

ACTION

Buy

Reliance Industries (RELI.BO)

Return Potential: 25%

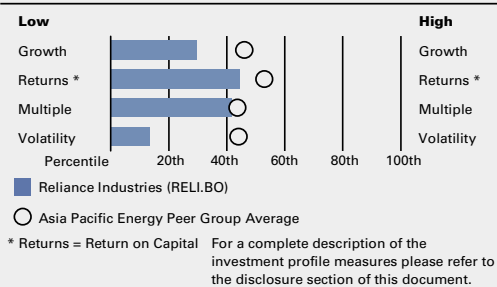
Equity Research

From 0/3 last year to at least 2/3 in 2011; add to Conviction Buy list

Source of opportunity

We add Reliance Industries (RIL) to our Asia Pacific Conviction Buy list as we believe that its cyclical businesses are turning around and will likely drive an earnings surprise over the medium term. With RIL's leverage to recovering complex refining margins and the global ethylene cycle likely to bottom out in 2HCY11, we believe two of RIL's three core businesses are falling into place going forward. With the delay in D-6 volume ramp-up widely known and likely priced in, any positive news flow on the E&P front could further re-rate RIL's share price, in our view. We also believe that there could be updates on RIL's broadband and retail businesses in 2HFY12E.

Investment Profile



Catalyst

(1) Continued strength in refining margins leading to consensus earnings upgrades; (2) recovery in ethylene cycle adding to strong polyester margins; (3) positive update on D-6 production ramp-up or exploration progress; (4) newsflow on progress in the new telecom venture and retail business; and (5) depreciation of the INR-USD exchange rate.

Valuation

Our new 12-m SOTP-based target price of Rs1,250 (Rs1,200 earlier) for RIL implies potential upside of 25%. We increase RIL's FY11E-13E earnings by 5%-11%, driven by our weaker INR-USD rate forecasts, partly offset by lower FY12E D-6 volumes of 55mmscmd vs. 60 earlier. At our TP, RIL would trade at 14X FY12E EPS vs. its historical range of 4X-33X. We believe RIL is trading at a discount to the Indian market owing to a lack of conviction on the street on the turnaround of its cyclical segments and on future growth; we think these attitudes will change as the catalysts cited above start to play out. We value RIL's refining at near trough-cycle multiples, petchem at trough-cycle and E&P business as a mix of DCF and EV/boe multiples.

Key risks

(1) Petchem weakness; (2) delay in D-6 ramp up; (3) expensive acquisitions.

INVESTMENT LIST MEMBERSHIP

Asia Pacific Buy List

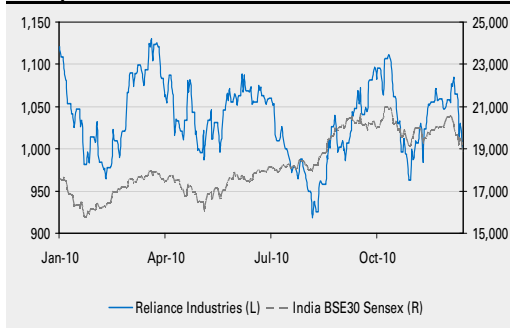
Asia Pacific Conviction Buy List

Coverage View: Neutral

Key data	Current
Price (Rs)	1,001.15
12 month price target (Rs)	1,250.00
RELI.L Price (\$)	44.09
RELI.L 12 month price target (\$)	53.40
Market cap (Rs mn / US\$ mn)	3,289,338.4 / 72,476.3
Foreign ownership (%)	23.0

	3/10	3/11E	3/12E	3/13E
EPS (Rs) New	49.35	64.99	84.37	99.59
EPS revision (%)	0.0	(0.2)	4.6	11.5
EPS growth (%)	(1.7)	31.7	29.8	18.0
EPS (dil) (Rs) New	49.35	64.99	84.37	99.59
P/E (X)	20.3	15.4	11.9	10.1
P/B (X)	2.4	2.1	1.9	1.6
EV/EBITDA (X)	13.3	10.2	8.0	6.4
Dividend yield (%)	0.6	0.7	0.8	0.8
ROE (%)	12.2	14.6	16.8	17.2
CROCI (%)	8.7	10.2	12.3	13.6

Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	(5.4)	(6.4)	(10.7)
Rel. to India BSE30 Sensex	2.8	(10.9)	(16.7)

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 1/14/2011 close.

