IDFC INSTITUTIONAL SECURITIES
India Research

Reliance Industries

Rs986
OUTPERFORMER

RESULT NOTE

Mkt Cap: Rs3.2trn; US$71bn

Analyst: **Probal Sen (91-22-6622 2569; probal.sen@idfc.com)**
Result: **Q3FY11**
Comment: **Results in line; Refining and Petchem revival gains steam**

Key valuation metrics

Year to March 31 (Rs m)	Net sales	yoy chg (%)	Net profit	EPS (Rs)	yoy chg (%)	PER (x)	EV/E (x)
2008	1,371,467	20.55	195,251	59.7	61.7	16.5	16.1
2009	1,512,240	10.26	149,503	45.7	(23.4)	21.6	16.1
2010	2,037,400	34.73	244,980	48.6	6.3	20.3	12.3
2011E	2,271,138	11.47	210,131	64.3	32.2	15.4	9.5
2012E	2,459,459	8.29	235,152	71.9	11.9	13.7	8.0

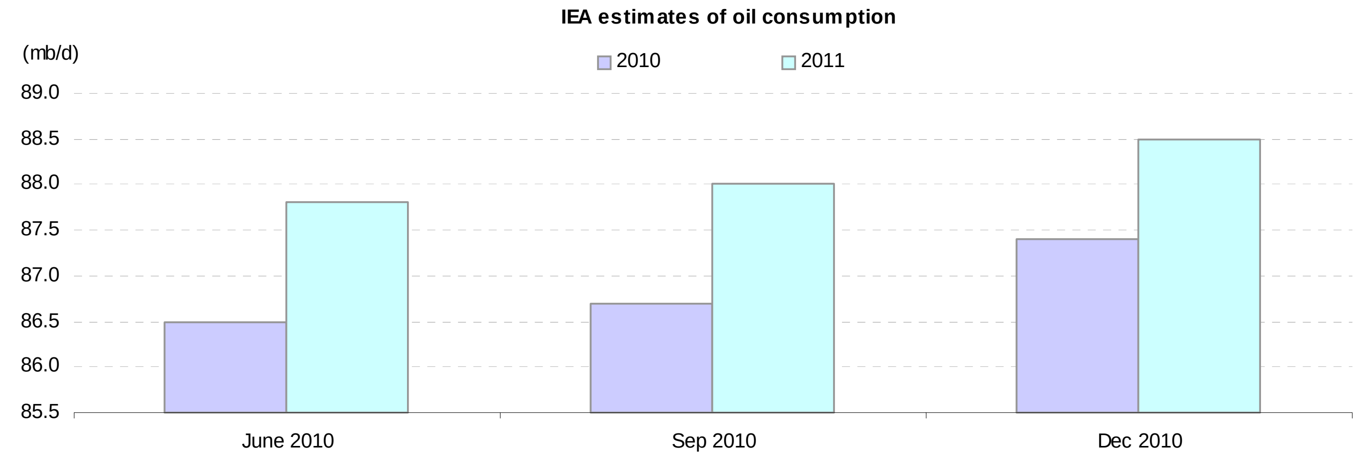
Key highlights

- Revenues increased by 5% yoy to Rs598bn, lower than our estimate of Rs614bn. The growth yoy is primarily due to additional refining volumes and higher realizations from the Petrochemical business.
- Refining throughput was 16.1mt, lower than our estimate of 16.2mt. KG volumes were 55mmscmd, in line with estimates.
- GRMs came in at US$9/bbl as against an estimate of US$9.1bbl. This represents 62% yoy and 14% qoq improvement. The sequential improvement is significant as the trend indicates that the improvement in global demand is taking hold. The Arab Heavy Light spreads is also improving, in line with greater supply by OPEC. The numbers also indicate the revival in global economy is gaining momentum.
- Petchem volumes were also robust with PE demand in India growing by 11% yoy. PP demand grew by 18% while the polyester segment showed a 15% yoy growth in demand. The extremely strong domestic demand environment, coupled with the huge improvement in polyester deltas, implies that this segment would continue to perform strongly going forward for RIL .
- EBITDA margins at 16% were in line with our estimate of 15.8%. RIL reported EBITDA of Rs95.5bn as against our estimate of Rs96bn.This represents growth of 22% yoy and 2% qoq.
- The company reported a sharp increase in DD&A costs primarily due to capitalization of E&P capex. DD&A costs came in at Rs34bn, up 20% yoy. This was primarily due to higher capitalization of KG D6 Capex. Interest costs at Rs5.5bn were however flat yoy.
- Other income for the quarter grew 46% yoy to Rs7.4bn, due to higher cash on hand (Rs318bn vs. Rs264bn at end of Q1FY11).
- Overall, net profit before extraordinary items was Rs51.4bn for the quarter, marginally lower than our estimate of Rs52.5bn. This represents growth of 28% yoy and 4% qoq.

