Equity | India | Energy

24 January 2011

Reliance Industries

A mixed bag

An improved outlook for refining and petrochemical margins is being diluted by problems in gas production and lack of new oil/gas discoveries. However, we believe the former marginally outweigh the latter and hence raise (and roll forward) our target price to Rs900 (from Rs855). Upgrade to Hold from Sell.

Change of recommendation

Hold (from Sell)

Target price
Rs900.00 (from Rs855.00)

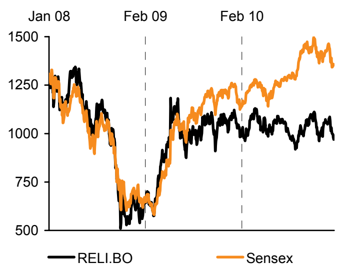
Price
Rs986.80

Short term (0-60 days)
n/a

Market view
Underweight

Price performance

	(1M)	(3M)	(12M)
Price (Rs)	1073	1082	1054
Absolute (%)	-8.0	-8.8	-6.4
Rel market (%)	-3.0	-2.8	-16.0
Rel sector (%)	-9.7	-16.0	-22.7



Market capitalisation
Rs3.23t (US$70.59bn)

Average (12M) daily turnover
Rs5587.30m (US$121.78m)

Sector: BBG AP Chemicals
RIC: RELI.BO, RIL IN
Priced Rs986.80 at close 21 Jan 2011.
Source: Bloomberg

Key forecasts

	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue (Rsm)	1,418,475	1,924,610	2,434,919	2,553,740	2,601,491
EBITDA (Rsm)	238,087	299,042	377,216	416,032 ▲	413,280
Reported net profit (Rsm)	153,094	162,356	200,264	220,737 ▲	218,255
Normalised net profit (Rsm)[1]	153,094	162,356	200,264	220,737	218,255
Normalised EPS (Rs)	55.30	55.60	67.30	74.10 ▲	73.30
Dividend per share (Rs)	6.50	7.00	7.50	8.00	8.50
Dividend yield (%)	0.66	0.71	0.76	0.81	0.86
Normalised PE (x)	17.80	17.70	14.70	13.30	13.50
EV/EBITDA (x)	15.60	12.10	9.68	8.56	8.65
Price/book value (x)	2.79	2.58	2.28	1.99	1.76
ROIC (%)	10.40	8.22	9.79	10.00	9.29

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

year to Mar, fully diluted

3QFY11 results 4% below expectations

RIL reported 3QFY11 net profit of Rs51.36bn (up 28% yoy), 4% below our expectations, due largely to lower-than-expected refining and E&P EBIT (driven by higher costs). Petchem profitability was in line and net debt was reduced marginally, from Rs389bn to Rs384bn.

Improved outlook for refining and petchems

Higher global GDP growth is driving a rise in refining and petrochemical margins. We had expected an improvement in refining and so we raise our gross refining margin (GRM) estimates by only US$0.5/bbl over FY11-13F. But in petrochemicals, the decline in polymer margins has been lower than our expectations and we now expect them to improve over FY12-13F. Additional margin upside is evident in polyester and its intermediates, where cotton shortages have taken some product margins to record levels.

E&P proving a big dampener

We reduce our KG-D6 oil/gas production forecasts due to an unexpected drop in production and lack of company guidance. We now forecast KG-D6 gas production at 60mmscmd for FY12 and FY13. Given lack of positive news flow on exploration, we also cut our exploration upside potential and now value a reserve base of 4.8bn boe (7.6bn boe earlier).

Upgrade to Hold, TP Rs900

Our EPS forecasts are up 5-9% for FY11/12, but down 3% for FY13, and are still 5-24% below Bloomberg consensus. We roll forward and raise our SOTP-based target price from Rs855 to Rs900 as the cut in E&P valuation (Rs134/share) is slightly outweighed by the rise in our valuation for the refining and petchem business. Given the rise in our target price, we upgrade the stock from Sell to Hold. We believe E&P probably still holds the biggest potential to provide either positive or negative surprise.

Researched by

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A mixed bag

RIL's stock price has not risen on higher refining and petchem margins due to concerns on its E&P operations. Lack of guidance on production/reserves is a risk, although there is potential for positive as well as negative surprises. We upgrade to Hold; new TP of Rs900.

3Q results 4% below expectations

RIL reported a 3QFY11 net profit of Rs51.36bn (up 28% yoy), 4% below our expectations and 2% below CNBC consensus. Petrochemicals EBIT was in line with our estimate, while refining and E&P disappointed due to higher operating expenses. Interest, depreciation and other income were largely in line with expectations.

EBITDA at Rs95.45bn (up 22% yoy) was 2% below our expectations. Net debt at Rs383.8bn was marginally down, compared with Rs388.5bn at the end of the prior quarter. RIL continues to maintain high debt as well as cash. This has not hurt earnings, with the interest paid on debt (largely forex) averaging 3.9%, while interest income on cash (largely in domestic currency) has yielded average returns of 8.7%.

E&P

Segment EBIT at Rs15.04bn (up 1.8% yoy) was 6% below our expectations despite KG-D6 oil/gas production being largely in line with expectations. This indicates rising lifting costs per barrel due to falling production. RIL management was unwilling to provide any guidance on future production levels.

Refining and marketing

Segment EBIT at Rs24.4bn (up 77% yoy) was 3% below expectations. Refining throughput was 16.1mt, 2.5% above expectations, while GRM at US$9/bbl was exactly in line with our expectations. Thus, the miss at the EBIT level was driven by higher operating expenses that we estimated at US$2.45/bbl, compared with US$1.96/bbl in 1QFY11 and US$2.32/bbl in 2QFY11. RIL GRMs were at the premium of US$3.58/bbl to Singapore Complex (Reuters) margins during 3QFY11. This premium was surprisingly lower compared to earlier quarters despite rising differentials between heavy/sour and sweet/light crude during the quarter. We believe that lower KG-D6 gas production would have reduced captive consumption, forcing RIL to consume more expensive spot LNG, resulting in a negative impact on reported GRMs.

Petrochemicals

Segment EBIT at Rs24.29bn (up 18% yoy) was just 1.2% above expectations. The higher profitability was mainly driven by record margins across the polyester chain, with products like PTA recording one of the highest-ever margins. All plants are now running at full capacity utilisation.

RIL management remains optimistic on petrochemical profitability. Polyester chain profitability is expected to improve further in 4QFY11 and remain firm over next few quarters. On the polymers side, management expects the next super cycle to commence in 18 months.

RIL has outlined capex plans of US$10bn in this segment over the next five years – US$4bn in the new cracker and downstream facilities, US$2.5bn in polyester and its intermediates and US$3.5bn in petcoke gasification. The first phase of the polyester plants is expected by management to progressively come onstream from mid-CY12. The other projects are still in the planning stage, with exact cost estimates and configuration expected to be settled within next quarter or so.

The new cracker depends on gas being used by both RIL refineries. Management opined that despite lack of clarity on availability of domestic gas, the new cracker economics would not be impacted even if imported LNG was used. Such a cracker would be competitive with new Middle East crackers using mixed feed because no new crackers are now likely to receive subsidised (US$0.75/mmbtu) gas.