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Reliance Industries: Summary Financials

Profit model (Rs mn)	3/10	3/11E	3/12E	3/13E	Balance sheet (Rs mn)	3/10	3/11E	3/12E	3/13E
Total revenue	1,885,452.4	2,646,442.9	3,039,033.6	3,020,043.4	Cash & equivalents	96,272.1	131,361.2	275,094.9	458,802.4
Cost of goods sold	(1,461,513.0)	(2,141,737.3)	(2,563,695.1)	(2,480,237.7)	Accounts receivable	62,848.4	88,214.8	101,301.1	100,668.1
SG&A	(129,323.7)	(134,392.0)	(148,218.9)	(157,395.9)	Inventory	157,021.9	226,740.9	259,026.2	249,371.1
R&D	--	--	--	--	Other current assets	130,797.8	130,797.8	130,797.8	130,797.8
Other operating profit/(expense)	0.0	0.0	0.0	0.0	Total current assets	446,940.3	577,114.7	766,220.1	939,639.4
EBITDA	294,615.8	370,313.6	448,918.4	526,662.9	Net PP&E	1,837,872.5	1,924,700.3	1,943,284.8	1,929,169.0
Depreciation & amortization	(100,469.2)	(110,677.6)	(121,798.8)	(144,253.1)	Net intangibles	0.0	0.0	0.0	0.0
EBIT	194,146.6	259,636.0	327,119.6	382,409.8	Total investments	236,064.9	303,858.7	370,021.1	444,150.5
Interest income	27,814.0	26,134.3	30,575.4	35,240.5	Other long-term assets	0.0	0.0	0.0	0.0
Interest expense	(19,299.1)	(18,861.7)	(11,180.5)	(8,657.7)	Total assets	2,520,877.7	2,805,673.7	3,079,525.9	3,312,958.9
Income/(loss) from uncons. subs.	0.0	0.0	0.0	0.0	Accounts payable	338,747.5	490,865.3	557,826.7	536,884.7
Others	0.0	0.0	0.0	0.0	Short-term debt	0.0	0.0	0.0	0.0
Pretax profits	202,661.5	266,908.6	346,514.5	408,992.6	Other current liabilities	0.0	0.0	0.0	0.0
Income tax	(40,532.3)	(53,381.7)	(69,302.9)	(81,798.5)	Total current liabilities	338,747.5	490,865.3	557,826.7	536,884.7
Minorities	0.0	0.0	0.0	0.0	Long-term debt	653,017.9	605,467.9	577,267.9	529,717.9
Net income pre-preferred dividends	162,129.2	213,526.9	277,211.6	327,194.1	Other long-term liabilities	112,487.0	124,487.0	136,487.0	148,487.0
Preferred dividends	0.0	0.0	0.0	0.0	Total long-term liabilities	765,504.9	729,954.9	713,754.9	678,204.9
Net income (pre-exceptionals)	162,129.2	213,526.9	277,211.6	327,194.1	Total liabilities	1,104,252.4	1,220,820.2	1,271,581.6	1,215,089.5
Post-tax exceptionals	0.0	0.0	0.0	0.0	Preferred shares	0.0	0.0	0.0	0.0
Net income	162,129.2	213,526.9	277,211.6	327,194.1	Total common equity	1,381,636.5	1,543,002.3	1,760,243.1	2,045,593.1
EPS (basic, pre-except) (Rs)	49.35	64.99	84.37	99.59	Minority interest	34,988.8	41,851.3	47,701.3	52,276.3
EPS (basic, post-except) (Rs)	49.35	64.99	84.37	99.59	Total liabilities & equity	2,520,877.7	2,805,673.7	3,079,525.9	3,312,958.9
EPS (diluted, post-except) (Rs)	49.35	64.99	84.37	99.59	BVPS (Rs)	420.52	469.63	535.75	622.60
DPS (Rs)	6.50	7.25	8.00	8.50					
Dividend payout ratio (%)	13.2	11.2	9.5	8.5					
Free cash flow yield (%)	(0.5)	4.8	8.6	10.9					
Growth & margins (%)	3/10	3/11E	3/12E	3/13E	Ratios	3/10	3/11E	3/12E	3/13E
Sales growth	32.9	40.4	14.8	(0.6)	CROCI (%)	8.7	10.2	12.3	13.6
EBITDA growth	23.7	25.7	21.2	17.3	ROE (%)	12.2	14.6	16.8	17.2
EBIT growth	4.3	33.7	26.0	16.9	ROA (%)	6.5	8.0	9.4	10.2
Net income growth	5.9	31.7	29.8	18.0	ROACE (%)	8.2	10.3	12.6	14.3
EPS growth	(5.5)	31.7	29.8	18.0	Inventory days	39.3	32.7	34.6	37.4
Gross margin	22.5	19.1	15.6	17.9	Receivables days	10.5	10.4	11.4	12.2
EBITDA margin	15.6	14.0	14.8	17.4	Payable days	86.9	70.7	74.7	80.6
EBIT margin	10.3	9.8	10.8	12.7	Net debt/equity (%)	39.3	29.9	16.7	3.4
					Interest cover - EBIT (X)	NM	NM	NM	NM
Cash flow statement (Rs mn)	3/10	3/11E	3/12E	3/13E	Valuation	3/10	3/11E	3/12E	3/13E
Net income pre-preferred dividends	162,129.2	213,526.9	277,211.6	327,194.1	P/E (analyst) (X)	20.3	15.4	11.9	10.1
D&A add-back	100,469.2	110,677.6	121,798.8	144,253.1	P/B (X)	2.4	2.1	1.9	1.6
Minorities interests add-back	0.0	0.0	0.0	0.0	EV/EBITDA (X)	13.3	10.2	8.0	6.4
Net (inc)/dec working capital	(43,582.2)	57,032.4	21,589.8	(10,653.9)	EV/GCI (X)	1.5	1.3	1.2	1.0
Other operating cash flow	(34,856.0)	(31,514.7)	0.0	0.0	Dividend yield (%)	0.6	0.7	0.8	0.8
Cash flow from operations	184,160.1	349,722.3	412,216.9	452,905.9					
Capital expenditures	(207,312.5)	(198,262.5)	(144,150.0)	(115,675.0)					
Acquisitions	(20,000.0)	(67,793.8)	(66,162.4)	(74,129.4)					
Divestitures	0.0	0.0	0.0	0.0					
Others	27,814.0	26,134.3	0.0	0.0					
Cash flow from investments	(199,498.5)	(239,922.0)	(210,312.4)	(189,804.4)					
Dividends paid (common & pref)	(24,351.3)	(27,161.1)	(29,970.9)	(31,844.1)					
Inc/(dec) in debt	(85,803.4)	(47,550.0)	(28,200.0)	(47,550.0)					
Common stock issuance (repurchase)	0.0	0.0	0.0	0.0					
Other financing cash flows	0.0	0.0	0.0	0.0					
Cash flow from financing	(110,154.8)	(74,711.1)	(58,170.9)	(79,394.1)					
Total cash flow	(125,493.2)	35,089.1	143,733.7	183,707.4					

