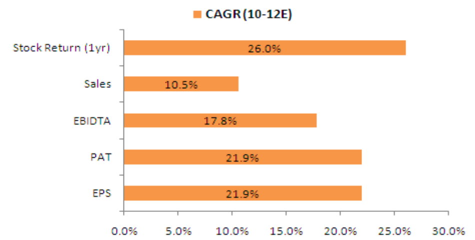
3Q FY11 Results Update

Industry	Oil & Gas

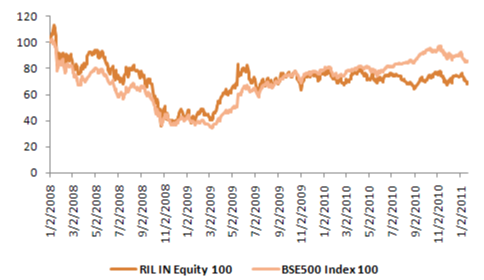


Price	987
Target Price	1,235
Last call	
Expected share price return	25.13%
Expected dividend yield	0.9%
Expected total return	26.04%

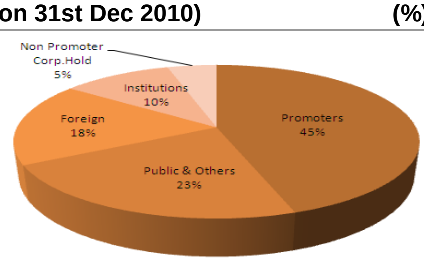
Market Data

Market Cap.	₹ 3,242bn/ US$ 72bn
Share Cap. (mn)	32,850
52 Wk High/Low	1187/ 841
Avg. Vol. (Weekly)	3,746,000

(Price Performance (RIC: RELI.BO, BB: RIL IN)



Shareholding Pattern
(As on 31st Dec 2010) (%)



Financials (₹ Mn)	FY10	FY11E	FY12E
Net Sales	2,037,397	2,445,363	2,489,817
EBIDTA	308,939	387,252	428,442
PBT	286,799	257,174	295,306
PAT	158,975	205,739	236,245
EPS (₹.)	48	63	72
EBIDTA Margin (%)	15.2%	15.8%	17.2%
PAT margin (%)	7.8%	8.4%	9.5%
Price/Earnings (x)	20	16	14
EV/EBIDTA	12	10	8
ROE (%)	13.2%	14.6%	14.8%
ROCE (%)	16.1%	13.7%	14.1%

Reliance Industries (RIL IN)

January 24, 2011

Cyclicals help post record PAT in 3Q

"ACCUMULATE" (CMP: ₹ 987)

Mkt Cap ₹ 3,242bn; USD72bn

RIL's 3Q FY11 PAT surged 28% YoY to record ₹51.4bn - highest ever quarterly recurring profit recorded till date. The robust growth was mainly led by its cyclical businesses viz. refining & petrochemicals that offset the impact of lacklustre E&P performance. While concerns on volume ramp-up in its KG D6 block may act as an overhang on the stock, we believe the traction in its cyclical businesses may limit any impact on earnings. At current levels, the stock trades maginally above our bear-case valuation of ₹973/share. Our base case EPS estimates for FY12E imply a 2-year CAGR at 22%. We thus reiterate our "ACCUMULATE" rating on RIL.

3Q PAT boosted by refining, petrochemicals

RIL's 3QFY11 PAT surged 28% YoY to ₹51.4bn, in line with our expectations and marginally below consensus. The robust growth in PAT was driven by uptick in its refining and petrochemical businesses – refining EBIT up 77% YoY and petchem EBIT up 18% YoY. The growth in these businesses offset the impact of flattish E&P EBIT to result in 30% YoY rise in overall EBIT to ₹64bn.

Higher GRMs, polyester margins offset impact of flattish E&P performance

3Q FY11 Gross Refining Margins (GRMs) rose 53% YoY to US$9/bbl, which offset the impact of 3% YoY decline in crude throughput, following the 4-week shutdown in one of the CDUs. Polyester chain margins too surged to a decade high of >US$1100/tonne (long-term average at US$715/tonne) thus boosting Petchem EBIT. These factors offset the impact of lacklustre E&P performance in 3Q FY11.

KG D6 volumes lower than earlier guidance; no clarity on ramp-up yet

RIL indicated in the analyst meet that its KG D6 block is producing gas @52-55mmcmd, 8-13% lower than earlier guided volume of 60mmcmd. Further, the MA oil field too is producing oil @ 17-17,500bpd, atleast 50% lower than its peak production potential. No clarity is yet available officially from RIL as to the timing of the ramp-up of oil/gas production in the KG D6 block to their peak production potential. However, RIL did indicate that ramp-up to peak potential is unlikely atleast in the near-term.