Table 1 : RIL quarterly results

Rsbn	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10	yoy %	qoq %	9MFY10	9MFY11	Yoy %
Net sales	**568.6**	**575.7**	**582.3**	**574.8**	**597.9**	**5.2%**	**4.0%**	**1348.9**	**1755.0**	**30.1%**
EBIDTA	78.4	91.4	93.4	94.0	95.5	21.7%	1.6%	214.5	282.8	31.9%
EBIDTA margin (%)	13.8	15.9	16.0	16.3	16.0			15.9	16.1	
Interest	-5.5	-5.3	-5.4	-5.4	-5.5	-0.2%	1.3%	-14.7	-16.3	10.9%
Depreciation	-28.0	-33.9	-34.9	-33.8	-33.6	20.2%	-0.5%	-71.1	-102.2	43.9%
Non-op income	5.1	6.2	7.2	6.7	7.4	45.9%	10.3%	18.5	21.4	15.7%
PBT	50.1	58.3	60.4	61.5	63.8	27.4%	3.7%	147.1	185.7	26.2%
Tax	-10.0	-11.2	-11.9	-12.3	-12.4	24.3%	1.3%	-31.9	-36.6	14.7%
Net profit	40.1	47.1	48.5	49.2	51.4	28.1%	4.3%	115.3	149.1	29.4%
Total tax (current + deferred)	20.0%	19.3%	19.7%	19.9%	19.5%			21.7%	19.7%	
No of shares bn(net of treasury shares)	2.9	3.0	3.0	3.0	3.0			2.9	3.0	
Diluted EPS (Rs)	13.7	15.8	16.3	16.5	17.3			39.2	50.1	27.9%
Segment EBIT										
Petrochemicals	20.6	22.2	20.5	22.0	24.3	18.2%	10.6%	63.6	66.8	5.0%
Refining	13.8	19.9	20.4	21.9	24.4	76.6%	11.1%	40.3	66.6	65.5%
Oil & gas	14.8	17.0	19.2	17.1	15.0	1.8%	-11.8%	37.1	51.3	38.3%
Others	0.1	0.1	0.1	0.1	0.1	-18.2%	12.5%	0.3	0.2	-22.6%
Total	49.2	59.2	60.2	61.0	63.8	29.6%	4.5%	141.3	185.0	30.9%
EBIT contribution										
Petrochemicals	41.8%	37.5%	34.1%	36.0%	38.1%			45.0%	36.1%	
Refining	28.0%	33.5%	33.8%	35.9%	38.2%			28.5%	36.0%	
Oil & gas	30.0%	28.7%	31.9%	28.0%	23.6%			26.3%	27.7%	
Others	0.2%	0.2%	0.1%	0.1%	0.1%			0.2%	0.1%	
Segment capital employed										
Petrochemicals	418.9	381.6	377.7	364.7	352.3	-15.9%	-3.4%	418.9	352.3	
Refining	789.8	780.9	789.3	761.2	767.0	-2.9%	0.8%	789.8	767.0	
Oil & gas	521.2	509.6	534.5	537.7	559.6	7.4%	4.1%	521.2	559.6	
Others	74.6	67.3	69.5	71.0	73.8	-1.1%	3.9%	74.6	73.8	
Unallocated corporate	358.0	366.5	488.4	518.1	567.2	58.5%	9.5%	358.0	567.2	
Total	2162.4	2105.9	2259.4	2252.6	2319.9	7.3%	3.0%	2162.4	2319.9	
Debt position										
Gross debt	700.1	625.0	734.2	682.0	702.1	0.3%	2.9%	700.1	702.1	
Cash	159.6	218.7	264.1	293.5	318.3	99.4%	8.4%	159.6	318.3	
Net debt	540.5	406.2	470.2	388.4	383.8	-29.0%	-1.2%	540.5	383.8	
Operational performance										
Refining										
Refinery crude throughput (mt)	16.62	16.70	16.89	16.91	16.10	-3.1%	-4.8%	44.25	49.90	12.8%
Refinery GRM (US$/bbl)	5.90	7.50	7.30	7.90	9.00	52.5%	13.9%	6.20	8.10	30.6%
Petrochemicals production										
Polyester (PFY, PSF, PET) 000t	469	400	422	429	449	-4.3%	4.7%	1,300	1,300	0.0%
Fiber intermediates (PX, PTA, MEG) 000t	1,192	1,100	1,100	1,100	1,200	0.7%	9.1%	3,500	3,400	-2.9%
Polymers (PE, PP, PVC) 000t	1,086	1,100	931	1,069	1,100	1.3%	2.9%	3,000	3,100	3.3%
Ethylene 000t	502	400	363	432	505	0.6%	16.9%	1,400	1,300	-7.1%
Propylene 000t	191	183	152	182	166	-13.1%	-8.8%	552	500	-9.4%
Oil & gas production										
PMT oil (kt) - net (30%)	150.9	163.8	133.7	37.4	106.7	-29.3%	185.3%	432.4	294	-32.0%
PMT gas (mmscm) -net (30%)	365.4	393.6	386.0	235.6	298.8	-18.2%	26.8%	1126.3	918	-18.5%
KG D6 oil (000 b/d) -gross	9,117	13,846	25,166	23,693	19,377	112.5%	-18.2%	9,111	27,519	202.0%
KG gas (mmscmd) -gross	45.7	59.8	59.1	57.9	54.5	19.4%	-5.7%	33.0	58	75.6%

Source: Company data

Improved outlook for refining and petrochemicals

Refining improvement, slightly faster than expected

Oil demand growth in CY10 has surprised on the upside. The International Energy Agency (IEA) estimates CY10 oil demand at 87.7m b/d, up 2.7m b/d yoy, compared with its growth estimate of 1.4m b/d made in January last year. According to the IEA, the demand strength appears to be more related to a buoyant economic recovery than to the frigid weather that prevailed in most of the northern hemisphere in late CY10. The IEA estimates global oil demand will rise by 1.4m b/d to 89.1m b/d in CY11.

On the back of rising demand, Singapore GRMs have been improving qoq for the past three quarters, and 3QFY11 GRM of US$5.42/bbl was the highest in the past two years. Margins in 3QFY11 would have also benefited from the surge in diesel demand in China due to extensive use of small-scale electricity generators in response to the government-mandated closures of coal-fired power plants aimed at meeting the country's five-year emission and energy efficiency targets. The government has officially declared that these targets have been met, which should ease diesel demand from January 2011 onwards. Singapore GRMs, however, have remained strong, averaging US$6.8/bbl to date this month.

The rise in crude oil prices has also inevitably raised the differentials between heavy/sour and sweet/light crude, providing additional upside for complex refiners like RIL. On the negative side, RIL GRMs are also impacted by the lower captive consumption of its own gas (which is cheaper than the alternative oil, imported LNG) due to the drop in production in its KG-D6 block (discussed below).

Although we had been expecting an improving trend in RIL's GRMs, the improvement was slightly faster than we expected. Hence, we raise our RIL GRM estimates by US$0.5/bbl to US$9.3/bbl in FY12 and US$9.8/bbl in FY13.

