

Reliance Industries

Refining margins surprise

Consolidated (₹ cr)	2QFY16	2QFY15	yoy (%)	1QFY16	qoq%
Net revenue	70,901	1,09,797	(35.4)	77,130	(8.1)
EBITDA	10,704	9,818	9.0	10,177	5.2
Margin (%)	15.1	8.9	616bp	13.2	190bp
Reported PAT	6,625	5,924	11.8	6,137	8.0

Source: Company, Angel Research

Reliance Industries (RIL)' net sales for 2QFY2016 declined by 35% yoy to ₹70,901cr as against ₹109,797cr in the corresponding quarter last year, due to fall in crude oil prices. The EBITDA however increased by 9% yoy to ₹10,704cr, way ahead of consensus estimates, led by strong gross refining margin (GRM) and better-than-expected EBITDA of the petrochemical division. The GRM stood at \$10.6/bbl for the quarter, the highest in seven years, as against \$8.3/bbl in 2QFY2015, and was ahead of consensus estimates. The outperformance over the Singapore GRM, by \$4.3/bbl, is also the highest in six years.

The Petrochemicals segment's revenue declined by 20% yoy to ₹21,239cr, led by lower crude and feedstock prices. The segment's EBIT however increased by 7.2% yoy to ₹2,531cr, led by strong polymer deltas and healthy polyester chain deltas, coupled with higher volumes. The E&P business continued to drag profitability and the outlook for the business continues to remain weak. The Retail division continued to add stores, helping drive revenue growth. RIL is building up an ecosystem for distribution of Jio devices; the company is gearing up for its roll out which would be in a phased manner. Reliance Retail will soon be launching its own brand of 4G LTE smart phones under the brand 'LYF'.

Outlook and valuation: We believe RIL's growth will be driven by its core Refining and Petrochemicals business. We value the refining business at 7x EBITDA, while we assign a 6.5x multiple to the Petrochemicals business. We value the Telecom business at 0.3x invested capital, and the Retail business at 1x sales. We retain our Accumulate rating on the stock with a target price of ₹1,050, implying a 10% upside from the current levels.

Key financials (Standalone)

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016E	FY2017E
Revenue	3,60,297	3,90,117	3,29,076	3,04,775	3,44,392
% chg	9.2	8.3	(15.6)	(7.4)	13.0
Adj. net profit	19,716	20,173	20,397	26,883	30,227
% chg	4.8	2.3	1.1	31.8	12.4
Adj. EPS (₹)	67.2	68.6	69.3	91.3	102.6
OPM (%)	8.5	7.9	9.6	12.6	13.4
P/E (x)	13.3	12.8	12.4	10.5	9.3
P/BV (x)	1.6	1.4	1.3	1.2	1.1
RoE (%)	12.1	11.7	11.0	11.8	12.0
RoCE (%)	8.8	8.2	7.7	9.0	9.5
EV/Sales (x)	0.8	0.9	1.1	1.2	1.0
EV/EBIDTA	9.9	10.8	11.6	9.7	7.8

Source: Company, Angel Research; Note: CMP as of October 21, 2015

ACCUMULATE

CMP	₹1,050
Target Price	₹955

Investment Period	12 Months
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Stock Info

Sector	Oil & Gas
Market Cap (₹ cr)	3,09,454
Net Debt (₹ cr)	87,045
Beta	1.1
52 Week High / Low	1,067/797
Avg. Daily Volume	38,02,145
Face Value (₹)	10
BSE Sensex	27,307
Nifty	8,262
Reuters Code	RELI.BO
Bloomberg Code	RIL IN

Shareholding Pattern (%)

Promoters	45.2
FII / NRIs / OCBs	18.7
MF / Banks / Indian Fls	13.1
Indian Public / Others	23.0

