Investors' Delight: Reliance Industries Ltd. (RIL) – "SELL for short term"

"Petrochemicals segment and lower KG-D6 output fail to impress domestic bourses"

Date	July 20, 2013
BSE Code/NSE Code	500325/RELIANCE
Bloomberg/Reuters Code	RIL IN/RIL.BO
Industry	Integrated Oil & Gas – Refining, Petrochemicals and Others
FV	₹10
Equity Share Capital	₹32.29 bn
Market Capitalization	₹2,980 bn
52 week high/low	₹954.8 (21st Jan, 2013)/₹707.3(26th July, 2012)
CMP	₹923
Short term Recommendation	"SELL" | Target Price: Rs.840 | Downside: 9%
Medium – Long Term Recommendation	"ACCUMULATE " |Target Price: Rs. 1,110 | Upside: 20%

Investment Summary

India's second biggest Company - RIL by market capitalization posted Revenues which were down by 4.6 percent to ₹ 90,589 crore on back of lower output from RIL's flagship KG-D6 gas fields and lower volume at the world's largest refining complex, which operated at 110 % capacity. GRM was at US$8.4 bbl versus US$8.5 in the previous quarter. Street had predicted profit to go up by 17-20% given the low base last year. Petrochemicals (petchem) earnings reduced due to the lack of improvement in oil and gas sector. As a result, we are slightly bearish on petchem segment. The management is optimistic about the petrochemicals business, where it is expanding capacity as it is investing heavily in the petchem business. RIL's new capacities are expected to start operations slowly and steadily from possibly H2FY14 onwards. However, according to us, its effect would be far sighted. At Ajcon, we believe, unless the petchem segment really starts outperforming from current scale, the positive impact on earnings and stock price performance would be modest. RIL's refining segment was also not performing well and there was not much capacity addition. We believe the Company should have gained slightly better because of the currency gain. At CMP, RIL trades at 12x FY15E EPS of ₹74.

We recommend: "SELL" for short term with a target of ₹840" in the immediate term as it has witnessed a strong rally recently and historically RIL's other income showed a steep increase of 33 percent as compared to last year of ₹2,535 crore, a historic high . Ideally, its earnings should have been bolstered by core business income rather than treasury gains which disappointed us. Structurally, the Company's profitability metrics has been under pressure, led by business slowdown resulting into sharp decline of EBITDA margin from 15.4 percent in FY11 and 10.2 percent in FY12 to 8.5 percent in FY13. RoCE for the Petchem/E&P segments has declined from 20 percent/10 percent a year ago to 13 percent/7 percent in FY13. In the interim period from present to 2015 gross refining margin volatility would definitely hurt investor confidence and RoE reaching sub 12% in FY13.

For long term investors, we recommend to "Accumulate" on dips with a target of ₹1,110 (15x at estimated FY15EPS of ₹74 as markets have historically traded at 15x and RIL deserves premium owing to its giant scale and gas price hike to augur well for its future along with strengthening retail business). Commenting on longer-term perspective, we are bullish owing to positive factors like Company possessing a strong Balance sheet (Cash reserves of the company reported at ₹ 93,000 crores which translates into ₹288 per share (31% of CMP). Book value as on FY13 stood at ₹554 per share (P/BV – 1.66x and 60% of CMP), Company would be a key beneficiary of gas price hike: as unlike PSU upstream companies it does not bear any subsidy burden. India is facing acute shortage of cheaper domestic gas

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because of a sharp fall in D6 output to 14 mmscmd at present from 61.8 mmscmd about three years ago. Reliance is expediting production from new discoveries in the D6 block as the management committee of the block has approved US$1.5 bn development plan for four satellite fields. We believe that the increase in gas volumes from KG D6 block would be a key trigger for RIL. Reliance Industries' (RIL) FY13 annual report indicated management focus on next capex cycle, so as to leverage integration capabilities at Jamnagar. We give thumps up to RIL for using low cost foreign currency debt – US$ 12 bn to fund its capital expenditure plans which would yield better PAT margins in future. Positive momentum building in the domestic upstream business with the successful discovery in MJ1 (in the KG-D6 block) and approval of the new gas price formula will give a kick to its earnings. Q1FY14 performance reflects higher operating rates and embedded options in crude sourcing and product placement given the size and scale of refining business.