Table 2 : Crude and product differentials

US$/bbl	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11
RIL reported GRM	6.80	6.00	5.90	7.50	7.30	7.90	9.00
Singapore Complex GRM (Reuters)	4.10	3.21	1.92	4.95	3.64	4.21	5.42
Spreads over Dubai crude							
Diesel	5.49	4.87	3.45	6.51	9.19	9.97	10.82
Jet fuel	7.36	7.26	6.64	8.45	11.27	11.91	13.88
Naphtha	(4.27)	(3.12)	(3.48)	(0.10)	(2.66)	(3.88)	1.32
Furnace oil	(9.32)	(6.81)	(8.78)	(8.72)	(11.67)	(9.87)	(13.84)
Gasoline	9.87	9.40	5.66	12.97	10.05	9.05	11.25
LPG	(22.32)	(22.10)	(16.95)	(16.47)	(20.26)	(20.72)	(11.91)
Crude differentials							
Arab light/heavy differential	1.90	1.68	1.54	1.66	2.66	2.78	3.15

Source: Company data, Reuters, Bloomberg, RBS estimates

Table 3 : GRM sensitivity to earnings

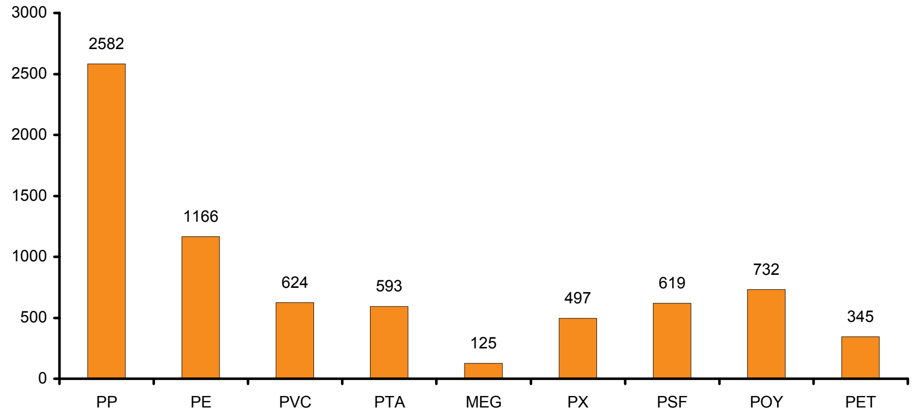
Year to 31 March	2011F	2012F	2013F
Current estimates			
RIL consolidated GRM (US$/bbl)	8.2	9.3	9.8
EPS (Rs)	67.3	74.1	73.3
EPS sensitivity for US$1/bbl change in GRM	10.0%	8.4%	8.5%

Source: RBS forecasts

Petrochemicals to provide significant positive surprise

Recent domestic margin trends show that while polymer margins have weakened, those across the polyester chain have improved very sharply (see Appendix). The improvement across the polyester chain has a relatively muted impact for RIL as the annual sales volumes of polymers (PP, PE, PX) at around 4.37mt exceeds that of polyester and its intermediates (2.9mt), as a significant portion of intermediates production (PX, PTA, MEG) is used in internal consumption for the production of polyester (PSF, PFY, PET). Overall, however, the decline in polymer margins has been below our initial expectations, while the polyester upside has been unexpected. Hence, we have now substantially upgraded our petrochemical margin forecasts.

Chart 1 : RIL annual sales volume of petrochemical products (kt), FY12F



Source: Company data, RBS forecasts

Table 4 : Petrochemical margin changes

US$/tonne	Old			New		
	FY11F	FY12F	FY13F	FY11F	FY12F	FY13F
PP less naphtha	490	380	430	580	600	680
PE less naphtha	435	400	420	460	550	600
PX less naphtha	300	300	400	336	350	400
PTA less naphtha	401	401	498	495	535	498
MEG less naphtha	336	305	366	416	336	366
PFY less naphtha	871	846	943	1,151	1,066	941
PSF less naphtha	506	481	578	791	816	641

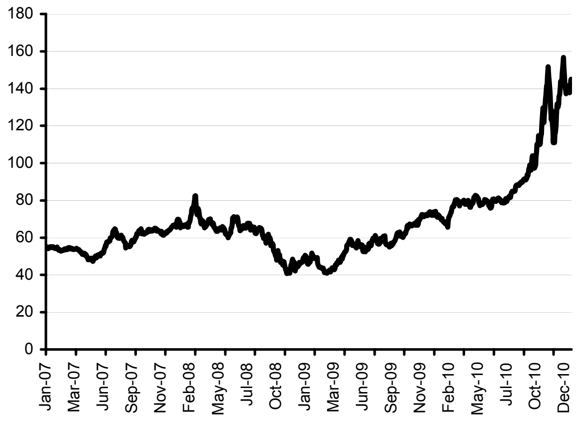
Source: RBS forecasts

In polymers, we believe that most of the capacity additions scheduled to come online have already become operational, with limited capacity additions planned going forward. We believe that the sector has passed its trough and margins will recover over the next two years. For details, see our report, *Petrochemical Journal – Upgrade to Overweight*, dated 4 November 2010.

Margins in polyester and its intermediates have been strong largely due to a surge in cotton prices. The International Cotton Advisory Committee estimates that at the start of fiscal year 2010/11 (starting 1 August), world cotton stocks were 8.9mt, the lowest since 1993/94. While demand has remained robust, supply has been hit following floods/bad weather in countries such as Pakistan, Australia and China, as well as lower export limits set by India. The futures market indicates that while prices are likely to weaken over next two years, they will still remain well above historical levels.

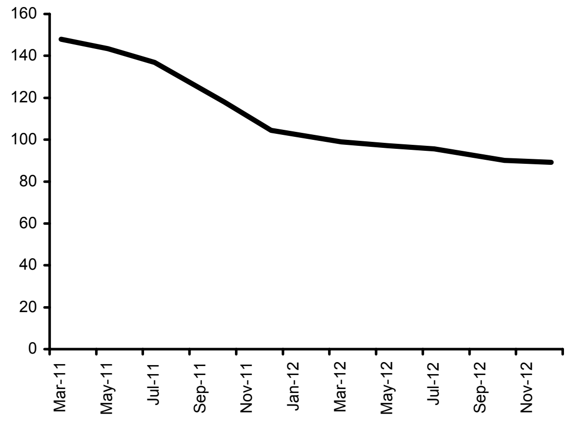
The cotton shortage has resulted in higher demand for competing fibres like polyester pushing up prices and margins in polyester and its intermediates. Also, PX prices have increased due to a fall in production in Iran, which has diverted its reformate into production of gasoline to cope with more stringent EU and US sanctions.

Chart 2 : US cotton prices (US$/lb)



Source: Bloomberg

Chart 3 : US cotton futures (US$/lb)



Source: Bloomberg

E&P proving a big dampener

No guidance on KG-D6 gas production

Based on management guidance earlier in the year, we had been forecasting KG-D6 gas production to be maintained at 60mmscmd in FY11, rising to 70mmscmd in FY12 and 80mmscmd in FY13. However, KG-D6 oil and gas production has been declining unexpectedly qoq for the past three quarters (see Table 1) and according to RIL, gas production is currently 52-54mmscmd. Management, however, has not provided any update or guidance on the production profile, stating that discussions are ongoing with the Indian government (GOI) on this issue and that it would comment on this issue only after some final decisions are made post consultations. Without the benefit of any guidance, we now estimate production will marginally improve to 60mmsmcd in FY12 based on additional well drilling and remain at that level going forward. On oil, we assume that current oil production of 18kbd is maintained in FY12 and FY13.

