

Reliance Industries

E&P Blip Obscures Strong Cyclical Biz

RIL reported Q3FY11 EBITDA of Rs 9,545 cr and PAT of Rs 5,136 cr bang in-line with our estimates. The petchem biz reported best ever EBIT of Rs 2,429 cr aided by decade high margins in polyester chain, which we expect to sustain going forward. The R&M segment also reported strong results backed by a cyclical recovery in margins. However, there was a slight blip in the E&P biz, wherein lack of clarity over future outlook of business may delay monetization of E&P assets, in our view.

- **Refining EBIT growth at 77% (YoY):** RIL exhibited strong cyclical recovery in refining biz, reporting a GRM of USD 9.0/bbl (Sing. margins at USD 5.0/bbl) on the back of strong recovery in gasoline spread along with widening light-heavy differential. Mgmt has indicated that the improvement in product spreads, along with stricter environmental norms in Europe/Turkey, would also support complex refining margins.
- **Petchem recorded decade high margins:** Polyester margins remained strong on the back of: (a) spiraling domestic demand (15% growth in 9M-YoY); (b) lack of incremental global capacity addition; and (c) tightness in cotton market. Most of the polymer capacity additions are behind us, which would support polymer margins going forward.
- **KG-D6 - lack of clarity an overhang:** The mgmt has indicated that RIL is continuing discussions with govt. and DGH to understand the policy framework and its impact on RIL. In view of the sensitivities, mgmt has not provided any clarity on KG-D6 production, which could remain an overhang on valuations. Moreover, the company's development/ exploratory plans in other blocks may get delayed, which would delay monetization of E&P assets further.

Maintain BUY with Target Price of Rs 1,145/ sh

Due to expected delay in exploratory plans in NEC-25, MN-D4 and lack of clarity on KG-D6, we have reduced RIL's E&P business valuation by 10% leading to our fair value coming to Rs 1,145/share. Our TP still offers 18% upside to CMP. We retain our Buy rating on the stock and believe any weakness in the stock is an opportunity to BUY.

Financial summary

Y/E Mar	Sales (Rs cr)	Adj.PAT (Rs cr)	Consensus EPS* (Rs)	EPS (Rs)	Change YoY (%)	P/E (x)	RoE (%)	RoCE (%)	EV/EBITDA (x)	DPS (Rs)
2010	203,740	15,898	-	48.6	2.2	-	12.1	11.0	-	6.3
2011E	210,028	20,113	64.6	61.5	26.5	15.7	13.4	13.3	8.9	7.0
2012E	223,009	24,232	75.8	74.1	20.5	13.1	14.2	16.0	7.4	7.0
2013E	222,090	27,225	88.4	83.2	12.4	11.7	14.1	16.6	6.6	7.0

Source: *Consensus broker estimates, Company, ENAM estimates

CMP (Rs)	971
Target price (Rs)	1,145
Potential upside	18%

Stock data

No. of shares (cr)	327
FV (Rs)	500325
Market cap (Rs cr)	317517
52 week high/low (Rs)	1,187/ 841
Avg. daily vol.* (shares)	5717401
BSE Code	500325
NSE Code	RELIANCE
Bloomberg code	RIL IB
Reuters Code	RELI.BO

* BSE & NSE 6 monthly

Shareholding (%)

	Dec-10	QoQ Chg
Promoter	44.7	0.0
FII's	17.6	0.8
MFs / UTI	2.3	0.3
Banks / Fis	8.2	(0.1)
Others	27.2	(0.9)

