Reliance Industries Limited

Commodity businesses shine, E&P disappoints

24 January 2011

ANTIQUE

Results highlights

Refining - A remarkable recovery

RIL's 3QFY11 earnings of INR51.4bn, up 28% YoY and 4% QoQ, is slightly below our expectations of INR51.9bn due to lower gas production from KG-D6. Refinery segment EBIT rose 11% QoQ and 77% YoY despite refinery shutdown and fall in utilisation rates to 104% (from 109% in 2QFY11) on account of a sharp recovery in GRMs to USD9/bbl, up 14% QoQ.

We believe that refining margins are expected to remain robust over FY11-13e led by strong distillate demand and improvement in light-heavy spreads.

Highest ever Petchem EBIT - led by buoyancy in Petchem margins

RIL reported its strongest ever Petchem EBIT of INR24.3bn, up 18% YoY and 11% QoQ. Apart from 3-5% QoQ volume growth across key polymer and polyester products, polyester products chain particularly witnessed robust improvement in margins.

E&P remains a laggard

E&P earnings continued to lag behind due to lower KG-D6 production at 54.5mmcmd, down 6% QoQ. PMT gas production however recovered from last quarter platform shutdown and was up 36% QoQ. We have lowered KG-D6 gas production assumption by 4mmcmd for FY12e and 15mmcmd for FY13-14e, reducing our KG-D6 valuations by INR11/share.

We also reduce valuation of contingent resources from USD4.5/boe to USD2.5/boe due to lack of clarity on timelines to develop these blocks, impacting our valuations by INR84/share. We see regulatory hurdles/delays as one of the reasons for slowdown in domestic E&P activities.

Valuation and outlook

We downgrade our FY12e EPS by 4% to INR78/share and reduce our sum-of-parts target price to INR1,053/share from INR1,152/share. We downgrade our recommendation to HOLD.

Results summary

INRbn	3QFY11	3QFY10	Chg (%)	9MFY11	9MFY10	Chg (%)
Net Sales	598	569	5	1,755	1,349	30
EBITDA	95	78	22	283	214	32
EBITDA Margin (%)	16.0	13.8	16	16.1	15.9	1
PAT	51	40	28	149	115	29
EPS(INR)	15.7	12.3	28	45.6	35.2	29
GRMs	9.0	5.9	53	8.1	6.2	30
Segment EBIT						
Petrochemicals	24	21	18	67	64	5
Refining	24	14	77	67	40	66
E&P	15	15	2	51	37	38
Others (INRm)	90	110	(18)	240	310	(23)

Source: Company, Antique

Current Reco	**: HOLD**
Previous Reco	**: BUY**
CMP	**: INR986**
Target Price	**: INR1,053**
Potential Return	**: 7%**

Market data

Sector	:	Oil & Gas
Market Cap (INRbn)	:	3,230
Market Cap (USDbn)	:	71
O/S Shares	:	3,273
Free Float (m)	:	1,618
52-wk HI/LO (INR)	:	1187/841
Avg Daily Vol ('000)	:	6,162
Bloomberg	:	RIL IN
Reuters	:	RELI.BO

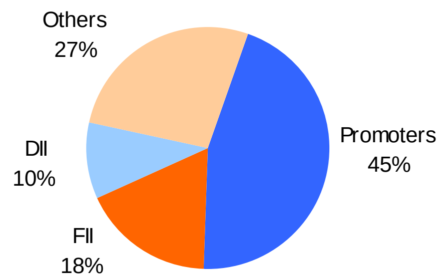
Source: Bloomberg

Returns (%)

	1m	3m	6m	12m
Absolute	(8)	(9)	(7)	(6)
Relative	(3)	(3)	(12)	(16)

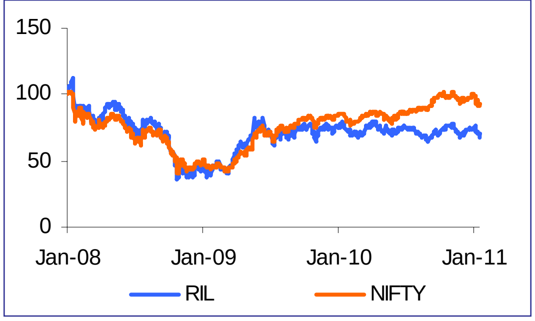
Source: Bloomberg

Shareholding pattern



Source: BSE

Price performance *vs* Nifty



Source: Bloomberg

Amit Rustagi
+91 22 4031 3434
amitr@antiquelimited.com

Ruchi Dugar
ruchi.dugar@antiquelimited.com

Miten Vora
miten.vora@antiquelimited.com

E&P activities at a standstill

KG-D6 gas production - no clarity on ramp-up

KG-D6 gas production averaged 54.5mmcmd in 3QFY11, down from 60mmcmd earlier. During 2QFY11 analyst meet, RIL stated that ramp up of gas production to 80mmcmd from 60mmcmd, would happen on completion of reservoir studies and new wells drilling, which may take 12-18months. However, this time RIL failed to provide any clarity on falling KG-D6 volume as well as future development efforts.

