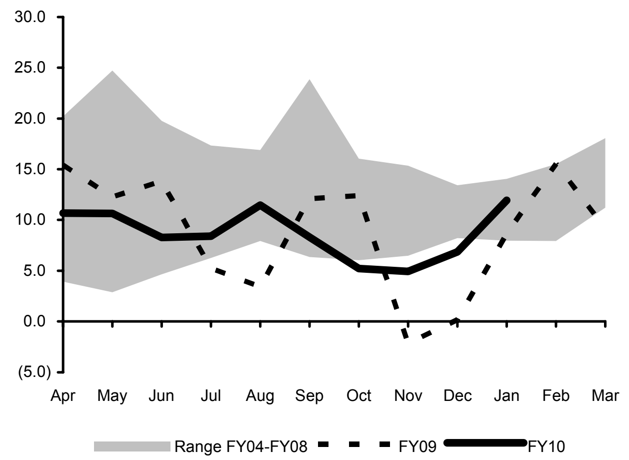
Source: Bloomberg

Chart 13 : Jet fuel – Dubai crude (US$/bbl)



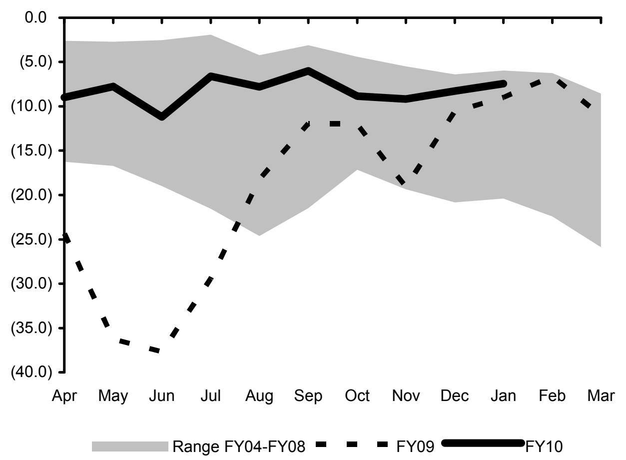
Source: Bloomberg

Chart 14 : Petrol – Dubai crude (US$/bbl



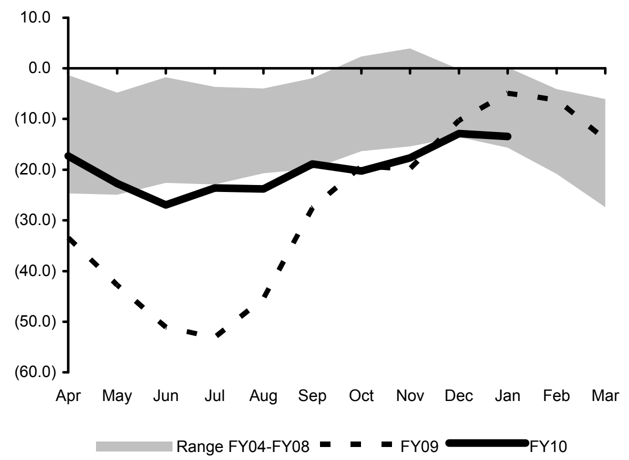
Source: Bloomberg

Chart 15 : Fuel oil – Dubai crude (US$/bbl)