❑ Business environment improving

Globally, the economic environment has seen material improvement over the past few months, and key indicators such as industrial production and GDP growth point to a better scenario going forward. RIL is very optimistic on its prospects over the next few quarters, with growth from Asia expected to more than offset the relative weakness in OECD countries. The economic revival is reflecting in the projections for crude demand, with both the IEA and EIA, two of the premier organizations tracking crude oil usage and trends globally, having raised their demand estimates for CY11 over the past six months.

Economic growth to be driven by Asia

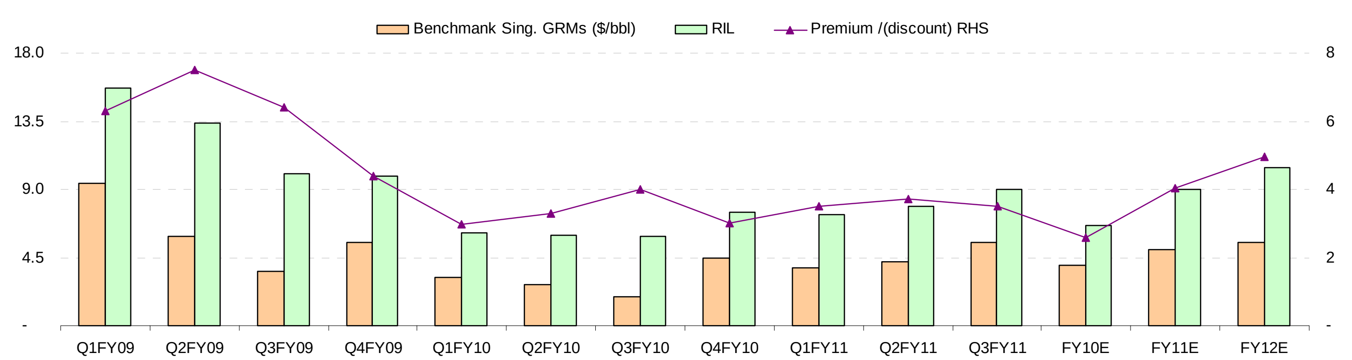


Source: IDFC Securities Research, Company, IEA

❑ Refining business continues to see momentum

GRMs for the quarter have come in at US$9/bbl, well above the US$5.9/bbl in Q3FY10. Further, this level is a considerable premium to Singapore benchmark GRMs, which were at US$5.5/bbl in Q1FY11, compared to US$1.8/bbl in Q3FY10. The continued outperformance against global benchmarks was achieved through superior risk management practices, higher refinery complexity, and a superior product slate. Total throughout at 16.1mmt was strong despite a 22 day maintenance shutdown, ensuring utilization rate at above 100% for this quarter as well..