Table 5 : EPS sensitivity to changes in gas price and KG-D6 gas production

Year to 31 March	2011F	2012F	2013F
KG-D6 gas production (gross) (mmscmd)			
Old estimates	60.0	70.0	80.0
Current estimates	56.0	60.0	60.0
KG-D6 gas price (US$/mmbtu)	4.20	4.20	4.20
EPS (Rs)	67.3	74.1	73.3
EPS sensitivity for US$0.5/mmbtu change in gas price	5.25%	4.64%	4.69%
EPS sensitivity for 10% change in output	3.76%	3.35%	3.38%

Source: RBS forecasts

Table 6 : EPS sensitivity to changes in oil price and KG-D6 oil production

Year to 31 March	2011F	2012F	2013F
KG-D6 oil production (gross) -000 bbls/d			
Old estimates	30	30	28
Current estimates	22	18	18
Crude oil (Brent) price US$/bbl	83.00	87.00	89.00
EPS (Rs)	67.3	74.1	73.3
EPS sensitivity for US$5/bbl change in oil price	1.00%	0.90%	0.80%
EPS sensitivity for 10% change in output	1.00%	0.70%	0.70%

Source: RBS forecasts

Cut in reserve estimates

RIL management has not commented on the production outlook or whether the production disappointment has implications for any cut in reserve estimates. Also, there have been no major oil/gas discovery announcements over the past few years, even in certain highly prospective deepwater blocks. For example, on 5 January 2011, Hardy Oil disclosed that the second well drilled in the D9 block (KG-DWN-2001/1, RIL 90% stake, Hardy 10%) yielded no commercial discoveries (the first one had a similar outcome). Hence, we have cut the extent of reserve upside that we have been building in our models.

Within the KG-D6 block, the three producing fields (D1, D3, D26) have a reserve base of 10.7tcf of gas and 59mmboe of oil (total 1969mmboe) as per the field development plan (FDP). In addition to these producing fields, RIL has made a further 16 discoveries within the block (termed as satellite fields to be developed in phase II) whose reserve size we have estimated at 4tcf (677mmboe). Given the high prospectivity of the block, we had also valued additional reserves of 10tcf (1791mmboe) that are yet to be found, which we expected to be developed in phase III.

In addition to KG-D6, we had also valued the discoveries in NEC-25 (reserve size 2.6tcf, or 455mmboe) and assumed additional exploration upside of 200mmboe in terms of oil discoveries and 10tcf (1.8bn boe) in terms of gas discoveries.

Given the lack of positive news flow, we have made the following changes in our model:

- Within KG-D6, we have maintained the reserve size of the three producing fields, but now assume that production will not rise beyond 60mmscmd. We have maintained the additional reserve base of 4tcf from the satellite fields and consequent additional production, but eliminate the 10tcf estimate for yet-to-be-found reserves. All our other assumptions have remained unchanged, including one that assumes the KG-D6 gas price will be revised to US$5.5/mmbtu from FY15. For further discussion on valuation, please see our earlier note, *Re-evaluating E&P potential*, 16 August 2010.
- For additional exploration upside, we now assume only 50mmboe for oil discoveries and 5tcf (0.9mmboe) for gas discoveries.

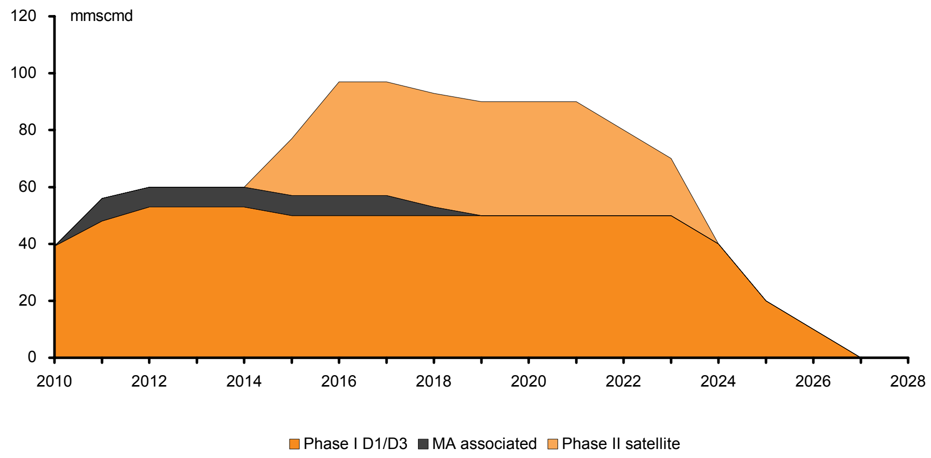
We have maintained our reserve estimates for PMT and NEC-25. Consequently, the total gross reserves that we value has dropped from Rs7.6bn boe to Rs4.8bn boe. Valuation of these reserves is down from Rs457/share to Rs324/share.

Table 7 : RIL E&P valuation

	Gross reserves (mmboe)		Value per share (Rs)	
	Old	**New**	**Old**	**New**
Existing PMT valuation	740	740	62	60
KG-D6				
Value of producing fields	1,969	1,969	198	155
New fields within same block	2,468	677	81	48
NEC-25	455	455	23	23
New oil reserves	200	50	35	9
New gas reserves	1,800	900	58	29
Total	**7,632**	**4,791**	**457**	**324**

Source: Company data, RBS forecasts

Chart 4 : KG-D6 gas production profile



Source: Company data, RBS forecasts

Upgrade to Hold, TP Rs900

Our EPS forecasts are up 5-9% for FY11/12, but down 3% for FY13. These forecasts are still 5-24% below Bloomberg consensus. We believe the consensus forecasts are yet to factor in lower KG-D6 gas production (especially in FY13).

We roll forward and raise our SOTP-based target price from Rs855 to Rs900, as the cut in E&P valuation (Rs134/share) is slightly outweighed by the rise in valuation for the refining and petrochemical business, and the lower debt arising from internal cash generation. Given the rise in our target price, we upgrade the stock from Sell to Hold.

In the absence of any management guidance, E&P business probably holds the biggest potential to provide either positive or negative surprise. The negative would be any cut in KG-D6 reserve estimates and an admittance that production may not even rise to our estimate of 60mmscmd. On the other hand, RIL may well declare a few months down the line that its technical problems have been solved, discussions with GOI had progressed smoothly and KG-D6 gas production would rise to 80mmscmd as per initial plans.

Prospects for new large discoveries still exist, in our view. However, there have been particularly high expectations from the D4 block in the Mahanadi basin (MN-DWN-2003/1) jointly owned with Niko Resources (RIL 85%, Niko 15%). If there is lack of good news from this block, there could be further cuts to analyst expectations of exploration upside.

