

RESULTS

REVIEW

Reliance Industries Ltd. (RIL)

Exploration silence clouds GRM positives

HOLD

Analyst

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Nifty: 5,697; Sensex: 19,008

CMP	Rs987
Target Price	Rs1,032
Potential Upside/Downside	+4.6%

Key Stock Data

Sector	Oil and Gas
Bloomberg / Reuters	RIL IN /RELI.BO
Shares o/s (mn)	3,270.4
Market cap. (Rs mn)	3,227,885
Market cap. (US\$ mn)	70,632
3-m daily average vol.	731,651

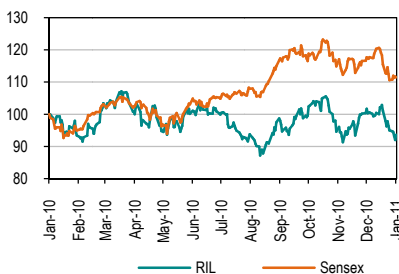
Price Performance

52-week high/low	Rs1,187/841		
	-1m	-3m	-12m
Absolute (%)	(8)	(9)	(6)
Rel to Sensex (%)	(3)	(2)	(18)

Shareholding Pattern (%)

Promoters	44.7
FII's/NRI's/OCBs/GDR	22.2
MF's/Banks/FIs	10.4
Govt.	0.1
Non Promoter Corporate	4.7
Public & Others	17.9

Relative to Sensex



Source: Capitaline

Summary

Reliance Industries (RIL) posted slightly below expected numbers in Q3FY11 driven by lower-than-expected GRM and lower-than-expected refinery throughput. However, the company's petrochemical business witnessed strong growth driven by strong growth in polyester prices. However, oil and gas segment saw decline in revenues and EBIT due to lower production volumes from KG basin. Going forward, we remain positive on its refinery and petrochemical business due to widening GRMs driven by strong resilience in demand from US and Asia and strong domestic growth for petrochemical products. Therefore, we have revised our GRM outlook for FY12 from US\$9/bbl to US\$9.7/bbl. However, the company maintained its silence on KG basin ramp-up and its other upstream production plans. Consequently, we have cut our valuation multiple for its upstream assets and maintain current production of 52-55mmcmd of gas and 17.5kbbls of oil from its KG basin from FY12 onwards. We have cut our EPS estimate by 4.3% in FY12 and downgrade our rating to **HOLD** from ACCUMULATE with revised target price of Rs1,032.

Result Highlights

- Revenue increased 61.6% YoY on higher volumes and price; beats our expectation

RIL's net sales at Rs598 bn, up 5.2% YoY in Q3FY11, came slightly below-expectation of Rs613 bn due to lower-than-expected refinery throughput. Growth was driven by YoY 16% jump in crude oil prices, 6% higher petchem prices 2%, YoY rise in petchem volumes and 19% growth in KG Basin gas production volumes. However, revenue growth was impacted by 3% decline in refinery throughput at 16.1mmt due to planned shutdown for 22 days during the quarter. Further, EBITDA margin improved 217bps YoY to 16% in Q3FY11 (versus 16.9% expectation) led by lower than expected GRM of US\$9/bbl (US\$9.3/bbl). Earnings were up 28% YoY to Rs51.4 bn (Rs52.6 bn).

- GRM's improved; Crude throughput declined due to maintenance shutdown

Driven by strong domestic economic growth and strong consumption growth from US and Asian countries, the company witnessed expansion in GRMs to US\$9/bbl in Q3FY11 from US\$5.9/bbl in Q3FY10. Further, higher light-heavy differential of US\$3.2/bbl (versus US\$1.5/bbl) aided GRMs. However, RIL's refinery capacity utilisation declined at 104% during the quarter from 107% in Q3FY10 due to maintenance shutdown for 22 days in Q3FY11.

- Refinery outlook remains positive; GRM expansion continues

Refining margin outlook remains positive as demand resilience has helped reducing US gasoline and middle distillates inventories. Further, IEA has again revised global demand outlook for crude oil upwards by 1mbpd painting a positive picture for global economic environment. Singapore GRMs also improved to US\$7.2/bbl in YTD Q4FY11, an improvement from US\$5.5/bbl in Q3FY11. Therefore, we have revised our Q4FY11 and FY12 GRMs outlook from US\$8.6/bbl and US\$9/bbl, respectively to US\$9.5/bbl and US\$9.7/bbl.