We have revised our production estimates from KG-D6 (including MA) to 57mmcmd (down 4mmcmd) for FY12e and 68mmcmd (down 15mmcmd) for FY13-14e to reflect concerns regarding decline in output and no clarity on ramp up efforts. This impacts our KG-D6 valuations by INR11/share. We expect ramp up of D6 output to 80mmcmd by beginning FY15e.

MA oil production - growth slowed down

RIL had earlier mentioned that oil production from MA oil field to remain at current levels of 20-25Mbbl/d till June 2011. The ramp up is below expectation as composition of oil & gas seems to be skewed and gas/oil mix will affect the recoverable of oil.

Delay in NEC-25 development due to regulatory hurdles

RIL has struck six consecutive commercial shallow water discoveries in this block, namely D9, D10, D11, D15, D20, D21, for which the development plan has already been submitted in May 2007 to the DGH for approval. Appraisal period and PEL for the block expired on March 08, 2010. RIL had submitted DOC and requested PEL extension for submission of Development Plan. However, DGH has yet to approve the extension of PEL and appraisal period bringing the activities to standstill.

Two more deep water discoveries have also been announced in the same block (D32 and D40). Declaration of commerciality for the same had been submitted in February 2010, but as per recent reports, DGH has denied approving DOC of D32 and D40 discoveries (2P reserves of 355bcf), due to lack of complete data.

With delay in filing the development plan (no clarity yet), start up of production may go beyond FY16e, impacting the valuation of reserves valued as E&P upside. RIL estimates 1.5tcf of resources in NEC-25 with expected production by mid 2015.

No updates on development of R1 and three cluster discoveries

RIL submitted a DOC for R1 gas discovery D34 (known as R-cluster) in February 2010 which is under examination at DGH. Total resources in these discoveries are estimated to be 1.6tcf. We had earlier expected that RIL would file the field development plan (FDP) in 1HFY12, with a first production target in 3-4 years from date of FDP approval. RIL also submitted a DOC for three other satellite gas discoveries D29, D30, D31 in February 2010 which is under examination at DGH. Total 2P reserves in these discoveries are estimated to be 0.5tcf. However, RIL failed to give any update on regulatory approvals as well as development efforts being carried out at these fields.

KG-D6 satellite discoveries - monetisation couple of years away

Total resources in these satellite fields are estimated to be 2.2tcf. RIL had earlier guided that it is conducting some pre-development activities at the block before filing the integrated development plan, which may take some more time. The development of discoveries is to be aligned with KG-D6 and the operator may wait till the pressure of two fields is synchronised. We believe that satellite discovery production may be used to maintain peak production of 80mmcmd at KG-D6. Hence, the monetisation of discoveries is still couple of years away.

Production likely to be capped at 80-90mmcmd in the medium to long-term

By building our production profile on above, we believe that RIL gas production is likely to be capped at 80-90mmcmd (after ramp up in FY15e) and not likely to cross beyond these levels in the medium to long term.

E&P valuations downgraded due to lack of clarity on future development efforts

We were hopeful of RIL filing field development plans for NEC-25 and KG-D6 satellite discoveries in FY12e, however RIL has not provided any timeline on development of these resources and exploration program going forward. We believe regulatory delays/ hurdles as one of the reasons for slowdown in domestic E&P activities. RIL had also stated that they are discussing broader issues with government before they take further steps in domestic E&P activities (across 28 domestic blocks) including new exploration. We see this as a risk to valuations of RIL contingent resources (exploration upside of INR188/share), currently included in our target price as E&P activities come to standstill.

Our optimism on RIL was primarily led by improving refining and Petchem fundamentals, which can lead to a 27% earnings growth in FY12e to INR77/share with current gas output of 55mmcmd. However, slow down in pace of E&P activities to impact valuation of future reserves and exploration upside. Three major fields like KG-D3, MN-D4 and KG-D9 are only at early exploration stages, while for NEC-25 and satellite discoveries, there is no clarity on filing of FDPs and hence production from the same is still many years away.

