Reliance Industries Ltd – BUY

CMP Rs1,133, Target Rs1,584

Sector: Oil and Gas	
Sensex:	8,814
CMP (Rs):	1,133
Target price (Rs):	1,584
Upside (%):	39.8
52 Week h/l (Rs):	2,707 / 930
Market cap (Rscr) :	178,303
6m Avg vol ('000Nos):	7,867
No of o/s shares (mn):	1,574
FV (Rs):	10
Bloomberg code:	RIL IB
Reuters code:	RELI.BO
BSE code:	500325
NSE code:	RELIANCE

Prices as on 22 Jan, 2009.

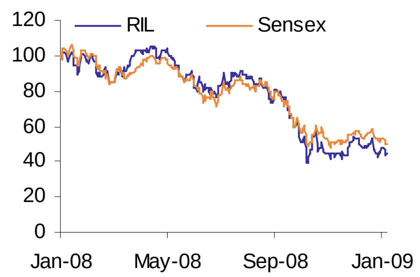
Shareholding pattern

December '08	(%)
Promoters	49.0
Institutions	24.6
Non promoter corp hold	4.7
Public & others	21.7

Performance rel. to sensex

(%)	1m	3m	1yr
Reliance	(0.7)	(0.7)	(5.1)
ONGC	4.9	0.7	16.7
Cairn	7.7	13.5	29.8
GAIL	(5.7)	(9.5)	(24.4)

Share price trend



- Revenues at Rs315bn, were lower than our estimates of Rs333bn due to higher than expected decline in refining segment revenues
- GRMs at US$10/bbl were better than our expectation of US$9.5/bbl
- 175% yoy jump in other income was on account of interest income on funds received by conversion of promoter's warrants
- KG-D6 oil production and operations at RPL refinery have commenced, KG-D6 gas expected in Q4 FY09
- Near term concerns on outcome of litigation with RNRL and declining profitability in refining and petrochemical segments, but E&P segment provide significant upsides, Maintain BUY

Result table

(Rs m)	Q3 FY09	Q3 FY08	% yoy	Q2 FY09	% qoq
Net sales	**315,630**	**345,900**	(8.8)	**447,870**	(29.5)
Material costs	(201,950)	(242,700)	(16.8)	(333,950)	(39.5)
Purchases	(26,200)	(15,680)	67.1	(11,370)	130.4
Personnel costs	(6,050)	(5,770)	4.9	(5,880)	2.9
Other overheads	(27,800)	(23,420)	18.7	(31,930)	(12.9)
Operating profit	**53,630**	**58,330**	(8.1)	**64,740**	(17.2)
OPM (%)	***17.0***	***16.9***	***13 bps***	***14.5***	***254 bps***
Depreciation	(13,170)	(12,130)	8.6	(12,640)	4.2
Interest	(4,840)	(2,530)	91.3	(4,370)	10.8
Other income	6,630	2,410	175.1	1,510	339.1
PBT	**42,250**	**46,080**	(8.3)	**49,240**	(14.2)
Tax	(7,240)	(7,260)	(0.3)	(8,020)	(9.7)
Effective tax rate (%)	***17.1***	***15.8***		***16.3***	
Adjusted PAT	**35,010**	**38,820**	(9.8)	**41,220**	(15.1)
Adj. PAT margin (%)	***11.1***	***11.2***	***(13) bps***	***9.2***	***189 bps***
Extra ordinary items*	-	41,970	-	-	-
Reported PAT	**35,010**	**80,790**	(59.4)	**41,220**	(15.1)
Ann. EPS (Rs)	89.0	106.8	(16.7)	113.4	(21.5)

Source: Company, India Infoline Research
** Extraordinary items are net off tax*

Segmental performance

	Q3 FY09	Q3 FY08	bps yoy	Q2 FY09	bps qoq
EBIT margins (%)					
Petrochemical	13.1	14.0	(87)	12.2	93
Refining	8.7	10.0	(134)	7.6	103
Others	50.9	43.1	782	61.2	(1,032)
EBIT contribution (%)					
Petrochemical	39.9	37.1	279	35.6	430
Refining	45.3	54.6	(927)	52.1	(677)
Others	14.7	8.3	648	12.3	247
Sales contribution (%)					
Petrochemical	35.5	31.9	355	29.3	616
Refining	61.1	65.7	(462)	68.7	(753)
Others	3.4	2.3	107	2.0	137