Traction in cyclical businesses to offset concerns on E&P

The concerns on volume growth in the E&P business, coupled with the fact that there is no official guidance yet on the timing of ramp-up of KG D6 oil/gas volumes to peak potential is likely to act as an overhang on the stock. However, we believe this is just a timing difference and any concerns on the ability of the field to ramp-up to 80mmscmd in the future may be misplaced. Statements by the DGH and RIL in the past prove the point that the potential to produce 80mmscmd exists – timing being the only imponderable factor. Further, the improving demand-supply in its cyclical businesses viz. refining & petrochemicals should help abate concerns on E&P, if any.

22% EPS CAGR over FY10-12E; Acccumulate

At current levels, RIL trades at just 1% above our bear case fair value of ₹973/share, assuming 50mmscmd of KG D6 gas production over FY12E-14E, marginal YoY increase in GRMs and flattish naphtha cracking margins. Our base case EPS forecasts for FY10-12E i.e. ₹48-72/share (FY12E lower than consensus EPS) implies 2-year EPS CAGR of 22%. We thus reiterate our "ACCUMULATE" rating on RIL.

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PAT up 28% YoY led by E&P, Refining

Higher GRMs, higher D6 volumes boost EBIT

RIL reported PAT of ₹51.4bn in 3Q FY11, which represents a robust growth of 28% YoY. This was mainly driven by 26% YoY growth in EBIT to ₹64bn v/s ₹49bn in 3Q FY10.

Table 1: RIL 3Q and 9M FY11 results

₹-mn	3Q FY11E	3Q FY10	Change	9M FY11	9M FY10	Change
Net sales	597,890	568,560	5.2%	1,754,960	1,348,910	30.1%
Total expenditure	502,440	490,120	2.5%	1,472,130	1,134,460	29.8%
EBIDTA	**95,450**	**78,440**	**21.7%**	**282,830**	**214,450**	**31.9%**
EBIDTA margin	**16.0%**	**13.8%**		**16.1%**	**15.9%**	
Interest	5,490	5,500	0%	16,320	14,720	11%
Depreciation	33,590	27,950	20%	102,210	71,050	44%
Other Income	7,410	5,080	46%	21,350	18,450	16%
PBT	63,780	50,070	27%	185,650	147,130	26%
Tax	12,420	9,990	24%	36,550	31,870	15%
Recurring PAT	**51,360**	**40,080**	**28%**	**149,100**	**115,260**	**29%**
Extra-ordinary items	0	0	#DIV/0!	0	0	#DIV/0!
PAT	**51,360**	**40,080**	**28%**	**149,100**	**115,260**	**29%**
EPS	**15.6**	**12.3**	**28%**	**45.4**	**35.1**	**29%**

Source: Company, Systematix research

Robust EBIT growth driven mainly by refining, E&P

RIL's refining EBIT surged 77% YoY to ₹24bn despite 3% YoY drop in crude throughput – a result of 4 week shutdown undertaken in one of its CDUs. The robust growth in refining EBIT was mainly driven by 53% YoY increase in Gross Refining Margins (GRMs) to US$9/bbl v/s US$5.9/bbl in 3Q FY10. E&P was flattish YoY at ₹15bn mainly due to higher proportion of KG D6 gas which earns a lower realization, as compared to PMT that has a comparatively higher realization, with 30% of 9M production volumes being oil/condensates. Petchem EBIT rose 18% YoY mainly driven by improvement in polyester chain deltas, which were above their 5-year averages.

Table 2: RIL 9M FY11 EBIT break-up

₹-mn	3Q FY11E	3Q FY10	Change	9M FY11	9M FY10	Change
Petrochemicals	24,290	20,550	18.2%	66,790	63,590	5.0%
Refining	24,360	13,790	76.6%	66,630	40,250	65.5%
Oil & Gas	15,040	14,770	1.8%	51,310	37,110	38.3%
Others	90	110	-18.2%	240	310	-22.6%
	63,780	**49,220**	**29.6%**	**184,970**	**141,260**	**30.9%**
Petrochemicals	38%	42%		36%	45%	
Refining	38%	28%		36%	28%	
Oil & Gas	24%	30%		28%	26%	
Others	0%	0%		0%	0%	
	100%	**100%**		**100%**	**100%**	