Note: Last actual year may include reported and estimated data.

Source: Company data, Goldman Sachs Research estimates.

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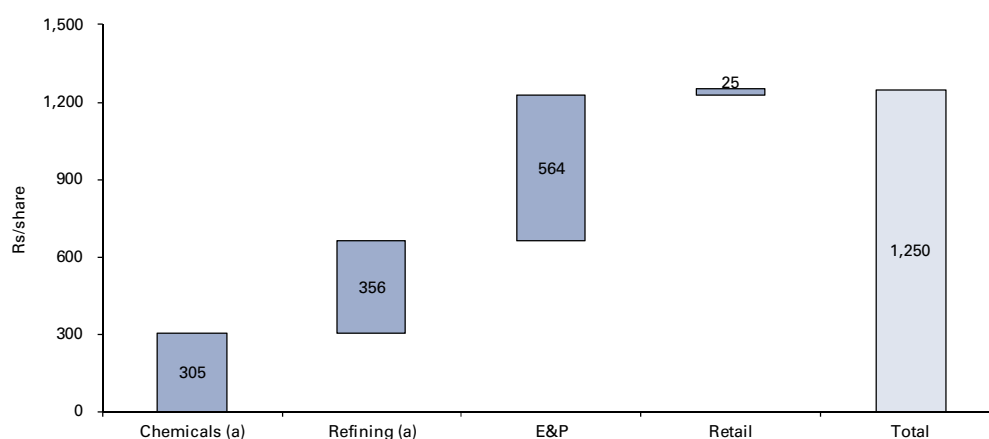
Investment view: Added to Conviction list; Rs1,250 target price

We reiterate our Buy rating on RIL and add it to our Asia Pacific Conviction Buy list as we believe that its cyclical businesses are turning around and will likely drive an earnings surprise over the medium term, with a new 12-month SOTP-based target price of Rs1,250 (Rs 1,200 earlier), implying 25% potential upside from the current share price level. We also add the GDR (RELIq.L) to the Conviction Buy list and nudge up its 12-month SOTP-based target price from US\$53.20 to US\$53.40. We lower our FY11-FY13E earnings estimates for the GDR by 1%-4% due to a weaker USD-INR rate.

