INITIATING COVERAGE

Share Data

Market Cap	Rs. 2464.42 bn
Price	Rs. 1,768.5
BSE Sensex	15272.72
Reuters	RELI.BO
Bloomberg	RIL IN
Avg. Volume (52 Week)	1.04 mn
52-Week High/Low	Rs. 1785/940
Shares Outstanding	1,393.5 mn

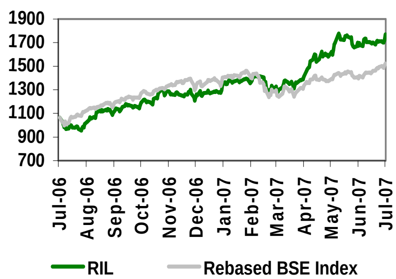
Valuation Ratios

Year to 31 March	2008E	2009E
EPS (Rs.)	83.0	108.8
+/- (%)	51.9%	61.3%
PER (x)	21.3x	16.3x
EV/ Sales (x)	2.4x	1.9x
EV/ EBITDA (x)	13.1x	10.0x

Shareholding Pattern (%)

Promoters	51
FIIs	20
Institutions	8
Public & Others	21

Relative Performance



Reliance Industries Limited — Buy

Marching ahead

Reliance Industries Limited (RIL) is a Fortune Global 500 conglomerate with operations including the entire hydrocarbon value chain, retail shopping and textiles. RIL is currently buoyed by high gross refining margins, high refinery utilization rates and increased demand for petrochemical products. The company's strategy to integrate upstream in the oil and gas industry and foray into the retail industry will provide significant opportunities for growth. Given RIL's reputation for prompt execution, we expect rapid expansion of its retail stores. The company's active participation in acquisition of hydrocarbon assets and track record of finding productive oil wells increases the probability of finding large new reserves.

Key Figures

Year to March	FY05	FY06	FY07	FY08E	FY09E	CAGR (%)
(Figures in Rs. mn, except per share data)						(FY07-09E)
Net Sales	665,977	830,248	1,053,630	1,153,915	1,426,090	16.3%
EBITDA	127,966	143,487	182,100	206,766	271,185	22.0%
Net Profit	76,282	93,982	109,080	115,663	151,551	17.9%
Margins(%)						
EBITDA	19.2%	17.3%	17.3%	17.9%	19.0%	
NPM	11.5%	11.3%	10.4%	10.0%	10.6%	
Per Share Data (Rs.)						
Normalised EPS	54.6	67.4	78.3	83.0	108.8	17.9%
PER (x)	32.4x	26.2x	22.6x	21.3x	16.3x	

- We expect sales to increase at a CAGR of 16.3% over FY07-09E due to production of oil and gas from KGD6 oil wells, contribution from Reliance Petroleum Ltd and expansion in number of retail stores.
- RIL is currently trading at P/E of 22.6x (FY07) and 21.3x (FY08E). Based on SOTP and relative valuation we have arrived at a target price of Rs 2,035 for FY08E.
- We believe the fundamentals of the company are strong and the corresponding comparable analysis indicates that the stock has a potential upside from current levels. Hence, we initiate the coverage with 'Buy'.

Investment Rationale

Refining & Marketing

Utilization rate expected to perk up

Average Utilization rate of 96% for FY07 much above global average

RIL has the world's third largest grassroot petroleum refinery with an installed capacity of 33 mn tonnes p.a. For FY07, the refinery processed 31.7 mn tonnes of crude at an average utilization rate of 96%. For the latest quarter, the average utilization rate was over 98%. Utilization rate for last year was adversely affected by planned shut down in May 06 and temporary stoppage of a part of its facilities due to fire in Oct 06. We expect the utilization rates to increase as no further planned capacity addition in the near future will put pressure on current capacity and thus raise efficiency of the refinery.

