

## Reliance Industries Ltd

### Pricing in 'doom and gloom'

In our July 12 Note (“Compelling valuations, de-rating unjustified”), we noted that we were worried about cyclical stress in the event of a global economic downturn. Unfortunately, our fears seem closer to materializing in the current scenario. RIL stock has corrected 14% since July and now reflects refining margins @US\$6.5/bbl(vs. US\$10.2YTD), 30% downside to our petchem spreads, and a 60 mmscmd plateau for D6 gas with no further value attributed to E&P. We maintain the asset is attractively priced; OW.

- **The stock is not immune to cyclical stress, risk aversion...** With strong linkages to global cyclical sectors, RIL stock and earnings are vulnerable to a global economic slowdown and equity risk aversion.
- **...but reflects an ugly global scenario:** RIL is currently trading at 5.2xEV/EBITDA on our earnings projections. This is below its 2008 trough. Earnings would need to contract 32% to reflect GFC multiples. At current prices, RIL is reflecting GRMs contracting to US\$6.5/bbl (vs. RIL GRMs@US\$6.6/bbl, Sing GRMs@US\$2.7/bb in FY10) and a 30% contraction in petchem EBITDA.
- **Current margins are still healthy; contraction could accelerate refining balance:** Benchmark Singapore GRMs are US\$7.8/bbl QTD, our forecast builds in moderation in GRMs over FY12 (US\$6/bbl for CY11). A collapse in GRMs would accelerate shutdowns of less efficient refineries, working out excesses in the refining system, improving refining economics for efficient, complex refiners like RIL.
- **Cash – from bane to boon?** With inflow of US\$5.2bn on conclusion of BP deal, RIL will have US\$15bn of cash. Uncertainty on deployment of the cash has been an overhang, but significant cash balances do give RIL dry powder to weather a downturn, explore inorganic opportunities.
- **Reiterate our OW call:** Potential catalysts include: 1) earnings delivery aided by rupee depreciation, and 2) roadmap to ramp up KG production – with fixed gas prices, E&P earnings will be stable even in a downturn. We believe the stock is attractively priced and reiterate our OW rating.

## Overweight

RELI.BO, RIL IN

Price: Rs741.20

Price Target: Rs1,200.00

### India

#### India Oil, Gas and Petrochemicals

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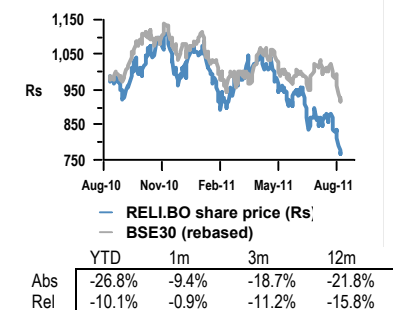
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J.P. Morgan India Private Limited

### Price Performance



### Reliance Industries Ltd (Reuters: RELI.BO, Bloomberg: RIL IN)

Rs in mn, year-end Mar	FY10A	FY11A	FY12E	FY13E	FY14E
Revenue (Rs mn)	2,037,400	2,658,106	3,132,220	3,005,420	2,946,670
Net Profit (Rs mn)	158,180.00	192,715.20	220,537.76	258,286.67	293,954.39
EPS (Rs)	53.12	64.65	73.98	86.64	98.61
DPS (Rs)	7.00	8.00	10.00	10.00	10.00
Revenue growth (%)	34.7%	30.5%	17.8%	-4.1%	-2.0%
EPS growth (%)	-4.2%	21.7%	14.4%	17.1%	13.8%
ROCE	12.0%	13.0%	12.6%	13.3%	13.8%
ROE	16.5%	17.5%	17.3%	17.6%	17.5%
P/E	14.0	11.5	10.0	8.6	7.5
P/BV	2.2	1.9	1.6	1.4	1.2
EV/EBITDA	8.4	6.3	5.2	4.5	3.8
Dividend Yield	0.9%	1.1%	1.4%	1.4%	1.4%

Source: Company data, Bloomberg, J.P. Morgan estimates.

### Company Data

Shares O/S (mn)	3,274
Market Cap (Rs mn)	2,426,892
Market Cap (\$ mn)	53,444
Price (Rs)	741.20
Date Of Price	18 Aug 11
Free float (%)	13.8%
3-mth trading value (Rs mn)	2,307.97
3-mth trading value (\$ mn)	50.83
3-mth trading volume (mn)	1.38
IN	

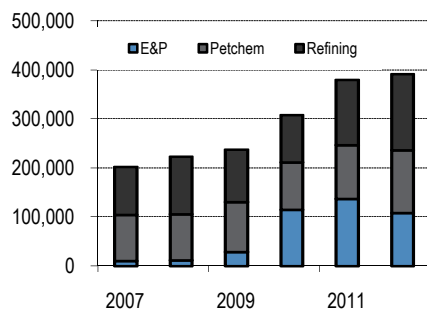
### See page 11 for analyst certification and important disclosures, including non-US analyst disclosures.