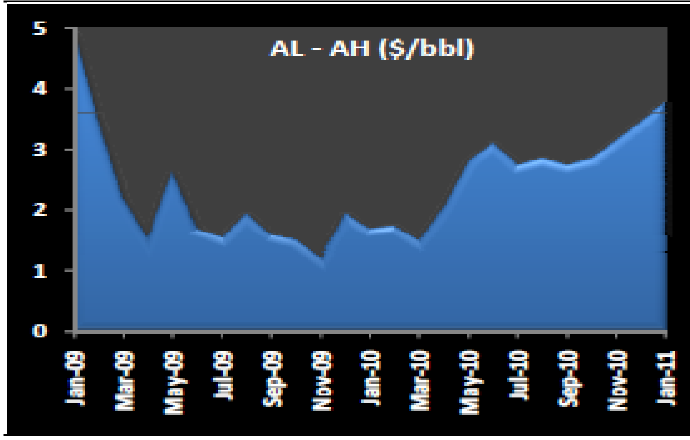
GRM trend – Q1FY09-12E

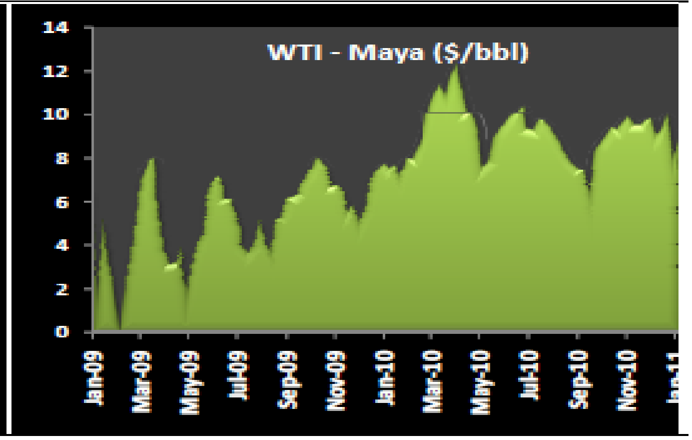


Source: IDFC Securities Research, Company

One key factor helping GRMs is the improving Arab Heavy-Light spread, which has seen levels of US$3/bbl on average over the last two months, after being consistently in the US$1.5-1.7/bbl range for most of FY10. We believe that with OPEC compliance continuing to be in the low 50s, and global demand improving, heavy oil availability would continue to improve, supporting the spreads. Heavy-light spreads is one of the key drivers of the premium earned by complex refineries such as RIL's over benchmarks.

Heavy light spreads improving

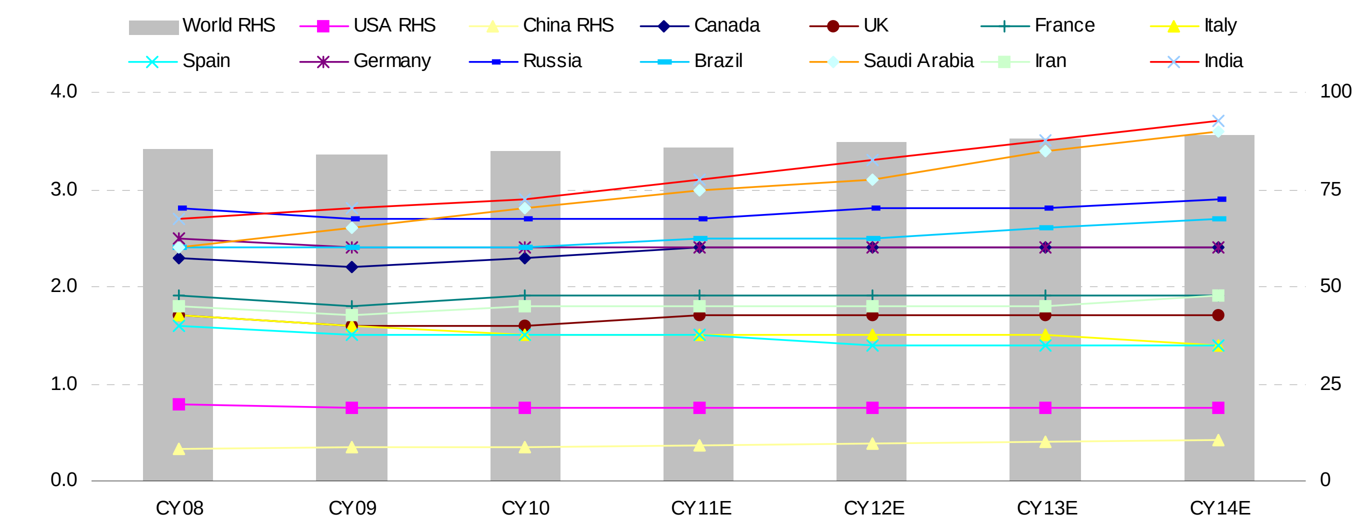




Source: IDFC Securities Research, Company

The revival in Singapore GRMs appears to have gained momentum over the past three months, and we believe that the emerging economies will be key drivers of growth in refining demand over the next five years, with the OECD countries expected to show only steady growth going forward. We believe that globally, supply additions from the Middle East and China would start to taper off CY12E onwards, thus tightening the demand-supply balance.

