Company Flash

2 July 2007 | 6 pages

Reliance Industries (RELI.BO)

Buy: Niko's 4QFY07 update; Gas Reserves move up, Oil quantified

- **Gas Reserves - headline at 40tcf, new discoveries not yet measured** — Niko disclosed an upgrade in the Resources Estimate leading to 2P+Best OGIP of 26.7tcf (23.2tcf earlier) and 3P+High of 40.0tcf (35.4tcf). While this incorporates results from 2 of 5 gas discoveries in FY07 and some in FY06, it leaves out MG-1, P2 and the R1 wells. The R1 well drilled to the deepest water depth is significant as it suggests that success achieved in shallower water segments could be repeated.

- **Oil Reserves on the lower side** — For the MA fields in the D6 block, Niko also disclosed OIP-High Case of 391MMBO (255MMBO recoverable). The targeted production level is 30-35kbpd beginning 2Q08. While the oil resources are on the lower side, it is compensated by likely higher recovery, early-commissioning and ready market. In any case, we have not considered any contribution from oil revenues in our E&P business valuation based on EV/FCF.

- **Capex targets for D6 indicate mid-2008 commissioning** — Company expects F&D capex of US$3.25bn in FY08 i.e. cumulative capex by end-FY08 likely to be ~US$4.0bn, out of the development capex of US$5.2bn for the recovery of 11.3tcf. Note that our DCF valuation of core D6 gas reserves assumes an ultimate recovery of 16.2tcf, lower than the updated 2P reserves of 16.9tcf (see table below).

- **Risks** — Slower ramp up in gas production, lower-than-expected gas price realization (US$4.5/mmbtu) and delay in exploratory drilling in non-D6 blocks (due to rig shortage) are key risks.

Buy/Low Risk	**1L**
Price (02 Jul 07)	Rs1,684.50
Target price	Rs2,005.00
Expected share price return	19.0%
Expected dividend yield	0.8%
Expected total return	**19.8%**
Market Cap	Rs2,347,364M
	US$57,924M

Figure 1. KG-D6: Reserve Estimate Changes (all figures in trillion cu.ft.)

Year ending March31,	Category	1P/Low	2P/Best	3P/High
2006	OGIP	5.72	18.80	27.20
2007	OGIP	5.72	18.80	27.20
2006	Resources	1.23	4.45	8.19
2007	Resources	3.76	7.88	12.76
2006	OGIP + Resources	6.95	23.25	35.39
2007	OGIP + Resources	9.48	26.68	39.96
2007	Total Recoverable	7.10	16.92	30.16

Source: Citigroup Investment Research estimates

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See Appendix A-1 for Analyst Certification and important disclosures.

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Figure 2. RIL – Sum-of-the-parts Valuation

	Rs m	Rs/share	Comments
FY07A EBITDA Actuals	182,224		
FY08E EBITDA forecast	185,877		
FY09E EBITDA forecast	168,360		Excluding contribution from KG basin
EV of Petrochem & Refining (Rs m)	1,151,270	826	@ EV/E of 6.5x mid-FY09E (vs. 6.0x FY08E earlier)
Net Debt (Rs m)	130,235	93	Estimated as on mid-FY08E, net of liquid inv. & ST debt
Key investments			
IPCL	40,401	29	P/E of 8x FY08E due to the announced merger
Reliance Petroleum	337,985	243	P/E of 8x contribution to consolidated profits in FY10E, discounted back
E&P Assets	879,471	631	Based on 10x steady state FCF (80mmscmd in FY11E)
Organised Retail	173,610	125	Rolling forward to Mar-08
Total value of investments & other assets	1,431,468	1,027	
EV of businesses	1,151,270	826	
Net Debt adjusted for key investments	(1,301,233)	(934)	
Value of Treasury stock	340,781	245	At target price
Value for Equity holders (Rs m)	**2,793,284**	**2,005**	
No. of shares (m.)	1,393		Pre-warrants pre-IPCL merger, includes treasury stock

Source: Citigroup Investment Research estimates

Figure 2. RIL – Asset-wise NAVs

	Recovery assumed tcf/mmboe	2P+Best OGIP tcf/mmbo	Value US$m	EV/boe US$	Value/share Rs	Remarks
KG-D6						
Dhirubhai-1&3 plus resources	16.2	23.2	9,166	3.5	270	Based on DCF assuming 70% recovery from 2P+Best OGIP of 23.2 tcf
Potential undrilled prospects						
- Oil	480	800	3,456	7.2	90	@60% recovery of undrilled prospects in Pliocene & Cretaceous, EV/boe at 20% discount to Cairn's US$9.0
- Gas	3.9	39.0	2,106	3.0	55	Based on 10% recovery of 39 tcf of undrilled gas prospects
Sub-total			14,728		415	
Other Blocks						
KG III-6 (Prospects)	150	500	750	5.0	22	@ 30% recovery on 500mmbbl of prospective resource
NEC-25	1.9	3.7	833	2.5	24	@ 50% recovery of 2P OGIP of 3.7 tcf
CBM (3P OGIP)	0.4	3.7	167	2.5	5	@ 10% recovery of 3P OGIP of 3.7 tcf
Total			**16,477**		**466**	

