

FEBRUARY 18, 2010

UPDATE

Coverage view: **Cautious**

Price (Rs): **1,033**

Target price (Rs): **950**

BSE-30: **16,429**

What to do with so much cash? In our view, the withdrawal of opposition by certain unsecured creditors to a restructuring plan proposed by the debtors and major secured creditors of LyondellBasell (LB) may have effectively ended RIL's chances of acquiring LB. It would be interesting to watch RIL's next moves on (1) LB, (2) any other international acquisition and (3) use of cash arising from large FCF generation over the next few years and money raised from sale of treasury shares.

Company data and valuation summary

Reliance Industries

Stock data		Forecasts/Valuations			
		2010	2011E	2012E	
52-week range (Rs) (high,low)	1,268-558	EPS (Rs)	48.0	68.7	81.4
Market Cap. (Rs bn)	3,011.9	EPS growth (%)	(5.2)	43.3	18.4
Shareholding pattern (%)		P/E (X)	21.5	15.0	12.7
Promoters	40.9	Sales (Rs bn)	2,121.2	2,483.4	2,599.6
FIs	19.8	Net profits (Rs bn)	157.6	225.9	267.5
MFs	2.7	EBITDA (Rs bn)	300.2	391.8	430.6
Price performance (%)		EV/EBITDA (X)	11.1	8.0	6.6
Absolute	1M 3M 12M	ROE (%)	10.6	13.3	14.1
Rel. to BSE-30	(7.0) (3.2) 63.0	Div. Yield (%)	0.6	0.8	0.9
	(0.6) 0.5 (10.4)				

LB may be out of RIL's reach unless it bids aggressively; we doubt it will

In our view, the withdrawal of opposition by certain unsecured creditors to a restructuring plan proposed by LB's debtors and major secured creditors may have effectively ended RIL's chances of acquiring LB. Under the restructuring plan submitted on December 24, 2009, major holders of secured and bridge debt have agreed to convert US\$18 bn of senior and bridge debt into equity. This was opposed by certain unsecured creditors then; they have now withdrawn their opposition to the proposed restructuring plan.

RIL may have to look at other acquisitions; acquisitions are never easy and rarely create value

As discussed in our February 8, 2010 note, RIL's increasing global thrust probably reflects limited opportunities to deploy its large and growing cash flows in India. Its purported interest in Value Creation Inc., a Canadian Oil Sands company, may reflect these constraints. (1) RIL's current size in terms of net profits and market capitalization, (2) limited success in new growth areas such as retailing and SEZs and (3) weak fundamentals of chemicals and refining businesses in general for the next few years may force RIL to look at other uses of cash to create meaningful value.

Payment of higher dividends or buy-back of shares unlikely at this stage

We would be surprised if RIL was to step up dividends (12.4% dividend pay-out in FY2009) and/or implement share buy-backs as a way of returning cash to shareholders. We note that RIL has recently raised about US\$2 bn through sale of treasury shares ostensibly to fund its purported acquisitions. Also, RIL has historically had a low dividend pay-out as it had chosen (rightly so, so far) to deploy cash into new projects to create value. We model RIL to generate US\$14 bn of gross cash flow in FY2011-12E.

QUICK NUMBERS

- EV of LB probably more than US\$20 bn
- RIL has raised US\$2 bn recently
- RIL to generate US\$14 bn of GCF in FY2011-12E