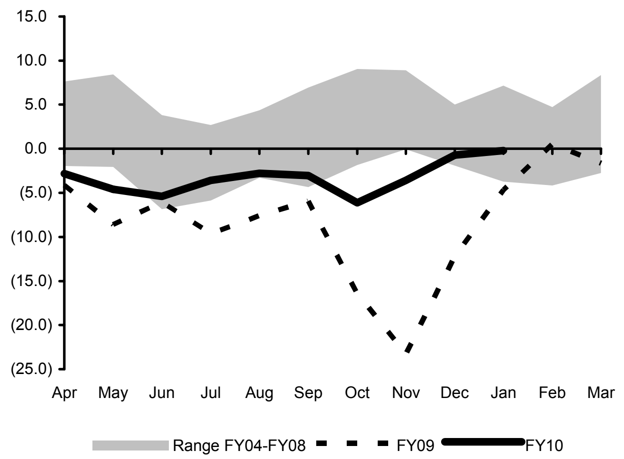
Source: Bloomberg

Chart 16 : LPG – Dubai crude (US$/bbl



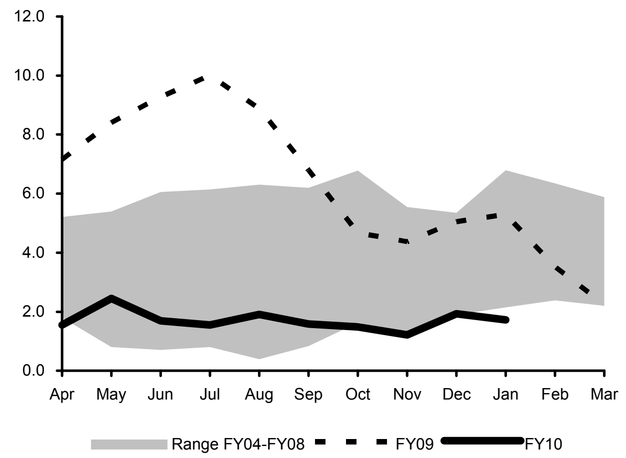
Source: Bloomberg

Chart 17 : Naphtha – Dubai crude (US$/bbl)



Source: Bloomberg

Chart 18 : Arab Light – Arab Heavy crude (US$/bbl)



Source: Bloomberg

Income statement

Rsm	FY08A	FY09A	FY10F	FY11F	FY12F
Revenue	1334430	1418475	2579267	2945714	3219622
Cost of sales	-1027521	-1122128	-2142310	-2433190	-2644411
Operating costs	-83718	-58260	-136153	-138538	-146731
EBITDA	**223191**	**238087**	**300803**	**373986**	**428480**
DDA & Impairment (ex gw)	-48471	-51953	-102765	-125629	-127791
EBITA	**174720**	**186134**	**198038**	**248357**	**300689**
Goodwill (amort/impaired)	n/a	n/a	n/a	n/a	n/a
EBIT	**174720**	**186134**	**198038**	**248357**	**300689**
Net interest	-10774	-17452	-20193	-31918	-35692
Associates (pre-tax)	n/a	n/a	n/a	n/a	n/a
Forex gain / (loss)	9868	-4947	7000	7000	6000
Exceptionals (pre-tax)	47335	0.00	0.00	0.00	0.00
Other pre-tax items	8953	20599	25627	21434	18471
Reported PTP	**230103**	**184333**	**210473**	**244873**	**289468**
Taxation	-35519	-31239	-45465	-50199	-59341
Minority interests	n/a	0.00	0.00	0.00	0.00
Exceptionals (post-tax)	n/a	n/a	n/a	n/a	n/a
Other post-tax items	0.00	-0.02	0.02	0.00	0.00
Reported net profit	**194584**	**153094**	**165008**	**194674**	**230127**
Normalised Items Excl. GW	41934	0.00	0.00	0.00	0.00
Normalised net profit	**152650**	**153094**	**165008**	**194674**	**230127**

Source: Company data, RBS forecasts — year to Mar

Balance sheet

Rsm	FY08A	FY09A	FY10F	FY11F	FY12F
Cash & market secs (1)	100118	250520	210397	204610	258027
Other current assets	311335	246264	458699	507089	544079
Tangible fixed assets	907363	1410460	1409928	1460820	1571689
Intang assets (incl gw)	n/a	n/a	n/a	n/a	n/a
Oth non-curr assets	215770	266405	269905	279905	289905
Total assets	**1534587**	**2173648**	**2348929**	**2452424**	**2663700**
Short term debt (2)	85225	62270	60194	58933	58976
Trade & oth current liab	221454	326910	403802	364036	393740
Long term debt (3)	407846	676775	621789	586304	556304
Oth non-current liab	108699	127372	142643	158730	170887
Total liabilities	**823223**	**1193327**	**1228427**	**1168004**	**1179907**
Total equity (incl min)	711363	980322	1120501	1284421	1483793
Total liab & sh equity	**1534587**	**2173648**	**2348929**	**2452424**	**2663700**
Net debt	392953	488525	471585	440627	357254