Price performance



Source: Cline, ENAM Direct Research

Results update

(Rs cr)	Quarter ended					12 months ended		
	Dec-10	Dec-09	% Chg	Sep-10	% Chg	Mar-11E	Mar-10	% Chg
Net Sales	59,789	56,856	5.2	57,479	4	210,028	203,740	3.1
EBITDA	9,545	7,844	21.7	9,396	1.6	37,998	30,894	23
Other income	741	508	45.9	672	10.3	2,828	2,186	29.4
PBIDT	10,286	8,352	23.2	10,068	2.2	40,826	33,080	23.4
Depreciation	3,359	2,795	20.2	3,377	(0.5)	13,312	10,946	21.6
Interest	549	550	(0.2)	542	1.3	2,295	2,060	11.4
PBT	6,378	5,007	27.4	6,149	3.7	25,220	20,074	25.6
Tax	1,242	999	24.3	1,226	1.3	5,107	4,256	20
Minority Interest	-	-	-	-	-	-	(79.6)	-
Adjusted PAT	5,136	4,008	28.1	4,923	4.3	20,113	15,898	26.5
Extra ordinary income/ (exp.)	-	-	-	-	-	-	8,606	-
Reported PAT	5,136	4,008	28.1	4,923	4.3	20,113	24,503	(17.9)
No. of shares (cr)	327	327	-	327	-	327	327	-
EBIDTA margin (%)	16	13.8	-	16.3	-	18.1	15.2	-
PBIDT margin (%)	17.2	14.7	-	17.5	-	19.4	16.2	-
EPS - annualized (Rs.)	62.8	49	28.1	60.2	4.3	61.5	48.6	26.5

Source: Company, ENAM Research

Segmental results

(Rs cr)	Quarter ended				
	Dec-10	Dec-09	% Chg	Sep-10	% Chg
Sales					
- Petrochemicals	15,962	14,756	8.2	15,096	5.7
- Refining	52,524	48,000	9.4	49,672	5.7
- Oil, Gas & Textiles	4,358	3,625	20.2	4,458	(2.2)
Total Segment Sales	72,844	66,381	9.7	69,226	5.2
PBIT				0	
- Petrochemicals	2,429	2,055	18.2	2,197	10.6
- Refining	2,436	1,379	76.6	2,192	11.1
- Oil, Gas & Textiles	1,513	1,488	1.7	1,714	(11.7)
Total Segment PBIT	6,378	4,922	29.6	6,103	4.5
Capital Employed				0	
- Petrochemicals	35,228	41,888	(15.9)	36,470	(3.4)
- Refining	76,703	78,976	(2.9)	76,120	0.8
- Oil, Gas & Textiles	63,339	59,579	6.3	60,869	4.1
- Other Un-allocable segments	56,724	35,795	58.5	51,805	9.5
Total Capital Employed	231,994	216,238	7.3	225,264	3.0
Segment PBIT Margin (%)					
- Petrochemicals	15.2	13.9	1.3	14.6	0.7
- Refining	4.6	2.9	1.8	4.4	0.2
- Oil, Gas & Textiles	34.7	41.0	(6.3)	38.4	(3.7)
Overall PBIT margin	8.8	7.4	1.3	8.8	(0.1)
ROCE (%)					
- Petrochemicals	27.6	19.6	8.0	24.1	3.5
- Refining	12.7	7.0	5.7	11.5	1.2
- Oil, Gas & Textiles	9.6	10.0	(0.4)	11.3	(1.7)
Overall ROCE (%)	11.0	9.1	1.9	10.8	

Source: Company, ENAM Research.

Analyst meet highlights

Refining: GRMs exhibit cyclical uptrend

RIL's GRM improved to USD 9.0/ bbl (Q2FY11- USD 7.9/ bbl) due to a strong recovery in gasoline spreads (up 25% QoQ) along with widening light-heavy crude differential (highest in last 2 years). Gasoil spreads remained firm as cold weather in Europe supported demand. Naphtha spreads turned positive, after a weak Q2FY11, primarily on the back of healthy demand from Saudi Arabia. **RIL's mgmt is expecting product cracks to widen going forward** on the back of (a) strong recovery in global demand; (b) reduction in product inventories; and (c) widening light-heavy differential amidst the increasing demand for lighter product along with weakening FO cracks. Utilization rate was marginally lower at 104% compared to 109% in Q2FY11, primarily due to planned shutdown in the CDU unit, albeit remained significantly high when compared to other global peers.