Source: Company, Systematix research

Table 3: Performance of refining division in 3Q FY11E

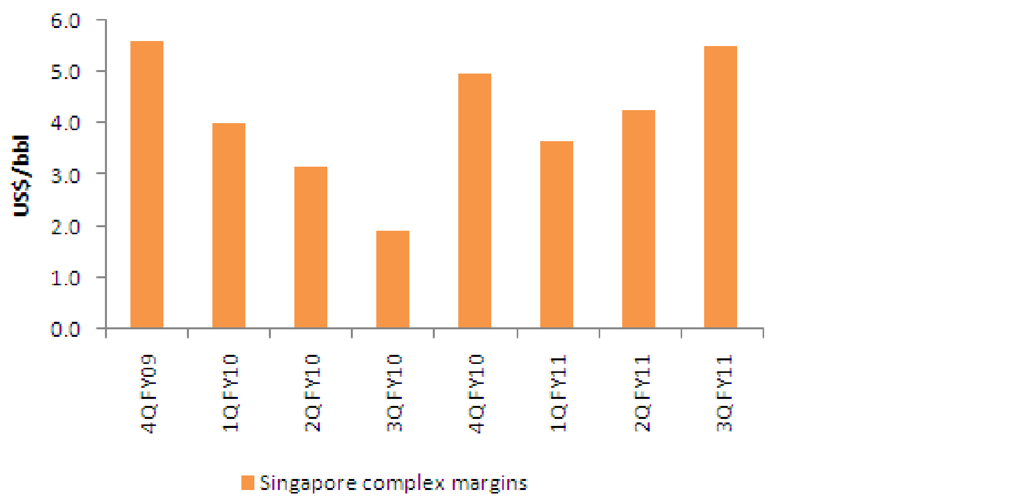
₹-mn	3Q FY11E	3Q FY10	Change	9M FY11	9M FY10	Change
Crude throughput (MT)	16.1	16.6	-3.1%	49.9	44.3	12.6%
Refining Margin (US$/bbl)	9.0	5.9	52.5%	8.1	6.2	30.6%

Source: Company, Systematix research

Benchmark refining margins highest in the last seven quarters…

Singapore complex refining margins rose to US$5.5/bbl – a level last seen in 4Q FY09. Singapore complex GRMs were up 189% YoY and 29% QoQ.

Chart 1: Trend in Singapore complex margins



Source: Company

… led by higher product cracks, light-heavy spreads

The significant improvement in GRMs were a result of an uptick in both product as well as light-heavy crude spreads. Most spreads except Fuel oil increased both sequentially as well as on YoY basis.

Chart 2: Trend in product cracks

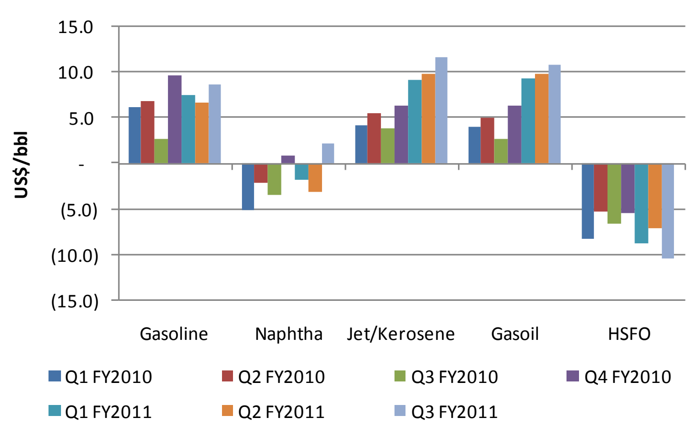
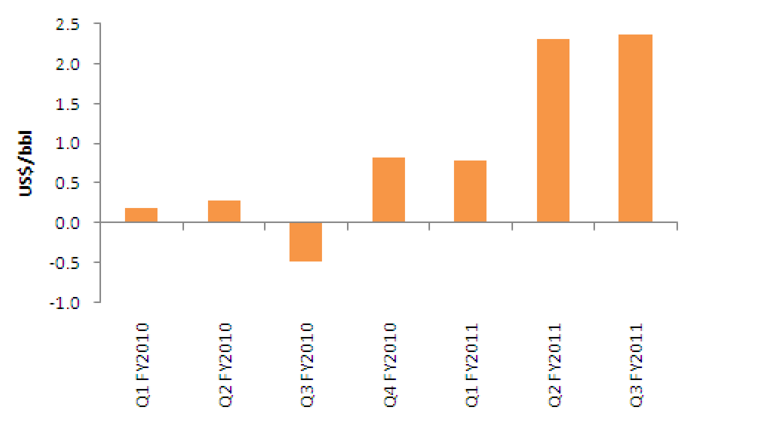


Chart 3: Trend in Brent-Dubai spreads



Source: Bloomberg

Diesel spreads expand 3.9x YoY and 10% QoQ led by robust Chinese demand

The improvement in diesel spreads has been led mainly by significant uptick in Chinese demand. China, in an attempt to reduce its energy intensity as it nears the end of its XI five year plan, started ramping up diesel imports since November 2010 to support its diesel fired generators. This is likely to continue atleast until January 2011 when its XI five year plan draws to an end. The Chinese New Year in February 2011 would mark the beginning of its XII five year plan, which may ease curbs on electricity output thereby easing diesel imports as well. Thus, distillate spreads should start to soften somewhat in February 2011.

E&P EBIT flattish YoY at ₹15bn

RIL's 3Q FY11 E&P EBIT was flat YoY at ₹15bn. The flattish EBIT performance despite 18% YoY growth in E&P was mainly due to higher contribution of KG D6 (which is mainly gas) in 3Q FY11 v/s mainly PMT in 3Q FY10. Oil has a higher share in PMT volumes (30% in 9M FY11 volumes) compared to KG D6 (only 6% is oil/condensates). Besides, higher depreciation on E&P post KG D6 commissioning further adversely impacted the YoY EBIT performance – E&P depreciation was up 33% YoY to ₹18bn.