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## Company Description

RIL is a conglomerate with interests in refining, petrochemical, E&P, retail and infrastructure development. RIL is India's largest company by market cap, and is a dominant player in the domestic petrochemical market. It recently merged RPL with itself. Over FY10-13, we estimate RIL's EPS would grow at a CAGR of 25%. Stable gas earnings would contribute ~37% of FY12E EBITDA.

## RIL Ebitda Break-up (Rs mn)



Source: Company, J.P. Morgan estimates.

## EPS: J.P. Morgan vs. consensus (Rs)

	J. P. Morgan	Consensus
FY12E	74.0	70.7
FY13E	86.6	79.8

Source: Bloomberg, J.P. Morgan estimates.

## P&L sensitivity metrics (FY12)

	EBITDA impact (%)	EPS impact (%)
GRM assumption		
Impact of each US\$1/bbl	-4.6%	-6.2%
Petchem margins		
Impact of 10% lower Petchem Ebitda	-3.0%	-4.0%
Gas Volume		
Impact of 10% lower gas volumes	-1.7%	-2.1%
Rupee depreciation		
Impact due to 5% rupee depreciation	4.1%	5.5%

Source: J.P. Morgan estimates.

## Price target and valuation analysis

Our Mar-12 PT is Rs 1200/share based on an SOTP valuation. We estimate 15% earnings CAGR for RIL over FY11-14E with robust refining and petchem performance and introducing shale gas revenues. We assume KG gas production of 50-65mmscmd over FY12/13.

FY12 EPS	74
FY12 EBITDA	392,255
Current Price	738
FY12E P/E	10.0
FY12E EV/EBITDA	5.5

We estimate gas revenues, along with improving refining and petchem margins would be the primary drivers for earnings growth over FY10-13E. Also RIL's earnings are positively linked to rupee depreciation. Key downside risk would be a prolonged global slowdown leading to lower refining and petchem earnings, and harsh regulatory action.

## Pricing in cyclical stress

News flow over the past two weeks has centered on renewed fears of a slowing global economy - raising the specter of a slowdown in RIL's cyclical businesses. RIL remains vulnerable to such stresses, and increased risk aversion. However, the stock correction of 14% (3% underperformance) over the last month builds in a 'doom and gloom' global economic scenario, in our view. At current stock prices, RIL is reflecting Singapore GRMs of US\$3-3.5/bbl (refinery valuations are below replacement levels of c.US\$15k/bpd capacity), petchem EBITDA contracting to GFC levels.

**Table 1: Current RIL stock price reflects bear-case valuation**

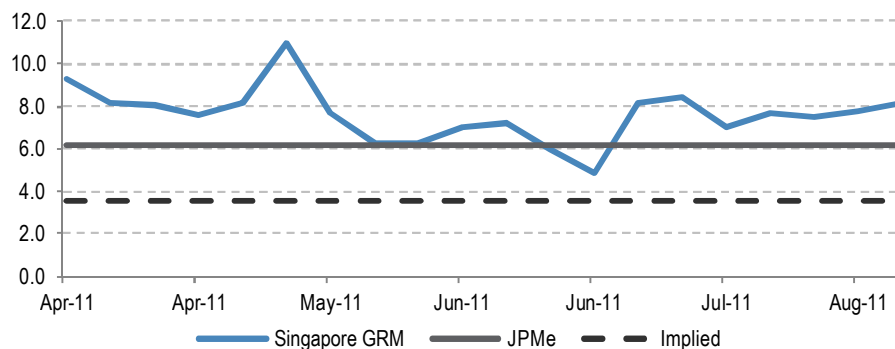
Business	Value/share (Rs)	Comments
Refining	218	GRMs at \$6.5/bbl, below GFC levels, refinery value below replacement cost at US\$12.8k/bpd
Petrochemicals	197	Petchem earnings lower 25-30% over FY12/13
E&P	104	Assuming a peak production rate of 60mmscmd - implies NPV of \$7.6bn. - BP deal values E&P assets at c.US\$14.4bn
Others	79	
Balance Sheet	135	Cash, investments and treasury stock
<b>TOTAL</b>	<b>733</b>	

Source: J.P. Morgan estimates.