Abs. (%)	3m	1yr	3yr
Sensex	(3.9)	3.3	46.2
RIL	(6.8)	2.2	19.0

3-year price chart



Source: Company, Angel Research

Rahul Dholam

Tel: 022- 3935 7800 Ext: 6847

rahul.dholam@angelbroking.com

Exhibit 1: 2QFY2016 performance (Consolidated)

(₹ cr)	2QFY16	2QFY15	yoy%	1QFY16	qoq%	FY2015	FY2014	yoy%
Net sales	70,901	1,09,797	(35.4)	77,130	(8.1)	3,75,435	4,34,460	(13.6)
Raw Material Cost	49,451	88,744	(44.3)	55,922	(11.6)	2,94,046	3,63,022	(19.0)
% of net sales	69.7	80.8		72.5		78.3	83.6	
Employee Cost	1,786	1,575	13.4	1,976	(9.6)	6,262	5,572	12.4
% of net sales	2.5	1.4		2.6		1.7	1.3	
Other expenditure	8,960	9,660	(7.2)	9,055	(1.0)	37,763	31,067	21.6
% of net sales	12.6	8.8		11.7		10.1	7.2	
Total expenditure	60,197	99,979	(39.8)	66,953	(10.1)	3,38,071	3,99,661	(15.4)
% of net sales	84.9	91.1		86.8		90.0	92.0	
EBITDA	10,704	9,818	9.0	10,177	5.2	37,364	34,799	7.4
Margin (%)	15.1	8.9	616bp	13.2	190bp	10.0	8.0	709bp
Interest	972	997	(2.5)	902	7.8	3,316	3,836	(13.6)
Depreciation	3,171	3,024	4.9	3,041	4.3	11,547	11,201	3.1
Other income	1,848	2,009	(8.0)	1,832	0.9	8,495	8,911	(4.7)
Profit before tax	8,409	7,806	7.7	8,066	4.3	30,996	28,673	8.1
% of net sales	11.9	7.1		10.5		8.3	6.6	
Tax	1,784	1,882		1,929		7,474	6,215	20.3
% of PBT	21.2	24.1		23.9		24.1	21.7	
Net Profit	6,625	5,924	11.8	6,137	8.0	23,522	22,458	4.7
Minority Int. / Share of ass.	95	48		85		44	35	
Reported Net Profit	6,720	5,972	12.5	6,222	8.0	23,566	22,493	4.8
Adjusted Net Profit	6,521	5,972	9.2	6,222	4.8	23,566.0	22,493.0	4.8