Table 8 : Change in forecasts

Year to 31 March	2011F	2012F	2013F
Net profit (Rsm)			
Revised	200,264	220,737	218,255
Previous	190,351	202,154	224,132
Change	*5.2%*	*9.2%*	*-2.6%*
EPS (Rs)			
Revised	67.3	74.1	73.3
Previous	63.9	67.9	75.3
Change	*5.2%*	*9.2%*	*-2.6%*
EPS (based on gross shares)			
RBS current estimate	61.2	67.5	66.7
Bloomberg consensus	64.6	75.8	88.4
RBS vs consensus	*-5%*	*-11%*	*-24%*

Source: Company data, Bloomberg consensus forecasts, RBS forecasts

Table 9 : RIL earnings breakdown

Year to 31 March (RSm)	2009	2010	2011F	2012F	2013F
Segmental EBITDA					
Petrochemicals	95,386	98,469	104,824	118,046	104,167
Old refinery	113,302	49,120	51,596	58,663	63,296
RPET		43,872	79,821	93,930	99,588
PMT	29,399	26,043	20,796	25,160	25,495
KG D6		81,539	120,179	120,233	120,734
Total	238,087	299,042	377,216	416,032	413,280
EBITDA share %					
Petrochemicals	40%	33%	28%	28%	25%
Refining & Marketing	48%	31%	35%	37%	39%
E&P	12%	36%	37%	35%	35%
Depreciation	(51,953)	(104,965)	(136,158)	(139,656)	(140,068)
Interest	(17,452)	(19,972)	(21,731)	(23,310)	(23,738)
Forex gains/(losses)	(4,947)	6,764	4,000		
Non-op income	20,599	24,605	28,438	26,781	25,666
Profit before tax	184,333	205,474	251,765	279,847	275,140
Tax	(31,239)	(43,118)	(51,501)	(59,110)	(56,884)
Effective tax rate	17%	21%	20%	21%	21%
Net profit	**153,094**	**162,356**	**200,264**	**220,737**	**218,255**
EPS (Rs)	55.3	55.6	67.3	74.1	73.3

Source: Company data, RBS forecasts

Table 10 : Key assumptions

Year to 31 March	2009	2010	2011F	2012F	2013F
Exchange rate year average (Rs/USD)	46.03	47.46	46.00	45.00	45.00
Refining & Marketing					
RIL consolidated throughput (mt)	32.01	60.86	66.63	67.45	67.45
RIL consolidated GRM (US$/bbl)	12.2	6.6	8.2	9.3	9.8
E&P					
PMT oil production (gross) -000 b/d	39	42	29	38	38
PMT gas production (gross) - mmscmd	16.1	13.9	11.4	12.0	12.0
KG-D6 gas production (gross) mmscmd		39.4	56.0	60.0	60.0
KG-D6 gas price (US$/mmbtu)		4.20	4.20	4.20	4.20
KG-D6 oil production (gross) -000 b/d	3	11	22	18	18
Crude oil (Brent) price US$/bbl	84.80	69.72	83.00	87.00	89.00
Petrochemicals					
Production volumes (000 tonnes)					
Polyester	1,534	1,666	1,754	1,798	1,798
Polyester intermediates	4,583	4,619	4,637	4,637	4,637
Polymers	3,076	4,091	4,293	4,373	4,373
Cracker (ethylene production)	1,757	1,805	1,805	1,805	1,805
Margins (US$/t) key products					
PP less naphtha	566	520	580	600	680
PE less naphtha	593	594	460	550	600
PX less naphtha	345	376	336	350	400
PTA less naphtha	390	472	495	535	498
MEG less naphtha	317	365	416	336	366
PFY less naphtha	828	864	1,151	1,066	941
PSF less naphtha	492	547	791	816	641

Source: Company data, RBS forecasts

Table 11 : RIL SOTP valuation

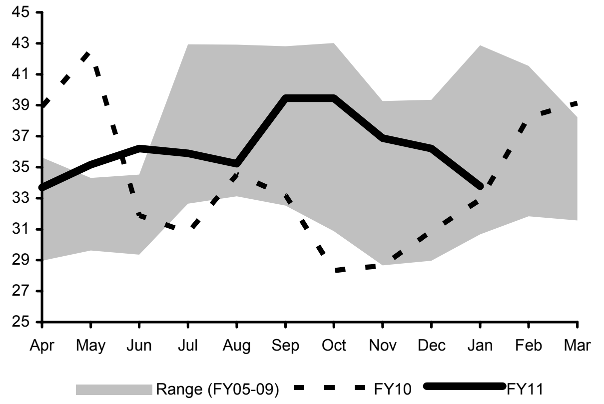
Sector	Base	Target multiple*	Valuation (Rsm)	US$m	New Rs/share	Old Rs/share	Change Rs/share
Existing business valuation on FY13F EV/EBITDA							
Petrochemicals EBITDA on Rsm	104,167	7	729,168	16,026	245	129	116
Refining EBITDA on Rsm	162,884	7	1,140,191	25,059	383	363	20
Petchems + refining			**1,869,360**	**41,085**	**628**	**492**	**136**
PMT EBITDA on Rsm	25,495	7	178,466	3,922	60	62	-2
KG-D6 oil/gas reserves on DCF	2,381.4	5.6	604,331	13,282	203	279	-76
NEC-25 reserves on DCF	455	2.6	67,000	1,185	23	23	-0
Exploration upside: oil reserves on US$/boe	50	11	26,400	550	9	35	-26
Exploration upside:gas reserves on US$/boe	900	2	86,400	1,800	29	58	-29
Total domestic E&P			**962,597**	**20,739**	**323**	**457**	**-134**
Shale joint ventures	10,000	1.0	10,000	220	3	3	0
Reliance Infotel at 1x price/book	70,000	1.0	70,000	1,538	24	16	8
Reliance Retail at 1x price/book	58,000	1.0	58,000	1,275	19	19	0
SEZs at 1x price/book	52,000	1.0	52,000	1,143	17	14	3
Balance businesses			**190,000**	**4,176**	**64**	**52**	**12**
Less: FY12F net debt			-335,644	-7,377	-113	-144	31
Total equity valuation			**2,686,314**	**58,623**	**902**	**857**	**45**

* We use FY13F EVEBITDA as our target multiples, based on historical average..
Source: RBS forecasts

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) a significant rise or fall in gas production; 3) announcements of new large discoveries, especially of oil; and 4) announcements of new value-accretive capex plans.

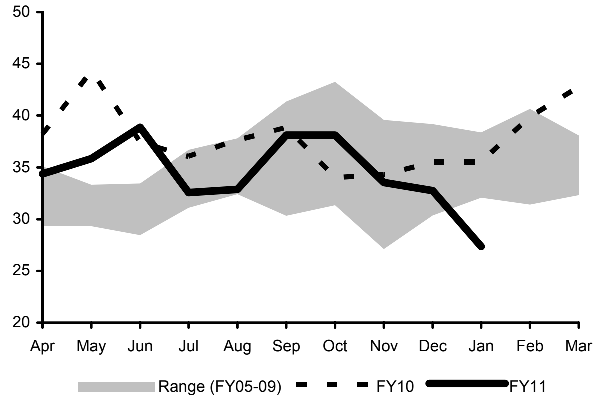
Petrochemical spreads

Chart 5 : PP-to-naphtha (Rs/kg)



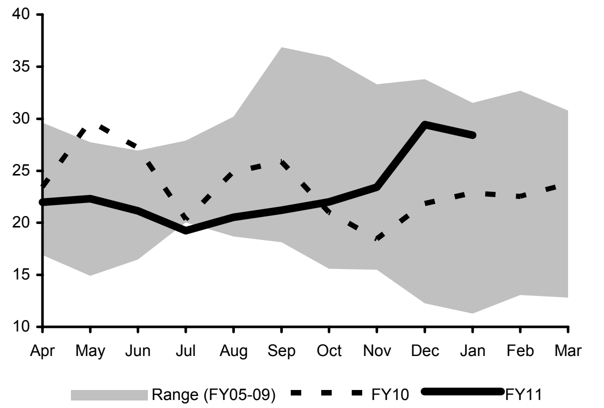
Source: RIL, RBS estimates

Chart 6 : PE-to-naphtha (Rs/kg)