We have valued RIL's contingent resources for fields/discoveries where declaration of commerciality (DoC) has been filed. The discoveries include 9 satellite discoveries at KG-D6, R- cluster at KG-D6, NEC-25 and other discoveries at GS-01 and CYD5.

While we keep the resource estimates for RIL's contingent resources intact at 12.8tcf (break-up provided in the table below), we reduce our valuation multiple used for valuing these resources to USD2.5/boe from USD4.5/boe used earlier, to reflect uncertainty in developing these resources. This reduces RIL's contingent resource valuations to INR104/share, down from INR188/share earlier. We would have a re-look at our estimates once we get further clarity on development efforts being taken by the company.

Gas discoveries accounted in our valuations

Name of fields	Stage of activity	Contingent resources (tcf)
D1, D3 3P resources	Under production	5.7
9 satellite discoveries (D2, D4, D6, D7, D8, D16, D19, D22, & D23)	FDP filed, OFDP under preparation	2.2
R-Cluster	FDP under preparation	1.6
NEC-25	FDP under preparation	1.5
D29, D30, D31 gas discoveries	DoC submitted	0.5
GS-01 and CY-D5	DoC submitted	1.3
Total resources for valuation		12.8

Source: Company, Industry reports

Valuation

We downgrade our FY12e EPS by 4% to INR78/share and reduce our SOTP based target price to INR1,053/share from INR1,152/share to reflect our changes. We downgrade our recommendation to HOLD.

SOTP valuation

Valuation of RIL on FY12e financials	Methodology	Multiple	INR/bn	EV	Value/share
Valuation of Petchem business	EV/EBITDA	7.0	109	764	257
Valuation of Refining business (incl RPL)	EV/EBITDA	7.0	188	1,319	443
Oil & Gas producing (PMT and international)	EV/EBITDA	7.0	28	198	67
KG-D6 (D1, D3 and MA fields)	DCF			586	197
NEC, KG-D6 14 discoveries and KG D1 & D3 3P reserves	Multiple	12.8tcf	2.5x	242	81
Retail	DCF			85	29
CBM	Multiple	3.5tcf	2.5x	68	23
SEZ	Valued on 1.0x		66	66	22
Atlas JV	DCF			100	33
Pioneer JV	DCF			45	15
Net debt				(336)	(113)
Total value				3,137	1,053
No of shares (Bn)			2.978		

Source: Antique

3QFY11 results update and analyst meet highlights

- Refinery segment EBIT rose 11% QoQ and 77% YoY due to sharp recovery in GRMs to USD9/bbl, up 14% QoQ. Refinery utilisation rates fell to 104% (from 109% in 2QFY11) due to a 22 days planned shut down at one of the refineries.
- RIL's GRMs continued to remain at a premium of USD3.6/bbl over Singapore GRMs.
- Refinery operating cost rose to USD4.4/bbl from average of USD3.8/bbl last year due to refinery shut down expenses of ~INR1bn and lower use of KG-D6 gas.
- RIL is expected to take FCCU shut down at its old refinery for about 37 days beginning first week of February. RIL is not expected to take any major refining shut down in next financial year.
- RIL indicated a KG-D6 gas usage of 4-5mmcmd in current quarter as compared to 7-8mmcmd in 1HFY11. RIL is also using LNG at its refining which is imported at ~USD10-11/mmbtu to replace lower KG-D6 gas output.

- RIL reported highest ever Petchem EBIT of INR24.3bn due to buoyancy in Petchem margins. EBIT increased 11% QoQ and 18% YoY. Higher product prices and increased volumes coupled with strong domestic demand of most products led to strong Petchem performance.
- RIL sees strong polymer cycle returning in next couple of years as strong ethylene capacity addition get absorbed with normal demand growth and pace of capacity addition return to below average levels.
- RIL polyester capacity addition is running on schedule to complete by FY13e end while the zero date for new off gas cracker will be finalized in next few months.
- Oil and gas EBIT continued to remain weak due to lower KG-D6 production at 54.5mmcmd down 6% QoQ. PMT gas production however recovered from last quarter platform shutdown and was up 36% QoQ.
- RIL's management has not given any guidance on KG-D6 output as well as timeliness on development of other discoveries in NEC-25, satellite discoveries in KG-D6.
- Interest cost remains flat QoQ while debt rose to INR702bn from INR682bn (QoQ). Cash balance rose to 318.3bn from INR293.5bn QoQ, keeping net debt flat.