Source: Company, India Infoline Research

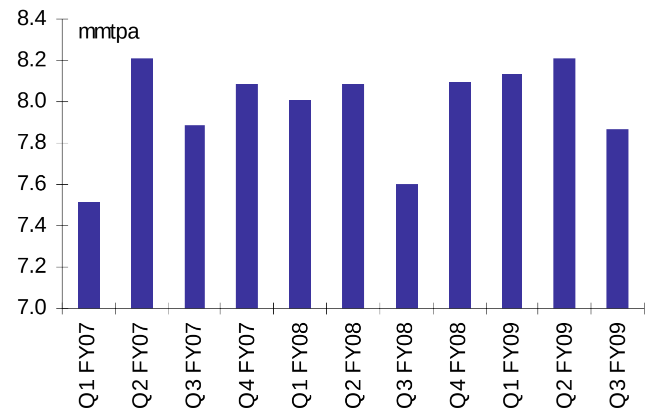
Refining segment

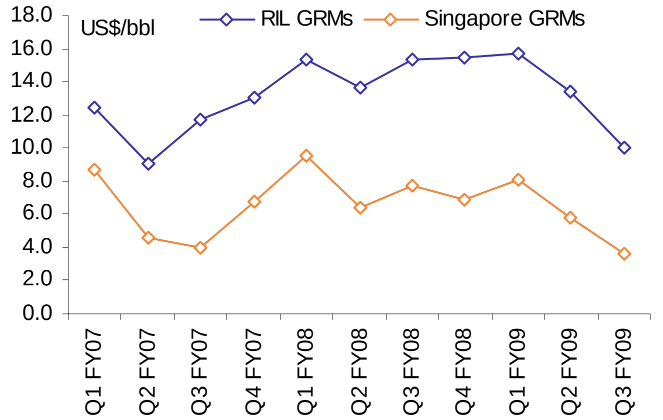
Reliance Industries Ltd (RIL) reported GRMs of US$10/bbl in Q3 FY09 as against US$15.4/bbl in Q3 FY08 and US$13.4/bbl in Q2 FY09. The GRMs were better than our estimates of US$9.5/bbl. During the quarter, RIL's GRMs were 2.8x benchmark Singapore GRMs as against 2x in Q3 FY08 and 2.2x in Q2 FY09. The refinery processed 7.87mn tons of crude, lower than Q2 FY09 throughput by 4.1%, as the company was carrying out modifications at various units of the refinery. The modifications were aimed at improving crude processing flexibility, meeting more stringent fuel specifications and bettering yield and efficiencies. Post the completion of capex, we believe that RIL's premium to Singapore GRMs will increase, which will cushion the downfall in the current weakening environment. Revenue for the segment was down 17% yoy and 40% qoq following steep correction in product prices across the globe. The impact was partially offset on account of sharp depreciation in Rupee against US Dollar. As a result of fall in GRMs, EBIT for the segment was down 28% yoy and 32% qoq.

Commencement of RPL project

On 25 Dec '08, RIL successfully commenced operations of its new refinery under its 70.4% owned subsidiary, Reliance petroleum Ltd (RPL). The first batch of products is likely to be dispatched in Jan '09. With a complexity higher than that of the existing refinery, we believe RPL will garner a premium of US$2-2.5/bbl in the initial two years. Beyond FY11, the premium would increase by ~US$1/bbl, if the KG-D6 gas supplies are made available to the refinery. In the current scenario, we feel that the company would go slow in its ramp-up process. We anticipate 75% utilization in FY10 and 85% in FY11. Our earnings estimate for RPL for FY10 and FY11 are R19.3 and Rs19.9 based on GRMs of US$13/bbl and US$13.5 respectively.