Source: Company data, RBS forecasts — year ended Mar

Cash flow statement

Rsm	FY08A	FY09A	FY10F	FY11F	FY12F
EBITDA	223191	238087	300803	373986	428480
Change in working capital	-58463	110026	-150070	-92593	-13976
Net interest (pd) / rec	-10774	-17452	-20193	-31918	-35692
Taxes paid	-26520	-12634	-33465	-40404	-47762
Other oper cash items	8953	20599	25627	21434	18471
Cash flow from ops (1)	**136388**	**338626**	**122702**	**230505**	**349520**
Capex (2)	-248512	-625143	-130585	-181521	-243660
Disposals/(acquisitions)	0.00	0.00	0.00	0.00	0.00
Other investing cash flow	-45666	12704	-3500	-10000	-10000
Cash flow from invest (3)	**-294178**	**-612438**	**-134085**	**-191521**	**-253660**
Incr / (decr) in equity	16643	209209	159.9	0.00	0.00
Incr / (decr) in debt	160143	245974	-57062	-36745	-29957
Ordinary dividend paid	-19085	-22195	-24988	-30754	-30754
Preferred dividends (4)	0.00	0.00	0.00	0.00	0.00
Other financing cash flow	481.0	-212650	0.00	0.00	0.00
Cash flow from fin (5)	**158182**	**220339**	**-81890**	**-67500**	**-60711**
Forex & disc ops (6)	n/a	n/a	n/a	n/a	n/a
Inc/(decr) cash (1+3+5+6)	**392.9**	**-53474**	**-93273**	**-28516**	**35149**
Equity FCF (1+2+4)	-112124	-286517	-7883	48983	105860

Lines in bold can be derived from the immediately preceding lines. — year to Mar
Source: Company data, RBS forecasts

Standard ratios

Performance	Reliance FY08A	Reliance FY09A	Reliance FY10F	Reliance FY11F	Reliance FY12F	Oil & Natural Gas Corp FY10F	Oil & Natural Gas Corp FY11F	Oil & Natural Gas Corp FY12F	PTT Pcl FY09F	PTT Pcl FY10F	PTT Pcl FY11F
Sales growth (%)	19.5	6.30	81.8	14.2	9.30	-13.1	8.35	11.7	-32.5	8.17	3.18
EBITDA growth (%)	10.1	6.67	26.3	24.3	14.6	6.21	4.78	11.6	-9.22	15.6	18.6
EBIT growth (%)	13.1	6.53	6.40	25.4	21.1	5.32	4.16	7.98	-17.6	19.2	19.6
Normalised EPS growth (%)	27.8	-9.07	2.25	15.6	18.2	-1.18	7.32	8.10	35.3	15.0	26.1
EBITDA margin (%)	16.7	16.8	11.7	12.7	13.3	42.5	41.1	41.0	10.7	11.4	13.1
EBIT margin (%)	13.1	13.1	7.68	8.43	9.34	26.4	25.4	24.6	7.74	8.53	9.88
Net profit margin (%)	11.4	10.8	6.40	6.61	7.15	18.7	18.5	17.9	5.20	5.53	6.75
Return on avg assets (%)	11.6	8.14	7.14	8.40	9.44	14.5	14.0	13.5	10.5	11.9	13.6
Return on avg equity (%)	26.5	18.5	15.7	16.2	16.6	20.8	19.9	19.2	16.6	16.7	18.2
ROIC (%)	13.3	10.4	8.39	9.68	10.8	24.0	20.9	19.4	17.8	19.5	22.6
ROIC - WACC (%)	3.05	0.24	-1.81	-0.51	0.62	10.9	7.90	6.39	0.00	0.00	0.00
					year to Mar			year to Mar			year to Dec
Valuation											
EV/sales (x)	2.79	2.69	1.47	1.28	1.14	2.05	1.90	1.71	0.56	0.49	0.41
EV/EBITDA (x)	16.7	16.0	12.6	10.1	8.60	4.83	4.63	4.16	5.22	4.26	3.14
EV/EBITDA @ tgt price (x)	13.7	13.2	10.4	8.30	7.05	5.05	4.85	4.35	7.26	6.02	4.63
EV/EBIT (x)	21.3	20.5	19.2	15.2	12.3	7.75	7.48	6.94	7.21	5.71	4.18
EV/invested capital (x)	3.15	2.44	2.23	2.04	1.87	2.36	2.04	1.79	1.18	1.08	0.94
Price/book value (x)	3.80	2.87	2.65	2.36	2.04	2.37	2.11	1.89	1.35	1.19	1.01
Equity FCF yield (%)	-4.39	-10.2	-0.27	1.62	3.49	2.66	3.12	3.83	1.35	10.2	16.4
Normalised PE (x)	16.7	18.4	18.0	15.6	13.2	12.1	11.2	10.4	8.70	7.56	6.00
Norm PE @tgt price (x)	13.4	14.7	14.4	12.5	10.5	12.6	11.7	10.8	12.9	11.2	8.92
Dividend yield (%)	0.64	0.64	0.64	0.79	0.79	2.90	3.17	3.45	4.34	5.28	5.64
					year to Mar			year to Mar			year to Dec