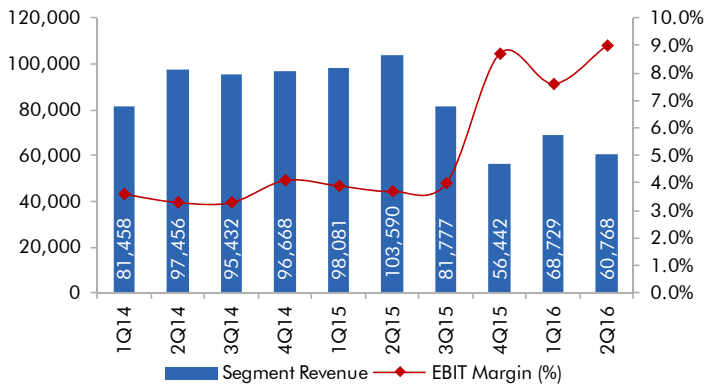
Source: Company, Angel Research

Result highlights

Refining margins well ahead of expectations

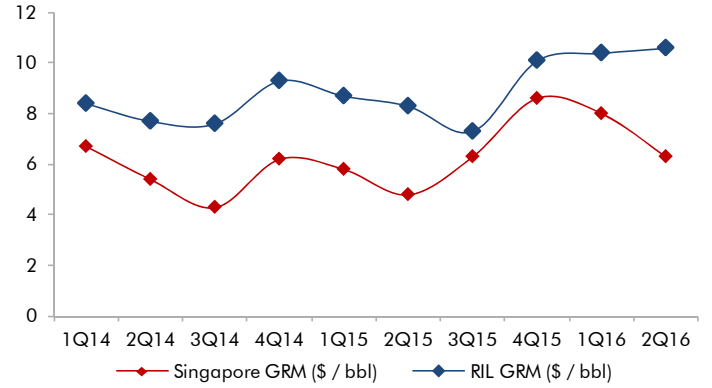
The Refining segment posted a strong set of numbers with a GRM of \$10.6/bbl for the quarter as against \$8.3/bbl in 2QFY2015. The GRM is ahead of consensus estimates and the highest in seven years. The outperformance over the Singapore GRM, by \$4.3/bbl, is also the highest in six years. The same was led by product mix flexibility, robust risk management, coupled with opportunistic crude sourcing and lower energy costs incurred during the quarter.

Exhibit 2: Refining Segment Revenues and EBIT Margin



Source: Company, Angel Research

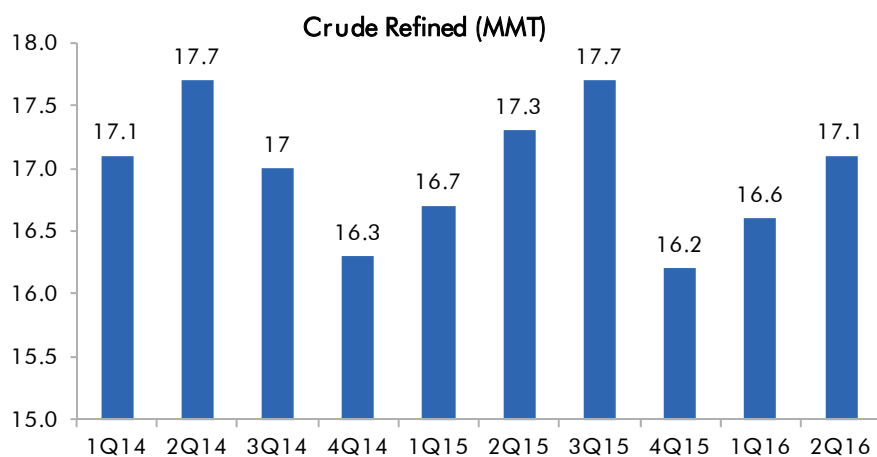
Exhibit 3: RIL's GRM vs Singapore GRM



Source: Company, Angel Research

The Refining and Marketing segment's revenue decreased by 41% yoy to ₹60,768cr, led by a decline in crude prices. The EBIT however increased 42% yoy to a record level of ₹5,461cr led by record GRM. Jamnagar refineries processed 17.1MMT of crude with an average utilization of 110%, as against 16.6MMT in the sequential previous quarter.