With RIL's leverage to recovering complex refining margins and the global ethylene cycle likely to bottom out in 2HCY11, we believe that two of RIL's three core businesses – refining and petrochemicals – are falling into place going forward.

Exhibit 1: Refining and Petchem contribute slightly more than 50% to valuation

Build-up of our new Reliance SOTP valuation



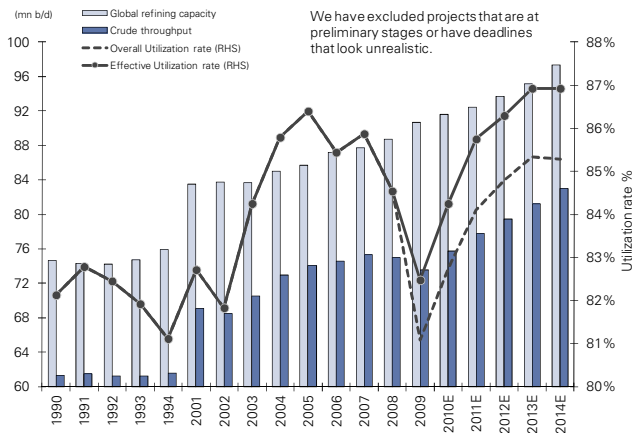
(a) We have adjusted for the debt of the refining, petrochemicals and oil & gas businesses. .
Source: Goldman Sachs Research estimates.

From 0/3 last year to 2/3 in 2011: Refining and petchem recovery

We believe that complex refining margins are likely to recover over the medium term and estimate that RIL's earnings are strongly leveraged to the same. Moreover, any widening of light-heavy oil price differential from robust global oil demand would further help RIL's refining profits, in our view, leading to RIL's margins likely showing greater improvement against Singapore complex margins over the medium term.

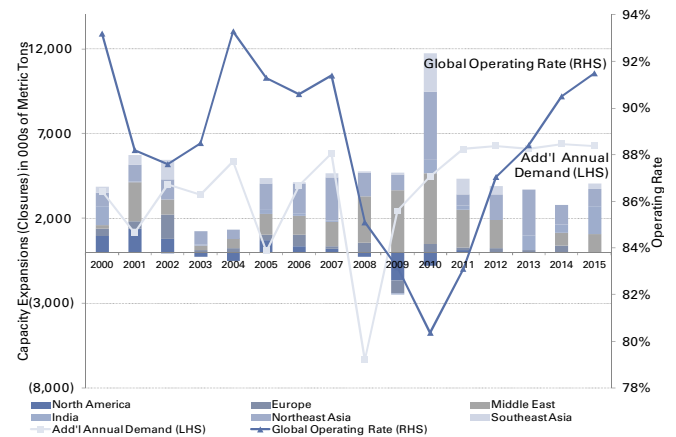
Also, we believe that the global ethylene cycle will likely bottom out in 2HCY11E, giving RIL's earnings a further cyclical push. Therefore, it is likely, in our view, that two of RIL's core businesses – refining and petrochemicals (together contributing 66% of RIL's FY12E EBITDA) – seem to be falling in place going forward.

Exhibit 2: Strong recovery in global refinery utilization rates in 2011E-2013E



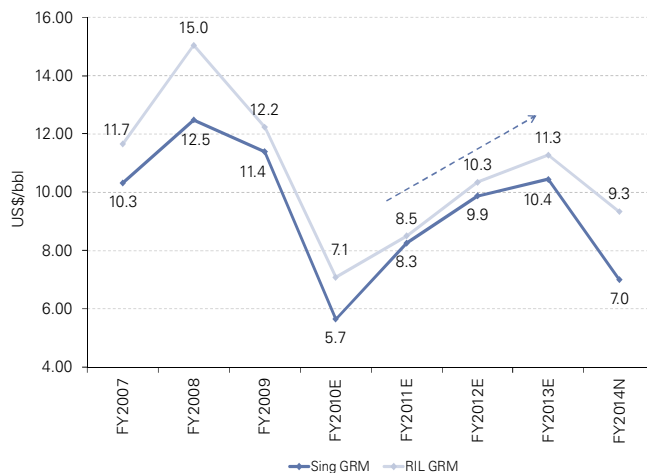
Source: Company data, Goldman Sachs Research estimates.