Q1FY14 result background...

Reliance Industries witnessed 19 percent yoy growth in Q1FY14 to touch ₹5,352 crore owing to stronger margins core oil refining business. Sales have, however, declined to ₹87,645 crore, down 4.5 percent on yoy basis. Gross refining margins (GRMs – a measure of the differential between the cost of raw material and revenues from selling finished products) stood at USD 8.4/bbl versus USD 7.6/bbl YoY. Refining revenue of the company is at ₹81,458 crores versus ₹77,872 crores qoq. Refining EBITDA margin stood at 3.6% vs. 4.5% qoq. Petrochemical EBITDA margin stood at 8.6% versus 8.5% qoq. The management explained that the GRMs in the quarter, although at a premium of between US$1.80 -1.90 to the Singapore benchmark, were lower on a quarterly basis because of smaller diesel and petrol cracks during the quarter. Earnings before interest and tax (EBIT) for the refining business fell to ₹2,951 crore in the first quarter, lower 16.2% sequentially but up 38.5% on yoy basis. RIL has been increasingly sourcing cheaper heavy crude from Venezuela. Petroleum refining revenue of the company stood at ₹21,950 crore versus ₹22,158 crore in the previous quarter. Shale Gas Revenue improved 84% on year. The production of shale gas at the company's overseas ventures is currently at 37.7 billion cubic feet (bcf), an increase of 71% y-o-y, while production at the KG-D6 Basin is approximately 49.2 bcf. Production at the Panna-Mukta fields is roughly 16.9 bcf.

Retail division doing good...

The Company is performing well in the retail segment and witnessed revenue growth of 53 percent to Rs. 3,474 crore. Every minute, Company sells 100 garments, 1,000 litres of milk and 1,000 kg of vegetables and fruit. It exported 10.1 mn tones of refined products during Q1FY14, up from 9.3 mn tonnes during previous year.

Earlier Q1FY14 Street expectations

RIL was estimated to report Q1FY14E GRMs at USD8.5/bbl v/s USD10.1/bbl in Q4FY13. Street expected some recovery in petchem profits which has not happened. Average Q1FY14E KG-D6 volume was estimated at 14.8mmscmd v/s 19.2mmscmd in Q4FY13. Street expected RIL to report PAT of ₹52.4b (v/s ₹44.7b in Q1FY13 and ₹55.9bn in Q4FY13) and it has achieved bottom-line above estimates. RIL trades at 12x FY15E adjusted EPS of ₹74.

Please find Actual segment wise performance metric in the next page.....

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Segment wise performance (Rs. crs)

Particulars	Q1FY14	Q4FY13	Q1FY13	FY13
Segment Revenue				
Petrochemicals	21,950	22,158	21,839	88,108
% of total	21	21.7	19.8	20.4
Refining	81,458	77,872	85,383	333774
% of total	77	76.3	77.6	77.4
Oil and Gas	1,454	1,597	2,508	8280
% of total	1.38	1.57	2.28	1.92
Others	616	359	249	953
% of total	0.58	0.35	0.23	0.22
Total	105,478	101,986	1,09,979	4,31,115
Segment EBIT	Q1FY14	Q4FY13	Q1FY13	FY13
Petrochemicals	1,888	1,895	1,756	7,328
% margin	8.60	8.55	8.04	8.32
% total	35.8	31.9	35.7	31.5
Refining	2,951	3,520	2,130	12,788
% margin	3.62	4.52	2.49	3.83
% total	55.9	59.4	43.3	54.9
Oil and Gas	352	460	972	2,887
% margin	24.2	28.8	38.8	34.86
% total	6.67	7.76	19.7	12.4
Others	84	48	58	255
% margin	13.6	13.4	23.3	26.8
% total	1.59	0.81	1.18	1.09
Total	5,275	5,923	4,916	23,258
EBIT Margin %	5	5.8	4.5	5.39
Profit after tax	5,352	5,589	4,503	21,003
PAT Margin (%)	5.07	5.48	4.09	4.87

Source: Company, Ajcon Research

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