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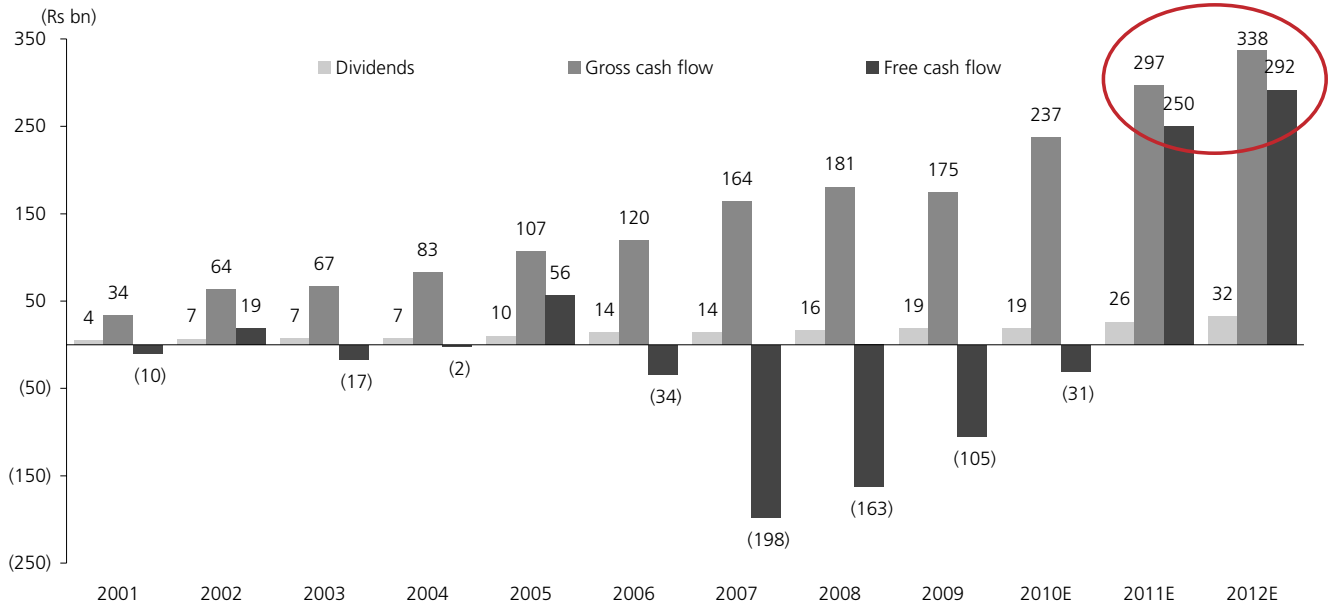
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RIL to generate significant free cash flows in FY2011-12E

Dividends and consolidated cash flows of RIL, March fiscal year-ends, 2001-2012E (Rs bn)



Source: Company, Kotak Institutional Equities estimates

RII: Profit model, balance sheet, cash model, March fiscal year-ends, 2005-2012E (Rs mn)