Table 4: YoY change in E&P production volumes

₹-mn	3Q FY11	3Q FY10	YoY change	2Q FY10	QoQ change
Panna-Mukta					
Oil ('000mt)	320	473	-32.3%	87	267.8%
Gas (mmscmd)	3.9	6	-31.4%	1	219.9%
Tapti					
Condensate ('000mt)	36	42	-14.3%	37	-2.7%
Gas (mmscmd)	6.9	8	-8.2%	7	-6.5%
KG D6					
Oil ('000mt)	220	115	91.3%	302	-27.2%
Gas (mmscmd)	55	46	19.4%	59	-6.8%

Source: RIL

Table 5: Segment-wise break-up of depreciation

₹mn	3Q FY11	3Q FY10	YoY change
Refining	9.7	8.6	12.8%
Petrochemicals	5.3	5.4	-1.9%
E&P	18.0	13.5	33.3%
Others/ unallocated	0.6	0.4	31.1%
Total	**33.6**	**28.0**	**20.2%**

Source: RIL

Petchem EBIT up 18% YoY led by better polyester margins

Petchem EBIT was up 18% YoY and 4% QoQ to ₹24bn. This was mainly driven by better chemical margins i.e. margins on products such as Butadiene, Poly Butadiene Rubber (PBR) and Linear Alkalyne Benzene (LAB). In the Polyolefins chain, PP deltas improved significantly while PE-naphtha deltas were down YoY and flattish QoQ.

Chart 4: HDPE-naphtha delta

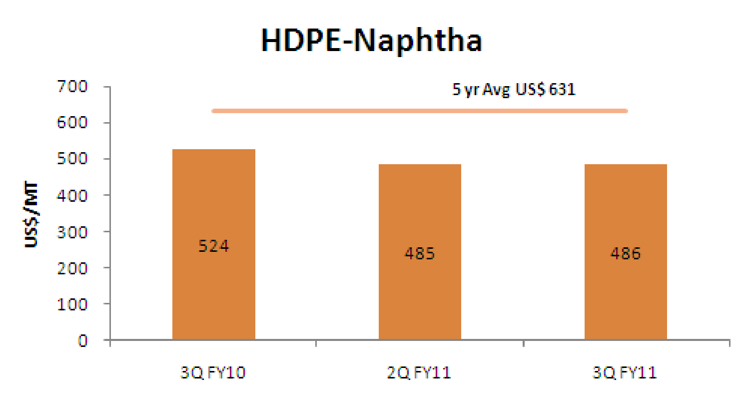
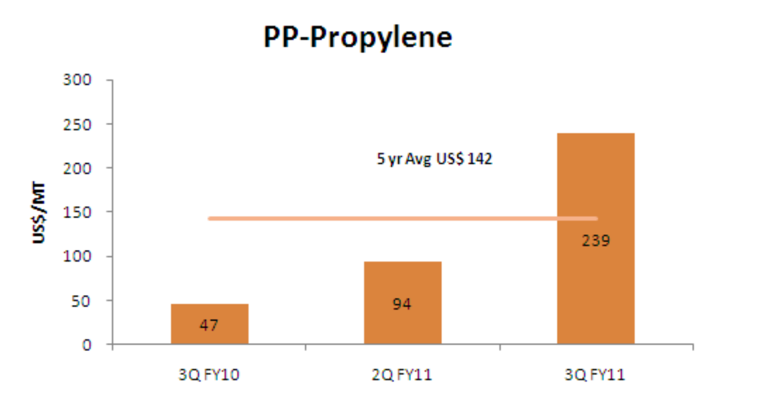


Chart 5: PP-propylene delta



Source: RIL

Chart 6: BD-LPG

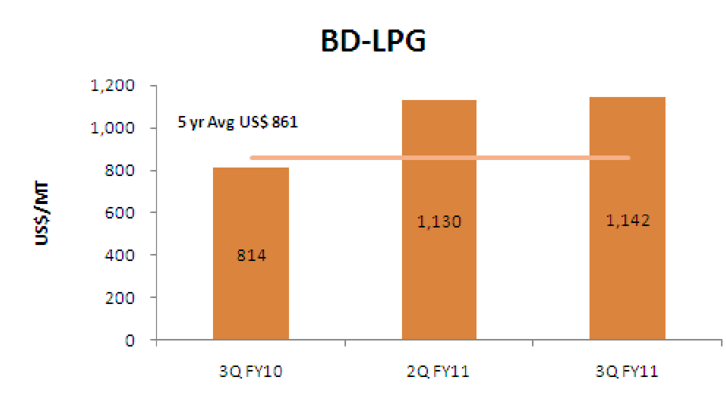
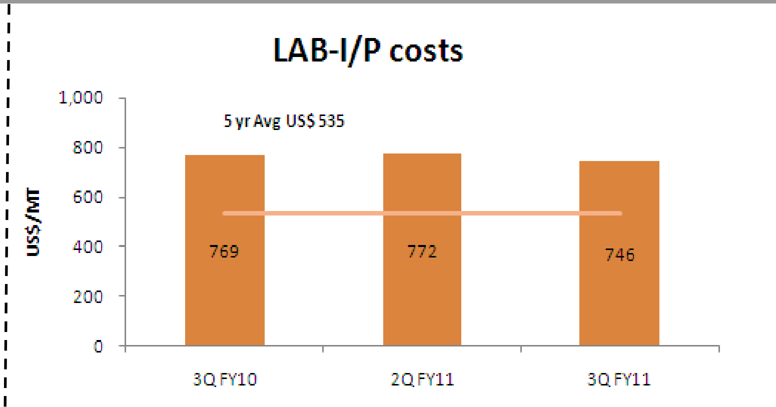