Refinery GRMs - Expected to remain buoyant

We expect refinery GRMs to remain robust led by strong oil products demand growth and slow down in new refinery capacity addition over CY11-13e. We believe that the market will continue to see net incremental demand (i.e., incremental demand > incremental supply) for the global refining industry over the next two years.

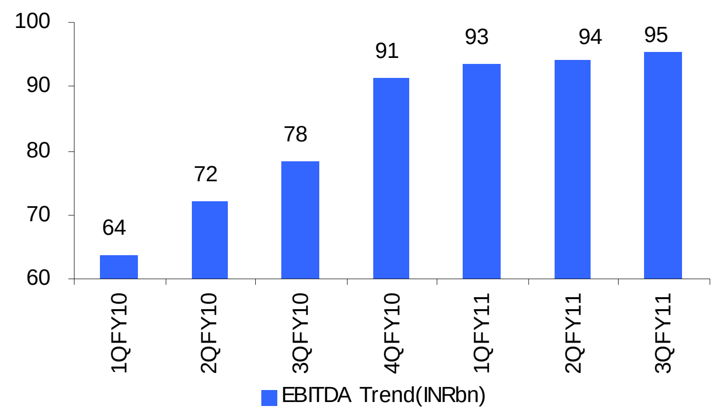
Key reasons supporting our bullish case are:

- Refiners witnessed three years (2008-10) of sluggish refinery margins on account of depressed demand in oil products and significant addition in refinery capacity over the same period. However, oil products demand in 2010 bounced back very sharply and IEA estimates continuation of this strong growth over the next few years led by China, India and other emerging markets.
- Our refinery capacity addition model suggests a slowdown in refinery capacity addition over next few years and also refinery closures to help the refiners.
- We do not expect utilisation levels to increase significantly in the near term due to delayed refinery expansion plans, ~3MMbbl/d of refinery capacity closures announced (both temporary and permanent) as well increasing trend of unplanned outages as 41% of refineries being operated globally for 40 years and above.
- Light heavy spreads have also recovered.

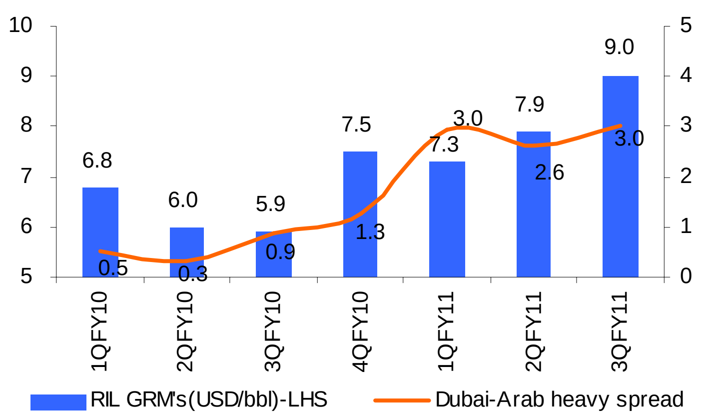
We thus believe that refining margins are expected to remain in an upward trajectory structurally over FY11-13e before next wave of capacity addition moderates that growth. We see distillate demand led by industrialisation and transportation demand from emerging markets to be the key driver of oil products demand. Distillate yield biased Asian refiners like RIL are therefore expected to be in a sweet spot, in our view.

After bottoming out in FY10, we estimate RIL's GRMs to improve to USD10.7/bbl in FY12e, up 29% YoY. These margins are still 30% lower than peak margins of USD15/bbl reported by RIL in FY08.

Higher EBITDA supported by improved GRMs and Petchem margins

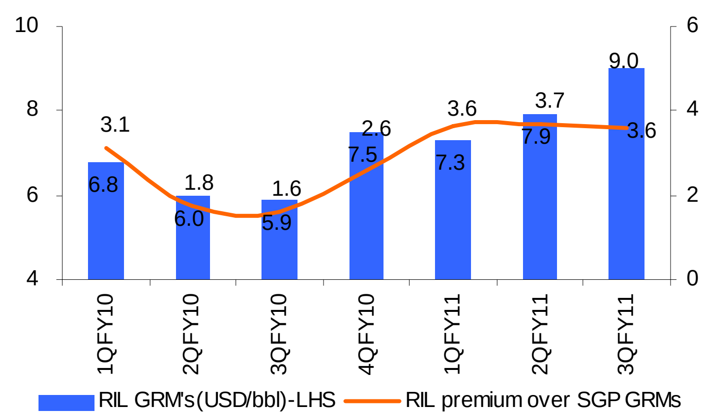


RIL's GRMs increase with improvement in product crack spreads and rise in light- heavy differential