Exhibit 3: Ethylene capacity utilization to rise from 1H2011 bottom



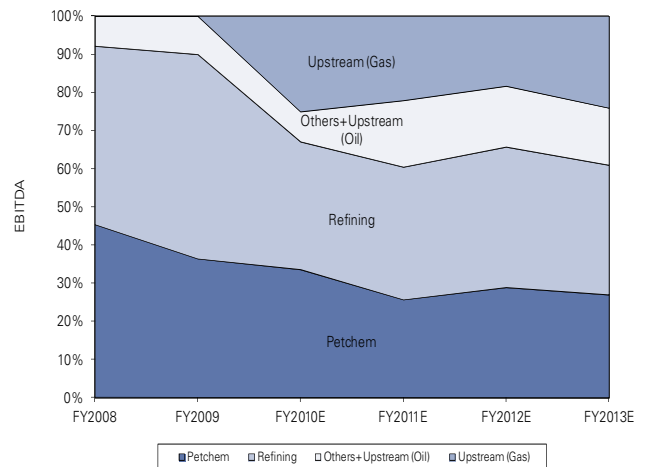
Source: Company data, Goldman Sachs Research estimates.

Exhibit 4: RIL's GRM to show greater improvement versus Singapore GRM over the next two years

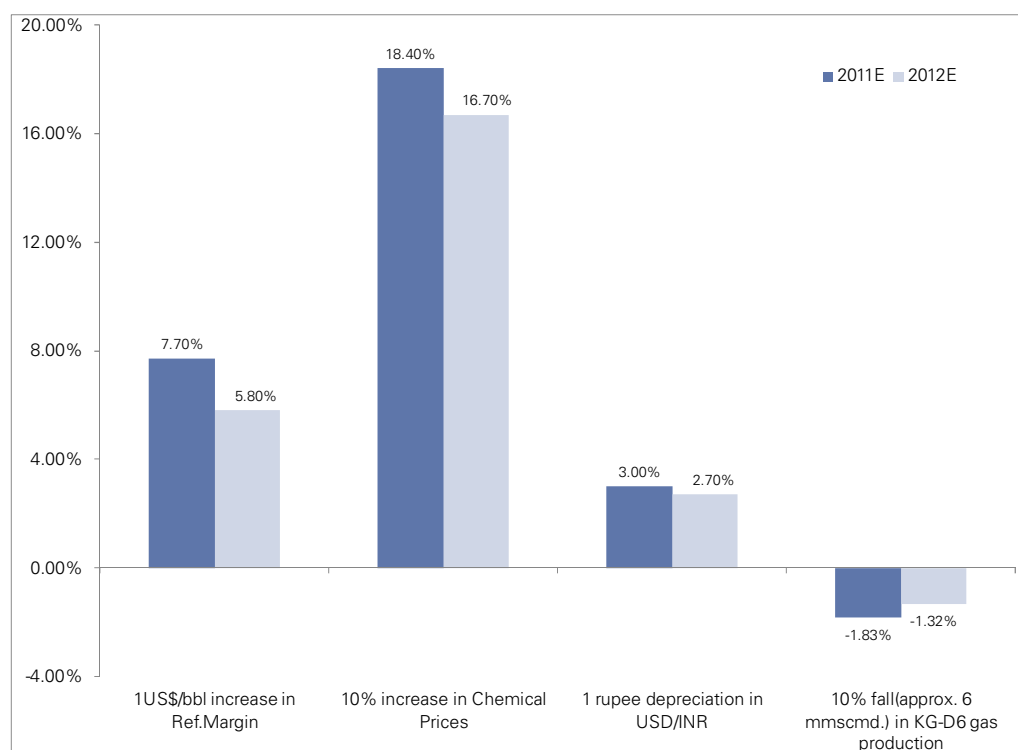


Source: Company data, Goldman Sachs Research estimates.

Exhibit 5: Refining and Petchem still significant contributors to EBITDA



Source: Company data, Goldman Sachs Research estimates.

Exhibit 6: RIL's earnings are highly levered to refining margins and chemical prices

Source: Goldman Sachs Research estimates.

Earnings changes driven by weaker USD-INR forecast; partly offset by lower D-6 gas volumes

The increase in our target price is primarily driven by upward revision in earnings. We have revised RIL's earnings by 5% for FY12E and by 11% for FY13E, mainly on account of our Global ECS Research team's weaker USD-INR exchange rate forecasts (for details, please see their note published on 6 Jan. 2011 entitled *Asia Views: Asian growth—only limited further upside from latest US revisions but still above consensus in 2011*). The upward earnings for FY12E have been partly offset by lowered forecasts for D-6 gas production, though.