Chart 7: LAB-I/P costs

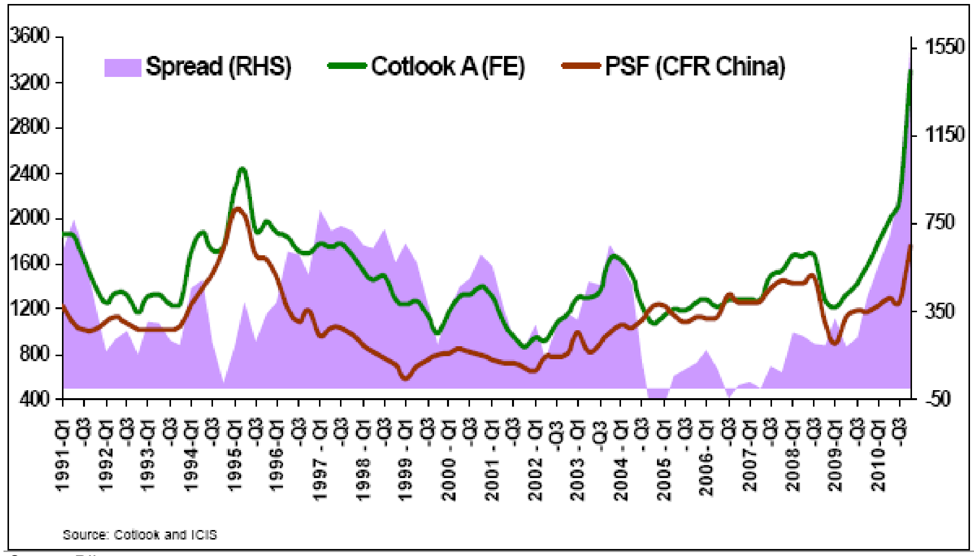


Source: RIL

Polyester – the dark horse

The main growth driver for the robust growth in RIL's petrochemical EBIT was its polyester business. The polyester business enjoyed the benefits of both cost push (led by higher input costs that are essentially crude oil derivatives) and ability to hike prices on the back of high cotton prices, which is a costlier substitute to Polyester.

Chart 8: Spread between cotton and PSF at all-time highs

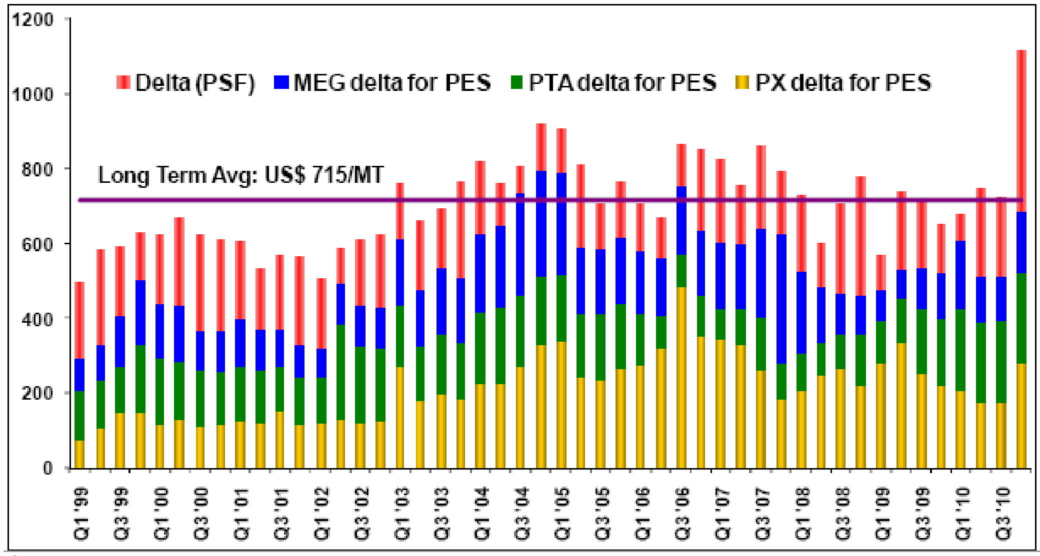


Source: RIL

Polyester demand growth a robust 15% YoY in 9M FY11

This was mainly led by significant uptick in PET demand – up 26% (higher consumerism and beverage demand) and POY demand – up 16% (high cotton prices). The robust demand growth was reflected in polyester chain deltas, which were higher than their 5 year as well as 10-year averages.