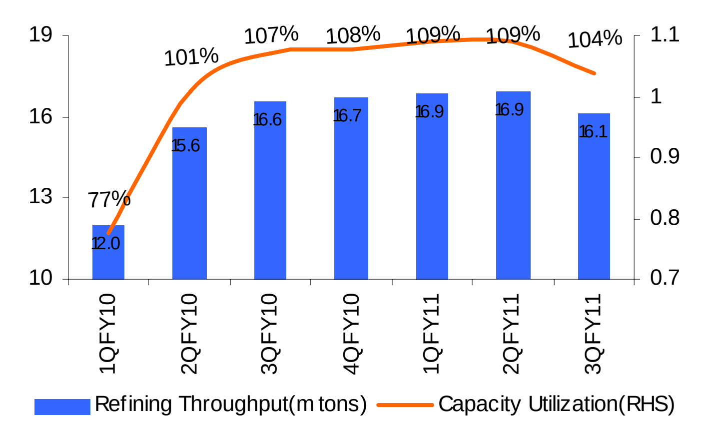


Source: Company, Antique

RIL GRMs premium over SGP GRMs remain flat at USD3.6/bbl

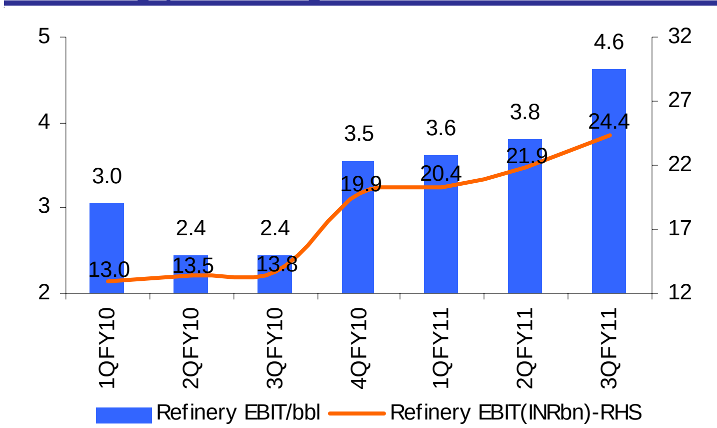


Refining throughput declined 5% QoQ due to a 22 days planned shutdown

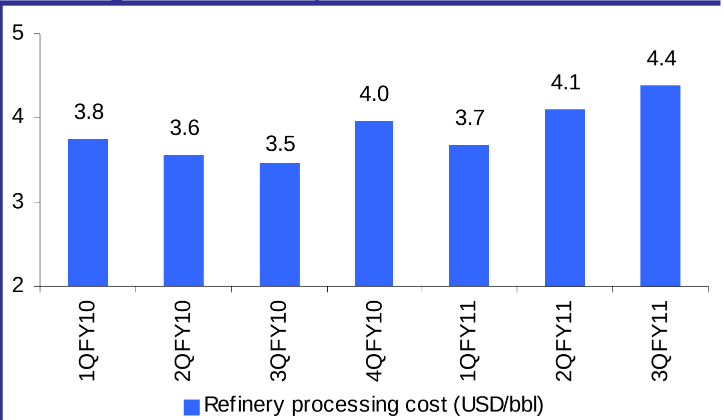


Source: Company, Antique

Refining EBIT up 77% YoY despite lower throughput due to higher GRMs

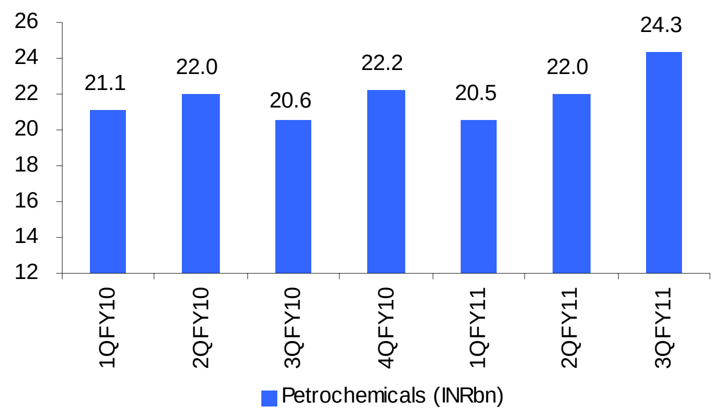


Refinery operating cost increased by 7% QoQ due to higher shutdown expenses

