

BUY

TP: Rs 1,430 | ▲ 23%

RELIANCE INDUSTRIES | Oil & Gas

| 12 August 2019

AGM highlights: Deleveraging via stake sale in cash cows

Chairman Mukesh Ambani's FY19 AGM speech laid out several key milestones: (a) deleveraging by FY21 through stake sales in refining/petchem (US\$ 15bn inflow), petroleum retail (US\$ 1bn inflow) and fibre InVIT; (b) enhancing shareholder value via higher dividend payouts, more bonus issuances and listing of RJio & Retail over five years; and (c) expanding RJio's value proposition by way of lateral offerings such as FTTH, set-top box and cloud services. We upgrade RIL to BUY (from ADD) and raise our TP 7% to Rs 1,430 on deleveraging initiatives.

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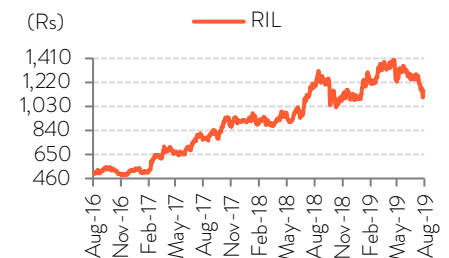
Stake sale in cash cows: Reliance Industries (RIL) has defined its integrated refining and petrochemicals unit as Oil2Chemicals, wherein it will offload a 20% stake to Saudi Aramco at an EV of US\$ 75bn (US\$ 15bn inflow to RIL). This deal values the business at ~8x FY21E EBITDA, close to our valuations, and entails hiving off the segment into a separate company (which may attract a holding company discount in RIL's SOTP). Stake sale is imperative considering that RIL's strategy to enhance the oil-to-chemicals ratio to >70% would entail setting up ~45mmtpa of petchem capacities at a capex of ~US\$ 30bn (as mentioned in our recent [annual report analysis](#)).

Ticker/Price	RIL IN/Rs 1,162
Market cap	US\$ 97.3bn
Shares o/s	5,927mn
3M ADV	US\$ 153.1mn
52wk high/low	Rs 1,418/Rs 1,016
Promoter/FPI/DII	47%/24%/28%

Source: NSE

RJio/Retail – lateral offerings to enhance value proposition: RIL's chairman affirmed that the investment cycle for RJio is now complete (after pumping in Rs 3.5tn over the last five years). Incremental capex would be earmarked towards capacity enhancement, though this would be minimal as primary assets such as tower and fibre have been hived off into separate InVITs.

STOCK PERFORMANCE



Source: NSE

Four new lateral offerings are on the cards at Jio: Internet of Things (IoT) with Rs 200bn revenue potential, home broadband (JioFiber) with commercial tariffs from Rs 700 a month, set-top box for DTH television, and content for JioFiber. Reliance Retail will launch a 'new commerce' initiative to tap India's 30mn small merchants and *kirana* shop owners (US\$ 700bn potential).

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Adj. net profit (Rs mn)	352,869	398,370	456,245	607,243	806,127
Adj. EPS (Rs)	59.6	67.2	77.0	102.5	136.0
Adj. EPS growth (%)	17.4	12.8	14.5	33.1	32.8
Adj. ROAE (%)	12.7	11.7	11.2	13.3	15.5
Adj. P/E (x)	19.5	17.3	15.1	11.3	8.5
EV/EBITDA (x)	13.9	10.3	10.1	7.5	5.5

Source: Company, BOBCAPS Research

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Key business commentary

Refining + Petchem (Oil2Chemicals)

- RIL will receive US\$ 15bn from the 20% stake sale in its Oil2Chemicals business to Saudi Aramco (at US\$ 75bn EV). This includes the petroleum retail JV with BP, covering 1,400 outlets. Saudi Aramco will also supply 500kbpd of oil to RIL as part of a long-term contract.
- RIL will clock up another ~US\$ 1bn for a 49% stake sale to BP in the recently concluded petroleum retail JV.
- All units of the petcoke gasification project have been commissioned.