Petroleum fuel demand – global CY09-14E

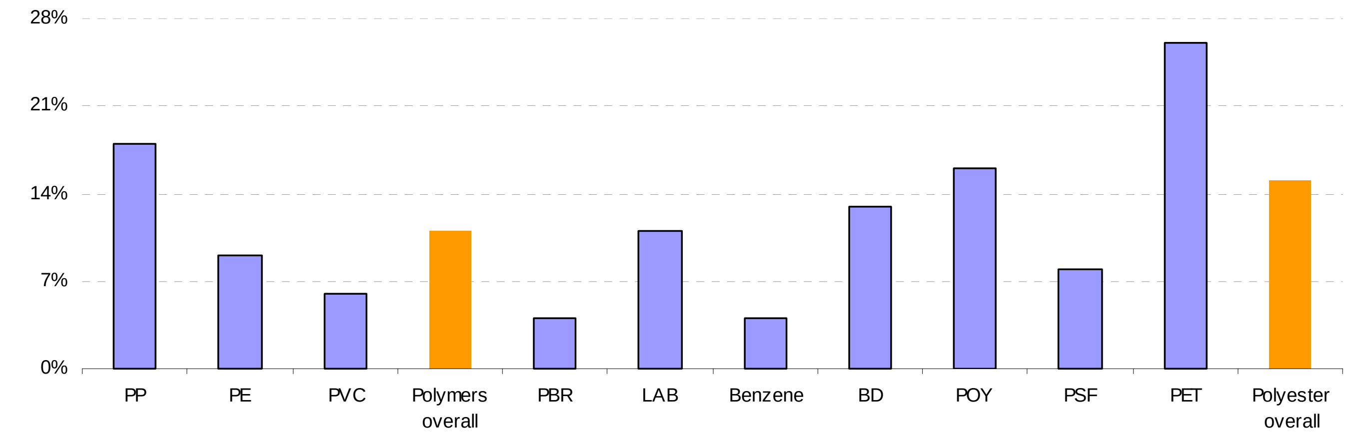


Source: Bloomberg, IEA

❑ Petrochemicals & Polyesters: Riding the Domestic growth story

The domestic growth story helped petchem volumes continue to show solid growth in Q3FY11. With Indian and Chinese demand for polymers and plastics growing in high double digits, RIL has posted another strong quarter in its petrochemical business. The domestic demand from segments of agriculture, packaging, infrastructure and automobiles is expected to support strong demand for petrochemicals in the country. We do see some sequential weakness because of a higher base, however, due to massive ethylene capacity buildups in China and the Middle East (12.9mt of capacity, or 9% of global capacity added in CY10 alone). However, we believe that the spate of capacity has bottomed out over the past twelve months, and, therefore, demand revival would boost margins. In the Polyester segment, with domestic demand growing by +17% yoy, the prospects for RIL remain very positive. The relative price advantage of polyester over cotton prices, coupled with the reduction in global cotton availability, implies polyester demand will continue to grow strongly, both globally as well as in India.

Polymer demand remains strong over 9MFY11 (yoy against 9MFY10)

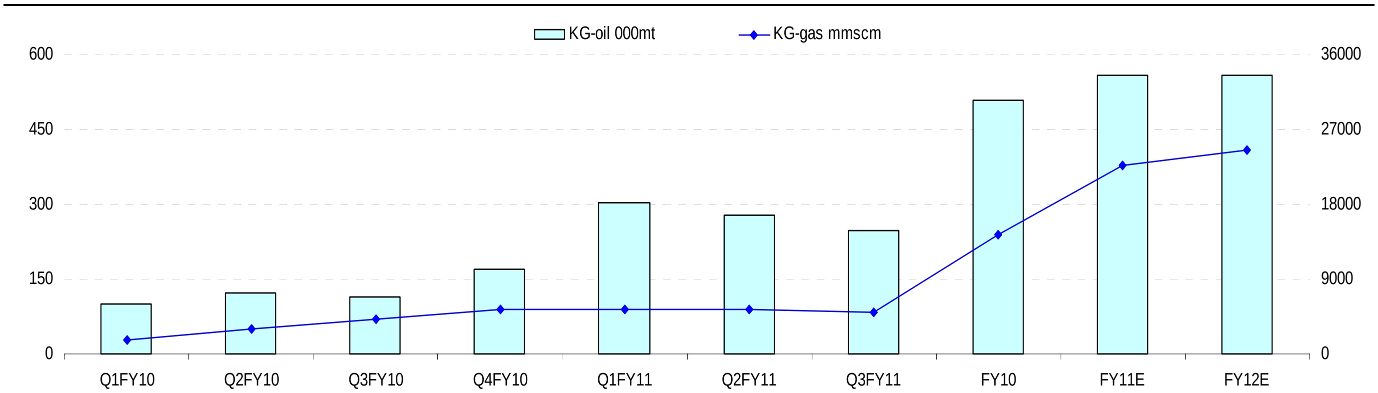


Source: IDFC Securities Research, Company

❑ E&P: Plateau to take longer than estimated

The exploration business saw production declining to 55 mmscmd in Q3FY11, with further uptick constrained by technical issues. The company has already successfully tested the facilities to be able to produce 80mmscmd, however, the commercial production of 80mmscmd is uncertain at the moment as the reservoir characteristics are being evaluated further to ensure sustained performance of the same over the field life. Also the production of oil from MA has also dropped to 20kb/d in Q3FY11, and the company has guided for flat oil and gas production from KG D6 for the next 3-4 quarters. So we have reduced our FY12 production estimates to account for this new guidance, at ~60 mmscmd of gas and ~20 kb/d of oil (from 65 mmscmd of gas and 25 kb/d of oil earlier). RIL is making good progress on developing the satellite discoveries on KG, and the NEC 25 block, with an optimized FDP for the satellite discoveries to be submitted to the DGH soon, and an integrated development plan for the NEC 25 field being finalized.