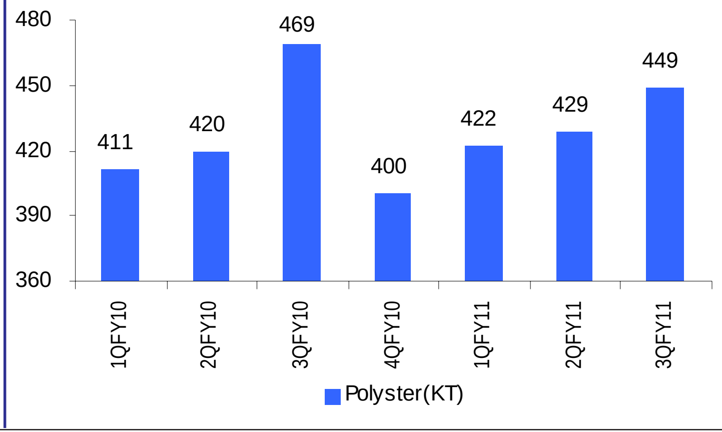


Source: Company, Antique

Petchem EBIT supported by increase in volumes and higher polyester margins

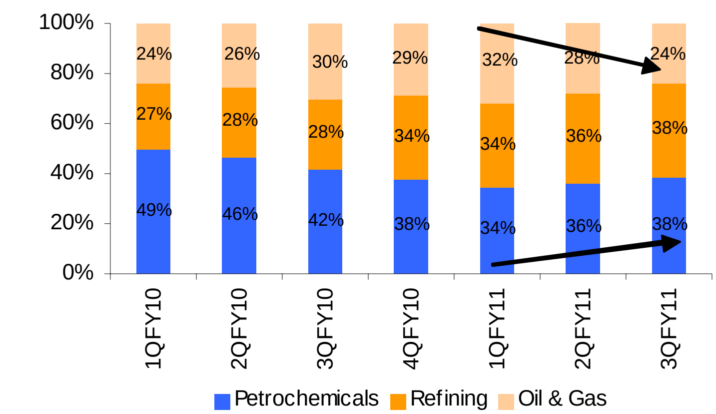


Polyester production increased 5% QoQ led by improvement in product margins

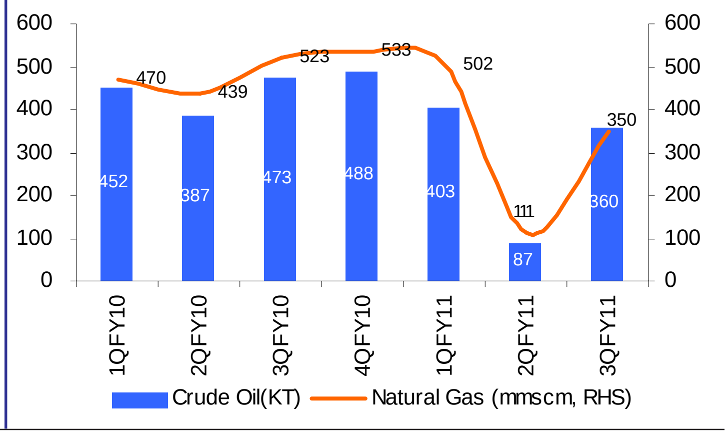


Source: Company, Antique

Decline in O&G contribution owing to decline in KG-D6 output and higher Petchem earnings