Reliance Jio

- **Digital services outlook:** Data from large economies shows that 3-5% of their GDP is spent on digital services. Even at 3%, this translates to a potential Indian digital service spend of close to Rs 5tn annually. RJio is ideally placed to earn a significant proportion of this technology-driven value addition.
- **IoT:** In another two years, it is estimated that there will be over 2bn connected IoT devices in the country. RJio aims to connect at least 1bn of these on its IoT platform, which translates into a Rs 200bn revenue opportunity annually for the company. RJio's IoT platform will be commercially available starting Jan'20.
- **Home broadband:** JioFiber will offer broadband speeds of up to 1gbps. Customers will also get a landline phone connection at no additional cost, virtual reality content and multi-party video conferencing. Those who opt for annual plans called Jio Forever will get a free HD or 4K LED television and a 4K set-top box. Jio First-Day-First-Show is targeted for launch in the middle of 2020 and will allow JioFiber customers to watch movies on the same day as their theatrical release.
- **MSMEs:** About 80% of the cost of running a start-up goes towards cloud and connectivity infrastructure. RJio will offer cloud and connectivity infrastructure free of cost for budding start-ups. For MSMEs, a bundle of connectivity, productivity and automation tools will be provided for a tenth of the average cost, at Rs 1,500 per month.
- **Fixed line international voice calling:** Default tariffs on Jio Home Phone will be one-fifth to one-tenth of existing industry tariffs. The company will also offer an unlimited international calling pack to the US and Canada priced at Rs 500/month.

- **Cloud platform:** RJio and Microsoft have entered into a long-term alliance, under which Jio will set up a network of large world-class data centres across India, while Microsoft will bring its Azure cloud platform into Jio's data centres.

Retail

- **New commerce initiative:** RIL sees 'new commerce' as a massive new business opportunity worth US\$ 700bn, and is deploying blockchain, IoT, AI and other new technologies across India to develop the business. Envisaged as a tech-enabled partnership that will link producers, traders, small merchants, consumer brands and consumers, new commerce aims to remove inefficiencies and value destruction in the current market ecosystem, thereby transferring significant value to consumers, producers and merchants.
- **Point of Sale (POS) solution:** The retail merchant POS solution – Jio Prime Partner POS – is integral to Reliance Retail's plan to create an ecosystem around small merchants. It is positioned as a user-friendly digital platform designed for inventory management, customer relationship management, financial services and other services.

Valuation methodology

RIL is trading at 11.3x FY21E EPS, re-rating from 9-10x levels over the last one year. We upgrade the stock to BUY (from ADD) and raise our Sep'21 SOTP-based target price to Rs 1,430 (from Rs 1,335) as we factor in deleveraging initiatives, viz. the Saudi Aramco and petroleum retail stake sales that would yield US\$ 16bn in cash inflow for RIL in FY21.

Our SOTP target price of Rs 1,430 is arrived at as follows:

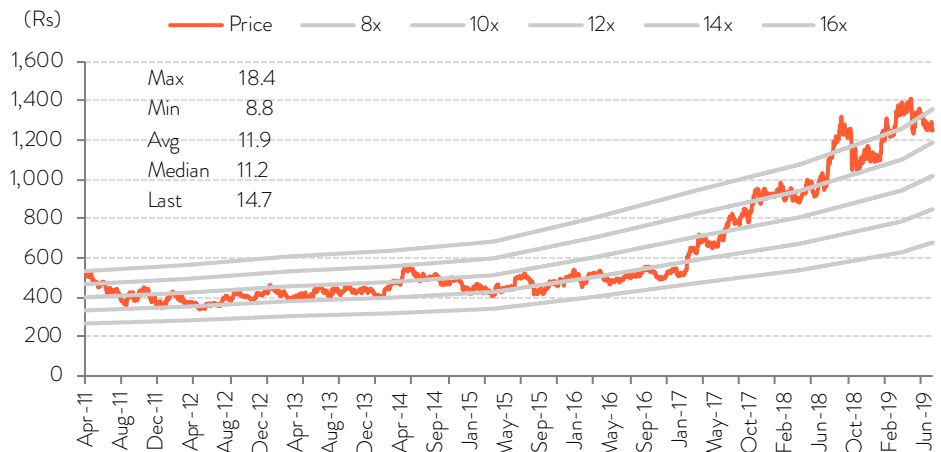
- **Cyclical businesses:** We value the refining (Rs 368/sh) and petrochemical (Rs 497/sh) businesses at 7x and 8x Sep'21E EBITDA respectively, at par with global peers.
- **RJio:** We value RJio at Rs 548/sh based on 6.5x Sep'21E EBITDA of Rs 500bn.
- **Retail:** The retail business is valued at 17.5x Sep'21E EBITDA.
- **E&P:** We build in the DCF value of the KG-D6 block and development of oil & gas reserves in the R-series block. The PMT field is valued at 7x Sep'21E EV/ EBITDA and the shale business is assessed on residual reserves at US\$ 2/boe.

FIG 1 – SOTP VALUATION SUMMARY

Business	Fair Value		Value/share (Rs)	Comments
	(US\$ bn)	(Rs bn)		
Refining	34	2,178	368	7x Sep'21E EBITDA
Petrochem	46	2,948	497	8x Sep'21E EBITDA
Oil2Chemicals business value	80	5,126	865	7.6x Sep'21E EBITDA
E&P business	2	120	20	Includes KG-D6, shale and PMT
Jio	50	3,249	548	6.5x Sep'21E EBITDA
Reliance Retail	44	2,810	474	17.5x Sep'21E EBITDA
Enterprise value	175	11,307	1,908	
Net Debt	44	2,836	479	Sep'20 Consol. net debt incl. current liabilities
Equity value	131	8,471	1,430	~14x FY21E EPS

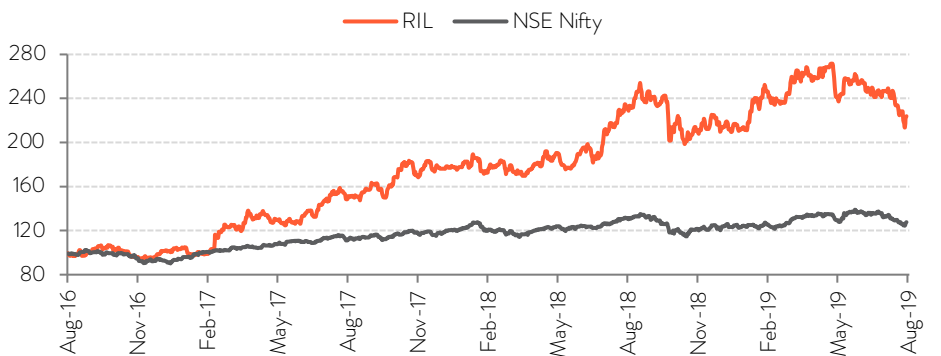
Source: BOBCAPS Research

FIG 2 – ROLLING ONE-YEAR FORWARD P/E BAND



Source: BOBCAPS Research, Company

FIG 3 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- **Global slowdown:** RIL’s valuations are highly sensitive to GRM and petrochemical crack movements. A slowdown in global economies can affect these spreads and hurt our valuation outlook.
- **Lower operating margins in RJio:** We factor in an aggressive ramp-up in RJio’s subscriber numbers (>350mn) and ARPU’s (~Rs 170/mth) by FY21. Operating margins could trend well below our estimates if a pricing war among telecom operators sustains beyond FY20. The telecom business also carries regulatory risks pertaining to tariffs and spectrum usage that could hamper RJio’s earnings outlook.
- **Lower growth in retail business revenues:** RIL has been significantly outperforming estimates on retail revenue growth. An economic slowdown could affect the outlook on retail revenues and hurt valuations.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue	4,082,650	5,810,200	5,814,664	6,221,680	6,183,332
EBITDA	641,760	839,180	943,323	1,266,977	1,555,768
EBIT	474,700	629,840	668,131	956,503	1,221,723
Net interest income/(expenses)	(80,520)	(164,950)	(195,252)	(247,195)	(255,595)
Other income/(expenses)	88,620	86,350	138,365	111,512	119,661
Exceptional items	10,870	0	0	0	0
EBT	482,800	551,240	611,244	820,820	1,085,789
Income taxes	(133,460)	(153,900)	(154,999)	(213,577)	(279,661)
Min. int./Inc. from associates	590	1,030	0	0	0
Reported net profit	360,800	398,370	456,245	607,243	806,127
Adjusted net profit	352,869	398,370	456,245	607,243	806,127