Table: Financial snapshot

(Rs mn)

Year	Revenue	EBITDA	EBITDA (%)	PAT	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoE (%)	RoCE (%)
FY09	1,512,240	234,222	15.5	149,687	47.6	20.8	16.1	14.5	10.0
FY10	2,037,397	308,939	15.2	158,976	48.6	20.3	12.2	12.1	8.8
FY11E	2,516,308	389,761	15.5	208,026	63.6	15.5	9.7	13.7	10.3
FY12E	2,574,218	423,315	16.4	220,959	67.6	14.6	8.9	12.8	9.9

Source: Company; IDBI Capital Research

■ **Strong Polyester prices supported petrochemical margin; outlook remains robust**

RIL's petrochemical margins improved to 15.2% in Q3FY11 from 13.9% in Q3FY10, which is in line with our expectation. Robust YoY growth in petrochemical business was driven by strong polyester prices as cotton price zoomed during the quarter and touched highest-ever price of US\$3,790/mt (120% YoY higher). POY, PSF and PET prices improved 49%, 54% and 16% YoY during the quarter which resulted in highest polyester margin in past one decade. Polymer margins also strengthened during the quarter primarily driven by higher poly-propylene margins, which offset by lower HDPE margins. As cotton demand is continuously growing and supply is limited (25mtpa of production in 33mn hectares), we expect delta between cotton and polyester would remain high and would support polyester prices and substitute products.

■ **KG basin oil and gas production declined sequentially**

The company's gas and oil production from its KG basin declined sequentially to 56mmscmd and 247KT from 59mmscmd and 278KT, respectively due to some technical issues. Consequently, the company's upstream segmental EBIT declined 11.8% QoQ to Rs15 bn.

Table: Actual vs estimated performance

(Rs mn)

	Actual	Estimated	% Variance
Net sales	597,890	613,031	(2.5)
EBITDA	95,450	103,806	(8.0)
EBITDA margin (%)	16.0	16.9	(97)bps
Adj net income	51,360	52,587	(2.3)
FDEPS (Rs)	15.7	16.1	(2.3)

Source: Company; IDBI Capital Research

Table: Quarterly performance

(Rs mn)

Year-end: March	Q3FY11	Q3FY10	% Chg YoY	Q2FY11	% Chg QoQ
Net sales	597,890	568,560	5.2	574,790	4.0
Expenditure	502,440	490,120	2.5	480,830	4.5
EBITDA	95,450	78,440	21.7	93,960	1.6
EBITDA margin (%)	16.0	13.8	217bps	16.3	(38)bps
Other income	7,410	5,080	45.9	6,720	10.3
Interest	5,490	5,500	(0.2)	5,420	1.3
Depreciation	33,590	27,950	20.2	33,770	(0.5)
PBT	63,780	50,070	27.4	61,490	3.7
Tax	12,420	9,990	24.3	12,260	1.3
Adj PAT	51,360	40,080	28.1	49,230	4.3
EPS (Rs)	15.7	12.3	28.1	15.1	4.3

Source: Company; IDBI Capital Research

Table: Segmental performance

(Rs mn)

Year-end: March	Q3FY11	Q3FY10	% Chg YoY	Q2FY11	% Chg QoQ
Gross turnover	728,440	663,810	9.7	692,260	5.2
Petrochemicals	159,620	147,560	8.2	150,960	5.7
Refining	525,240	480,000	9.4	496,720	5.7
Oil & gas	41,780	35,300	18.4	43,030	(2.9)
Others	1,800	950	89.5	1,550	16.1
EBIT	63,780	49,220	29.6	61,030	4.5
Petrochemicals	24,290	20,550	18.2	21,970	10.6
Refining	24,360	13,790	76.6	21,920	11.1
Oil & gas	15,040	14,770	1.8	17,060	(11.8)
Others	90	110	(18.2)	80	12.5
EBIT margin (%)	8.8	7.4	134bps	8.8	(6)bps
Petrochemicals	15.2	13.9	129bps	14.6	66bps
Refining	4.6	2.9	176bps	4.4	22bps
Oil & gas	36.0	41.8	(584)bps	39.6	(365)bps
Others	5.0	11.6	(658)bps	5.2	(16)bps

Source: Company; IDBI Capital Research

■ Company's silence on its upstream business worrying

The management has chosen to keep silent on the development program of KG basin and its other upcoming projects in other KG basin, Cauvery basin and Mahanadi basin. The company is in talks with DGH on the future of its upstream assets and therefore, is quiet on giving appropriate plan of production ramp-up. However, the company hinted not to assume production ramp-up in D6 block from current level of production of 52-55mmscmd, for the time being. Therefore, we have revised our production ramp up to 54mmscmd in FY12 from earlier 65mmscmd and maintain 54mmscmd as peak production from KG-D6 block.