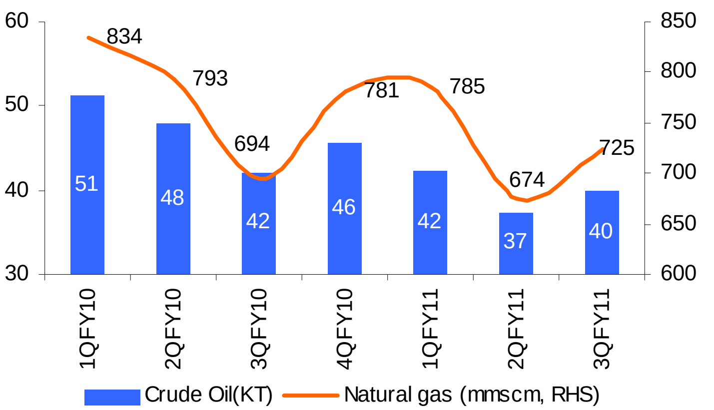


Tapti O & G production recover QoQ

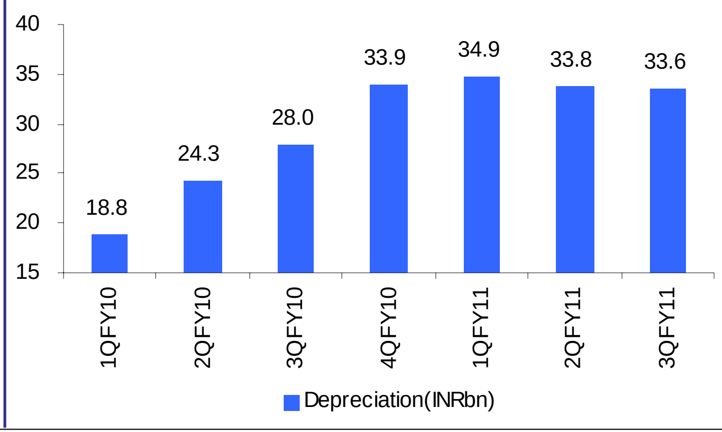


Source: Company, Antique

Panna-Mukta output recovered after production resumed from revamped platform



Depreciation remained flat QoQ



Source: Company, Antique

Financials

Profit and loss account (INRbn)

Year ended 31st Mar	2008	2009	2010	2011e	2012e
Revenues	**1,371**	**1,512**	**2,037**	**2,427**	**2,620**
Expenses	(1,140)	(1,275)	(1,728)	(2,056)	(2,176)
EBITDA	**231**	**238**	**309**	**371**	**444**
Depreciation & amortisation	(50)	(57)	(109)	(122)	(133)
EBIT	**181**	**181**	**199**	**250**	**311**
Interest expense	(11)	(18)	(21)	(25)	(30)
Other income	60	16	199	25	37
Profit before tax	**230**	**179**	**377**	**250**	**318**
Taxes incl def. taxation	(35)	(29)	(43)	(50)	(64)
Profit after tax	195	150	245	200	255
Adjusted profit after tax	**148**	**153**	**154**	**200**	**255**
Recurring EPS (INR)	**53**	**47**	**47**	**61**	**78**

Balance sheet (INRbn)

Year ended 31st Mar	2008	2009	2010	2011e	2012e
Share Capital	14.5	16.4	29.8	29.8	29.8
Reserves & Surplus	841	1,198	1,380	1,555	1,784
Networth	**855**	**1,215**	**1,410**	**1,585**	**1,813**
Debt	507	763	646	624	602
Capital Employed	**1,362**	**1,977**	**2,056**	**2,209**	**2,415**
Gross Fixed Assets	1,092	1,572	2,241	2,425	2,661
Accumulated Depreciation	451	501	639	761	894
Net Assets	**641**	**1,070**	**1,602**	**1,664**	**1,767**
Capital work in progress	499	738	170	180	80
Investments	95	66	131	131	131
Current Assets, Loans & Advances					
Inventory	191	201	344	402	433
Debtors	61	48	101	118	127
Cash & Bank balance	45	227	139	208	394
Loans & adv. and others	218	110	107	125	135
Current Liabilities & Provisions					
Creditors	228	345	381	453	480
Other liabilities & provisions	41	44	45	45	46
Net Current Assets	**246**	**199**	**265**	**354**	**564**
Def. tax assets/ (liabilities)	(78)	(96)	(107)	(115)	(122)
Minority interest	(41)	(1)	(6)	(6)	(6)
Application of Funds	**1,362**	**1,977**	**2,056**	**2,209**	**2,415**

Per share data

Year ended 31st Mar	2008	2009	2010	2011e	2012e
No. of shares (m)	2,907	3,269	3,270	3,271	3,272
BVPS (INR)	294	371	431	485	554
CEPS (INR)	68	64	81	98	118
DPS (INR)	13	13	7	8	8

Margins (%)

Year ended 31st Mar	2008	2009	2010	2011e	2012e
EBITDA (%)	17	16	15	15	17
EBIT (%)	13	12	10	10	12
PAT (%)	11	10	8	8	10

Source: Company, Antique

Cash flow statement (INRbn)