### Refining

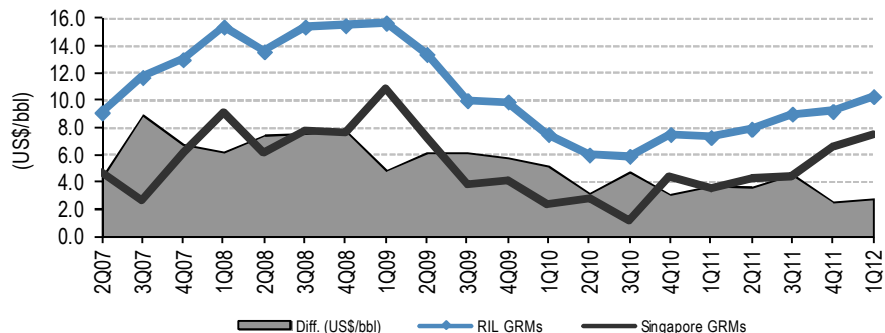
Singapore refining margins during 3QFY10 fell to a multi-year low of \$1.13/bbl – with RIL GRMs dipping below \$6/bbl. However, while markets have been unsettled, refining margins have not yet corrected (average \$7.6/bbl FY12TD), with key product cracks such as diesel, while off the highs seen post the Japan earthquake, remaining healthy (\$17-\$18/bbl since July).

**Figure 1: Singapore GRMs vs. JPMe/Implied**



Source: Bloomberg, J.P. Morgan estimates.

Figure 2: RIL GRMs vs. Singapore GRMs

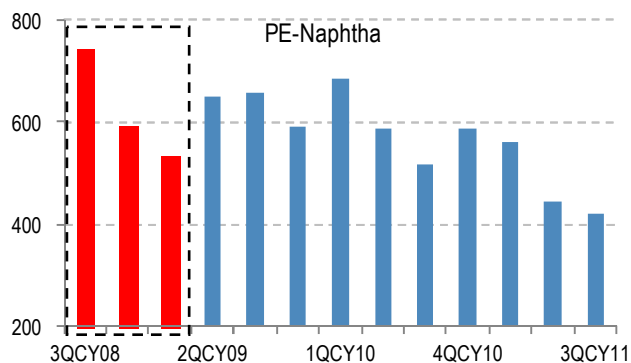


Source: Bloomberg, Company reports.

**Petrochemicals**

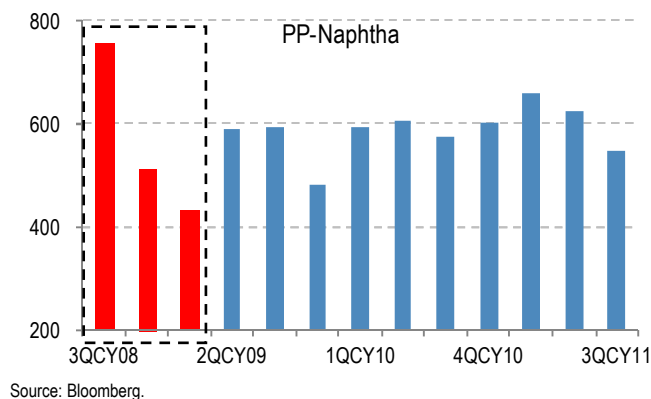
The polyester business has seen margin contraction over the past few months, with cotton prices correcting 50% since early March. However, margins for the overall chain remain at levels higher than those seen in early 2010. The polymers business has been facing supply side led headwinds for over a year, and is expected to find a bottom in 2HCY11 with limited capacity adds –this should be a positive for margin recovery.

Figure 3: PE-Naphtha spread (US\$/MT) - CY10 cap adds are playing out



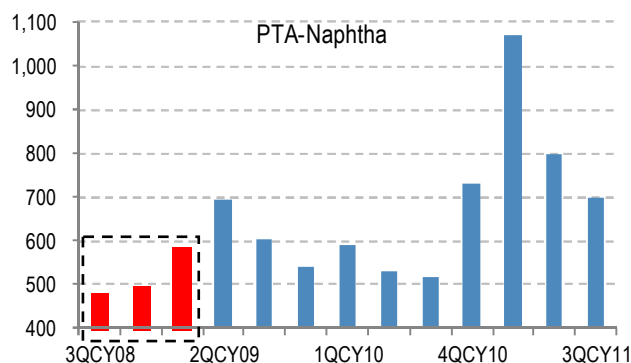
Source: Bloomberg.