■ FY12 estimates revised downwards to factor in higher GRM and lower hydrocarbon production

We have revised our FY11 earnings estimate upwards by 1.2% to factor in higher GRMs. However, FY12E EPS has been cut by 4.3% to factor in lower hydrocarbon production from KG basin, partially offset by higher GRMs.

Table: Change in estimates

Key parameters	FY11E			FY12E		
	Old	New	% Chg	Old	New	% Chg
Revenue (Rs mn)	2,444,941	2,516,308	2.9	2,510,479	2,574,218	2.5
EBITDA (Rs mn)	422,081	389,761	(7.7)	498,590	423,315	(15.1)
EBITDA margin (%)	17.3	15.5	(177)bps	19.9	16.4	(342)bps
Net profit (Rs mn)	205,601	208,026	1.2	230,924	220,959	(4.3)
EPS (Rs)	62.9	63.6	1.2	70.6	67.6	(4.3)

Source: Company; IDBI Capital Research

■ Revising TP downwards to Rs1,032; Downgrading to HOLD

We have revised our SOTP based target price downwards to factor in 1) lower KG-D6 gas production (-Rs 49/share), lower oil production from MA field (-Rs 8/share) and lowering multiple for E&P prospects from US\$4/boe to US\$3/boe (-Rs50/share) due to lack of clarity from the management. We feel that improvement in GRMs should be viewed as a near term growth prospect for the company, but uncertainty on upstream projects would remain an overhang. Therefore, we downgrade our rating to HOLD from ACCUMULATE with revised target price at Rs1,032/share from Rs1,173.

Table: SOTP valuation

Particulars	EBITDA (Rs mn)	Multiple (x)	Value (Rs mn)	Value per share (Rs)	Comments
Refining	175,964	7.5	1,319,734	404	EV/EBITDA basis
Petrochem	120,896	7.5	906,721	277	EV/EBITDA basis
KG - D6 gas			487,407	149	DCF, WACC of 10%
NEC-25			90,000	28	US\$4/boe on 0.7bn boe of
Atlas Shale Gas			94,810	29	DCF, WACC of 10%
Pioneer Shale Gas			63,251	19	DCF, WACC of 10%
CBM - Sohagpur			61,594	19	US\$3/boe on 0.4bn boe of
PMT field			124,200	38	US\$12/boe on 0.23bn boe of
KG D6 MA			32,226	10	DCF, WACC of 10%
New E&P Blocks			342,244	105	US\$3/boe on 2.5bn boe of
RIL Retail			104,000	32	1.2x of P/BV
Business EV			3,626,186	1,109	
Less: Net debt			250,733	77	FY12E
Equity Value			3,375,453	1,032	
No of shares (mn)			3,270	-	
Target price/share (RS)			1,032	1,032	

Source: IDBI Capital Research

Financial Summary

Profit & Loss Account (Rs mn)

Year-end: March	FY09	FY10	FY11E	FY12E
Revenue	1,512,240	2,037,397	2,516,308	2,574,218
Growth (%)	10.3	34.7	23.5	2.3
EBITDA	234,222	308,939	389,761	423,315
Growth (%)	1.2	31.9	26.2	8.6
Depreciation & Amortisation	56,510	109,458	138,690	153,470
EBIT	177,712	199,481	251,071	269,845
Growth (%)	(2.0)	12.2	25.9	7.5
Interest	18,163	20,596	22,058	21,879
Other income	22,420	107,913	27,233	23,123
EBT	181,969	286,799	256,246	271,089
Income taxes	29,188	42,563	49,261	51,232
Effective tax rate (%)	16.0	14.8	19.2	18.9
Min int / inc from assoc	(184)	(796)	(1,041)	(1,101)
Reported net income	152,965	245,031	208,026	220,959
Adjusted net income	149,687	158,976	208,026	220,959
Growth (%)	(2.3)	6.2	30.9	6.2
Shares outstanding (mn)	3,147.6	3,270.4	3,270.4	3,270.4
Adjusted EPS (Rs)	47.6	48.6	63.6	67.6
Growth (%)	(9.8)	2.2	30.9	6.2
DPS (Rs)	8.1	7.0	7.5	8.5