Source: Citigroup Investment Research estimates

Figure 3. E&P – Valuation based on EV/FCF

	FY11E
FCF (Rs m)	106,416
EV/FCF 12-mnth fwd (x)	10.0
EV Mar-10E (Rs bn)	1064
Imputed fwd PER (x)	10.9
EV Mar-08E (Rs bn)	879
Value per share (Rs)	**631**
NAV per share (Rs)	466
Premium to NAV (%)	35%

Source: Citigroup Investment Research estimates

Reliance Industries

Company description

Reliance Industries is a conglomerate with interests in upstream oil & gas (E&P), refining, and petrochemicals. It is building a super-size refinery project through its 75% subsidiary (RPL) and is now undertaking development of a large gas find in KG basin. RIL is foraying into organized retailing and has plans to undertake SEZ projects over the medium to long term.

Investment thesis

We rate RIL Buy/Low Risk with a target price of Rs2,005. We expect regional refining margins to remain robust due to project delays in the Middle East, with RIL enjoying an enhanced premium for its superior complexity. E&P business has delivered positive surprise and looks set to become more meaningful in the next 3-4 years as KG D6 field commences production and new discoveries are brought on stream. Upgrade of reserves in KG basin adds to the value, although the NAV of the gas find depends on development capex and the demand profile from anchor customers. Given the track record of exploratory success and the evolving portfolio (much beyond KG D6), RIL's E&P business needs to be valued as a going concern rather than a combination of assets. We have therefore valued E&P business (Rs631/share) on more traditional EV/FCF multiple rather than the consensus NAV approach. While petrochemicals will likely face pressure in FY09E, this will be offset by diversity of products to some extent. Factors such as diversity of revenues, integration across product chains, and volume growth should help RIL tide over downturns in product cycles.

Valuation

Our target price of Rs2,005 is based on a sum-of-the-parts value: 1) RIL's core petrochem and downstream oil business is valued on an EV/EBITDA of 6.5x mid-FY09E, in line with the regional chemicals and refining peers; 2) Total E&P assets including oil & gas prospects and other blocks are valued at Rs631/share based on 10x steady state (FY11E) FCF; 3) Investment in IPCL and RPL valued at 8x profit contribution to consolidated profits; 4) Organized retail business value is rolled forward to Mar-08E and factored in at Rs125/share, as per Citigroup's Retail Analyst, Princy Singh; and 5) Treasury stock is valued at RIL's target price.

Risks

We rate RIL Low Risk, as opposed to the Medium Risk suggested by our quantitative risk-rating system, which tracks 260-day historical share-price volatility. Diversified earnings and significant value contribution from the emerging E&P business and investment in listed subsidiaries have led to qualitative changes in the value constituents of the stock. Risks that could impede the stock from reaching our target price are: RIL's margins are exposed to the global petrochemical and refining cycles; the group could be asked to offer larger discounts on products sold to oil public sector units; delays in the key KG-D6 gas development and RPL refinery project; delays in the drilling programme for the new blocks (D9, D3, D4); and the organized retail business would call for significant investment in non-core areas.

Appendix A-1

Analyst Certification

We, Rahul Singh and Saurabh Handa, research analysts and the authors of this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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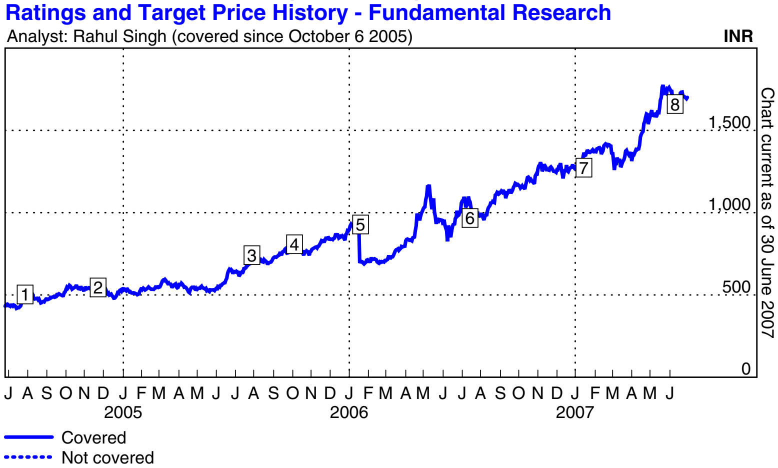
Analyst: Rahul Singh (covered since October 6 2005)



#	Date	Rating	Target Price	Closing Price
1:	28 Jul 04	1L	*473.09	470.50
2:	23 Nov 04	1L	*497.01	528.30
3:	28 Jul 05	1L	*598.65	NA
4:	5 Oct 05	1L	*697.31	801.95
5:	19 Jan 06	1L	*794.00	704.20
6:	14 Jul 06	*2L	*1,150.00	1,065.15
7:	15 Jan 07	2L	*1,450.00	1,364.65
8:	11 Jun 07	*1L	*2,005.00	1,668.20

*Indicates change.

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