Exhibit 4: Refining volumes

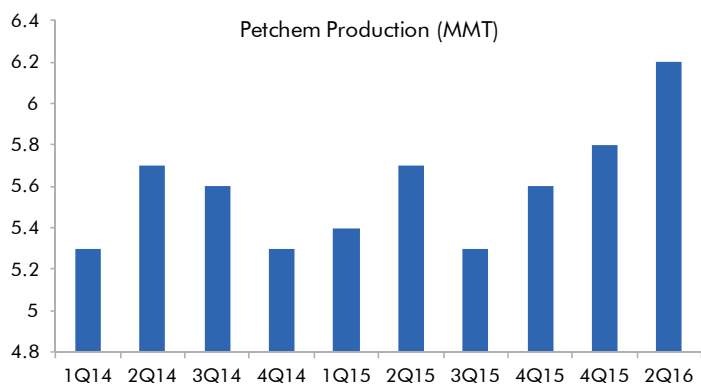


Source: Company, Angel Research

Petrochemicals business posts strong margin expansion

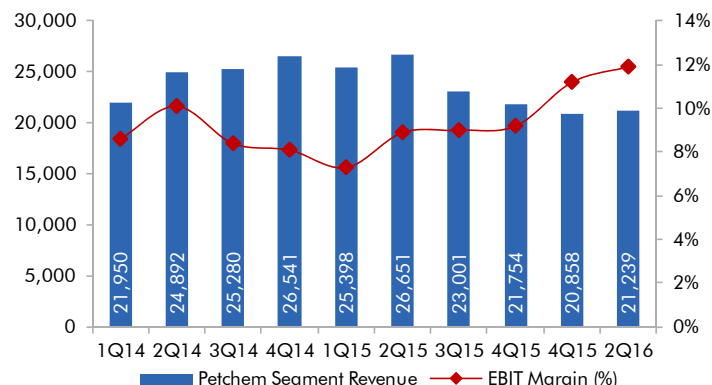
The Petrochemicals segment's revenue declined by 20% yoy to ₹21,239cr, led by lower crude and feedstock prices. The segment's EBIT however increased 7.2% yoy to ₹2,531cr, led by strong polymer deltas and healthy polyester chain deltas, coupled with higher volumes. Despite lower product prices, the segment's EBIT margin improved by 300bp yoy to 11.9%. RIL is currently stabilizing operations at its new 150KTA capacity SBR plant at Hazira; the plant is expected to make India self-sufficient in meeting its entire SBR requirement domestically.

Exhibit 5: Strong increase in petchem production



Source: Company, Angel Research

Exhibit 6: Petchem EBIT margin rises 300bp



Source: Company, Angel Research

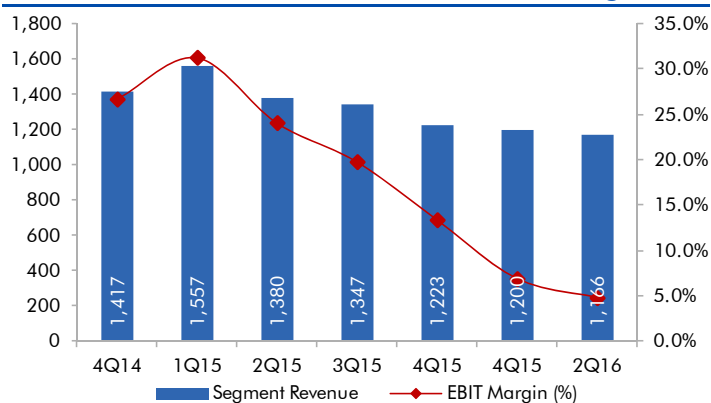
E&P segment outlook continues to remain bleak

On the domestic front, crude oil production at KG-D6 continues to decline; during the quarter, it declined by 24% yoy to 0.39MMBBL, while natural gas production declined by 9% yoy to 37BCF. Production at the Panna-Mukta fields increased with crude oil production rising 7% to 1.88MMBBL, while natural gas production increased by 5% to 17.2BCF. The Tapti fields produced 0.03MMBBL of condensate and 0.6BCF of natural gas during the quarter, a yoy decline of 52% and 85%, respectively. Fall in oil and gas production in the fields could mainly be attributed to geological reasons.

The domestic Oil & Gas segment's revenue declined 16% yoy to ₹1,166cr, led by a decline in volumes. The segment's EBIT margin declined significantly, ie to 4.8% for the quarter as against 24.1% in 2QFY2015, led by decline in revenue.

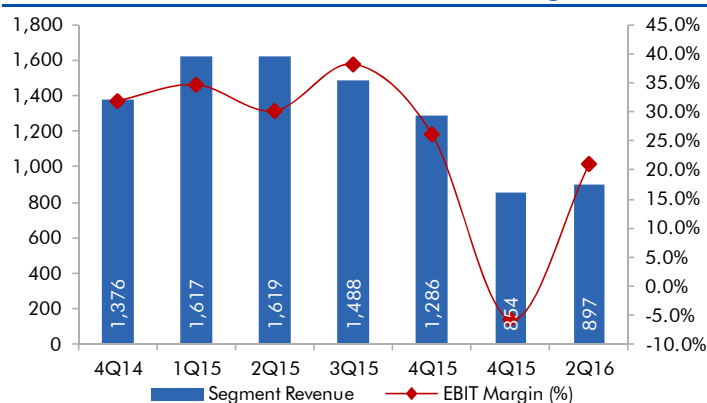
On the US shale front, the macroeconomic environment remained quite challenging. Higher supplies from the OPEC and a slowdown in China affected crude prices and resulted in unit realizations declining by 51% yoy. Consequently, even with modest growth in volumes, the revenue for the quarter declined 45% yoy to ₹897cr. The segment's EBIT margin declined to 21% during the quarter as against 30.1% in 2QFY2015.