Figure 4: PP-Naphtha spread (US\$/MT)



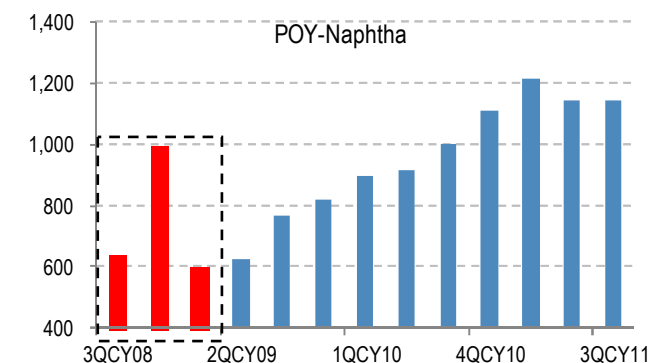
Source: Bloomberg.

Figure 5: PTA-Naphtha spread (US\$/MT)



Source: Bloomberg.

Figure 6: POY-Naphtha spread (US\$/MT)



Source: Bloomberg.

### ...and the stock reflects a very bearish outcome

As an exercise to determine what level of correction in cyclical businesses could take place, and what is already priced into the stock, we carry out a scenario analysis where: (i) we take GRMs for FY12E/13E down to \$6.5/bbl (RIL reported GRMs of \$10.3/bbl in 1Q12), and (ii) we take petrochemical earnings down to levels seen in the GFC and reduce refining and petchem multiples. Further, to reflect continuing investor concerns on the E&P business, we cut KG-D6 volumes building a peak production level of 60mmscmd (implying a cut to reserve assumptions). We also ascribe no value to any other domestic field that is part of the BP JV. E&P value of US\$7.6bn arrived at in this scenario is c50% of value implied for this business by the BP deal.

Table 2: RIL indicative bear case SOTP

Mar-12 SOTP	Rs m	US\$ bn	Rs/share	Comments
<b>Refining Business</b>				
Existing Refinery				
Refining EBITDA	95,275			
EV of Refining business	714,562	15.9	218	At 7.5x EV/EBITDA
<b>Value of Refining businesses</b>	<b>714,562</b>	<b>15.9</b>	<b>218</b>	
<b>Petrochemicals</b>				
Petchem EBITDA	91,939			
EV of petchem business'	643,575	14.3		At 7x EV/EBITDA
<b>Value of Petrochem business</b>	<b>643,575</b>	<b>14.3</b>	<b>197</b>	
<b>PMT and other assets</b>				
PMT and other EBITDA	43,365			
PMT and other businesses	260,190	5.8	79	At 6x EV/EBITDA
New E&P Assets	339,823	7.6	104	SOP of E&P assets without sustainability premium
<b>Value of total E&amp;P &amp; other assets</b>	<b>600,013</b>	<b>13.3</b>	<b>183</b>	
<b>Investments and Net debt</b>				
Treasury stock	227,761	5.1	70	
Net Debt (FY12)	(213,827)	-4.8	(65)	(Debt- Investments -Cash)
<b>Value of Investments and Net debt</b>	<b>441,588</b>	<b>9.8</b>	<b>135</b>	
<b>Value for Equity holders (Rs m)</b>	<b>2,399,738</b>	<b>53.3</b>	<b>733</b>	
<b>New E&amp;P Assets</b>				
	Rs mn	US\$ bn	Rs/Share	
KG D-6 Gas + Oil	339823	7.6	104	DCF based on 60 mmscmd of peak production + 60K b/d of oil production from MA fields
<b>New E&amp;P Valuation</b>	<b>339823</b>	<b>7.6</b>	<b>104</b>	

Source: J.P. Morgan estimates.

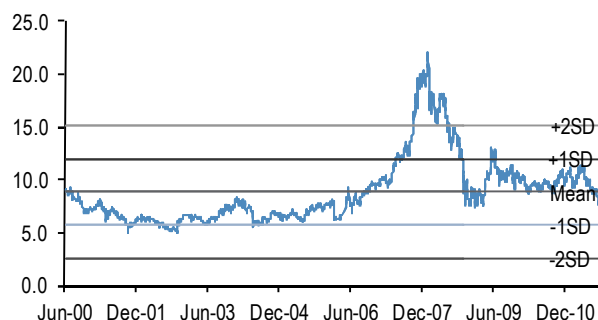
Adjusting for these conditions, our SOTP (March '12) is reduced to Rs733 –current market levels, implying that RIL stock is already pricing in a significant slowdown, with a simultaneous cyclical dip across refining/polyester/polymers.