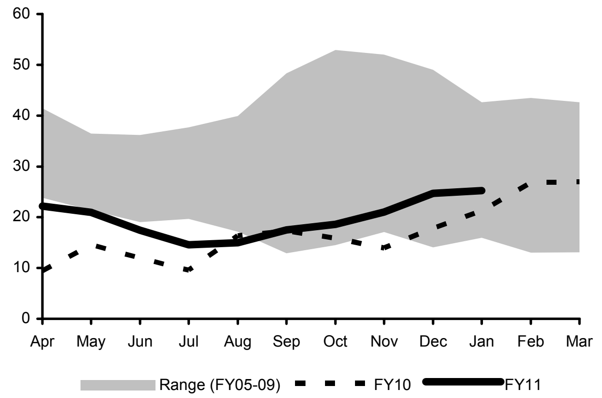
Source: RIL, RBS estimates

Chart 7 : PTA-to-naphtha (Rs/kg)



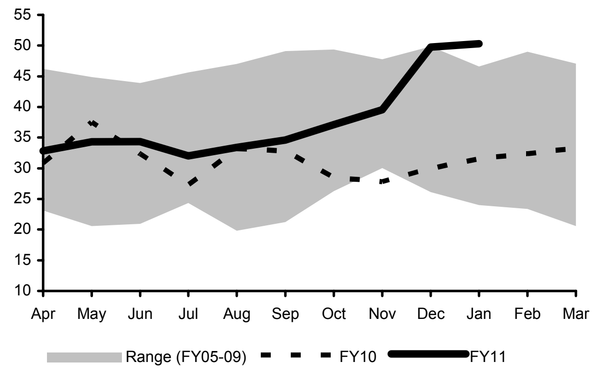
Source: RIL, RBS estimates

Chart 8 : MEG-to-naphtha (Rs/kg)



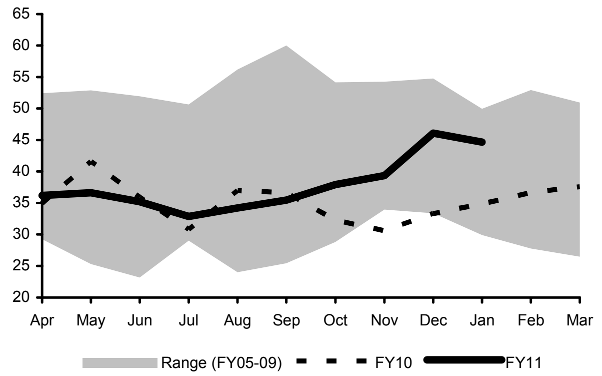
Source: RIL, RBS estimates

Chart 9 : PSF-to-naphtha (Rs/kg)



Source: RIL, RBS estimates

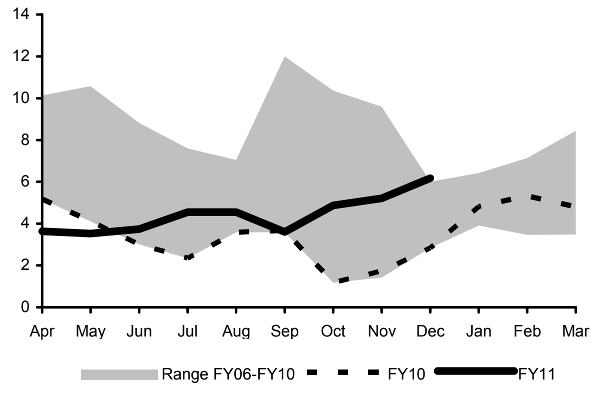
Chart 10 : POY-to-naphtha (Rs/kg)