Trend in throughput and GRMs





Source: India Infoline Research

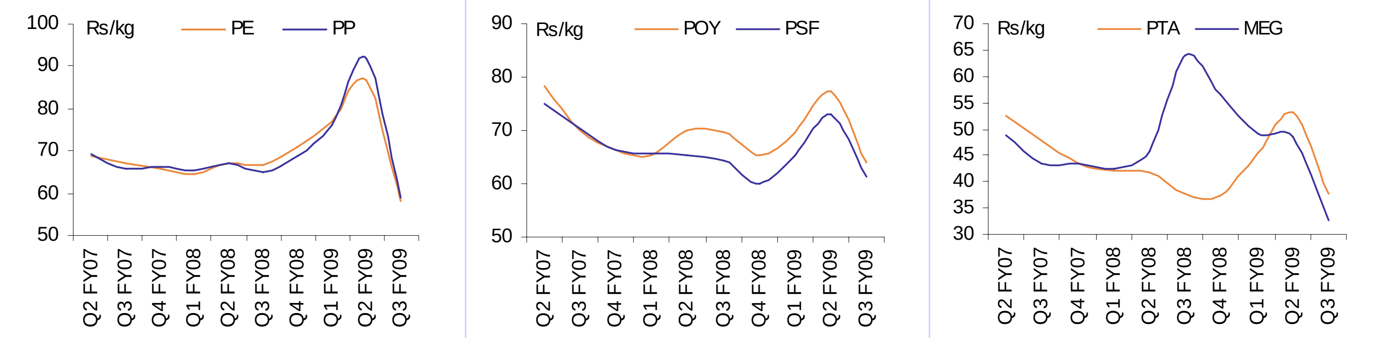
Outlook for GRMs

- Following the credit crisis in US, petroleum products demand is likely to witness a sharp fall on a yoy basis led by decline in gasoline consumption. With the crisis having worldwide impact, marked slowdown has been witnessed in countries such as China and India, which were the key growth drivers for the world demand. With the commencement of RPL, the gasoline market is more than adequately supplied, which will keep gasoline crack under pressure (RPL has capacity produce 8-10mmtpa of gasoline).
- Over the next few years, significant capacity additions have been lined up, especially so in China and Middle East. Any delays in these capacity additions could provide some relief to the falling trend in margins.
- With their high degree of complexities, both RIL and RPL refineries will post relatively lesser declines in GRMs in the current cyclical downturn.

Petrochemical segment

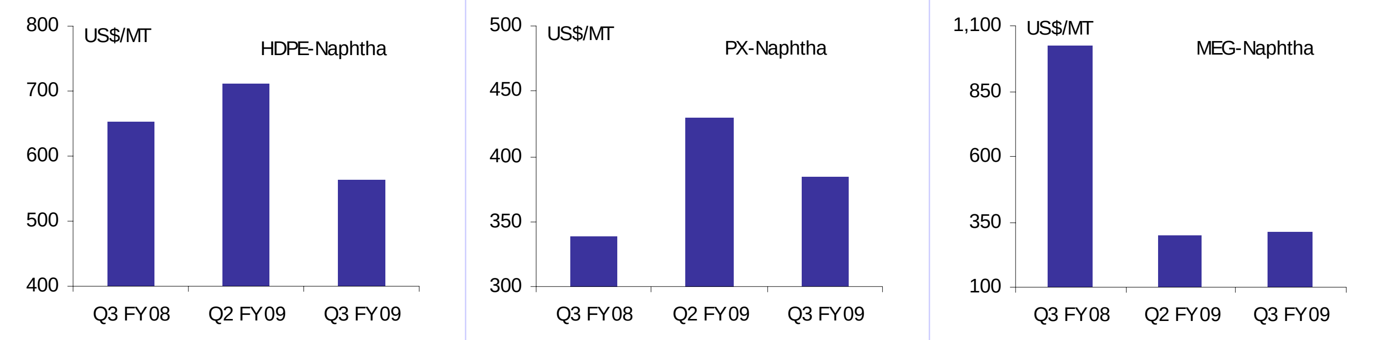
During Q3 FY09, petrochemical segment reported flattish revenue growth on a yoy basis but a decline of 19% qoq. The fall was primarily on account of steep correction in product prices, which were partially offset by Rupee depreciation. RIL's polymer units operated at 83% utilization during the quarter, while fiber intermediate and polyester plants operated at 91% and 81% respectively. Lower utilization was on account of maintenance shutdown at the Patalganga facilities. EBIT margins for the segment declined by 90bps yoy on account of fall in spreads across polymer chain. However, on a qoq basis EBIT margins improved by 90bps as a result of improvement in polyester spreads.