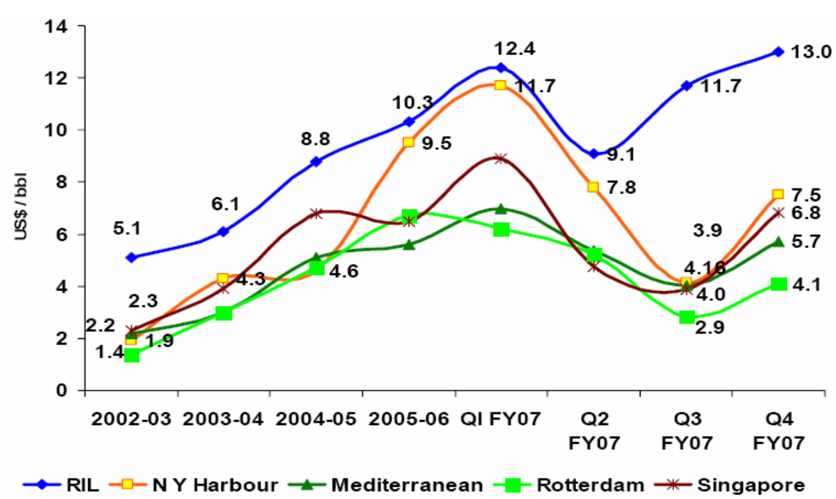
Consistent out-performance of GRMs' over regional benchmarks

GRM's increased on account of strong product prices, especially that of gasoline

The company has reported a Gross Refining Margin (GRM) of USD 13/bbl for the quarter ended Mar 07 which reflects a premium of USD 6.2/bbl over benchmark Singapore Crack Margins. RIL has consistently out-performed the regional and global benchmarks over the period. This highlights the benefit of operating high complexity refinery (Nelson complexity of 11.3) which has the capability to process sour crude and produce superior quality product.

We expect the refining margins to remain high due to the use of low cost 'sour crude' for production, conversion capacity crunch, and strong product prices.

Gross Refining Margins



ATF consumption demand increased by 21.5% in FY07

Entry into high growth aviation fuel segment

RIL entered into high growth aviation turbine fuel business in the second half of FY07. In Q307 it started the first ATF station and expanded these to five by Q407. The company plans to setup 12 additional stations by the end of FY08. On the back of rising consumption demand (21.5% yoy in FY07), the current expansion plans is expected to drive sales volume in the near term.

Retail outlets stood at 1,385, representing a network share of about 4%.

Shifting focus to exports

With the slowdown in the pace of retail outlets expansion, the company has shifted its focus on exports. This reflects the current challenges of the domestic market e.g. under recoveries in the current crude price environment and uneven playing field for private players. During last year, the company recorded export revenues of USD 11.3 bn which accounted for 57% of total refinery product volumes. The shift to exports also enabled RIL to secure an Export Oriented Unit (EOU) status which in effect helps it in keeping the effective tax rate to the current levels and thus sustain margins.

RPL on track for completion by Dec 08

Reliance Petroleum to impact valuations

During FY06, RIL commenced the setting up of a new export-oriented refinery through its subsidiary, Reliance Petroleum Limited (RPL). The refinery will have a total atmospheric distillation capacity of approximately 580,000 barrels per day with a Nelson Complexity of 14.0 and an integrated polypropylene plant with a capacity of 0.9 MMTPA. RPL expects to commission the refinery and the polypropylene plant in and around December 2008. We expect the plant to start contributing to the topline from Q4'09. RPL's operation provides a major upside potential to RIL's valuations since it holds 75% equity stake in RPL.

Petrochemicals

Polymer consumption demand expected to grow by 5 MMTA to 12 MMTA by 2011

Robust market demand

The strong demand for petrochemicals globally is fuelled by the booming economies of India and China. The polymer consumption is expected to grow by 27% globally over the next 5 years, but Indian consumption is expected to grow at a much faster rate. The consumption in India is expected to grow from 5 MMTA in 2006 to 12 MMTA by 2011, an increase of 140%. The increase in demand for polymers in the Indian market is driven primarily by three industries- packaging, infrastructure and agriculture.

Synergies between petrochemical and other segments

Integration of refining and petrochemical business provides strong operational synergies

RIL is the largest private company in India and it has a diverse business. In addition to petrochemicals, it is also involved in refining, infrastructure, exploration and textiles. RIL's involvement in the other segments especially in refining and infrastructure provides positive synergies with the petrochemical segment. Petrochemicals are made from the by products of crude oil when it goes through the refining process. As RIL also does refining, the petrochemical segment has a constant supply of raw materials. The infrastructure segment operates pipelines that are used in the transportation of petroleum products.