Source: RIL, RBS estimates

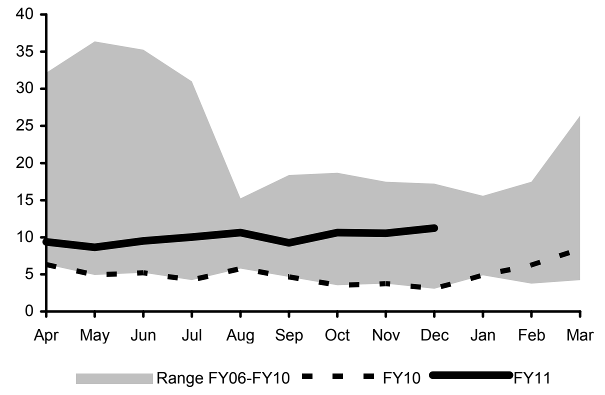
Oil product spreads

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



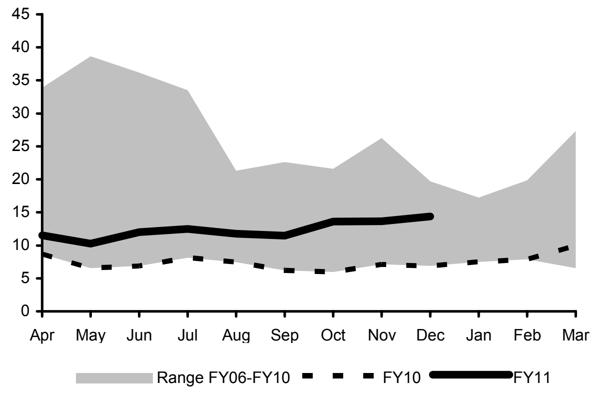
Source: Reuters

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



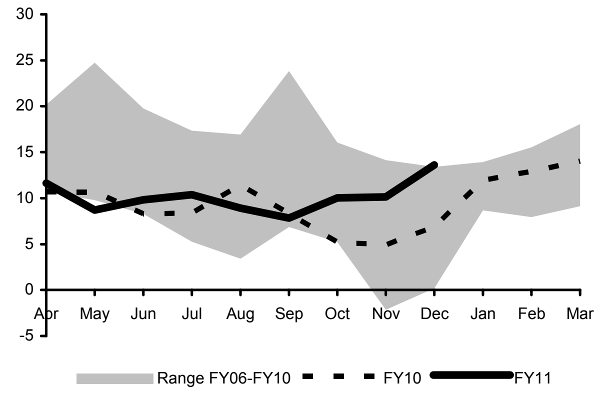
Source: Bloomberg, RBS estimates

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



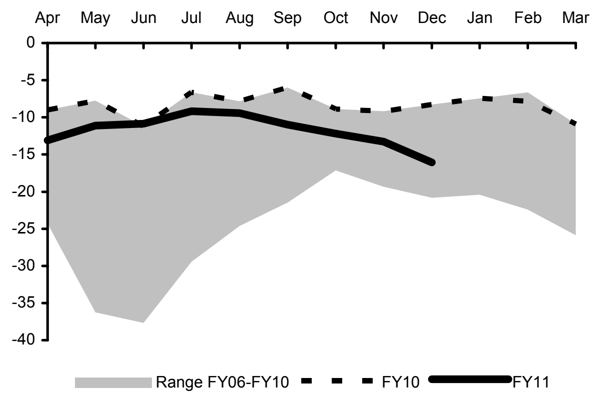
Source: Bloomberg

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



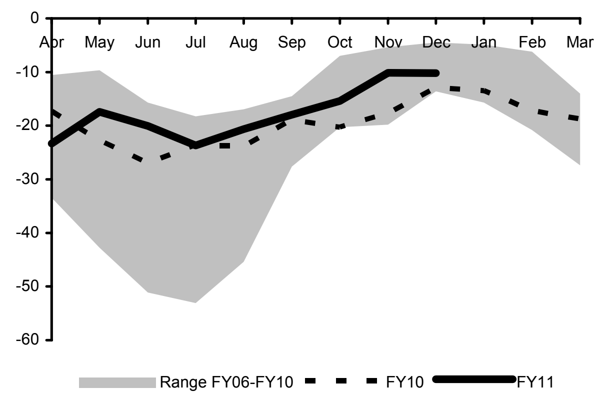
Source: Bloomberg

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



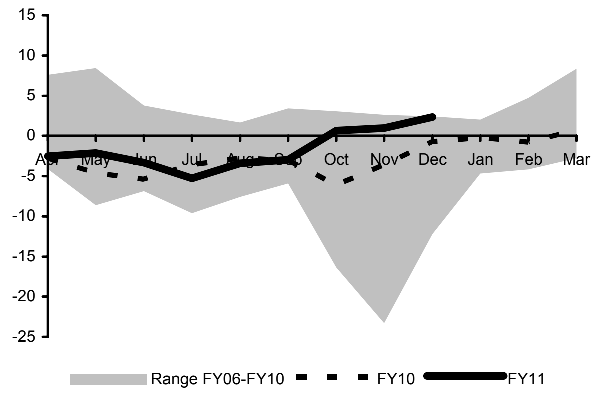
Source: Bloomberg

Chart 16 : LPG – Dubai crude (US$/bbl)



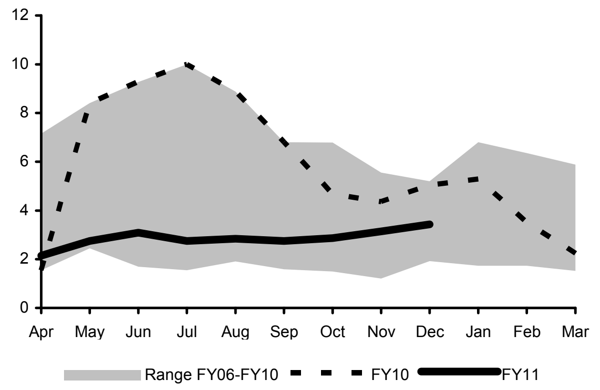
Source: Bloomberg

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



Source: Bloomberg

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



Source: Bloomberg

Income statement

Rsm	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue	1418475	1924610	2434919	2553740	2601491
Cost of sales	-1122128	-1524478	-1906574	-1981365	-2027110
Operating costs	-58260	-101090	-151129	-156342	-161102
EBITDA	**238087**	**299042**	**377216**	**416032**	**413280**
DDA & Impairment (ex gw)	-51953	-104965	-136158	-139656	-140068
EBITA	**186134**	**194077**	**241057**	**276376**	**273212**
Goodwill (amort/impaired)	n/a	n/a	n/a	n/a	n/a
EBIT	**186134**	**194077**	**241057**	**276376**	**273212**
Net interest	-17452	-19972	-21731	-23310	-23738
Associates (pre-tax)	n/a	n/a	n/a	n/a	n/a
Forex gain / (loss)	-4947	6764	4000	0.00	0.00
Exceptionals (pre-tax)	0.00	0.00	0.00	0.00	0.00
Other pre-tax items	20599	24605	28438	26781	25666
Reported PTP	**184333**	**205474**	**251765**	**279847**	**275140**
Taxation	-31239	-43118	-51501	-59110	-56884
Minority interests	0.00	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	-0.02	0.02	0.00	0.00	0.00
Reported net profit	**153094**	**162356**	**200264**	**220737**	**218255**
Normalised Items Excl. GW	0.00	0.00	0.00	0.00	0.00
Normalised net profit	**153094**	**162356**	**200264**	**220737**	**218255**

Source: Company data, RBS forecasts year to Mar

Balance sheet

Rsm	FY09A	FY10A	FY11F	FY12F	FY13F
Cash & market secs (1)	250520	218905	235472	250492	143353
Other current assets	246264	435989	487965	506001	516557
Tangible fixed assets	1410460	1400383	1432225	1515477	1692497
Intang assets (incl gw)	n/a	n/a	n/a	n/a	n/a
Oth non-curr assets	266405	201183	270308	302308	337308
Total assets	**2173648**	**2256460**	**2425970**	**2574278**	**2689715**
Short term debt (2)	62270	59503	74094	75654	77369
Trade & oth current liab	326910	368494	318040	329640	336742
Long term debt (3)	676775	565444	584532	510482	412545
Oth non-current liab	127372	144917	159629	178695	197515
Total liabilities	**1193327**	**1138358**	**1136296**	**1094471**	**1024170**
Total equity (incl min)	980322	1118102	1289674	1479807	1665545
Total liab & sh equity	**2173648**	**2256460**	**2425970**	**2574278**	**2689715**
Net debt	488525	406042	423155	335644	346561

Source: Company data, RBS forecasts year ended Mar

Cash flow statement

Rsm	FY09A	FY10A	FY11F	FY12F	FY13F
EBITDA	238087	299042	377216	416032	413280
Change in working capital	165047	-142596	-97718	-4161	-1144
Net interest (pd) / rec	-17452	-19972	-21731	-23310	-23738
Taxes paid	-12634	-31118	-41501	-42319	-40376
Other oper cash items	15652	31369	32438	26781	25666
Cash flow from ops (1)	**388700**	**136725**	**248704**	**373024**	**373688**
Capex (2)	-575143	-94888	-168001	-222908	-317088
Disposals/(acquisitions)	0.00	0.00	0.00	0.00	0.00
Other investing cash flow	12704	65222	-69125	-32000	-35000
Cash flow from invest (3)	**-562438**	**-29666**	**-237126**	**-254908**	**-352088**
Incr / (decr) in equity	209209	1225	0.00	0.00	0.00
Incr / (decr) in debt	245974	-114098	33679	-72491	-96222
Ordinary dividend paid	-22195	-24309	-28692	-30605	-32517
Preferred dividends (4)	0.00	0.00	0.00	0.00	0.00
Other financing cash flow	-212650	-1491	0.00	0.00	0.00
Cash flow from fin (5)	**220339**	**-138673**	**4988**	**-103095**	**-128739**
Forex & disc ops (6)	n/a	n/a	n/a	n/a	n/a
Inc/(decr) cash (1+3+5+6)	**46600**	**-31614**	**16566**	**15020**	**-107139**
Equity FCF (1+2+4)	-186443	41837	80703	150116	56600

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

Standard ratios

Performance	Reliance FY09A	FY10A	FY11F	FY12F	FY13F	Oil & Natural Gas Corp FY11F	FY12F	FY13F	Sinopec FY10F	FY11F	FY12F
Sales growth (%)	6.30	35.7	26.5	4.88	1.87	17.2	8.67	11.9	21.1	6.23	10.3
EBITDA growth (%)	6.67	25.6	26.1	10.3	-0.66	23.2	12.0	10.9	24.2	4.43	7.54
EBIT growth (%)	6.53	4.27	24.2	14.7	-1.14	27.0	11.7	8.52	31.0	1.66	7.75
Normalised EPS growth (%)	-9.07	0.61	20.9	10.2	-1.12	22.1	12.8	8.24	24.1	1.12	10.8
EBITDA margin (%)	16.8	15.5	15.5	16.3	15.9	34.4	35.4	35.1	5.95	5.85	5.70
EBIT margin (%)	13.1	10.1	9.90	10.8	10.5	26.6	27.4	26.5	3.93	3.76	3.68
Net profit margin (%)	10.8	8.44	8.22	8.64	8.39	19.0	19.7	19.1	2.73	2.59	2.61
Return on avg assets (%)	8.14	7.19	8.36	8.74	8.24	15.6	15.6	15.1	9.67	8.99	9.15
Return on avg equity (%)	18.5	15.5	16.6	15.9	13.9	22.3	22.2	21.1	18.8	16.5	16.0
ROIC (%)	10.4	8.22	9.79	10.0	9.29	24.8	22.0	20.1	13.1	12.0	11.8
ROIC - WACC (%)	0.24	-1.98	-0.41	-0.19	-0.91	13.4	10.6	8.68	3.25	2.17	2.00
					year to Mar			year to Mar			year to Dec

