ICICI direct Research

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Refining gains to drive earnings…

Global oil & gas prices continue to trade at elevated level post supply disruption following the geopolitical conflict in Europe. Brent crude oil prices currently trend around US$110/bbl while Asian spot LNG prices are trading at US$37/mmbtu. Concern over oil demand-supply mismatch, products inventory depletion coupled with summer demand in the US led to a surge in price of key products for Indian refiners. Petrol, diesel and ATF cracks continue to trade near all-time high levels that will result in sharp rise in refining gains. Companies with lower exposure to marketing segment like Reliance Industries (RIL) will benefit from rise in GRMs. On OMCs front, refining gains are likely to be offset by losses in marketing segment.

Refining companies in sweet spot

- Benchmark Singapore GRMs are at ~US$ 21/bbl in Q1FY23E-TD against average GRMs of US$ 8.1/bbl in Q4FY22.
- Petrol, diesel and ATF constitute 60-65% refining slate for Indian companies and rise in product cracks will drive GRMs for refining segments. As diesel constitutes largest portion of its refining slate, RIL stands to benefit from higher diesel cracks
- As per media reports, Russian crude imports constituted ~16% of India's overall crude imports in May. RIL has also increased Russian crude imports in line with other Indian refiners. Refiners have purchased Russian crude at discounted price which may have provided further boost to RIL refining margins as per our understanding.

Marketing losses to weigh on OMCs

Oil marketing companies (OMCs) have not fully passed on increase in crude oil costs to customers. Petrol & diesel prices at retail outlets have been steady while crude oil prices have been trending at elevated level. This is likely to result in marketing losses for OMCs. Losses in marketing segment will partially offset refining gains and OMCs' overall profitability is likely to be muted in the near term.

Gas realisation to inch upwards

Global spot LNG prices are trending near US$37/bbl in last two weeks. Amid concerns over supply disruption in Europe and outage of one of US LNG facilities, LNG prices increased globally. On the domestic front, PPAC revised HPHT gas prices upwards by 62% in April. In its next price revision in October, gas prices are expected to increase further as global gas benchmark are trending at higher level. RIL-BP's gas production is currently at 18 mmscmd. It will be ramped up to 30 mmscmd from Q3FY23E onwards. Higher realisation for gas production from KG basin augurs well for Reliance.

Valuation and Outlook

As product cracks continue to stay elevated, we remain positive on refining segment. Also, favourable gas pricing scenario will lift profitability of upstream segment. In our coverage, we prefer refining companies with lower exposure to marketing segment. Thus, we remain optimistic about RIL's prospects as it offers a play on refining as well as upstream segment. We maintain **BUY** rating on Reliance Industries with a target price of ₹ 3050/share.

Sector top picks

Company	CMP	Target price	Upside (%)
Reliance Industries	2,492	3,050	22%

Key risks

(i) Weaker than expected refining margins (ii) lower than expected crude throughput

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Top picks in oil & gas coverage universe

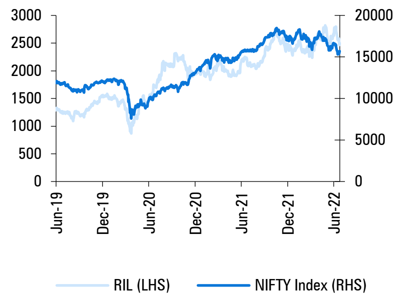
Reliance Industries

Reliance Industries (RIL) is one of India's biggest conglomerates with a presence in oil to chemicals (O2C), exploration, retail, digital services and media, etc. making it a well-diversified business entity

- At the EBITDA level in FY22, O2C segment contributed ~44% while exploration segment contributed 5% of total segmental EBITDA.

With diesel cracks trending near all-time highs, RIL will benefit as major portion of its refining slate constitutes of diesel. Media reports indicate that the company has amped up its Russian crude imports which are being purchased at discount to Brent crude price, thereby reducing overall oil import costs. Overall, we expect sharp surge in operating profits as we estimate O2C EBITDA to increase 48% YoY to ₹ 78020 crore in FY23E. In exploration segment, we expect gas production to be ramped up from Q3FY23E onwards. Additionally, realisation for gas from difficult fields is likely to be increased in its next semi-annual price revision in October. Higher realisation along with increased production will lead to rise in profits in exploration segment. We expect exploration segment EBITDA to increase 119% YoY to ₹ 11977 crore in FY23E. **We maintain BUY rating on Reliance Industries with a target price of ₹ 3050/share.**

Price Chart



Particulars

Particular	Amount
Market Capitalization (₹ Crore)	16,85,838.0
Total Debt (FY21) (₹ Crore)	2,92,714.0
Cash (FY21) (₹ Crore)	17,397.0
EV (₹ Crore)	19,61,155.0
52 week H/L	2855/ 2016
Equity capital (FY21) (₹ Crore)	6,445.0
Face value (₹)	10.0