Exhibit 7: We have changed RIL's consolidated FY11E-13E EPS by 5% - 11%

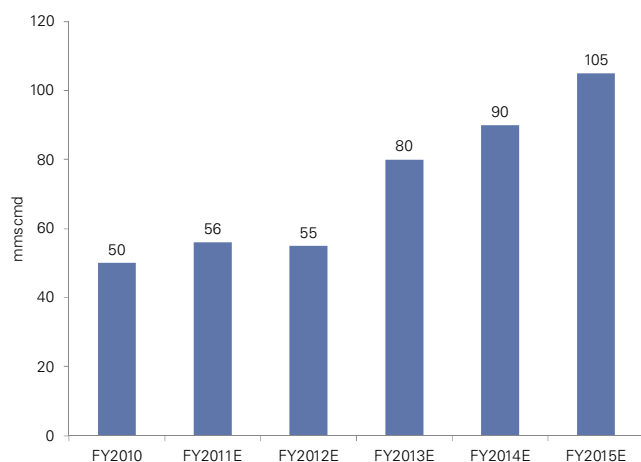
Period	EPS (Rs.)		% Change	Comments
	Old	New		
FY11E	65.1	65.0	0%	Updation of quarterly numbers
FY12E	80.6	84.4	5%	Weaker USD INR, lower gas production
FY13E	89.3	99.6	11%	Weaker USD INR, lower gas production

Source: Goldman Sachs Research estimates.

News flow on the E&P/other businesses could further re-rate RIL

While the cyclical businesses are likely to drive earnings growth going forward, we have assumed almost flat yoy D-6 gas and oil volumes in FY12E, given the uncertainty on the ramp-up schedule of the project. Since this is already widely known and likely priced in the RIL stock, any positive news flow on the E&P front could further re-rate RIL's share price, in our view.

Exhibit 8: Any ramp-up in D-6 gas production during FY2012 could potentially add to RIL's valuation



Source: Company data, Goldman Sachs Research estimates.

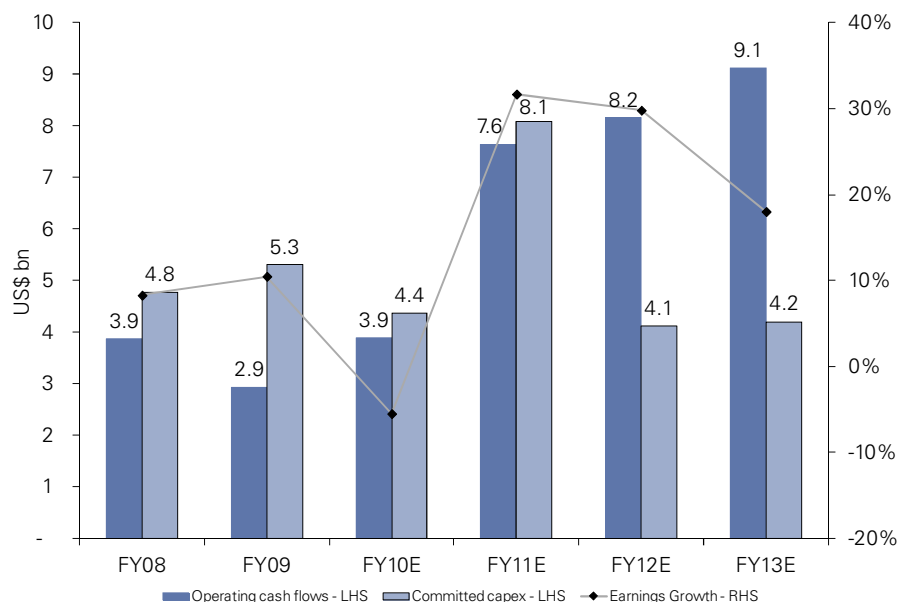
Exhibit 9: Possible exploration upside: 2011 drilling program

Block	RIL's participating interest	Partner	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec
D6	90%	Niko	Continuous Drilling			
D4	85%	Niko	1 Well	1 Well	1 Well	
NEC-25	90%	Niko			3 Wells	
D3	90%	Hardy Oil	1 Well		1 Well	
D9	90%	Hardy Oil		1 Well		1 Well
Assam	90%	Hardy Oil			1 Well	

Source: Niko resources, Hardy Oil.