RIL and IPCL merger

The combined entity will have a market share of appx. 70%

The merger of RIL and IPCL will create a behemoth that will have a combined market share of close to 70% of the Indian polymer market. Majority of the products produced by IPCL are similar to those of RIL with an exception of a few like polybutadiene rubber and acrylic fibre that will allow RIL to further diversify its product portfolio. The merger would also allow RIL to diversify its raw material source required for production of petrochemicals. IPCL primarily uses natural gas crackers to produce petrochemicals whereas RIL uses naphtha crackers to produce petrochemicals. The merger between the companies gives RIL access to larger customer base.

Exploration and Production

Market pricing of NELP acquired reserve output to increase cash flow

Production from KG fields expected to commence in 2H FY08-09

NELP ushered in a new era of exploration and growth of India's oil and gas reserves. This policy signalled the intention of Indian government towards deregulation in the oil and gas industry inviting private and international exploration and production companies.

After gaining stake in the oil rich KG basin, RIL discovered one of the largest gas reserves (KG D6 MA) in the country. Unlike the output from Panna-Mukta-Tapti fields, output from KG D6 fields could be sold at market prices. As Reliance Industries and its partner is expected to begin production from KG fields in 2H FY08-09. Initial production is expected to be at 40 mmscmd, reaching a peak production of 80 mmscmd.

Given the increase in demand and rise in oil and gas prices, RIL will realize a steady stream of cash flow from wells discovered in its NELP fields.

RIL discovered 3.65 trillion cubic feet of hydrocarbons in Coal Bed Methane blocks located in Sohagpur east and west blocks. The company is awaiting confirmation from Directorate General of Hydrocarbons for additional discoveries in hydrocarbon rich KG basin. These additional discoveries, once confirmed should affect the stock price positively.

Output from Tapti NRPOD to increase revenues

Natural gas production from Tapti field is expected to increase by 30%, during FY07- FY08

New Revised Plan of Development (NRPOD) for Tapti field is expected to increase production of natural gas by 30% to 17 mmscmd during FY07-FY08. Since this output is derived from new investment, it is does not fall under the aegis of Administered Price Mechanism. Hence, RIL is allowed to sell its share of output at market price providing higher margin.

Given the benefit of increasing production beyond the then initial estimates, RIL and its partners are investing in output enhancement programmes on other fields.

Exploration of oil and gas fields to provide growth opportunities

Expanding presence in E&P across markets, in India and abroad

RIL is rapidly expanding into the E&P business by actively acquiring hydrocarbon rich properties during NELP. During the recently ended NELP (VI), RIL landed an additional 7 blocks bringing its portfolio to 48 blocks. In addition to the domestic reserves, RIL has acquired one block each in Yemen and Oman. The company has also signed a Technical Evaluation Agreement with ANH (Columbia's hydrocarbon regulator) and also entered into a cooperation agreement with Ecopetrol (National Oil Company of Columbia) for farm-in opportunities in that country.

RIL has a stake in hydrocarbon rich KG basin (11.3 TCF – 2P reserves), NEC-25 (2.3 TCF Original Gas in Place) and Coal Bed Methane gas field (3.65+1.5 TCF OCIP) with further potential for exploration. Heavy investment in R&D, acquisition on reserves and ongoing exploration provides the company ample opportunity to discover large hydrocarbon reserves in the future.

Retail business

Foray into retail sector with robust expansion plans

Currently, Reliance Retail has over 135 retail outlets covering 370,000 sq. ft.

Currently in India, the organized sector accounts for around 3% of the total retail market (as against 20% of China), indicating a huge potential for growth. Realizing the potential of this untapped market, Reliance Retail Ltd (RRL) has opened retail outlets under the brand name Reliance Fresh and Reliance Digital. We expect that the company would benefit from its foray into the organized retail sector which is still in its embryonic stage.

The retail industry is marked with low margins. Due to its large operations, RRL has an opportunity to achieve economies of scale and hence has better prospects of operating at higher margins as compared to its competitors.

With RRL entering the organized market, the company expects to cash in on the opportunities in the growing retail sector and hence increase its shareholders' value.