Exhibit 7: Domestic E&P revenues and EBIT Margin



Source: Company, Angel Research

Exhibit 8: US Shale revenues and EBIT Margin



Source: Company, Angel Research

Store expansion continues to drive Retail segment revenues

The Retail segment added 110 stores during the quarter, leading to a 22% increase in revenue at ₹4,167cr. The store count reached 2,857 with 1,379 of these being Reliance Digital stores. The segment's EBIT remained stable at 2.3% as against 2.4% in 2QFY2015.

RIL is building up an ecosystem for distribution of Jio devices; the company is gearing up for its roll out, which would be in a phased manner. Reliance Retail will soon be launching its own brand of 4G LTE smartphones under the brand 'LYF'. The company has made investments of ~₹95,000cr in the Telecom business. Reliance Jio is the first telecom operator to hold a pan-India Unified License and holds the highest amount of liberalised spectrum among telecom operators, totaling to 751.1MHz. The company plans to provide seamless 4G services using LTE in 800MHz, 1800MHz and 2300MHz bands through an integrated ecosystem. We believe the Retail and Telecom businesses would be the key drivers for growth for the company in the coming years.

Investment arguments

Growth in core business profits to remain strong

We expect RIL's core Refining and Petrochemicals business to continue to outperform, led by its leadership in these segments. Refining margins are expected to remain strong considering delays in other upcoming refinery projects, which should limit supplies in the market. Also, new capacity additions are expected to drive revenues and EBIT of the Petrochemicals business. While the E&P business would continue to remain a drag, we believe the Refining and Petrochemicals businesses would more than offset the declines.

Strong investments in Jio and Retail business to drive growth

RIL is nearing the end of its massive capex programme of ~₹200,000cr, the full benefit of which should start showing up from the next fiscal. The company has made huge investments in Jio (~₹95,000cr so far with another ~₹5,000cr to be invested by the time of launch of services), while it continues to invest in the Retail business. RIL plans to expand its store presence from 200 locations to over 900 cities and towns. Apart from these, the company has spent ~80% of the capex for its four key projects (petcoke gasification plant at its refinery, refinery off-gas cracker in petrochemicals, polyester/aromatics capacity expansion and import of ethane from US). We expect these investments to drive EBITDA for the company over the coming years.

Outlook and valuation

We believe RIL's growth in the coming years to be driven by its core Refining and Petrochemicals business. We value the Refining business at 7x EBITDA, while we assign a 6.5x multiple to the Petrochemicals business. We value the telecom business at 0.3x invested capital, while retail is valued at 1x sales. We retain our Accumulate rating on the stock with a target price of ₹1,050, implying a 10% upside from current levels.

Exhibit 9: RIL - SOTP Valuation

Business	Value (₹ Cr)	₹ per share	Methodology
Refining Segment	1,70,736	580	EV/EBITDA (7x)
Petrochemicals	1,35,325	459	EV/EBITDA (6.5x)
KG D6	12,014	41	DCF
PMT	5,396	18	EV/EBITDA (4x)
Shale	8,273	28	EV/EBITDA (3x)
Retail	21,189	72	1x Sales
Telecom	30,000	102	0.3x investments
Net Debt	(73,510)	(250)	
Target Value	3,09,424	1,050	

Source: Company, Angel Research

Company background

Reliance Industries Ltd is a Fortune Global 500 company and the largest private sector company in India with interests in the energy and materials value chain. Over the years the company has successfully integrated backwards in the energy chain and has attained leadership in most areas. The company operates one of the largest refining capacities of 1.24mmbbl/day and has one of the most complex refineries in the world. The company is now foraying into newer businesses such as organized retail and broadband services.