Figure 7: RIL 12m forward EV/EBITDA



Source: Bloomberg, J.P. Morgan estimates, Company data

Figure 8: RIL 12m forward EV/EBITDA - bear case



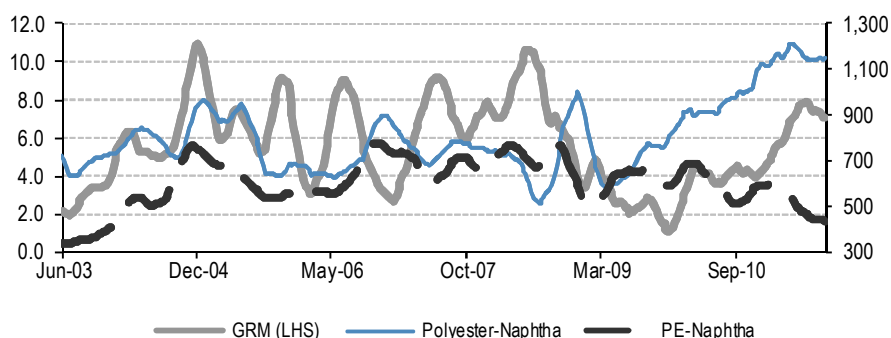
Source: Bloomberg, J.P. Morgan estimates, Company data

RIL's multiples have trended downwards sharply, with the EV/EBITDA now 1SD below historical mean multiples. Assuming multiples seen during the GFC, EBITDA would be lower than our estimates by ~30-32%; in line with our bear-case assumptions of 27-30% lower EBITDA over FY12E/13E.

### Cycles are not necessarily coincident

We note, however, that cycles across these businesses do not necessarily coincide, providing some valuation comfort – the move down in polyester (and the move up before) was linked to cotton prices, rather than crude. Also, the domestic E&P business is less vulnerable to global pricing pressure as gas prices are fixed.

Figure 9: Refining, polyester, polymer cycles not coincident



Source: Bloomberg.

### Cash pile – finally becoming a virtue?

RIL's growing cash balance has been an investor concern - but, in uncertain times, this could provide RIL with a cushion, and allow it to explore inorganic growth opportunities – additionally, counter-cyclical investments offer an avenue for lowering capex costs. RIL has planned large investments, particularly on the petrochemical side – some of which will be funded out of internal accruals.

### Valuation, risks

We maintain our OW rating and SOTP-based Mar-12 price target of Rs1200. Key risks to our estimates stem from further margin compression in the refining/petchem businesses, and harsh regulatory action on the E&P business. Potential stock performance catalysts for RIL in our view are: (1) continued earnings delivery, even in a challenging environment – rupee depreciation is a positive for RIL, with a 5.5% EPS sensitivity for a 5% change in INR/USD and (2) a road map for ramp up of KG-D6 production. Given fixed gas prices, E&P earnings will remain stable even in the face of a downturn.