Key Risks

Drop in Gross Refining Margins

Reliance is consistently operating at a high GRM vs benchmark index. An increase in crude oil prices and demand-supply imbalance can lead to a drop in refining margins which will have a negative impact on its profitability.

Final decision awaited on price of gas from KGD6

Pricing of Gas holds the key to E&P business profitability and expansion plans

RIL has proposed a sales price of $5.2/mbtu to $6.2/mbtu for its production from KGD6 and the government of India has approved the pricing formula. However, ministry of fertilizer (demanding no more than $5/mbtu) and ministry of power (demanding $2.5/mbtu) have raised concerns regarding the price. Higher than traditionally subsidized prices will lead to lower profits for fertilizer and power PSUs. Any change to the proposed price will lead to lower contribution to the exchequer in the form of lower royalty and taxes. It will also signal government's intervention in setting market prices and discourage investment in future exploration and production. Although the government has avoided intervening in the situation, any change to the pricing could negatively affect cash flow not only from KGD6, but also from future oil discoveries.

Restriction on the entry of Private players in the retail sector can hurt expansion plans

Restriction on the entry of retail

The Kerala government is planning to bring in a law to ban corporate retailers, both Indian and MNCs, in the state. This would not be a conditional or limited ban but a blanket ban on the entry of the corporate houses in the state. Instead, the government plans to open outlets on its own. The new law is unlikely to impact the first 6 shops of RRL, which have already been opened in Kerala; however, the company's blueprint for opening 70 shops in the state will come to a standstill. If other states follow the Kerala government's path, RRL's future growth plans could be adversely affected.

Decrease in demand or increase in supply of petrochemicals

The petrochemical industry is a highly cyclical industry. The decrease in demand due to slowdown in the economy, or increased competition would affect the bottom line of RIL. The competitors of RIL are expanding their facilities to keep up with the growing demand. As the new competitor facilities come into service, the influx of new supply can increase pressure in pulling down market prices and thus lower margins.

Outlook

Indian economy is growing at an impressive rate of over 8% and is likely to continue growing at this rate in the coming years. The growth has also accelerated the energy demand of the country, which has created new opportunities for the company in the 'Refining and Marketing' and 'Exploration and Production' segments. Further, with the Indian Retail industry expected to grow at a CAGR of 40%, RIL's foray into retail is likely to provide huge addition to sales volume. Currently, the company derives close to 98% of its sales revenue from refining and petrochemical segment, but E&P and Retail segments share is expected to increase at a tremendous pace.

Reliance's efficient business model, strong market share across all operating segments, strong execution capabilities, presence in high growth business areas, and strong fundamentals, all indicate towards potential gains in investor net worth.

Based on SOTP and relative valuation we value RIL at Rs. 2,035 per share for FY08E and initiate the coverage with 'Buy'.

Company Background

Reliance Industries Limited (RIL) is the largest private sector business enterprise in India. It is the only private sector company from India to feature in the Fortune Global 500. RIL's operations include exploration and production of crude oil and gas, refining and marketing of petroleum, and, production of petrochemicals and textiles. Also, the company recently forayed into retail business and has aggressive future growth plans for this segment

RIL is the largest Oil & Gas acreage holder among the Private sector companies in India with 34 domestic exploration blocks covering an area of about 331,000 sq. km. This is in addition to its interest in one exploration block each in Yemen and Oman; and interests in Panna Mukta and Tapti fields. RIL also has 5 coal bed methane blocks covering an area of about 4,000 sq. km.

RIL's Jamnagar refinery, is the world's third largest grassroot refinery (present capacity of 33 mn tones p.a.), and has acquired the status of an EOU w.e.f. 2007.

Reliance Retail has opened its first retail store in November 2006 and now holds over 135 retail stores covering 16 cities with a total square footage of over 370,000 sq. ft.

RIL operates mainly in India but has business activities and customers in more than 100 countries around the world. The company has entered into a merger agreement with Indian Petrochemical Corporation Ltd. (IPCL) and awaits approval from appropriate authorities. Reliance Industrial Infrastructure Limited and Reliance Europe Limited are RIL's other two major associate companies.

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