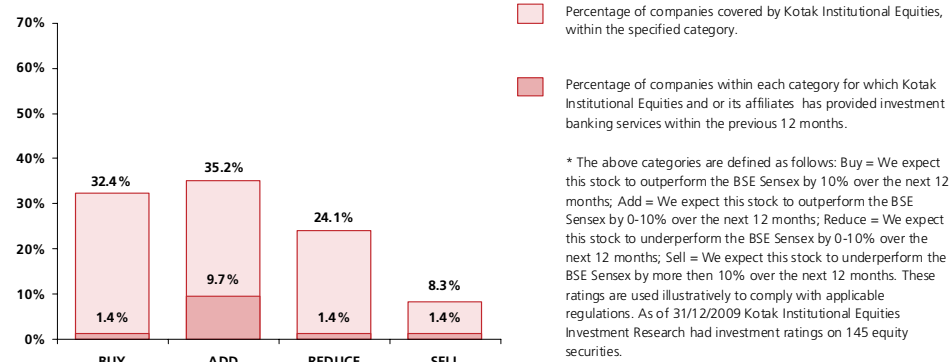
	2005	2006	2007	2008	2009	2010E	2011E	2012E
Profit model (Rs mn)								
Net sales	656,223	809,113	1,114,927	1,334,430	1,418,475	2,121,197	2,483,417	2,599,619
EBITDA	123,820	139,991	198,462	233,056	233,139	296,638	388,221	426,989
Other income	14,498	6,829	4,783	8,953	20,599	24,466	23,488	22,578
Interest	(14,687)	(8,770)	(11,889)	(10,774)	(17,452)	(20,625)	(21,657)	(7,254)
Depreciation & depletion	(37,235)	(34,009)	(48,152)	(48,471)	(51,953)	(100,162)	(113,500)	(117,021)
Pretax profits	86,397	104,041	143,205	182,764	184,332	200,318	276,552	325,292
Extraordinary items	4,290	3,000	2,000	47,335	—	—	—	—
Tax	(7,050)	(9,307)	(16,574)	(26,520)	(12,634)	(28,768)	(63,122)	(73,857)
Deferred taxation	(7,920)	(7,040)	(9,196)	(8,999)	(18,605)	(13,944)	12,445	16,052
Net profits	75,717	90,693	119,434	194,580	153,093	157,606	225,875	267,488
Adjusted net profits	72,135	88,152	117,789	152,605	153,093	157,606	225,875	267,488
Earnings per share (Rs)	26	32	41	52	51	48	69	81
Balance sheet (Rs mn)								
Total equity	404,033	430,543	673,037	847,853	1,263,730	1,492,428	1,687,582	1,917,522
Deferred taxation liability	42,668	49,708	69,820	78,725	97,263	111,207	98,763	82,711
Minority interest	—	—	33,622	33,622	—	—	—	—
Total borrowings	187,846	218,656	332,927	493,072	739,045	611,876	370,910	117,736
Current liabilities	171,315	164,545	192,305	251,427	357,019	331,277	380,351	396,762
Total liabilities and equity	805,863	863,452	1,301,712	1,704,700	2,457,057	2,546,788	2,537,606	2,514,730
Cash	36,087	21,461	18,449	42,822	221,765	197,694	170,233	174,951
Current assets	248,438	224,283	286,566	402,721	325,358	451,642	498,228	511,198
Total fixed assets	350,823	626,745	899,403	1,081,638	1,693,869	1,681,386	1,653,079	1,612,516
Investments	170,515	(9,038)	97,294	177,519	216,065	216,065	216,065	216,065
Deferred expenditure	—	—	—	—	—	—	—	—
Total assets	805,863	863,452	1,301,712	1,704,700	2,457,057	2,546,787	2,537,605	2,514,730
Free cash flow (Rs mn)								
Operating cash flow, excl. working capital	107,002	119,520	164,285	180,718	174,508	237,475	296,970	337,586
Working capital	46,875	(32,188)	(13,075)	(31,071)	(37,983)	(152,027)	2,488	3,441
Capital expenditure	(52,440)	(94,273)	(247,274)	(239,691)	(247,128)	(140,684)	(73,025)	(71,990)
Investments	(48,192)	(32,364)	(105,760)	(78,953)	(10,392)	—	—	—
Other income	3,032	5,159	4,143	6,132	16,195	24,466	23,488	22,578
Free cash flow	56,276	(34,146)	(197,681)	(162,865)	(104,800)	(30,770)	249,921	291,615
Ratios (%)								
Debt/equity	42.1	45.5	44.8	53.2	54.3	38.2	20.8	5.9
Net debt/equity	34.0	41.1	42.3	48.6	38.0	25.8	11.2	(2.9)
RoAE	17.6	19.9	20.3	18.9	13.6	11.0	13.8	14.5
RoACE	13.0	13.8	13.9	12.7	11.2	9.0	10.8	12.3

Source: Company, Kotak Institutional Equities estimates

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Distribution of ratings/investment banking relationships



Source: Kotak Institutional Equities

As of December 31, 2009

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ADD. We expect this stock to outperform the BSE Sensex by 0-10% over the next 12 months.

REDUCE. We expect this stock to underperform the BSE Sensex by 0-10% over the next 12 months.

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Our target price are also on 12-month horizon basis.

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