Table 3: RIL SOTP

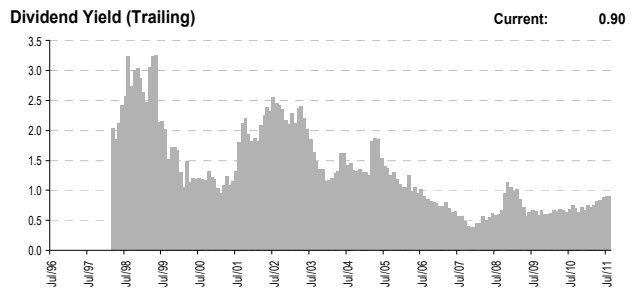
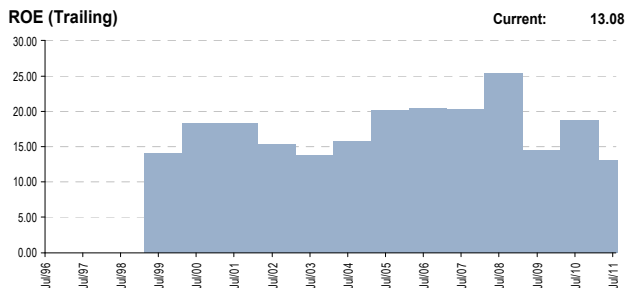
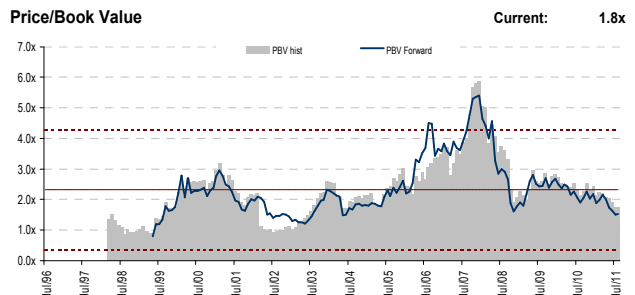
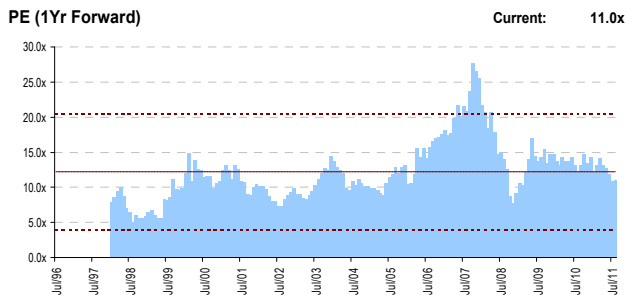
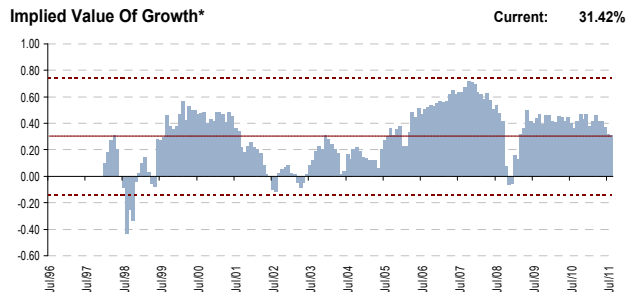
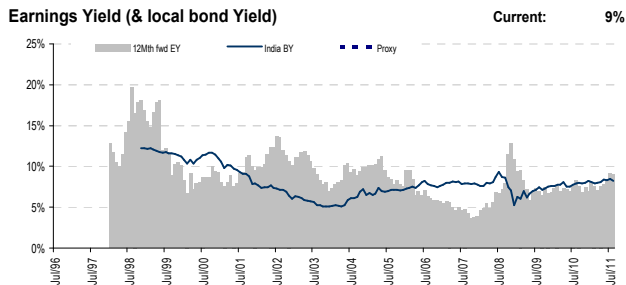
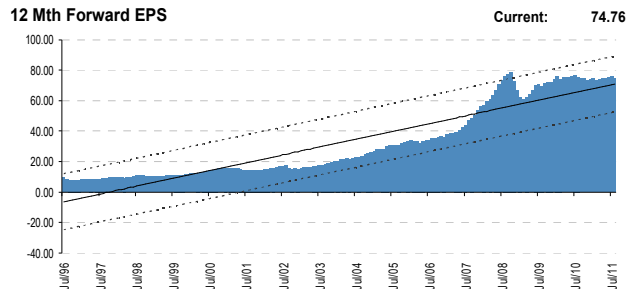
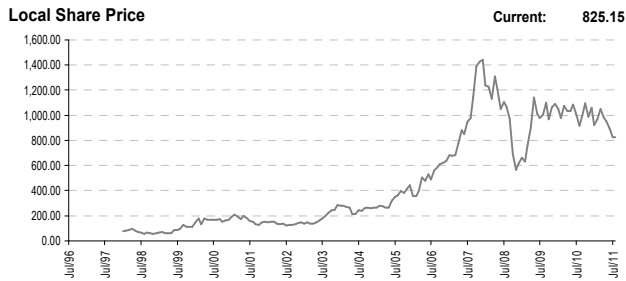
Mar-12 SOTP	Rs m	US\$ bn	Rs/share	Comments
<b>Refining Business</b>				
Existing Refinery				
Refining EBITDA	172,339			
EV of Refining business	1,378,714	30.6	421	At 8x EV/EBITDA
<b>Value of Refining businesses</b>	<b>1,378,714</b>	<b>30.6</b>	<b>421</b>	
<b>Petrochemicals</b>				
Petchem EBITDA	128,939			
EV of petchem business'	967,045	21.5		At 7.5x EV/EBITDA
<b>Value of Petrochem business</b>	<b>967,045</b>	<b>21.5</b>	<b>295</b>	
<b>PMT and other assets</b>				
PMT and other EBITDA	43,365			
PMT and other businesses	325,238	7.2	99	At 7.5x EV/EBITDA
New E&P Assets	663,221	14.7	203	SOP of E&P assets with sustainability premium
<b>Value of total E&amp;P &amp; other assets</b>	<b>988,459</b>	<b>22.0</b>	<b>302</b>	
<b>Investments and Net debt</b>				
Treasury stock	295,794	6.6	90	
Net Debt (FY12)	(293,987)	-6.5	(90)	(Debt - Investments - Cash)
<b>Value of Investments and Net debt</b>	<b>589,781</b>	<b>13.1</b>	<b>180</b>	
<b>Value for Equity holders (Rs m)</b>	<b>3,923,998</b>	<b>87.2</b>	<b>1,199</b>	
<b>New E&amp;P Assets</b>				
	Rs mn	US\$ bn	Rs/Share	
KG D-6 Gas + Oil	395320	8.8	121	DCF based on 90 mmscmd of peak production + 60K b/d of oil production from MA fields
NEC-25 + CBM	95955	2.1	29	NEC -25 50% recovery and CBM at 50% recovery at US\$ 3.5/boe
Sustainability premium	171946	3.8	53	35% of quantified discoveries
<b>New E&amp;P Valuation</b>	<b>663221</b>	<b>14.7</b>	<b>203</b>	

Source: J.P. Morgan estimates.