Trend in petrochemical prices



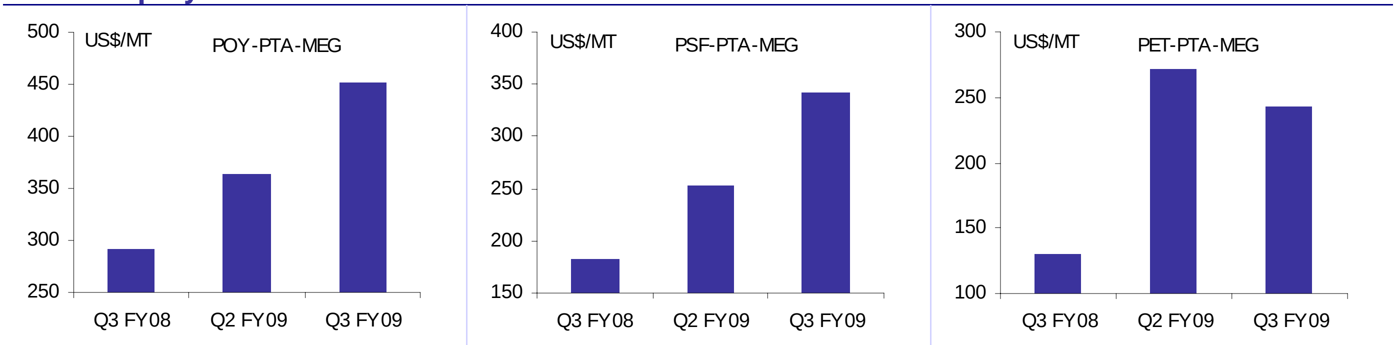
Source: Company

Trend in polymer and fiber intermediate deltas



Source: Company

Trend in polyester deltas



Source: Company

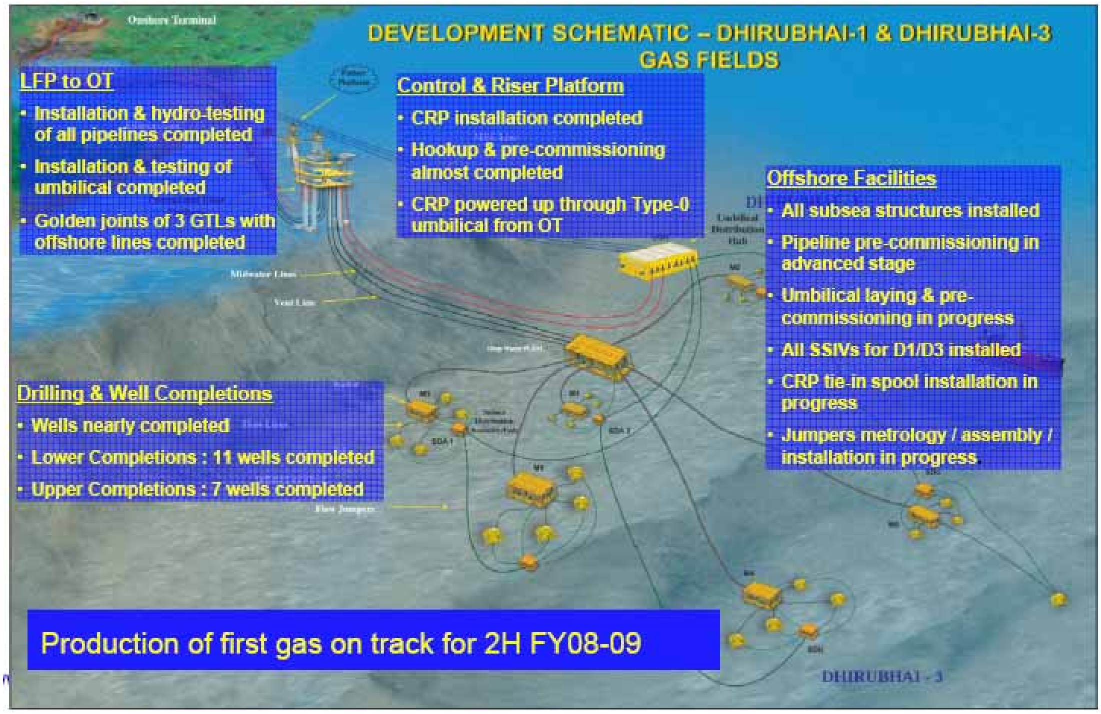
Outlook for petrochemical segment

With the economies across the globe witnessing a slowdown, demand for petrochemicals is expected to decline substantially. This has translated into sharp correction in product prices and margins over the last few months. We believe that the scenario would continue to impact profitability of the players in the near term. However, RIL with its integrated nature would be able to post a relatively better performance.

E&P segment

Crude oil production from Panna-Mukta was down 3.8% yoy, while gas production was lower 4.6% yoy on account of natural decline in the production profile. Gas production from the Tapti field remained flat on a yoy basis. Oil production from the KG-D6 block was at 0.58mmbls during the quarter. The production has been stalled since 9 Dec '08 due to a small accident. While the issue with RNRL continues to remain unsettled, gas production from the KG-D6 block is set to commence from Q4 FY09.

Status on development of D1 and D3 fields



Source: Company

Other key highlights for the segment

- RIL, along with BP, was awarded the deep water block KG-DWN-2005/2 offered under NELP VII. RIL is the operator of the block and has 70% participating interest.
- RIL made two gas discoveries during the quarter:
  Discovery B1 in Block KG – VD3
  Discovery 42 in the KG - D6 Block
- It executed two production sharing contracts in Kurdistan, Iraq
- RIL acquired acreage in Peru by farming in three on-land blocks, including a block in which RIL is the operator
- RIL farmed out 25% participating interest in block K located in East Timor to Oil India Ltd and Indian Oil Corporation Ltd