Per share data	FY08A	FY09A	FY10F	FY11F	FY12F
Tot adj dil sh, ave (m)	2510	2768	2918	2977	2977
Reported EPS (INR)	77.5	55.3	56.6	65.4	77.3
Normalised EPS (INR)	60.8	55.3	56.6	65.4	77.3
Dividend per share (INR)	6.50	6.50	6.50	8.00	8.00
Equity FCF per share (INR)	-44.7	-103.5	-2.70	16.5	35.6
Book value per sh (INR)	267.6	354.1	384.0	431.5	498.4
					year to Mar

Solvency	FY08A	FY09A	FY10F	FY11F	FY12F
Net debt to equity (%)	55.2	49.8	42.1	34.3	24.1
Net debt to tot ass (%)	25.6	22.5	20.1	18.0	13.4
Net debt to EBITDA	1.76	2.05	1.57	1.18	0.83
Current ratio (x)	1.34	1.28	1.44	1.68	1.77
Operating CF int cov (x)	16.1	21.1	8.73	9.49	12.1
Dividend cover (x)	8.00	6.90	6.60	6.33	7.48
					year to Mar

Priced as follows: RELI.BO - Rs1017.75; ONGC.BO - Rs1103.00; PTT.BK - B216.00
Source: Company data, RBS forecasts

Valuation methodology

Sector	Base	Multiple	Valuation Rsm	Valuation US$m	New Rs/share	Old Rs/share	Change
Existing business valuation on FY12F EV/EBITDA							
Petrochemicals EBITDA on Rsm	51,996	7	363,972	7,827	122	122	1
Refining EBITDA on Rsm	149,308	7	1,045,153	22,476	351	332	19
Oil& gas EBITDA on Rsm	27,187	7	190,312	4,093	64	65	-1
Sub total			1,599,437	34,396	537	519	19
Less: FY11F net debt			(440,627)	(9,476)	(148)	(149)	1
KG-D6 oil/gas reserves on DCF on US$/boe	3991.5	4.4	822,000	17,677	276	287	-10
Sub total			**1,980,810**	**42,598**	**665**	**656**	**10**
Option values now considered for target price							
NEC-25 reserves on DCF on US$/boe	455	2.6	67,000	1,185	23	23	-0
Exploration upside: oil reserves on US$/boe	200	11	105,600	2,200	35	36	-1
Exploration upside: gas reserves on US$/boe	1800	2	172,800	3,600	58	59	-1
Reliance Retail at 1x price/book on Rsm	58000	1.0	58,000	1,247	19	20	-0
SEZs at 1x price/book on Rsm	42000	1.0	42,000	903	14	20	-5
Sub total			445,400	9,136	150	157	-8
Total valuation/earlier target price			**2,426,210**	**51,734**	**815**	**813**	**2**