Petrochem: margins are at decade high, to sustain going forward

RIL's mgmt has indicated that despite rising feedstock costs (oil/naphtha), the company has managed to achieve significant growth in petchem profitability as spiraling demand along with high operating rates supported petchem margins. Polyester margins remained strong on the back of: (a) spiraling domestic demand (15% growth in 9M- YoY); (b) lack of incremental global capacity addition; and (c) tightness in cotton market. The Chemical profitability further improved as shortage of Benzene, Butadiene and SBR/PBR increased pricing power. Lastly, since most of ethylene cracking facilities are behind us, recovery in polymer spreads over the next two years is expected, which would support petrochemical margins for RIL.

E&P - lack of clarity mars outlook

The mgmt has indicated that they have initiated a discussion with GoI and DGH over interpretation of E&P policy framework. The mgmt has not provided any further details citing that the discussion is sensitive in- nature. We believe that the on-going discussion would not only impede production outlook of existing KG-D6 basin, but also likely to delay monetization of RIL's other E&P blocks.

Earnings revision

We have marginally revised our FY11/12/13E estimates downward by 1.0-2.0%. The revised estimates have largely remained flat vis-à-vis our previous estimates as the upward revision in R&M/petchem business have been partly offset by weakness in upstream business (lower KG-D6 production and higher risk factor to incorporate the lack of visibility over future outlook of the business).

Earning revision

(Rs cr)	Old			New			% change		
	2011E	2012E	2013E	2011E	2012E	2013E	2011E	2012E	2013E
EBITDA	38,766	43,853	46,631	37,998	43,410	46,003	(2.0)	(1.0)	(1.3)
PAT	20,207	24,550	27,481	20,113	24,232	27,225	(0.5)	(1.3)	(0.9)
EPS (Rs/sh)	61.8	75.1	84.0	61.5	74.1	83.2	(0.5)	(1.3)	(0.9)

Source: ENAM Research

Valuation and assumptions

Building in delay in E&P asset monetization and strong cyclical recovery in R&M/petchem

E&P business: RIL's upstream business has recently faced headwinds amidst the slower-than-expected ramp-up of its KG-D6 gas production and a minor setback in its exploratory portfolio (D9 dry well). The company's mgmt has not furnished any clarity over the future outlook of its upstream business. We believe that the current uncertainty would not only impede production outlook of existing KG-D6 basin, but also likely to delay monetization of RIL's other E&P assets. We have incorporated the uncertainty over E&P business by: (a) moderating our production estimates for KG-D6 block; and (b) applying a risk discount of 20% on valuation of other reserves (NEC-25, CBM, contingent and future reserve accretions). We have reduced our fair value estimates for RIL's E&P business to Rs 394/share from our earlier estimates of Rs 440/share.

Refining and petrochemicals biz: We have marginally raised our refining margin assumptions from USD 8.2/9.3/10 to USD 8.4/10/10.5 per bbl for FY11/12/13E respectively, owing to a strong recovery in global demand. Additionally, we are building in a substantial cyclical recovery in petrochemical margins, even higher than our previous estimates, on the back of an indication from RIL mgmt that the current healthy petchem margins are likely to sustain in future. We value the extant R&M and petchem biz at Rs 631/share.