Chart 9: Polyester chain deltas at decade-high levels



Source: RIL

3Q FY11 PAT up 4% QoQ

Petchem growth offsets volume de-growth in refining, E&P

RIL's 3Q FY11 EBIT was up just 4% QoQ, mainly due to volume de-growth in its refining and E&P segments. Refining EBIT was down 13% QoQ mainly due to the impact of the three week shutdown in one of its CDUs which resulted in 11% QoQ decline in the crude throughput. This more than offset the 10% QoQ increase in GRMs. Also, the 7% QoQ decline in KG D6 gas volumes to 55mmscmd led to 12% QoQ decline in E&P EBIT.

However, the 11% QoQ increase in petchem EBIT mainly led by better polyester product margins offset the impact of decline in refining/ E&P EBIT. Higher other income led by higher cash balances also contributed to the QoQ PAT growth.

3Q PAT in line with expectations

3Q refining EBIT was much higher than our expectations mainly led by higher than expected GRMs (US$9/bbl reported v/s US$8.7/bbl expected) and crude throughput (16.1mmt reported v/s15mmt expected). The positive surprise in refining EBIT was more than offset by lower than expected E&P EBIT. Petrochemical EBIT was marginally above our expectations.

Analyst meet takeaways

E&P update

KG D6 gas currently producing @52-55mmscmd; MA oil @ 17-17,500bpd

RIL indicated in its analyst meet that it is currently producing ~52-55mmscmd of gas from its KG D6 block while the amount of oil being produced is ~17-17,500bpd. Out of the total 52-55mmscmd gas being produced, D1 and D3 fields account for ~43-45mmscmd of gas with the balance volumes pertaining to MA gas. This is 8-13% lower than the eariler guided volumes of 60mmsmd. Similarly, in the case of oil, the current rate of production is 50% lower than the indicative peak output of 35,000bpd.

No clarity on ramp-up to 80mmscmd of gas production, 35,000bpd oil in KG D6

The management did not give any clarity on the ramp-up to 80mmscmd gas production and 35-40,000bpd oil production in the KG D6 block. However, the management did indicate that given the current scenario, ramp-up to 80mmscmd gas production in the D6 block appears to be difficult atleast in the near-term.

Refining update

Internal consumption of KG D6 gas for refinery lesser than earlier guided

RL indicated in the analyst meet that KG D6 gas is able to meet only ~40-45% of its total requirement for internal consumption of gas of ~8mmscmd. RIL is resorting to more expensive LNG (US$10-10.5/mmbtu) to fill up the balance. Lesser usage of KG D6 gas v/s expensive LNG would narrow the benefit that RIL would derive from using gas v/s liquid fuels in its refinery. We estimate that at crude prices of US$90-100/bbl, RIL would make a benefit of only US$0.6-0.7/bbl by using lower KG D6 volumes v/s US$1.7-2.0/bbl, if its entire requirement of gas is met by KG D6.

FCCU shutdown likey in 4Q FY11

The FCCU for the old refinery with a capacity of ~200kbpd is likely to be shutdown in the first week of February 2011 for a period of 36-37 days. This would have a marginal negative impact on GRMs due to lower secondary processing capacity available for the period of the shutdown.

Outlook for refining margins likely to be robust

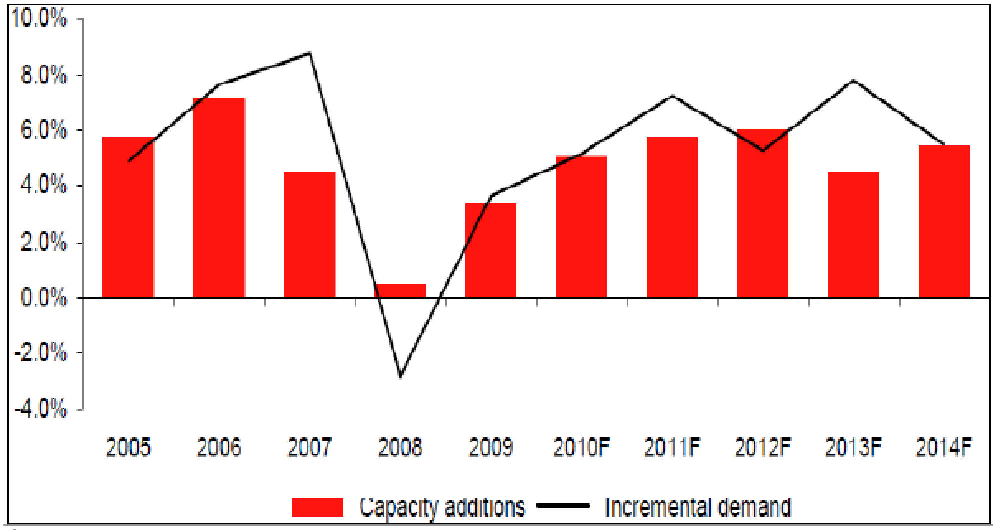
RIL potrayed a robust outlook for refining margins going forward led by i) Improving global demand scenario; ii) Improving light-heavy spreads led by reduced OPEC compliance resulting in higher flows of heavier crudes; and iii) Stricter sulphur content norms for Fuel oil (FO) resulting in capex required to produce sulphur compliant FO and thus a higher product price for the compliant FO grades.

