Reliance Industries - BUY

It's just getting better

During Q3 FY18, performance of petrochemical segment for Reliance Industries (RIL) was ahead of estimates while refining segment performance came in line with estimates. While GRMs were at US$11.6/bbl v/s our expectation of US$11.2/bbl, throughput came in at 17.7mn tons v/s our estimate of 18mn tons. Resultantly, overall net profit for the standalone entity came in ahead of our estimates. Highlight for the quarter, yet again, was a strong performance reported by Reliance Jio as it registered an EBIDTA margin of 38% as against our estimates of 21% for FY18. Future outlook for refining and petrochemical segments look upbeat as the company ramps up off gas cracker and commences operations of petcoke gasifiers. We are raising estimates for retail and petrochemicals segment, while we maintain our forecasts for refining segment. We retain our BUY rating with a two year price target of Rs1,500 (Rs1,300 earlier). Top pick in the Oil & Gas sector.

Refining segment performance in line with forecasts

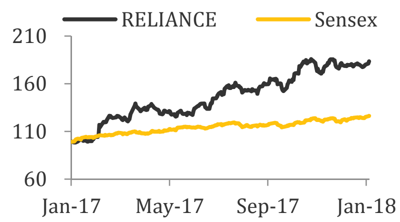
For Q3 FY18, RIL reported a GRM of US$11.6/bbl as compared to our estimate of US$111.2/bbl. On a qoq basis, while the benchmark Singapore GRMs declined by US$0.9/bbl, RIL GRMs were lower by only US$0.4/bbl. The outperformance was primarily on account of 1) optimization of production wherein the company produced more of middle distillates where crackcs were stronger particularly so for Jet Fuel and 2) start up of the extract hydrotreater. Throughput at 17.7mn tons was lower than our forecast of 18mn tons, offsetting the impact of higher than anticipated GRMs. With the new PX unit scaling up to full utilization, the petrochemical intensity of the refinery has reached to the levels unmatched in the world. This will yield substantial gains over the longer term.

CMP (Rs) 929	24-mts Target (Rs) 1,500	Upside 61.5%

Stock data (As on January 19, 2018) — **Sector: Oil & Gas**

Sensex:	35,512
52 Week h/l (Rs):	960 / 506
Market cap (Rs mn) :	6,056,991
Enterprise value (Rs mn):	7,296,871
6m Avg t/o (Rs mn):	5,841
FV (Rs):	10
Div yield (%):	0.6
Bloomberg code:	RIL IS
BSE code:	500325
NSE code:	RELIANCE

Stock performance



Shareholding pattern (%)

Promoter	47.6
FII+DII	35.5
Others	16.9

Figure 1: Result table (Standalone)

(Rs mn)	Q3 FY18	Q3 FY17	% yoy	Q2 FY18	% qoq
Net sales	732,560	618,060	18.5	685,320	6.9
Operating profit	137,440	106,040	29.6	129,830	5.9
OPM (%)	18.8	17.2	160 bps	18.9	-18 bps
Depreciation	(24,750)	(20,770)	19.2	(22,680)	9.1
Interest	(10,940)	(9,310)	17.5	(13,140)	(16.7)
Other income	16,240	30,250	(46.3)	20,570	(21.1)
PBT	117,990	106,210	11.1	114,580	3.0
Tax	(33,450)	(25,990)	28.7	(31,930)	4.8
Effective tax rate (%)	28.3	24.5		27.9	
Reported PAT	84,540	80,220	5.4	82,650	2.3
Ann. EPS (Rs)	53.4	98.9	(46.0)	52.2	2.3

Source: Company, IIFL Research

Analyst: Prayesh Jain

Four gasifiers of the petcoke gasification project are expected to commence operations in Q4 FY18, while the remaining are expected to commence by in Q1 FY19. The surge in LNG prices in the recent past and possibility of these trends sustaining over the medium term has improved the economic viability of the petcoke gasification project. In terms of the marketing segment, the company has seen robust volume growth at its retail outlets and bulk sales. Recent fall in marketing margins on diesel will not be deterrent for the company to scale up its marketing network as throughput at its outlets is more than double of OMCs. With regards to GRM outlook, the company expects product spreads to remain strong considering that demand growth of petroleum products is likely to outpace capacity additions globally.

Petrochemical segment delivers an impressive performance

Production in the petrochemical segment saw a sharp increase of 29% yoy as the company reaped benefits from the scale up of utilization at the new polymer and MEG capacities. In terms of product spreads while ethane cracks have come off historic highs, polyester chain has seen strong deltas led by strong demand from China. This coupled with improved competitiveness of the cracker portfolio as ethane cracking stabilized in Hazira, led to EBIT margins of 17.4% a jump of 191bps yoy. The refinery off gas cracker has commenced operations and is currently operating at high utilization rates. The hurricane Harvy is expected to significantly delay new capacities in US, while a clamp down on polluting industries in China is likely to restrict capacity additions there. While stronger economic growth will keep demand strong leading to stronger product spreads globally.

Oil & Gas segment continues to bleed

The standalone oil & gas segment performance continued to deteriorate with an EBIT loss of Rs910mn. The weak performance is in the light of declining production owing to the natural decline in the fields. This was partially offset by improved realisations considering that crude prices have trended higher and gas prices were raised in the domestic market. CBM gas production continues to scale up and the company was getting a market discovered price for it. However, the gas has now been offered through competitive bidding for a long term agreement. Also scale up in production from the three discoveries from 2020 will also attract a market discovered prices vis-à-vis a government declared price for the current production. Shale gas performance continued to be weak.