Balance Sheet (Rs mn)

Year-end: March	FY09	FY10	FY11E	FY12E
Cash and cash eq	227,421	138,908	323,260	326,906
Accounts receivable	48,450	100,829	124,486	127,346
Inventories	201,096	343,933	424,778	434,554
Others current assets	110,494	107,386	120,392	121,964
Investments	64,355	131,123	152,538	178,237
Gross fixed assets	1,545,870	2,245,870	2,445,870	2,745,870
Net fixed assets	1,057,299	1,585,232	1,643,388	1,785,187
CWIP	738,460	170,337	168,633	166,947
Deferred tax assets, net	(95,513)	(106,776)	(114,318)	(122,298)
Total assets	2,365,241	2,487,676	2,859,855	3,035,541
Other current liabilities	12,559	7,650	9,448	9,665
Provisions	31,150	36,950	36,950	36,950
Debt funds	762,566	646,055	702,488	679,067
Other liabilities	1,389	5,735	4,694	3,593
Equity capital	27,494	29,780	32,704	32,704
Reserves & surplus	1,185,072	1,380,250	1,602,697	1,791,851
Shareholder's funds	1,212,565	1,410,030	1,635,400	1,824,555
Total liabilities	2,365,241	2,487,676	2,859,855	3,035,541
BVPS (Rs)	441.0	473.5	500.1	557.9

Source: Company; IDBI Capital Research

Cash Flow Statement (Rs mn)

Year-end: March	FY09	FY10	FY11E	FY12E
Net income + Depreciation	230,090	385,038	346,716	374,429
Non-cash adjustments	(43,181)	(135,155)	55,069	3,596
Changes in working capital	(57,725)	(59,381)	(26,091)	(3,154)
Cashflow from operations	129,185	190,502	375,694	374,871
Capital expenditure	(277,320)	(230,168)	(198,297)	(298,314)
Change in investments	33,663	26,447	(21,416)	(25,699)
Other investing cashflow	(1,015)	(191)	-	-
Cashflow from investing	(244,673)	(203,911)	(219,712)	(324,013)
Issue/repay debt	165,145	(58,221)	56,433	(23,421)
Dividends paid	(19,085)	(22,195)	(28,063)	(23,792)
Other financing cashflow	(13)	(4)	-	-
Change in cash & cash eq	182,207	(88,703)	184,352	3,646
Closing cash & cash eq	227,421	138,908	323,260	326,906

Financial Ratios

Year-end: March	FY09	FY10	FY11E	FY12E
Profitability & Return ratios (%)				
EBITDA margin	15.5	15.2	15.5	16.4
EBIT margin	11.8	9.8	10.0	10.5
Net profit margin	9.9	7.8	8.3	8.6
ROE	14.5	12.1	13.7	12.8
ROCE	10.0	8.8	10.3	9.9
Working capital & Liquidity ratios				
Receivables (days)	13	13	16	18
Inventory (days)	59	61	70	77
Payables (days)	86	81	77	86
Current ratio (x)	1.6	1.8	2.1	2.1
Quick ratio (x)	0.8	0.6	0.9	0.9
Turnover & Leverage ratios (x)				
Gross asset turnover	1.1	1.1	1.1	1.0
Total asset turnover	0.7	0.8	0.9	0.9
Interest coverage ratio	9.8	9.7	11.4	12.3
Adjusted debt/equity	0.6	0.5	0.4	0.4
Valuation ratios (x)				
EV/Sales	2.5	1.8	1.5	1.5
EV/EBITDA	16.1	12.2	9.7	8.9
P/E	20.8	20.3	15.5	14.6
P/BV	2.2	2.1	2.0	1.8

Quarterly Trend (Rs mn)

Year-end: March	Q4FY10	Q1FY11	Q2FY11	Q3FY11
Revenues	575,700	582,280	574,790	597,890
YoY growth (%)	120.7	86.7	22.7	5.2
EBITDA margin (%)	15.9	16.0	16.3	16.0
Adjusted net profit	47,100	48,510	49,230	51,360
YoY growth (%)	34.5	25.2	35.4	40.1



Notes

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Key to Ratings

Stocks:

BUY: Absolute return of 15% and above; **ACCUMULATE:** 5% to 15%; **HOLD:** Upto $\pm 5\%$; **REDUCE:** -5% to -15%; **SELL:** -15% and below.

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