Petrochemicals update

Benign demand-supply scenario in polyester likely over the next few years

RIL indicated of an improving demand-supply scenario for polyester fibre over the period 2011E-2014E. RIL believes that the increase in global capacity by 5.7% would be more than offset by faster demand growth @ 7.2%. In CY 2011, RIL expects capacity to grow by ~3-3.5mtpa while demand growth is likely to be higher at 4-4.5mtpa.

Chart 10: Demand-supply scenario for Polyester set to improve going forward s



Source: RIL

Very low inventory holding period indicates robust demand picture

RIL indicated in its analyst meet that its current inventory holding period is just around 1.5 days, which indicates a robust demand picture. Moreover, RIL's focus on domestic markets also makes it relatively immune to demand fluctuations in the overseas markets.

Tight cotton prices only reinforce bullish outlook for polyester

RIL appeared to be confident about a bullish picture for polyester going forward. This banks on the expectations of high cotton prices led by tight global availability of cotton. RIL thus indicated that polyester margins would most likely witness a sequential jump in 4Q FY11 compared to 3Q FY11, led by the bullish outlook indicated above.

Retain "Accumulate"

RIL's CMP close to our bear case fair value of ₹973/share

At current levels, RIL trades at just 1% above our bear case fair value of ₹973/share. Our bear-case fair value assumes ~50mmscmd of KG D6 gas production over FY12E-14E, marginal YoY increase in GRMs and flattish naphtha cracking margins.

Base case EPS CAGR at 22% over FY10-12E

Our base case EPS for RIL implies a robust 22% CAGR over FY10-12E. We model 15% YoY increase in FY12E EPS and 13% YoY increase in FY13E EPS. Our EPS forecasts and consequently EPS CAGR forecasts are much lower than that of the consensus – consensus FY11-12E EPS at ₹65-77/share (2 year EPS CAGR over FY10-12E at 27%).

Growth in cyclical businesses to offset concerns on E&P

RIL's YTD underperformance is mainly due to the concerns on volume growth in its E&P business. We have assumed ~65mmsmcd KG D6 gas volumes in FY12E, which may appear to be slightly higher given the current scenario. However, we have been relatively conservative in our FY12E assumptions for its cyclical businesses – only 6% YoY growth assumed in GRMs and 10% YoY growth in naphtha cracking margins (still below FY10 levels). Thus, any downside in the E&P business would most likely be offset by possible upgrades in its cyclical businesses ultimately limiting any impact on EPS

We thus retain our "ACCUMULATE" rating on RIL with a target price of ₹1235/share.

Profit & Loss A/c

Table 6: Profit and Loss a/c

₹-million	FY09	FY10	FY11E	FY12E	FY13E
Revenue	1,512,240	2,037,397	2,445,363	2,489,817	2,405,461
Raw material consumed	(1,124,261)	(1,546,027)	(1,892,323)	(1,925,406)	(1,768,112)
Other expenditure	(153,758)	(182,431)	(165,789)	(135,970)	(148,169)
Total expenditure	(1,278,019)	(1,728,458)	(2,058,111)	(2,061,375)	(1,916,281)
EBITDA	**234,222**	**308,939**	**387,252**	**428,442**	**489,180**
Depreciation	(56,510)	(109,458)	(133,669)	(144,918)	(171,039)
Interest	(18,163)	(20,596)	(26,327)	(18,944)	(15,731)
Other Income	19,142	21,858	29,918	30,727	31,683
Extra-ordinary/prior period items	3,280	86,056	0	0	0
PBT	181,972	286,799	257,174	295,306	334,093
Tax	(29,188)	(42,563)	(51,435)	(59,061)	(66,819)
Reported Profit	152,783	244,236	205,739	236,245	267,274
Net Profit	149,503	158,180	205,739	236,245	267,274
Minority interest	184	795	0	0	0
Consolidated profit	**149,687**	**158,975**	**205,739**	**236,245**	**267,274**
Outstanding shares	3,285	3,285	3,285	3,285	3,285
Reported EPS	45.6	48.4	62.6	71.9	81.4
y-o-y change	-10%	6%	29%	15%	13%
Recurring EPS	45.6	48.4	62.6	71.9	81.4
y-o-y change	-10%	6%	29%	15%	13%

