

RELIANCE INDUSTRIES

Date
20/06/11

Sensex
17506.63

Nifty
5257.90

Sector
Diversified

CMP
Rs.834

Face Value
Rs.10/share

Equity Capital
Rs.3273.37cr

52 Week H/L in Rs.
1187-834

Market cap Rs. Cr.
273197.96

Share Holding

	Shares	% holding
Promoters	1463923695	44.72
Fin.Inst.	265076350	8.10
FII	579259479	17.70
Pvt.Corp.	320156455	9.78
NRI's	23962514	0.73
Others	2944927	0.09
NRI's	23962514	0.73
Public	408145773	12.47
Totals	3273374008	100

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Summary

We are strongly positive on sustainability of Reliance's various businesses going forward on account of its huge cash surplus (app \$12 bn) which can help the Company to invest in new projects without adding strain to its balance sheet through external debts. In our opinion the under performance of the KGD6 basin is exaggerated by the market and is one of the main reason for the stock to underperform compared to benchmark. We believe that Company can turnaround the situation with the help of British Petroleum's expertise in deep water exploration. In addition to the domestic E&P (Exploration and Production), its foray into Shale gas resources in North America buttresses the Company's reputation of investing in assets which has always over a long term helped in creating wealth to its shareholders. Newer business segments like wireless telecom, we believe will be in a position to create value towards the second half of this decade.

Exploration & Production (E&P)

Recent Underperformance

RIL's KGD6 gas production during 4th quarter averaged at 51 mmscmd as against 54.5 mmscmd in Q3 FY2011. Crude oil production from the KG basin decreased to 16666 bpd in 4QFY2011 from 19400 bpd in 3QFY2011.

Outlook

The principal reason for the underperformance of the KGD6 can be overcome

- According to various experts, the gas reservoir is more complex than anticipated, but they are resolvable and that Reliance will be able to ramp up to planned output targets as additional wells are drilled.
- The other reason for the underperformance is a slower pace in the field development plan. Till now 18 wells are drilled, this is lower than the projected 26 wells. Completion of the 1st drilling program plus initiation of the Phase 2 drilling program will restore production growth thus letting the production to come back to 80 mmscmd.
- Moreover British Petroleum's recent deal with RIL to acquire 30% stake in 23 blocks gives us a confidence for a turnaround in the KGD6 basin as BP will bring its expertise in deep water exploration.

- In our opinion, there may be a commercial aspect apart from the above mentioned reasons. While domestic gas in KGD6 is priced at US\$4.20/mscf at the beach, imports of LNG and Oil are running at US\$10-15/mscf. Company would like this imparity to be sorted out with the Government. We are positive on a price hike of domestic gas as the Country can ill afford to import at high prices especially when there is a rich domestic reserve of natural gas to the tune of 50 TCF that lies untapped. Recent press reports about the Govt. willing to increase prices for non-core sectors is a positive development.

Refining

Performance

The crude processing stood flat at 16.7 mn tonnes during the fourth quarter with a capacity utilization of 108%. Despite flat crude output, higher petroleum product prices led to 22.3% YOY increase in refining revenue to Rs.62,704 cr. RIL reported GRM of \$9.2/bbl. Improvement in refining margin was mainly due to improved product spread of middle distillates on account of rising demand. Refined product exports stood at 38.7MMT (US\$32.9 bn) in FY2011 as against 32.8MMT (US\$24.5 bn) in FY2010 on incremental export volumes from the SEZ refinery.

Outlook

We expect the refining margin to improve next fiscal as the shutdown that had been taken place earlier in one of the unit at DTA refinery segment in Jamnagar has been completed and the unit has successfully started. The other key growth drivers would be higher demand for middle distillates and increasing light heavy crude oil differentials.

Petrochemical

Performance

The revenue from this segment grew by 17.8% YOY to Rs.18194 cr. in 4Q due to higher polymer and polyester prices. The increasing price of cotton helped for the demand growth in polyester. The polyester price increased by 20-25% thus giving higher realization and hence better margin. Polypropylene delta, which surged from US\$94/MT during 2QFY2011 to US\$239/MT in 3QFY 2011, fell marginally to US\$222/MT in 4QFY2011. Similarly, margins in the High density poly ethylene-naphtha segment fell to US\$451/MT vs. US\$486/MT during 3QFY2011, as naphtha prices moved faster on higher crude prices. However, some strength in margin was seen in the Poly vinyl chloride ethylene dichloride segment, which stood at US\$439/MT as against US\$395/MT in 3QFY2011.

Outlook

We believe that the spike in EBIT margin and the average realized price is unsustainable for long term and we expect to see a correction in the near term.

Recent Investments

Shale Gas Ventures

The Company entered into a JV with various US based companies to acquire shale gas reserves totaling app 12 TCF. These ventures are particularly interesting as shale gas constitutes 34% of US domestic natural gas resource base of 2543 TCF and 50% of 48 onshore resources in US.

BWA Spectrum

RIL acquired a 95% stake in Infotel broadband Services Ltd. which emerged as a successful bidder in all the 22 circles of the auction for Broadband Wireless Access (BWA) spectrum conducted by Department of Telecommunication, Government of India. RIL has invested Rs.4201.64 cr by way of subscription to equity capital issued by Infotel broadband. The roll out strategy of this service is likely to begin 2012 and considering that data penetration in India is extremely low, we reckon that this will be the next growth driver for Reliance, albeit towards the latter part of the decade.

Recommendation

We believe that the key driver in the coming fiscal would be its core business i.e. refining and marketing due to the expected increase in margins due to the recommencement of its unit in Jamnagar refinery, higher demand for middle distillates as well as increase in the light-heavy crude oil differentials. But we are strongly bullish for the scrip over a long term as we expect the Company to ramp up its production in KGD6 with the expertise of BP, so that it can come back to its original level of 80 mmscmd. Any upside on the pricing of the gas and commercialization of newer discoveries will be additional positives.

The scrip is currently trading at a PE of 14x (Trailing twelve month) EPS which we believe is a good entry point as the stock is trading at historical low levels close to its 2 years lows. We expect the future growth to be at least in the 12-15% CAGR range. This makes the current price extremely attractive and we recommend a **BUY**.

Financial Statement

Rs in Crore	2011	2010	% growth	BALANCE SHEET	2011	2010
Revenue				Paid Up Capital	3273	3270
Petrochemicals	63155	55251	14.30%	Reserves & Surplus	142799	125095
Refining and Marketing	215431	163249	32.00%	Loan funds	67396	62494
Oil & gas	17250	12649	36.00%	Total	213470	190861
EBIT				Net fixed assets	137239	144455
Petrochemicals	9305	8581	8.40%	Capital work in progress	12819	12138
Refining and Marketing	9172	6011	52.60%	Investments	33019	19255
Oil & gas	6700	5413	23.80%	Net current assets	30391	15011
EBIT Margins				Total	213470	19086
Petrochemicals	14.7	15.5				
Refining and Marketing	4.3	3.7				
Oil & gas	38.8	42.8				
Valuation	2011	2010		Valuation	2011	2010
EPS	62.00	49.60		ROE	14.8	13.4
PE	13.45	16.81		ROCE	12.9	11.3
P/BV	1.87	2.06		Net debt/Equity	0.4	0.3

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