Source: Company data, RBS forecasts

Company description

Sell

Reliance is India's largest private-sector enterprise by market cap. RIL is ranked 103rd amongst the world's Top 200 companies in terms of profits by Fortune Global list. It also features in the Forbes Global list of the world's 400 best big companies. It is controlled by the Mukesh Ambani family and its interests span petrochemicals, refining and E&P. Its key success factors include vertical integration, world-scale production facilities and globally competitive capital as well as operating costs. In petrochemicals, it is one of the largest producers in the world, ranking No 1 in POY/PSF, No 4 in PX, No 5 in MEG, No 6 in PTA and No 7 in PP (according to RIL). It has built another refinery at Jamnagar. This makes it the single-largest refinery at any single location worldwide. RIL has also recently made a foray into organised retailing.

Price relative to country

Strategic analysis

Average SWOT company score: 4

Strengths — 4

India's dominant petrochemical producer and largest single-location petroleum refiner. It is also the country's largest private-sector upstream producer and has made significant new oil/gas discoveries. Ability to execute world-scale projects to budget and on time.

Weaknesses — 3

Limited upstream integration (eg, oil/gas reserves) as of now. Government-controlled oil-product prices for petrol, diesel, LPG and kerosene do not let RIL fully exploit its marketing network.

Opportunities — 4

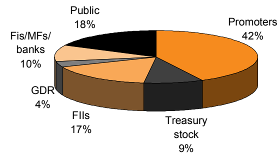
Ability to build global-scale refining operations to benefit from the tightness in global supply. Potential to expand E&P operations substantially via domestic exploration/production and acquisition of global E&P opportunities.

Threats — 3

A significant downturn in regional refining/aromatic margins could put pressure on earnings. Significant rupee appreciation would strain profitability. RIL may face a gas supply glut as it begins its own gas production in December 2008.

Scoring range is 1-5 (high score is good)

Shareholding, December 2009



Source: BSE

Market data

Headquarters
Maker Chambers IV, Nariman Point, Mumbai.

Website
www.ril.com

Shares in issue
3270.0m

Freefloat
45%

Majority shareholders
Mukesh Ambani family 41.13%

Country view: India

Valuations have run ahead of regional counterparts, while the market also looks expensive relative to where it traded in the past. Another concern is the market seems to believe that policy reform will act as a catalyst for a never-ending re-rating of risky assets. Meanwhile, it appears that monetary policy might turn sooner than the market is anticipating, due to possible rising inflationary pressure. Recent statements from the central bank (RBI) suggest it may be steering the country down a tighter policy path going forward.

The country view is set in consultation with the relevant company analyst but is the ultimate responsibility of the Strategy Team.

Country rel to Asia Pacific

Competitive position

Average competitive score: 4+

Supplier power — 4+

Moderate. Crude oil is the key raw material and is freely available in international markets. RIL has additional flexibility to source any type of crude.

Barriers to entry — 3-

High capital intensity and ever-increasing economies of scale are key barriers.

Customer power — 4-

Seems weak. User industries are usually small and very fragmented. However, RIL's gas customers may have some bargaining power as the company will have a huge quantity of gas to market.

Substitute products — 3+

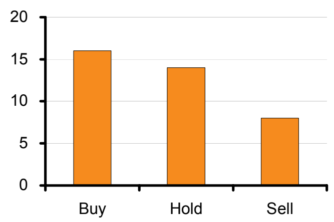
Outside Reliance's product portfolio, cotton is the key substitute. However, the cotton output is highly constrained. For its gas production likely to come in December 2008, coal is a key substitute.

Rivalry — 4+

Reliance holds dominant market share in petrochem, although IOC, the new entrant, is likely to be a key threat in future. In fuel retailing, PSUs are constrained by LPG/kerosene losses.