Sum of the parts (SoTP) valuation

Sum of Parts Valuation	(Rs cr)	(Rs/ Shr)	Comments
Refining	113,143	346	FY12e EV/EBITDA of 7.0x
Oil and gas production (PMT, Yemen)	11,858	36	FY12e EV/EBITDA of 6.0x
Petrochemicals	81,408	249	FY12e EV/EBITDA of 6.5x
Core business enterprise val	206,408	631	
Reliance Retail & SEZ	8,260	25	Total investments made till date
Marcellus Shale Acquisition	1,741	5	Investment Upside
Eagle ford shale	802	2	Investment Upside
E&P business			
KG basin valuation	64,909	198	DCF; WACC of 12.3%, 14 tcf recoverable reserve
NEC-25	17,429	53	20% discount on DCF; WACC of 12.3%, 8.5tcf recoverable reserve
CBM	7,491	23	20% discount on EV/reserves based valuation
Contingent reserves valuation (KG D-6, NEC)	15,167	46	20% discount on valn of risked reserves
Further reserve accretion (D3, D4, D9,Cauvery)	23,960	73	20% discount on value for future expl'n upside
E&P business valuation	128,956	394	
Cash from sale of treasury shares	8,600	26	
Enterprise Value	354,766	1,085	
Net Debt (Adj. for CWIP, investments in E&P as well as cash in D6 JV)	10,737	33	Adjusted FY11 debt
Equity value	344,028	1,052	
Treasury stock	29,978	92	
No of shares adj for treasury stock	327		Adjusted for warrants
Value per share (on existing business)		1,144	
Total value per share		1,144	

Source: ENAM Research.

Refining - assumptions

	Units	FY11E	FY12E	FY13E
Capacity	MMTPA	62	62	62
Crude throughput	MMTPA	64.9	67.0	67.0
Cap. utilisation	%	104.7	108.0	108.0
Avg. GRMs	USD/ bbl	8.4	10.0	10.5

Source: ENAM Research

Petchems - assumptions

	Units	FY11E	FY12E	FY13E
Polymers				
- Ethylene-Naphtha Margins	USD/ton	307	290	300
- Propylene-Naphtha	USD/ton	395	350	360
- Benzene-Naphtha	USD/ton	154	180	195
Polyesters				
- PSF-PTA Margins	USD/ton	436	450	455
- PFY-PTA	USD/ton	370	380	385
- PTA-PX	USD/ton	281	300	320

Source: ENAM Research

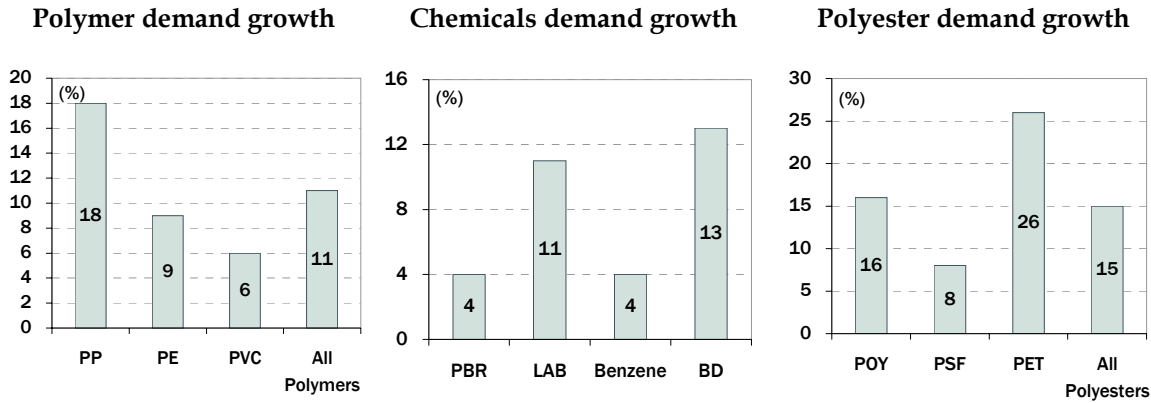
EBITDA break-up assumptions

(Rs cr)	FY11E	FY12E	FY13E
Petchem and others	12,400	12,500	12,800
Refining	12,900	16,200	16,500
E&P - Panna Mukta & Tapti	2,000	2,000	1,900
E&P - KG D6 gas & MA oil	10,700	12,700	14,800
Total	38,000	43,400	46,000