**JPM Q-Profile**  
**Reliance Industries Ltd. (INDIA / Energy)**  
 As Of: 11-Aug-2011

**Global Equity Quantitative Analysis**  
 Quant\_Strategy@jpmorgan.com



**Summary**

Reliance Industries Ltd.		SEDOL		6099626		As Of:		11-Aug-11			
INDIA						Local Price:		825.15			
Energy						EPS:		74.76			
	Latest	Min	Max	Median	Average	2 S.D.+	2 S.D. -	% to Min	% to Max	% to Med	% to Avg
12mth Forward PE	11.04x	5.09	27.67	11.74	12.24	20.50	3.98	-54%	151%	6%	11%
P/BV (Trailing)	1.75x	0.86	5.89	2.24	2.33	4.29	0.38	-51%	236%	28%	33%
Dividend Yield (Trailing)	0.90	0.38	3.25	1.19	1.35	2.76	-0.06	-58%	261%	32%	50%
ROE (Trailing)	13.08	13.08	25.40	18.24	17.70	24.43	10.97	0%	94%	39%	35%
Implied Value of Growth	31.4%	-0.43	0.72	0.36	0.30	0.75	-0.14	-238%	129%	14%	-4%

Source: Bloomberg, Reuters Global Fundamentals, IBES CONSENSUS, J.P. Morgan Calcs

\* Implied Value Of Growth = (1 - EY/Cost of equity) where cost of equity = Bond Yield + 5.0% (ERP)

## Reliance Industries Ltd: Summary of Financials

Income Statement						Cash flow statement					
Rs in millions, year end Mar	FY09	FY10	FY11	FY12E	FY13E	Rs in millions, year end Mar	FY09	FY10	FY11	FY12E	FY13E
Revenues	1,512,245	2,037,400	2,658,106	3,132,220	3,005,420	EBIT	181,123	199,480	239,228	263,330	299,254
% change Y/Y	13.3%	34.7%	30.5%	17.8%	(4.1%)	Depr. & amortization	56,510	109,460	141,208	128,925	141,424
Gross Margin	27.3%	24.1%	23.1%	56.9%	58.6%	Change in working capital	-46,221	-143,128	25,257	-98,787	1,656
EBITDA	237,633	308,940	380,436	392,255	440,679	Taxes	-12,740	-31,250	-44,124	-60,512	-70,026
% change Y/Y	6.5%	30.0%	23.1%	3.1%	12.3%	Others	-	-	-	-	-
EBITDA Margin	15.7%	15.2%	14.3%	12.5%	14.7%	Cash flow from operations	159,502	210,573	359,180	240,279	380,568
EBIT	181,123	199,480	239,228	263,330	299,254	Capex	-437,983	-219,210	-150,474	-175,500	-267,000
% change Y/Y	3.7%	10.1%	19.9%	10.1%	13.6%	Disposal/(purchase)	-	-	-	-	-
EBIT Margin	12.0%	9.8%	9.0%	8.4%	10.0%	Free cash flow	-278,481	-8,638	208,705	388,779	113,568
Net Interest	-2,720	87,320	1,321	21,184	33,438	Equity raised/(repaid)	68,056	-116,128	-1,973	0	0
Earnings before tax	175,123	372,860	240,550	284,514	332,692	Debt raised/(repaid)	398,046	-116,511	195,007	-42,682	-31,802
% change Y/Y	-35.6%	112.9%	-35.5%	18.3%	16.9%	Other	-	-	-	-	-
Tax	-29,190	-42,560	-47,834	-63,976	-74,406	Dividends paid	-22,195	-24,286	-34,729	-34,729	-34,729
as % of EBT	16.7%	11.4%	19.9%	22.5%	22.4%	Beginning cash	-	-	-	-	-
Net income (reported)	152,492.60	158,180.00	192,715.20	220,537.76	258,286.67	Ending cash	-	-	-	-	-
% change Y/Y	-0.1%	3.7%	21.8%	14.4%	17.1%	DPS	6.90	7.00	8.00	10.00	10.00
Shares outstanding	2,749	2,978	2,981	2,981	2,981						
EPS (reported)	55.46	53.12	64.65	73.98	86.64						
% change Y/Y	5.6%	(4.2%)	21.7%	14.4%	17.1%						
Balance sheet						Ratio Analysis					
Rs in millions, year end Mar	FY09	FY10	FY11	FY12E	FY13E	Rs in millions, year end Mar	FY09	FY10	FY11	FY12E	FY13E
Cash and cash equivalents	227,421	138,908	301,390	561,259	570,266	EBITDA margin	15.7%	15.2%	14.3%	12.5%	14.7%
Accounts receivable	48,450	100,829	156,952	109,575	105,875	Operating margin	12.0%	9.8%	9.0%	8.4%	10.0%
Inventories	201,096	343,933	385,194	414,881	392,310	Net margin	10.1%	7.8%	7.2%	7.0%	8.6%
Others	110,494	107,409	137,273	139,952	142,699	Sales per share growth	19.8%	24.4%	30.3%	17.8%	(4.1%)
Current assets	651,816	822,203	1,324,271	1,625,113	1,648,625	Sales growth	13.3%	34.7%	30.5%	17.8%	(4.1%)
LT investments	-	-	-	-	-	Net profit growth	-0.1%	3.7%	21.8%	14.4%	17.1%
Net fixed assets	1,498,880	1,375,761	1,385,028	1,107,602	1,233,178	EPS growth	5.6%	(4.2%)	21.7%	14.4%	17.1%
Total Assets	2,150,696	2,197,964	2,709,299	2,732,715	2,881,803	Interest coverage (x)	87.36	-	-	-	-
Liabilities						Net debt to total capital	35.2%	22.6%	10.6%	-7.8%	-10.7%
Short-term loans	83,675	66,192	131,886	131,662	131,662	Net debt to equity	52.1%	36.9%	16.6%	-11.9%	-15.4%
Payables	-	-	-	-	-	Sales/assets	0.87	0.94	1.08	1.15	1.07
Others	483,833	532,815	685,329	571,544	549,675	Assets/equity	1.84	1.67	1.53	1.43	1.84
Total current liabilities	567,508	599,007	817,215	703,206	681,337	ROE	19.8%	16.5%	17.5%	17.3%	17.6%
Long-term debt	678,891	579,863	709,176	666,718	634,916	ROCE	13.6%	12.0%	13.0%	12.6%	13.3%
Other liabilities	0	0	0	0	0						
Total Liabilities	1,246,399	1,178,870	1,526,391	1,369,924	1,316,253						
Shareholders' equity	904,296	1,019,093	1,182,908	1,362,791	1,565,550						
BVPS	328.91	342.20	396.81	457.16	525.17						