Profit & Loss Statement (Standalone)

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016E	FY2017E
Net Sales	3,60,297	3,90,117	3,29,076	3,04,775	3,44,392
Other operating income	0	0	0	0	0
Total operating income	3,60,297	3,90,117	3,29,076	3,04,775	3,44,392
% chg	9.2	8.3	(15.6)	(7.4)	13.0
Total Expenditure	3,29,510	3,59,240	2,97,474	2,66,250	2,98,286
Raw Material cost	3,03,312	3,30,249	2,65,075	2,28,623	2,41,235
Employee Costs	3,354	3,370	3,686	4,928	5,416
Other Expenses	22,844	25,621	28,713	21,01,219	35,86,895
EBITDA	30,787	30,877	31,602	38,524	46,106
% chg	(8.4)	0.3	2.3	21.9	19.7
(% of Net Sales)	8.5	7.9	9.6	12.6	13.4
Depreciation & Amortisation	9,465	8,789	8,488	8,922	12,009
EBIT	21,322	22,088	23,114	29,602	34,097
% chg	(4.1)	3.6	4.6	28.1	15.2
(% of Net Sales)	5.9	5.7	7.0	9.7	9.9
Interest & other Charges	3,036	3,206	2,367	2,746	3,155
Other Income	7,998	8,936	8,721	8,167	9,028
Profit before tax	26,284	27,818	29,468	35,023	39,969
% chg	2.1	5.8	5.9	18.9	14.1
Tax Expense	5,281	5,834	6,749	8,141	9,742
(% of PBT)	20.1	21.0	22.9	23.2	24.4
Recurring PAT	21,003	21,984	22,719	26,883	30,227
Adjusted PAT	19,716	20,173	20,397	26,883	30,227
% chg	4.8	2.3	1.1	31.8	12.4
(% of Net Sales)	5.5	5.2	6.2	8.8	8.8

Balance Sheet (Standalone)

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016E	FY2017E
SOURCES OF FUNDS					
Equity Share Capital	3,229	3,232	3,236	3,236	3,236
Reserves & Surplus	1,76,791	1,93,859	2,12,940	2,36,099	2,61,432
Shareholders Funds	1,80,020	1,97,091	2,16,176	2,39,335	2,64,668
Total Loans	72,427	89,968	97,620	1,07,750	1,03,075
Deferred Tax Liability	12,293	12,376	12,956	13,109	14,474
Other Long term liabilities	0	0	1,404	0	0
Total Liabilities	2,64,740	2,99,435	3,28,156	3,60,194	3,82,217
APPLICATION OF FUNDS					
Gross Block	2,13,154	2,22,565	2,36,062	2,50,210	3,31,775
Less: Acc. Depreciation	1,03,406	1,13,159	1,21,499	1,30,779	1,43,154
Net Block	1,09,748	1,09,406	1,14,563	1,19,432	1,88,622
Capital Work-in-Progress	19,116	41,716	75,753	92,250	33,000
Investments	52,509	86,062	1,12,573	1,15,989	1,19,114
Current Assets	1,15,610	1,01,963	65,637	96,376	1,09,798
Cash	49,547	36,624	11,571	16,239	25,044
Inventories	42,729	42,932	36,551	31,243	33,830
Debtor	11,880	10,664	4,661	6,468	7,363
Other	11,454	11,743	12,854	42,427	43,561
Current liabilities	53,871	68,309	69,908	63,853	68,317
Net Current Assets	61,739	33,654	(4,271)	32,523	41,481
Other Assets	21,628.0	28,597.0	29,538.0	-	-
Total Assets	2,64,740	2,99,435	3,28,156	3,60,194	3,82,217