Jio performance continues to surprise

Jio with an active subscriber base of more than 160mn delivered an ARPU of Rs154/month. While the ARPU is lower on a sequential basis, Q2 FY18 ARPU included some portion of Q1 FY18 revenues pertaining to Jio Summer Surprise and Jio Dhan Dhana Dhan offer. As compared to adjusted ARPU of Rs130/subscriber/month in Q2 FY18, the growth was at 18.5%. EBIDTA margins of 38.2% was significantly ahead of ours and street estimates for entire of FY18. For the quarter the total data consumption was a staggering 4.3bn GB that translates into a consumption of 9.6GB per customer per month. This again is significantly better than forecasts. Going ahead the company is hopeful that the capex for the core wireless business will taper off in the next couple of quarters. By then the company would have achieved 4G coverage for 99% of India's population. Jio Phone would be the next big driver as the company has resolved the issues pertaining to the supply chain. In the Fibre to Home business the company wants to reach 50mn households over the medium term. We believe such strong financial metrics along with significant growth drivers will drive further upgrades in estimates as well valuations for the Jio business.

Retail segment continues to see exponential growth

Organised retail segment on Reliance Industries saw more than doubling of revenues on yoy basis as it sees strong growth across segments. Most notable growth has been seen in the Digital services and bazaar segment. Total number of stores now stands at 3,751 outlets. Profitability of the segment has continued to improve given the benefits of operating leverage.

Figure 2: Segmental breakup (Standalone)

Revenues (Rs. mn)	Q3 FY18	Q3 FY17	% yoy	Q2 FY18	% qoq
Petrochemical	325,330	216,900	50.0	268,260	21.3
Refining	638,060	532,150	19.9	593,240	7.6
Oil and gas	7,520	6,230	20.7	7,600	(1.1)
EBIT margins (%)	**Q3 FY18**	**Q3 FY17**	**bps yoy**	**Q2 FY18**	**bps qoq**
Petrochemical	17.4	15.5	191	18.3	(92)
Refining	9.5	11.5	(199)	11.0	(149)
Oil and gas	(12.1)	(20.1)	796	(12.6)	53
Revenue contribution (%)	**Q3 FY18**	**Q3 FY17**	**bps yoy**	**Q2 FY18**	**bps qoq**
Petrochemical	33.4	28.6	479	30.8	264
Refining	65.5	70.2	(468)	68.0	(251)
Oil and gas	0.8	0.8	(5)	0.9	(10)
EBIT contribution (%)	**Q3 FY18**	**Q3 FY17**	**bps yoy**	**Q2 FY18**	**bps qoq**
Petrochemical	48.1	35.5	1,265	42.8	528
Refining	51.6	64.7	(1,302)	56.9	(529)
Oil and gas	(0.8)	(1.3)	55	(0.8)	6

Source: Company, IIFL Research

Figure 3: Result table (Consolidated)

(Rs m)	Q3 FY18	Q3 FY17	% yoy	Q2 FY18	% qoq
Net sales	998,100	794,080	25.7	914,810	9.1
Operating profit	175,880	115,520	52.3	155,650	13.0
OPM (%)	17.6	14.5	307 bps	17.0	61 bps
Depreciation	(45,300)	(27,930)	62.2	(42,870)	5.7
Interest	(20,950)	(12,090)	73.3	(22,720)	(7.8)
Other income	22,180	27,360	(18.9)	23,170	(4.3)
PBT	131,810	102,860	28.1	113,230	16.4
Tax	(37,750)	(27,190)	38.8	(32,400)	16.5
Effective tax rate (%)	28.6	26.4		28.6	
Other provisions / minority etc	170	(610)	(127.9)	260	(34.6)
Adjusted PAT	94,230	75,060	25.5	81,090	16.2
Adj. PAT margin (%)	9.4	9.5	-1 bps	8.9	58 bps

Source: Company, IIFL Research

Figure 4: Financial summary (Consolidated)

Y/e 31 Mar (Rs. mn)	FY16	FY17	FY18E	FY19E	FY20E
Revenues	2,765,440	3,053,820	3,709,649	4,000,943	4,285,504
yoy growth (%)	(26.3)	10.4	21.5	7.9	7.1
Operating profit	442,570	461,940	664,939	799,361	924,447
OPM (%)	16.0	15.1	17.9	20.0	21.6
Pre-exceptional PAT	272,070	297,800	348,740	436,798	525,658
Reported PAT	276,300	297,800	348,740	436,798	525,658
yoy growth (%)	17.2	7.8	17.1	25.3	20.3
EPS (Rs)	42.1	46.1	54.0	67.6	81.4
P/E (x)	22.0	20.1	17.2	13.7	11.4
Price/Book (x)	2.5	2.3	2.0	1.8	1.6
EV/EBITDA (x)	17.1	16.9	12.1	9.9	8.4
Debt/Equity (x)	0.7	0.7	0.7	0.6	0.5
RoE (%)	11.8	11.7	12.5	13.9	14.7
RoCE (%)	9.4	9.7	10.7	12.0	13.2

Source: Company, IIFL Research