IMV Equity Report: Reliance

From Research Desk

- ***Fundamentals***
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- ***Disclaimer***

Stock	Industry	Recommendation	CMP	Targets
Reliance	*Oil & Gas - REFINERIES*	*Buy Around 1060--1030*	*1050*	*1335+*

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Fundamentals Aspects: Reliance

RIL is the largest private player in the refining, petrochemical and E&P sectors in India. While RIL's refining complex in Jamnagar is the largest in the world and among the most complex, it is also among the largest integrated petrochemical producers globally. Apart from E&P in India, RIL has made significant investments in US shale gas. In terms of EBIT, Refining contribute 60% and Petrochemicals 30%. RIL is also expanding its presence in the areas of consumer retailing and telecom. EBIT contribution from retail is 2% while telecom operations has been commercially launched in September 2016, which we believe will have 3 years of start-up losses at EBITDA level. RIL has a weight of 9.1% in BSE Sensex and 7.5% in S&P CNX Nifty.

Stock Info	
BSE Code	500325
NSE Code	Reliance
Bloomberg	RIL
CMP	1055.00
Face Value	10.00
Market Cap(Cr.)	343,350.60
Book Value	749.49
EPS	87.99
PE Ratio	12.03
52 Week High	1128.90
52 Week Low	888.50

RIL's Q2FY17 earnings at Rs 77bn (+18% YoY) outperformed expectations on higher other income.

Refining EBIT at Rs 59bn was in line, while petrochemical EBIT at Rs 35bn (+37%YoY) beat estimates on better margins. PX expansion and ROGC projects are on track for full utilisation by Q1FY18.

The petcoke gasification ramp-up could be delayed to Q4FY18. While we see significant benefits from RIL's investments in cyclical businesses (US$ 17bn)

RJio's earnings profile would be critical for its outlook.

- ***Refining business earnings remain robust***: *GRMs underperformed at US$ 10.1/bbl, but higher refining throughput at 18MMT led to an in-line refining EBIT of Rs 59bn. RIL's current GRMs are trending well above US$ 11/bbl as oil demand outlook improves. This insulates its FY18 earnings from a cut on account of management's guidance of a delay in full ramp-up of the petcoke gasification plant to Q4FY18.*

- ***Petrochemicals outperform***: *Petchem EBIT outperformed at Rs 35bn driven by an increase in unit EBITDA to US$ 18/MT (+11% YoY) on higher spreads. Spreads continue to trend higher (especially PVC and PX) in Q3FY17. Domestic polymer and polyester demand growth improved in Q2FY17. PX expansion (ramp up in phases by Mar'17) and ROGC (ramp up by Q1FY18) projects seem be on track, and carry the potential to contribute over US$ 1.4bn to EBITDA in FY18.*

- ***Subscriber addition raises RJio expectations***: *RJio's addition of 16mn subscribers so far has been a big surprise, mostly driven by the inaugural offer of free data. Data consumption of ~1GB/day for each subscriber has been above expectations. However, Rjio faces challenges from call drops and sustaining high data speeds as subscriber additions surge. Management hinted on a possibility of extending the inaugural offer beyond Dec'16 if higher call drops continue. RIL has deployed Rs 1,590bn in Rjio till date, and would continue to absorb more cash in the near term.*

Reliance Jio Infocomm Limited, doing business as Jio, is a LTE mobile network operator in India. It is a wholly owned subsidiary of Reliance Industries headquartered in Mumbai, that provides wireless 4G LTE service network (without 2G/3G based services) and is the only 100% VoLTE (Voice over LTE) operator in the country, with coverage across all 22 telecom circles in India. The services were first beta-launched to Jio's partners and employees on 27 December 2015 on the eve of 83rd birth anniversary of late Dhirubhai Ambani, founder of Reliance Industries, and later services were commercially launched on 5 September 2016.

Outlook

➢ *Refining*

- *GRMs are trending higher in Q3FY17 driven by improving gasoil spreads. Oil demand outlook remains buoyant.*
- *Petcoke gasification economics currently indicates GRM upsides of ~US$ 1.5/bbl (impact to be visible from H2FY18).*
- *RIL looking to expand market share in petroleum retail. However, there has been a delay in ramping up retail outlets, and a revival to 1,400 operational outlets by Mar'17 (vs. 1,100 currently) appears challenging.*
- *Diesel sales market share (retail sales) has improved to 3.3% (from 2.8% QoQ).*

➢ *Petrochemicals*

- *EBITDA/MT improves to US$ 188 from US$ 178 QoQ, driven by improved product spreads. o PX commissioning will lead to improvement in the polyester chain delta by ~US$ 100/MT. o Cash costs for ROGC would be in the range of US$ 200-300/MT, implying a delta of US$ 900-1,000/MT at current PE prices.*