Source: ENAM Research

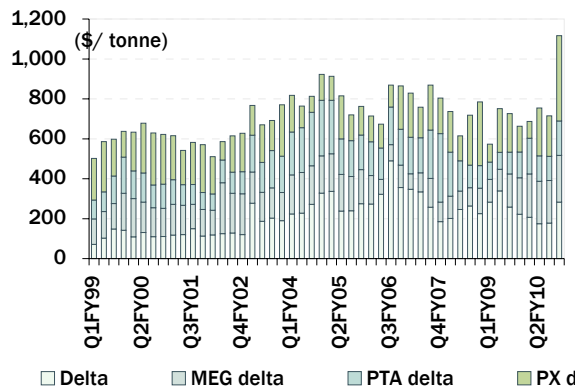
Macro trends

Petrochemical industry: Healthy domestic demand growth (9MFY11 - YoY)

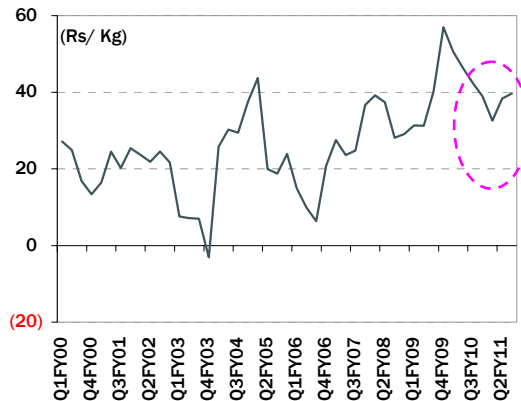


Source: Company, ENAM Research

Polyester chain deltas: Highest in two decades

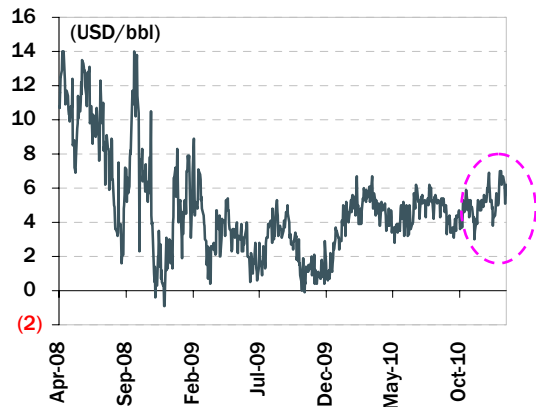


Cotton yarn pricing premium to POY (Rs./kg)