- It acquired one exploration block (Block 155) in Peru in partnership with Plus Petrol, CNOC and Peru Petro

Maintain BUY

We maintain our long term BUY rating on the stock with a revised sum of parts target of Rs1,584. Although petrochemical segment is likely to witness margin pressures in the near term, the integrated nature of the segment will help RIL post a relatively strong performance in the downtrend. Refining segment might continue to see pressure on GRMs but will sustain over long term averages. With KG D6 all set to commence production from Q4 FY09, RIL will emerge as a leading global player in the E&P segment. We anticipate a 15.5% CAGR in its profits during FY08-11E. The stock is trading at 8.6x FY10E earnings of Rs131.5, which we find attractive. Further, we believe that current stock price factors nil upsides from its E&P activities, which is unwarranted given the nature of its assets. On the other hand, pending decision on RIL-RNRL case will remain a key overhang on the stock price.

Financial summary

Y/e 31 Mar (Rs mn)	FY08	FY09E	FY10E	FY11E
Revenues	1,334,430	1,612,707	1,801,333	1,920,251
yoy growth (%)	19.5	20.9	11.7	6.6
Operating profit	233,059	238,780	320,808	378,919
OPM (%)	17.5	14.8	17.8	19.7
Pre-exceptional PAT	147,248	152,799	206,996	226,708
Reported PAT	194,583	152,799	206,996	226,708
yoy growth (%)	23.2	3.8	35.5	9.5
EPS (Rs)	133.9	97.1	131.5	144.0
P/E (x)	8.5	11.7	8.6	7.9
Price/Book (x)	2.0	1.9	1.6	1.3
EV/EBITDA (x)	10.2	10.3	7.5	6.2
RoE (%)	18.1	16.1	18.2	16.8
RoCE (%)	16.4	15.1	18.4	19.8

Source: Company, India Infoline Research

Recommendation parameters for fundamental reports:

Buy – Absolute return of over +10%

Market Performer – Absolute return between -10% to +10%

Sell – Absolute return below -10%

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