Source: Company and Systematix Institutional Research

Table 7: Balance Sheet

₹-million	FY09	FY10	FY11E	FY12E	FY13E
Assets					
Gross fixed assets	2,316,773	2,418,095	2,515,142	2,828,320	3,130,613
Less: accumulated depreciation	1,368,629	910,319	968,512	1,311,855	1,681,312
Net fixed assets	948,144	1,507,776	1,546,630	1,516,464	1,449,301
Capital work in progress	738,460	170,337	215,837	327,087	435,837
Net fixed assets and Capital WIP	**1,686,604**	**1,678,113**	**1,762,466**	**1,843,551**	**1,885,137**
Investments	64,355	131,123	55,641	45,431	85,431
Cash and bank balance	227,421	138,908	244,571	281,251	330,461
Current Assets					
Inventories	201,096	343,933	345,102	351,561	328,245
Sundry debtors	48,450	100,829	189,500	194,335	198,604
Loans to subsidiaries	0	0	0	0	0
Other current assets	110,494	107,386	97,987	98,859	89,028
	360,040	**552,149**	**632,590**	**644,755**	**615,877**
Less: Current liabilities					
Sundry creditors	345,011	381,256	338,482	342,407	288,010
Dividend provision	19,860	24,309	29,967	33,713	37,459
Other liabilities	23,849	20,291	25,794	25,499	22,350
	388,720	425,856	394,243	401,619	347,819
Net current assets	-28,680	126,293	238,347	243,135	268,058
Total assets	**1,949,700**	**2,074,436**	**2,301,025**	**2,413,369**	**2,569,088**
Liabilities					
Borrowings	762,566	646,055	683,515	581,515	494,055
Deferred tax liability	95,513	106,776	117,063	128,875	142,239
Minority interest	1,389	5,735	5,735	5,735	5,735
Equity share capital	28,879	29,780	32,850	32,850	32,850
Reserves and surplus	1,061,353	1,286,090	1,461,862	1,664,394	1,894,209
	1,090,231	1,315,870	1,494,712	1,697,244	1,927,059
Total liabilities	**1,949,700**	**2,074,436**	**2,301,025**	**2,413,369**	**2,569,088**

Source: Company and Systematix Institutional Research

Table 8: Cash Flows

₹-million	FY09	FY10	FY11E	FY12E	FY13E
Net profit	152,783	244,236	205,739	236,245	267,274
Add: deferred tax	16,454	11,314	10,287	11,812	13,364
Add:Depreciation	56,510	109,458	133,669	144,918	171,039
	225,747	365,008	349,695	392,975	451,677
Add:Change in working capital	227,316	-154,973	-117,712	-8,535	-28,669
Less: dividend	19,350	19,860	24,309	29,967	33,713
	433,713	190,175	207,674	354,473	389,295
Less change in investment	-30,873	66,767	-75,481	-10,210	40,000
Less:Capex	777,155	98,466	215,586	223,566	210,188
	-312,569	24,942	67,570	141,117	139,107
Add:change in equity	239,403	5,545	3,070	0	0
Less:repayment of debt	-255,605	116,511	-37,460	102,000	87,460
Change in cash balance	**182,439**	**-86,025**	**108,100**	**39,117**	**51,647**

Source: Company and Systematix Institutional Research

Ratios

Table 9: Ratios

₹-million	FY09	FY10	FY11E	FY12E	FY13E
Recurring EPS	45.6	48.4	62.6	71.9	81.4
PE	21.7	20.4	15.8	13.7	12.1
DPS	5.77	6.35	8.00	9.00	10.00
Yield	0.6%	0.6%	0.8%	0.9%	1.0%
Book Value	332	401	455	517	587
P/BV	3.0	2.5	2.2	1.9	1.7
EV/EBITDA	16.1	12.1	9.5	8.3	7.0
ROCE	12.5%	16.1%	13.7%	14.1%	14.9%
ROE	15.5%	13.2%	14.6%	14.8%	14.7%

Source: Company and Systematix Institutional Research

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Stock Ratings

BUY (B)	The stock's total return is expected to exceed 20% over the next 12 months.
ACCUMULATE (A)	The stock's total return is expected to be within 10-20% over the next 12 months.
HOLD (H)	The stock's total return is expected to be within0-10% over the next 12 months.
SELL (S)	The stock's is expected to give negative returns over the next 12 months.
NOT RATED (NR)	The analyst has no recommendation on the stock under review.

Industry Views

ATTRACTIVE (AT)	Fundamentals /Valuations of the sector is expected to be attractive over the next 12-18 months.
NEUTRAL (NL)	Fundamentals /Valuations of the sector are expected to neither improve nor deteriorate over the next 12-18 months.
CAUTIOUS (CS)	Fundamentals /Valuations of the sector is expected to deteriorate over the next 12-18 months.

Disclosure of Interest

1. The analysts who have prepared the report have in no way received or are expected to receive any compensation from the subject company.
2. The analysts do not hold any position in the subject company's stock, as on the date of release.
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