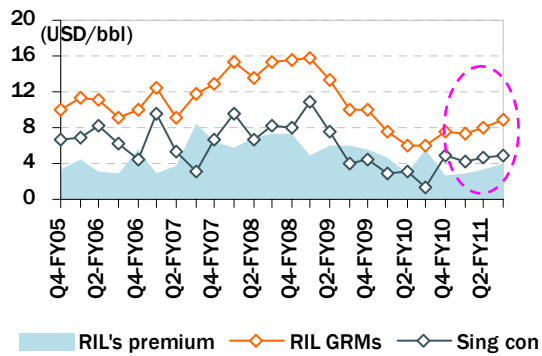


Source: Bloomberg, ENAM Research, Delta over PES

Singapore complex refining margins

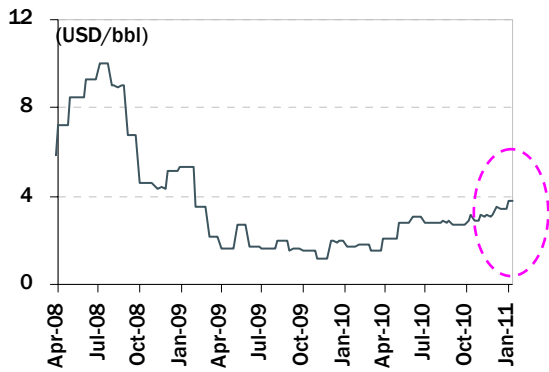


GRMs trend - RIL vs. Singapore complex

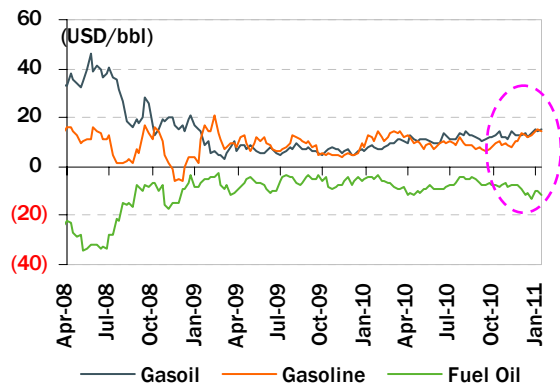


Source: Bloomberg, ENAM Research

Light-Heavy crude differential

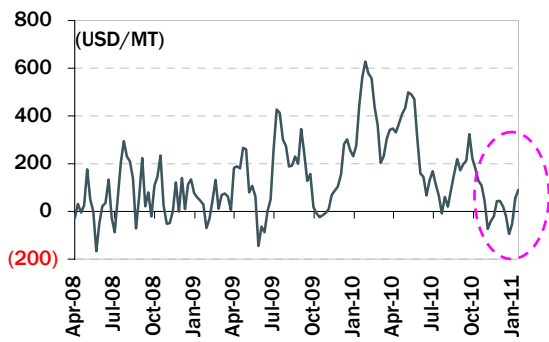


Product spreads over Dubai Fateh

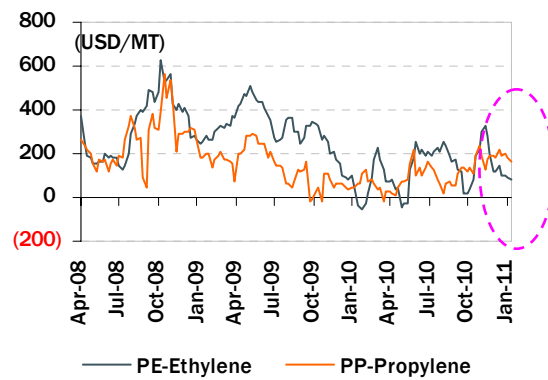


Source: Bloomberg, ENAM Research

Naphtha Cracker margins

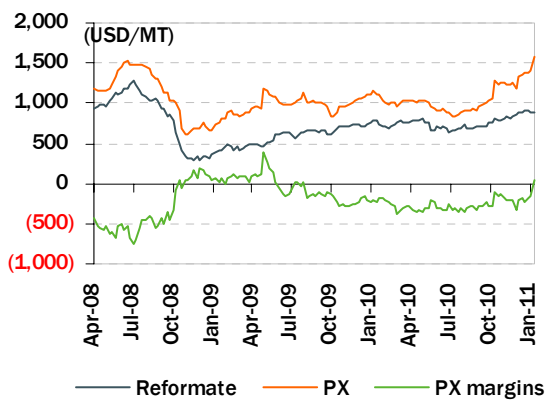


Polymer spreads

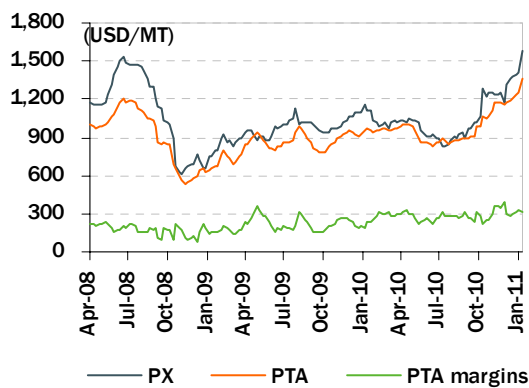


Source: Bloomberg, ENAM Research

PX- Reformate spreads



PTA-PX spreads



Source: Bloomberg, ENAM Research

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