Cash flow statement (Standalone)

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016E	FY2017E
Profit before tax	39,598	49,547	33,224	35,023	39,969
Depreciation	9,465	8,789	8,488	8,922	12,009
Change in Working Capital	5,782	14,515	8,315	(32,127)	(152)
Others	(17,185)	(24,626)	(8,660)	28,036	(1,261)
Direct taxes paid	(4,665)	(6,065)	(6,082)	(7,987)	(8,377)
Cash Flow from Operations	32,995	42,160	35,285	31,868	42,187
(Inc.)/ Dec. in Fixed Assets	(15,911)	(32,399)	(42,634)	(30,645)	(22,315)
(Inc.)/ Dec. in Investments	2,132	(31,232)	(23,403)	(3,416)	(3,125)
Others	(1,018)	(382)	10,039	0	0
Cash Flow from Investing	(14,797)	(64,013)	(55,998)	(34,061)	(25,440)
Issue of Equity	12	183	226	-	-
Inc./(Dec.) in loans	1,230	12,476	5,453	10,130	(4,675)
Dividend Paid (Incl. Tax)	(2,924)	(3,093)	(3,268)	(3,268)	(3,268)
Others	(6,567)	(4,036)	(3,351)	-	-
Cash Flow from Financing	(8,249)	5,530	(940)	6,862	(7,943)
Inc./(Dec.) in Cash	9,949	(16,323)	(21,653)	4,668	8,805
Opening Cash balances	39,598	49,547	33,224	11,571	16,239
Closing Cash balances	49,547	33,224	11,571	16,239	25,044

Key ratios

Y/E March	FY2013	FY2014	FY2015	FY2016E	FY2017E
Per Share Data (₹)					
Reported EPS	71.5	74.8	77.2	91.3	102.6
Adjusted EPS	67.2	68.6	69.3	91.3	102.6
Cash EPS	103.8	104.7	106.0	121.5	143.4
DPS	9.0	9.5	10.0	10.0	10.0
Book Value	613.1	670.4	734.5	812.4	898.4
Valuation Ratio (x)					
P/E (on FDEPS)	13.3	12.8	12.4	10.5	9.3
P/CEPS	9.2	9.1	9.0	7.9	6.7
P/BV	1.6	1.4	1.3	1.2	1.1
Dividend yield (%)	0.9	1.0	1.0	1.0	1.0
EV/Sales	0.8	0.9	1.1	1.2	1.0
EV/EBITDA	9.9	10.8	11.6	9.7	7.8
EV/Total Assets	1.1	1.1	1.1	1.0	0.9
Returns (%)					
ROCE	8.8	8.2	7.7	9.0	9.5
ROE	12.1	11.7	11.0	11.8	12.0
Turnover ratios (x)					
Asset Turnover (Gross Block)	1.7	1.8	1.4	1.3	1.2
Inventory (days)	39.9	40.1	44.1	40.6	34.5
Receivables (days)	15.3	10.5	8.5	6.7	7.3
Payables (days)	51.8	57.2	76.7	80.1	70.0
WC cycle (ex-cash) (days)	14.9	4.3	(10.4)	0.3	17.3
Solvency ratios (x)					
Net debt to equity	0.1	0.3	0.4	0.4	0.3
Net debt to EBITDA	0.3	0.6	0.9	0.8	0.8
Interest Coverage (EBIT / Int.)	7.0	6.9	9.8	10.8	10.8

Research Team Tel: 022 - 39357800

 E-mail: research@angelbroking.com

 Website: www.angelbroking.com

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Disclosure of Interest Statement	Reliance Industries
1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors

Ratings (Based on expected returns over 12 months investment period):	Buy (> 15%)	Accumulate (5% to 15%) Reduce (-5% to -15%)	Neutral (-5 to 5%) Sell (< -15)
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