Exhibit 1: Key Financial Summary

Key Financials	FY19	FY20	FY21	5 Yr CAGR (FY16-21)	FY22E	FY23E	FY24E	3 Yr CAGR (FY21-24E)
Revenue (₹ crore)	6,23,400.0	6,58,866.0	5,39,238.0	12.9	7,92,756.0	9,73,187.2	10,03,435.3	23.0
EBITDA (₹ crore)	83,918.0	88,709.0	80,737.0	14.1	1,10,460.0	1,58,299.1	1,67,127.8	27.4
PAT (₹ crore)	39,837.0	39,354.0	49,128.0	10.6	60,705.0	87,042.7	88,574.4	21.7
EPS (₹)	67.2	62.1	76.2		89.7	128.7	130.9	
P/E (x)	37.1	40.1	32.7		27.8	19.4	19.0	
P/BV (x)	3.8	3.5	2.3		2.1	1.9	1.8	
RoCE (%)	8.9	8.1	5.5		7.7	11.5	11.4	
RoE (%)	10.3	8.9	7.7		8.5	11.0	10.4	

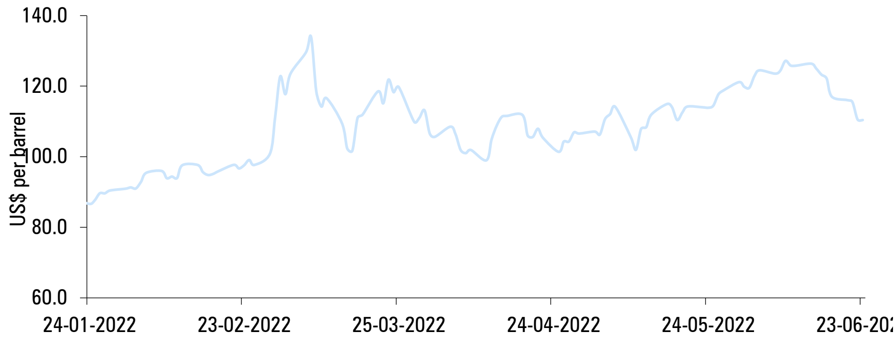
Source: Company, ICICI Direct Research

Exhibit 1: Valuation

Busienss segments	Valuation Methodology	Value (₹ crore)	₹/share
Energy			
Oil to Chemicals	8x FY24E EBITDA	565794	836
Oil & Gas	6.5x FY24E EBITDA	100953	149
Value of Energy business		**666748**	**986**
Consumer Business			
Retail (RIL share)	40x FY24E EBITDA	733392	1084
Digital services (RIL share)	DCF	549842	813
Value of Consumer business		**1283234**	**1897**
Others		154200	228
Net debt		41021	61
Equity value		**2063161**	**3050**

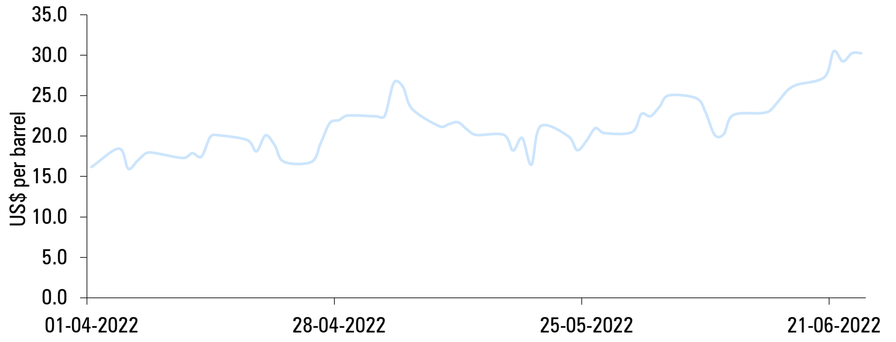
Source: Reuters, ICICI Direct Research

Exhibit 2: Brent crude oil price trending at US$ 100/bbl



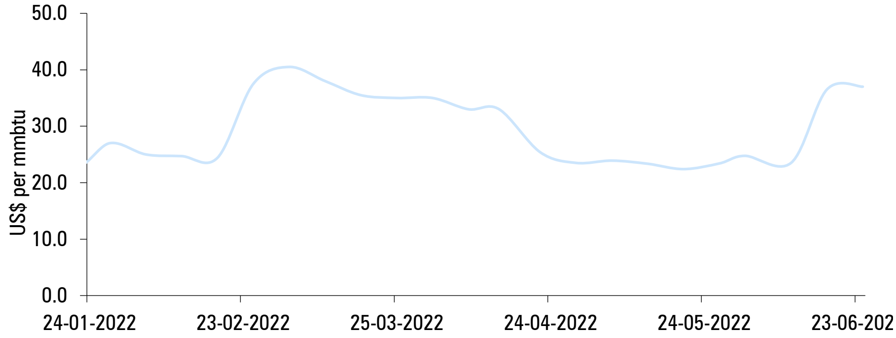
Source: Bloomberg, ICICI Direct Research

Exhibit 3: Benchmark Singapore GRMs trending at elevated levels



Source: Reuters, ICICI Direct Research

Exhibit 4: Spot LNG price continues to trade above US$ 20/mmbtu



Source: Bloomberg, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%

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