Valuation	Reliance FY09A	FY10A	FY11F	FY12F	FY13F	Oil & Natural Gas Corp FY11F	FY12F	FY13F	Sinopec FY10F	FY11F	FY12F
EV/sales (x)	2.62	1.89	1.50	1.40	1.37	1.77	1.66	1.44	0.28	0.26	0.23
EV/EBITDA (x)	15.6	12.1	9.68	8.56	8.65	5.16	4.69	4.11	4.71	4.46	4.06
EV/EBITDA @ tgt price (x)	14.4	11.2	8.92	7.88	7.96	6.12	5.56	4.89	5.16	4.90	4.46
EV/EBIT (x)	20.0	18.7	15.1	12.9	13.1	6.66	6.08	5.44	7.13	6.94	6.29
EV/invested capital (x)	2.37	2.22	1.99	1.83	1.65	1.99	1.71	1.53	1.12	1.01	0.92
Price/book value (x)	2.79	2.58	2.28	1.99	1.76	2.08	1.83	1.62	1.32	1.16	1.01
Equity FCF yield (%)	-6.83	1.45	2.75	5.11	1.93	0.98	3.31	7.89	2.63	4.36	6.15
Normalised PE (x)	17.8	17.7	14.7	13.3	13.5	9.92	8.80	8.13	7.58	7.49	6.76
Norm PE @tgt price (x)	16.3	16.2	13.4	12.1	12.3	11.7	10.3	9.56	8.56	8.47	7.64
Dividend yield (%)	0.66	0.71	0.76	0.81	0.86	3.80	4.07	4.34	3.13	3.28	3.43
					year to Mar			year to Mar			year to Dec

Per share data	FY09A	FY10A	FY11F	FY12F	FY13F
Tot adj dil sh, ave (m)	2768	2918	2977	2977	2977
Reported EPS (INR)	55.3	55.6	67.3	74.1	73.3
Normalised EPS (INR)	55.3	55.6	67.3	74.1	73.3
Dividend per share (INR)	6.50	7.00	7.50	8.00	8.50
Equity FCF per share (INR)	-67.4	14.3	27.1	50.4	19.0
Book value per sh (INR)	354.1	383.2	433.2	497.1	559.5
					year to Mar

Solvency	FY09A	FY10A	FY11F	FY12F	FY13F
Net debt to equity (%)	49.8	36.3	32.8	22.7	20.8
Net debt to tot ass (%)	22.5	18.0	17.4	13.0	12.9
Net debt to EBITDA	2.05	1.36	1.12	0.81	0.84
Current ratio (x)	1.28	1.53	1.84	1.87	1.59
Operating CF int cov (x)	24.0	9.40	14.4	18.8	18.4
Dividend cover (x)	6.90	6.68	6.98	7.21	6.71
					year to Mar

Priced as follows: RELI.BO - Rs986.80; ONGC.BO - Rs1105.55; 0386.HK - HK$7.92
Source: Company data, RBS forecasts

Valuation methodology

Sector	Base	Target multiple*	Valuation (Rsm)	US$m	New Rs/share	Old Rs/share	Change Rs/share
<u>**Existing business valuation on FY13F EV/EBITDA**</u>							
Petrochemicals EBITDA on Rsm	104,167	7	729,168	16,026	245	129	116
Refining EBITDA on Rsm	162,884	7	1,140,191	25,059	383	363	20
Petchems + refining			**1,869,360**	**41,085**	**628**	**492**	**136**
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Shale joint ventures	10,000	1.0	10,000	220	3	3	0
Reliance Infotel at 1x price/book	70,000	1.0	70,000	1,538	24	16	8
Reliance Retail at 1x price/book	58,000	1.0	58,000	1,275	19	19	0
SEZs at 1x price/book	52,000	1.0	52,000	1,143	17	14	3
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Total equity valuation			**2,686,314**	**58,623**	**902**	**857**	**45**

* We use FY13F EV/EBITDA to calculate our target multiples, base on **historical average**.
Source: RBS forecasts

Company description — Hold

Reliance (RIL) is India's largest private-sector company on all major financial parameters. RIL features in the Fortune Global 500 list of 'World's Largest Corporations' and ranks 117th among the world's Top 200 companies in terms of profits. 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, N0 5 in PP, and No 7 in PTA/MEG (according to RIL). It has the largest refinery at any single location worldwide. In FY11, RIL has entered the broadband telecom market and also acquired shale gas companies in the US.

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 — 4

Government-controlled oil-product prices for petrol, diesel, LPG and kerosene do not let RIL fully exploit its marketing network. Core earnings still driven by regional refining and petrochemical margins, which are volatile.

Opportunities — 3

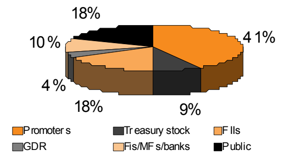
Ability to build global-scale refining operations to benefit from the tightness in global supply. Potential to expand E&P operations substantially via domestic exploration/production and acquisition of global E&P opportunities.

Threats — 3

A significant downturn in regional refining/petrochemical margins could put pressure on earnings. Significant rupee appreciation would strain profitability. Government controls may limit ability to grow domestic E&P business and use captive gas for future projects.

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

Shareholding pattern, Dec 10



Source: BSE

Market data

Headquarters
Maker Chambers IV, Nariman Point, Mumbai.

Website
www.ril.com

Shares in issue
3270.0m

Freefloat
50%

Majority shareholders
Mukesh Ambani family (41%)

Country view: India

The Indian market remains a remarkable marriage of high hopes and expectations, extended valuations and a weakening macro-economic backdrop. As pointed out by Parul Saini, RBS's India strategist, earnings risk is rising while exploding food prices can only increase the pressure on already lagging monetary policy. Thus, we have an Underweight rating on India.

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: 3+

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 — 2-

Barriers to entry are coming down as new global capacity is getting built in Middle East (which has low-cost feedstock) and China (which has the demand).

Customer power — 3-

Seems weak in domestic market (petrochemicals), but high for exports (applicable for refining).

Substitute products — 3+

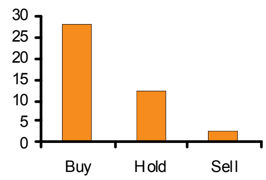
Cotton is the key substitute for polyester, but whose production cannot grow too fast. For gas production, coal is a key substitute, though domestic production of both is below domestic needs.

Rivalry — 4+

Reliance holds dominant market share in petrochem, although IOC is likely to be a future threat. For refined products, RIL competes favourably with global competitors due to its low cost structure.

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

Broker recommendations



Source: Bloomberg

Global disclaimer