➢ *Retail:*

- *Company owned-company operated (CoCo) petroleum retail outlets currently contribute Rs 12bn to revenues. Current sales from retail outlets average at ~216kl per month. Of the 1,100 operational retail outlets, ~400 are CoCo ones.*

➢ *Exploration & Production*

- *Challenging outlook on low oil & gas prices.*
- *Development projects include CBM, KGD6 satellite fields, and the Cambay basin block.*
- *Satellite field development may commence in FY18 (assumes premium gas pricing formula), with production expected by 2020-22.*
- *CBM production could start by end-FY17 or FY18, provided RIL gets free pricing like other operational CBM blocks in West Bengal.*

Conclusion

With over 50mn subscribers in less than 3 months, RJIO has grown faster than Facebook, Skype and Whats App and exceeding our March 2017 target of 40mn subscribers... Following conclusion of RIL's ongoing mega capex, we expect Free Cash Flow to turnaround and Return on Equity to rise. We expect RJIO to gather significant data volume market share even when it becomes a paid service.

At CMP of 1060 Reliance industries is trading at 12x of EPS of 87.99.

Maintain 'BUY' with target price of INR 1300.

Technical Aspect

On seeing weekly chart, Reliance Industries looks positive and any downside movement will be buying opportunity in it. Reliance Industries has immediate hurdle at 1080 and support at 1000. Prices have recovered from bottom level of 906.60. It looks positive and could test 1130--1150 mark. Three consecutive closes + weekly close above 1150 will see sharp upside rally in it. Chances are bright for upside move in Reliance and could test 1300+ mark in near term. We'll expect positive momentum will remain continue. Reliance trading above its 21DEMA and below 55DEMA is at 1010 and 1030 respectively. Technical indicator RSI (14) is trading at 62.80 indicating an upside potential for the stock prices along with it strong base formation with heavy volume builds up. Seeing technical and fundamentals we are hopeful for upside move in Reliance and likely to test our above targets in coming weeks.

Recommendation:

Traders can buy and accumulate

Reliance in around 1060--1030 and add more quantity in panic for the initial target of 1335+.

Fed calls on interest rate hike.

Federal Open Market Committee met in November indicates that the labour market has continued to strengthen and that economic activity has been expanding at a moderate pace since mid-year. Job gains have been solid in recent months and the unemployment rate has declined. Household spending has been rising moderately but business fixed investment has remained soft. Inflation has increased since earlier this year but is still below the Committee's 2 percent longer-run objective, partly reflecting earlier declines in energy prices and in prices of non-energy imports. Market-based measures of inflation compensation have moved up considerably but still are low; most survey-based measures of longer-term inflation expectations are little changed, on balance, in recent months.

The Committee expects that, with gradual adjustments in the stance of monetary policy, economic activity will expand at a moderate pace and labour market conditions will strengthen somewhat further. Inflation is expected to rise to 2 percent over the medium term as the transitory effects of past declines in energy and import prices dissipate and the labour market strengthens further. Near-term risks to the economic outlook appear roughly balanced. The stance of monetary policy remains accommodative, thereby supporting some further strengthening in labour market conditions and a return to 2 percent inflation.

The Federal Reserve has made the following decisions to implement the monetary policy stance announced by the Federal Open Market Committee in its statement on December 14, 2016:

• The Board of Governors of the Federal Reserve System voted unanimously to raise the interest rate paid on required and excess reserve balances to 0.75 percent, effective December 15, 2016.

Impact on Emerging Market as well as India

- *Companies relying on dollars have to refrain themselves as hike will cause increase in lending rates. This will ultimately curtail them from expansion of company, as well as creating employment.*
- *Foreign Institution Investment (FII) will try to repatriate their money from emerging market, consequence of which will be serious threat to local market.*
- *In India, some of its impact on economy are more likely to be anticipated such as weakness in stock and bonds. So market must brace itself for volatility.*
- *Fed rate can have direct impact on exchange rate, Rupee is more likely to slide against dollar. So industries relying on import of goods have to undergo squeeze in their profit margin.*
- ***Banking, Infrastructure and IT Companies will be affected -*** *The Rise of Interest Rate in America will impact Indian IT, Banking and Infrastructural Companies mostly, because 60% of the income of IT Companies is generated from America and Europe. FED Hike will increase dollar index and this will increase debts of companies.*

RBI Policy

On 7 December, the Reserve Bank of India's Monetary Policy Committee (MPC) surprised the market by leaving policy rates unchanged. Since most market participants were expecting a 25 or 50 bps cut, there was panic.

Will RBI cut policy rates in its next meeting on 7 and 8 February?

- *The general expectation right now is that RBI will cut rates as it will be in a position to take a more informed decision. First, the impact of any US Fed hike would have stabilised by then.*
- *Second, the real impact of demonetisation would also be visible by then.*
- *Third, it is coming after the Budget announcement on 1 February, so there would be more clarity about fiscal numbers.*

Disclaimer