Year ended 31st Mar	2008	2009	2010	2011e	2012e
EBIT	**181**	**181**	**199**	**250**	**311**
Depreciation & amortisation	68	77	140	122	133
Interest expense	(11)	(18)	(21)	(25)	(30)
(Inc)/Dec in working capital	(46)	(58)	(59)	(20)	(23)
Tax paid	(25)	(19)	(31)	(41)	(57)
Others	(6)	0	(23)	28	34
CF from operating activities	**162**	**163**	**205**	**313**	**367**
Capital expenditure	(267)	(279)	(233)	(194)	(136)
Inc/(Dec) in investments	43	34	26	2	2
Others	(80)	14	24	19	31
CF from investing activities	**(304)**	**(231)**	**(182)**	**(172)**	**(102)**
Inc/(Dec) in share capital	17	152	5	1	1
Inc/(Dec) in debt	172	184	(57)	(22)	(23)
Others	(21)	(85)	(60)	(51)	(58)
CF from financing activities	**167**	**250**	**(111)**	**(72)**	**(79)**
Net cash flow	**25**	**182**	**(89)**	**69**	**186**
Opening balance	19	45	227	138	208
Closing balance	**45**	**227**	**138**	**208**	**394**

Growth indicators (%)

Year ended 31st Mar	2008	2009	2010	2011e	2012e
Revenue	21	10	35	19	8
EBITDA	15	3	30	20	20
PAT	22	3	1	29	27
EPS	27	(11)	1	29	27

Valuation (x)

Year ended 31st Mar	2008	2009	2010	2011e	2012e
PE	18.7	21.1	20.9	16.1	12.7
P/BV	3.4	2.7	2.3	2.0	1.8
EV/EBITDA	14.3	13.9	10.7	8.9	7.4
EV/Sales	2.4	2.2	1.6	1.4	1.3
Dividend Yield (%)	1.3	1.3	0.7	0.8	0.8

Financial ratios

Year ended 31st Mar	2008	2009	2010	2011e	2012e
RoE (%)	17	13	11	13	14
RoCE (%)	13	9	10	11	13
Debt/Equity (x)	0.6	0.6	0.5	0.4	0.3
EBIT/Interest (x)	17	10	10	10	10

Source: Company Antique

Important Disclaimer:

This report is prepared and published on behalf of the research team of Antique Stock Broking Limited (ASBL). ASBL, its holding company and associate companies are a full service, integrated investment banking, investment advisory and brokerage group. Our research analysts and sales persons provide important inputs for our investment banking and allied activities. We have exercised due diligence in checking the correctness and authenticity of the information contained herein, so far as it relates to current and historical information, but do not guarantee its accuracy or completeness. The opinions expressed are our current opinions as of the date appearing in the material and may be subject to change from time to time without any notice. ASBL or any persons connected with it do not solicit any action based on this report and do not accept any liability arising from the use of this document. The recipients of this material should rely on their own judgment and take their own professional advice before acting on this information. The research reports are for private circulation and are not to be construed as, an offer to sell or solicitation of an offer to buy any securities. Unless otherwise noted, all research reports provide information of a general nature and do not address the circumstances of any particular investor. The distribution of this document in certain jurisdictions may be restricted by law, and persons in whose possession this document comes, should inform themselves about and observe, any such restrictions. ASBL its holding company and associate companies or any of its connected persons including its directors or employees shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained, views and opinions expressed in this publication. ASBL its holding company and associate companies, officers, directors, and employees may: (a) from time to time, have long or short positions in, and buy or sell the securities thereof, of company(ies) mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as advisor or lender/borrower to such company(ies) or have other potential conflict of interest with respect to any recommendation and related information and opinions. ASBL, its holding company and associate companies, directors, officers or employees may, from time to time, deal in the securities mentioned herein, as principal or agent. ASBL its holding company and associate companies may have acted as an Investment Advisor or Merchant Banker for some of the companies (or its connected persons) mentioned in this report. The research reports and all the information opinions and conclusions contained in them are proprietary information of ASBL and the same may not be reproduced or distributed in whole or in part without express consent of ASBL. The analyst for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject company or companies and its or their securities, and no part of his or her compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report.

One of the Directors in Antique group is a Partner in audit firm, who are the statutory auditors of Reliance Industries Ltd.

Analyst ownership in stock	No

ANTIQUE

Antique Stock Broking Limited
Nirmal, 2nd Floor, Nariman Point, Mumbai 400 021.
Tel. : +91 22 4031 3444 • Fax : +91 22 4031 3445
www.antiquelimited.com