We also believe that there could be updates on RIL's broadband and retail businesses in 2HFY12E. Furthermore, we note that while RIL's FY11E cash flows are largely utilized in reinvestment into the businesses, the company will likely generate excess cash of around US\$9bn over FY12E-13E after its committed capex.

Exhibit 10: FY11E operating cash flows will be fully utilized to meet capex



Source: Company data, Goldman Sachs Research estimates.

Exhibit 11: Channeling the cash flows: Investments in core and non-core businesses

Investments in US\$ mn

Date Announced	Investment	FY 2011E	FY 2012E	FY 2013E	FY 2014E	FY 2015E	Comments
9-Apr-10	Marcellus Shale (JV with Atlas Energy)	405	161	271	461	401	The first shale investment in attractive Marcellus play; we are positive on US shale plays
16-Apr-10	Deccan 360 (Approx.)	25					Small investment in the logistics business
11-Jun-10	Infotel Broadband Services Pvt. Ltd	2,900	166	290	370	253	Big commitment; however US\$2.9bn was spent on spectrum, which is a valuable resource and provides downside protection to the investment
24-Jun-10	Eagle Ford Shale (JV with Pioneer)	360	260	401	295		The second US shale investment by RIL; Eagle Ford is a major shale gas play with good potential
5-Aug-10	Marcellus Shale (JV with Carrizo Oil & Gas)	392					Second Marcellus shale investment
30-Aug-10	ElH Limited	263					A bit strange non-core investment; but in a liquid quoted stock and value can be readily determined; ElH open offer may drain another US\$350mn cash from RIL
21-Dec-10	Butyl Rubber Production (JV with SIBUR)	100	100	100			RIL has entered into the JV to gain a significant presence in the synthetic rubber business
		4,445	587	962	1,126	654	

Source: Company data, Goldman Sachs Research estimates.

Valuation: Sum-of-the-parts valuation shows 25% potential upside

We use SOTP methodology to value RIL as we believe that it is the best method to value a company that has such diverse businesses with different earnings drivers. Our valuation produces a 12-month target price of Rs1,250/share implying potential upside of 25%.

Exhibit 12: Upstream contributes about 50% to our SOTP based target price of Rs1,250

RIL sum-of-the parts valuation

	Valuation base (Rs bn)		Multiple (X)		EV (Rs bn)	Share value (Rs)
	Other	EBITDA	Multiple	EV/EBITDA		
Chemicals		130		7.5	975	326
Refining & Marketing		165		7.0	1,156	386
Oil and gas—producing		22		6.0	129	43
Oil and gas—developing						
KG Basin D-6 Gas (DCF-based)	749	—	100%	—	749	250
NEC-25, CBM (a)	140	—	100%	—	140	47
KG Basin D-6 Oil (EV/boe)	142		100%	—	142	47
Marcellus Shale JV	99		100%	—	99	33
Eagle Ford Shale JV	74		100%	—	74	25
Other discoveries (DCF-based, EV/boe)	505	—	100%	—	505	169
Organised Retail (1.5x book value)	75		100%		75	25
Total					4,043	1,350
Net debt (b)					302	100
Implied equity value					3,741	1,250
Implied value of share						1,250

Source: Company data, Goldman Sachs Research estimates.

At our target price, RIL would trade at 14X FY12E EPS vs. its historical range of 4X-33X. We believe RIL is trading at a discount to the Indian market owing to a lack of conviction on the street on the turnaround of its cyclical segments and on future growth; we think these attitudes will change as the catalysts cited earlier start to play out.

Exhibit 13: RIL has underperformed the index since the beginning of 2010, largely due to lack of visibility on future growth