KG gas output



Source: IDFC Securities Research, Company

❑ Shale gas: Starting to pick up steam

RIL has, over the last year or so, invested in three oil and gas assets in the shale gas space, putting in place an investment commitment of over US$3.4bn, representing one of the largest foreign investments in the US Shale gas space. The three assets combined give access to net acreage of 318,000 acres, with a resource potential 11.8 tcfe (2bn bboe). We believe that this is a significant new vista for growth for RIL, and even though the investment will take 3-5 years to add material value to RIL's P&L, the opportunity to scale this up is immense and can offer more upsides.\

❑ Valuations & view

Overall, in the key businesses of refining & petrochemicals, the marked recovery in both volume offtake and prices has helped RIL post strong numbers even as higher depreciation and operating expenditure have offset the improvement somewhat. Strength in the Asian economies, particularly in India and China, is expected to help demand grow steadily through FY10-12E for both fuels and petrochemicals. However, we note that post several months of delays, a huge amount of ethylene capacities have come online over CY10, putting pressure on RIL's petrochemical margins even as demand remains robust thanks to the strength in the domestic economy. KG D6 remains flat, with peak output ramp-up now delayed for at least 18 months due to a detailed study of the reservoir being undertaken to avoid any damage to the same by ramping up too fast. As a result, we reduce our production estimates for FY12 and EPS estimates for FY11E by 6.5% and FY12E by 8.5% to Rs64/share and Rs72/share respectively. Reiterate Outperformer with a price target of Rs1183/ share, implying a potential 20% upside from current levels.

Quarterly results

Rs mn	1QFY10	2QFY10	3QFY10	4QFY10	1QFY11	2QFY11	3QFY11
Net Sales	**320,550**	**468,480**	**568,560**	**575,700**	**582,280**	**574,790**	**597,890**
RM cons	(174,730)	(375,050)	(426,190)	(430,800)	(458,180)	(435,720)	(455,850)
Purchase	(82,380)	(11,980)	(7,940)	(6,070)	(4,740)	(3,160)	(4,330)
Inventory	22,030	28,040	(17,880)	(2,240)	16,060	3,340	5,770
Other Expenses	(26,260)	(37,320)	(38,110)	(45,230)	(42,000)	(45,290)	(48,030)
Total Expenses	**(261,340)**	**(396,310)**	**(490,120)**	**(484,340)**	**(488,860)**	**(480,830)**	**(502,440)**
EBITDA	**59,210**	**72,170**	**78,440**	**91,360**	**93,420**	**93,960**	**95,450**
OPM (%)	0	0	0	0	0	0	0
Other Income	7,020	6,280	5,080	6,150	7,220	6,720	7,410
Interest	(3,450)	(4,620)	(5,500)	(5,250)	(5,410)	(5,420)	(5,490)
Depreciation	(16,280)	(24,320)	(27,950)	(33,920)	(34,850)	(33,770)	(33,590)
PBT	**46,500**	**49,510**	**50,070**	**58,340**	**60,380**	**61,490**	**63,780**
Tax	(7,900)	(8,000)	(6,990)	(8,210)	(11,870)	(10,260)	(10,420)
Deferred tax	(2,240)	(2,990)	(3,000)	(3,030)	-	(2,000)	(2,000)
Tax Rate (%)	(0)	(0)	(0)	(0)	(0)	(0)	(0)
PAT	**36,360**	**38,520**	**40,080**	**47,100**	**48,510**	**49,230**	**51,360**
Reported PAT	36,360	38,520	40,080	47,100	48,510	49,230	51,360
Growth (yoy, %)							
Net Sales	(0.23)	0.05	0.80	1.03	0.82	0.23	0.05
EBITDA	(0.03)	0.11	0.46	0.68	0.58	0.30	0.22
Other Income	2.11	1.78	1.25	1.72	2.19	1.97	2.28
Interest	0.17	0.06	0.14	0.10	0.57	0.17	(0.00)
Depreciation	0.41	0.92	1.12	1.56	1.14	0.39	0.20
PBT	(0.05)	0.01	0.19	0.37	0.30	0.24	0.27
PAT	(0.12)	(0.07)	0.14	0.33	0.33	0.28	0.28
Reported PAT	(0.12)	(0.07)	0.14	0.33	0.33	0.28	0.28

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