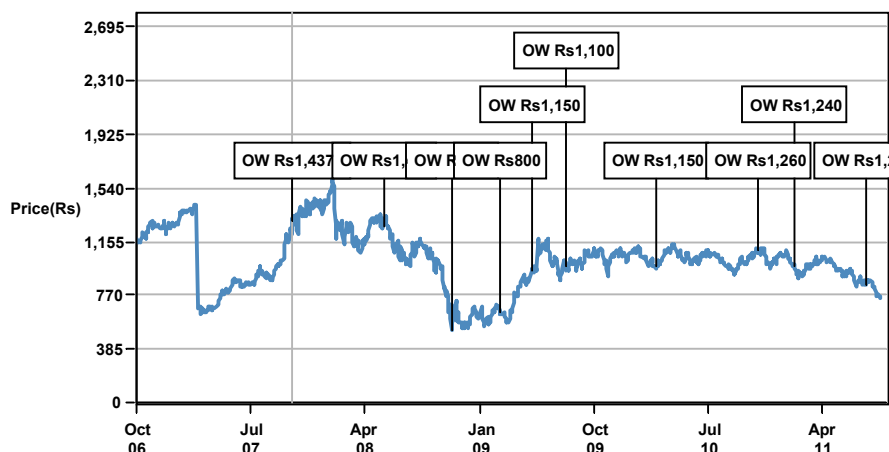
Source: Company reports and J.P. Morgan estimates.

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Reliance Industries Ltd (RELI.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
11-Oct-07	OW	1309.20	1437.50
15-May-08	OW	1265.38	1455.00
24-Oct-08	OW	509.75	875.00
18-Feb-09	OW	647.58	800.00
06-May-09	OW	941.83	1150.00
26-Jul-09	OW	970.33	1100.00
24-Feb-10	OW	978.80	1150.00
31-Oct-10	OW	1096.25	1260.00
22-Jan-11	OW	969.85	1240.00
13-Jul-11	OW	847.75	1200.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.  
 Initiated coverage Oct 11, 2007.

The chart(s) show J.P. Morgan's continuing coverage of the stocks; the current analysts may or may not have covered it over the entire period.

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