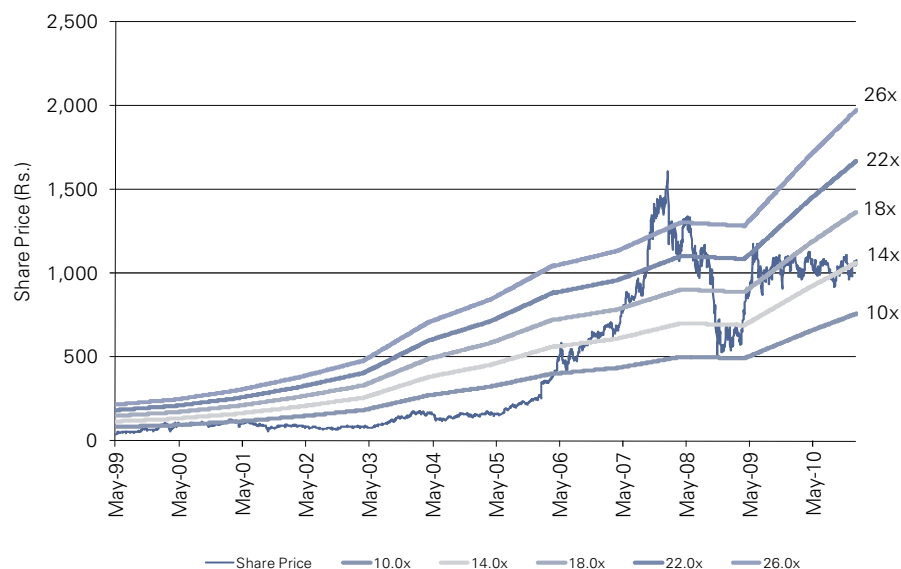
RIL vs. NIFTY P/E



Source: Company data, Goldman Sachs Research estimates.

Exhibit 14: RIL is currently trading near the lower end of its historical trading band

RIL P/E band chart



Source: Company data, Goldman Sachs Research estimates.

Reg AC

We, Nilesh Banerjee and Vikas S. Jain, hereby certify that all of the views expressed in this report accurately reflect our personal views about the subject company or companies and its or their securities. We also certify that no part of our compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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The Goldman Sachs Investment Profile provides investment context for a security by comparing key attributes of that security to its peer group and market. The four key attributes depicted are: growth, returns, multiple and volatility. Growth, returns and multiple are indexed based on composites of several methodologies to determine the stocks percentile ranking within the region's coverage universe.

The precise calculation of each metric may vary depending on the fiscal year, industry and region but the standard approach is as follows:

Growth is a composite of next year's estimate over current year's estimate, e.g. EPS, EBITDA, Revenue. **Return** is a year one prospective aggregate of various return on capital measures, e.g. CROCI, ROACE, and ROE. **Multiple** is a composite of one-year forward valuation ratios, e.g. P/E, dividend yield, EV/FCF, EV/EBITDA, EV/DACF, Price/Book. **Volatility** is measured as trailing twelve-month volatility adjusted for dividends.

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Coverage group(s) of stocks by primary analyst(s)

Nilesh Banerjee: Asia Pacific Energy.

Asia Pacific Energy: Bharat Petroleum, Cairn India Ltd., Formosa Petrochemical Corp., Gas Authority of India, GS Holdings, Gujarat State Petronet, Hindustan Petroleum, Indian Oil Corp., OCI Company, Oil & Natural Gas Corp., Oil India, Petronet LNG, PTT Public Company, PTTEP, Reliance Industries, Reliance Industries (GDR), S-Oil Corp., SK Energy, Thai Oil.

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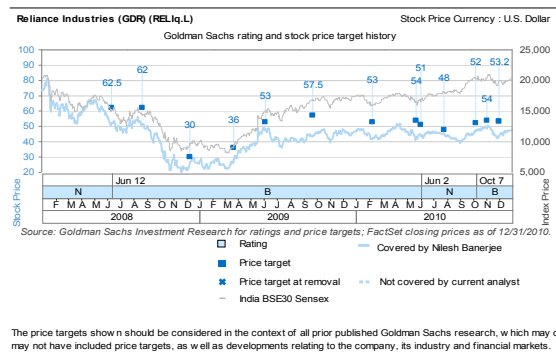
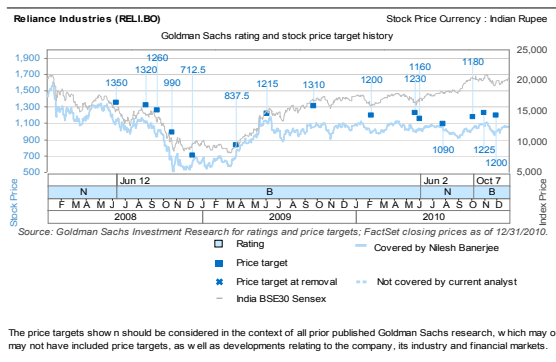
Distribution of ratings/investment banking relationships

Goldman Sachs Investment Research global coverage universe

	Rating Distribution			Investment Banking Relationships		
	Buy	Hold	Sell	Buy	Hold	Sell
Global	31%	54%	15%	50%	42%	37%

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Price target and rating history chart(s)



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