Scoring range 1-5 (high score is good) Plus = getting better Minus = getting worse

Broker recommendations



Source: Bloomberg

Recommendation structure

Absolute performance, short term (trading) recommendation: A Trading Buy recommendation implies upside of 5% or more and a Trading Sell indicates downside of 5% or more. The trading recommendation time horizon is 0-60 days. For Australian coverage, a Trading Buy recommendation implies upside of 5% or more from the suggested entry price range, and a Trading Sell recommendation implies downside of 5% or more from the suggested entry price range. The trading recommendation time horizon is 0-60 days.

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%. For UK Mid/Small Cap Analysis a Buy/Sell implies upside/downside of 10% or more, an Add/Reduce 5-10% and a Hold less than 5%. For UK-based Investment Funds research the recommendation structure is not based on upside/downside to the target price. Rather it is the subjective view of the analyst based on an assessment of the resources and track record of the fund management company. For listed property trusts (LPT) or real estate investment trusts (REIT) the recommendation is based upon the target price plus the dividend yield, ie total return.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Sector relative to market: The sector view relative to the market is the responsibility of the strategy team. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

Distribution of recommendations

The tables below show the distribution of recommendations (both long term and trading). The first column displays the distribution of recommendations globally and the second column shows the distribution for the region. Numbers in brackets show the percentage for each category where there is an investment banking relationship.

Long term recommendations (as at 17 Feb 2010)

	Global total (IB%)	Asia Pacific total (IB%)
Buy	669 (10)	440 (1)
Add	0 (0)	0 (0)
Hold	385 (4)	212 (0)
Reduce	0 (0)	0 (0)
Sell	92 (0)	57 (0)
Total (IB%)	1146 (7)	709 (0)

Source: RBS

Trading recommendations (as at 17 Feb 2010)

	Global total (IB%)	Asia Pacific total (IB%)
Trading Buy	4 (0)	4 (0)
Rec	00 (00)	00 (00)
Trading Sell	0 (0)	0 (0)
Total (IB%)	4 (0)	4 (0)

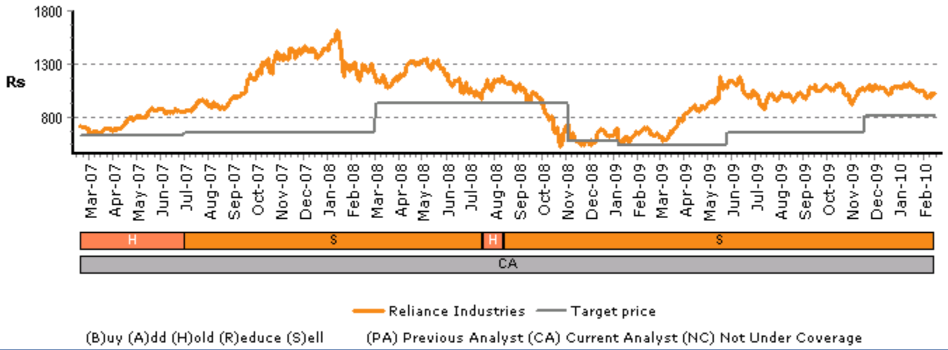
Source: RBS

Valuation and risks to target price

Reliance Industries (RIC: RELI.BO, Rec: Sell, CP: Rs1017.75, TP: Rs815.00): The key risks to our sum-of-the-parts-based target price are: 1) refining and petrochemical margins moving higher or lower than our expectations; 2) announcements of major new discoveries, especially oil; 3) RIL winning the case against RNRL/NTPC; and 4) any increases in the KG-D6 gas price.

Reliance Industries coverage data

Stock performance, recommendations and coverage (as at 16 Feb 2010)



Avadhoot Sabnis started covering this stock on 24 Nov 03

Source: RBS

Trading recommendation history (as at 17 Feb 2010)

Date	Rec	Analyst
	n/a	

Source: RBS

Regulatory disclosures

Subject companies: **RELI.BO**

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