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	1,068,610	1,083,090	968,357	875,544	878,275
Other current liabilities	1,688,780	1,442,530	1,442,530	1,442,530	1,442,530
Provisions	41,380	41,820	54,249	59,898	66,096
Debt funds	1,816,040	2,719,420	2,719,420	1,919,420	1,919,420
Other liabilities	498,280	687,620	696,893	707,132	718,431
Equity capital	59,220	59,260	59,260	59,260	59,260
Reserves & surplus	2,871,300	3,813,090	4,215,781	4,778,776	5,535,005
Shareholders' fund	2,930,520	3,872,350	4,275,041	4,838,036	5,594,265
Total liabilities and equities	8,079,000	9,929,630	10,249,291	9,945,359	10,731,817
Cash and cash eq.	42,550	75,120	115,502	316,785	337,755
Accounts receivables	175,550	300,890	308,094	293,385	291,856
Inventories	608,370	675,610	618,213	571,782	573,148
Other current assets	514,840	744,760	817,678	779,382	775,821
Investments	828,620	2,354,880	1,954,880	1,954,880	1,954,880
Net fixed assets	3,980,720	3,863,770	4,954,282	4,531,305	5,290,517
CWIP	1,870,220	1,794,630	1,350,671	1,357,871	1,357,871
Intangible assets	58,130	119,970	129,970	139,970	149,970
Total assets	8,079,000	9,929,630	10,249,291	9,945,359	10,731,817

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	507,120	605,860	731,437	917,717	1,140,172
Changes in working capital	598,380	(653,830)	(125,029)	12,272	12,653
Other operating cash flows	(70,660)	116,700	(129,092)	(101,273)	(108,363)
Cash flow from operations	1,034,840	68,730	477,317	828,716	1,044,463
Capital expenditures	(812,550)	(14,950)	(930,445)	105,303	(1,093,257)
Change in investments	13,010	(1,331,060)	410,000	10,000	10,000
Other investing cash flows	85,190	(47,010)	138,365	111,512	119,661
Cash flow from investing	(714,350)	(1,393,020)	(382,080)	226,815	(963,595)
Equities issued/Others	570	40	0	0	0
Debt raised/repaid	(240,930)	917,090	0	(800,000)	0
Dividends paid	(39,160)	(42,810)	(54,854)	(54,249)	(59,898)
Other financing cash flows	(28,650)	482,540	0	0	0
Cash flow from financing	(308,170)	1,356,860	(54,854)	(854,249)	(59,898)
Changes in cash and cash eq.	12,320	32,570	40,382	201,282	20,970
Closing cash and cash eq.	42,550	75,120	115,502	316,785	337,755

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	60.9	67.2	77.0	102.5	136.0
Adjusted EPS	59.6	67.2	77.0	102.5	136.0
Dividend per share	6.0	7.7	7.6	8.4	9.3
Book value per share	494.9	653.5	721.4	816.4	944.0

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	2.2	1.5	1.6	1.5	1.4
EV/EBITDA	13.9	10.3	10.1	7.5	5.5
Adjusted P/E	19.5	17.3	15.1	11.3	8.5
P/BV	2.3	1.8	1.6	1.4	1.2

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	71.5	72.3	74.6	74.0	74.2
Interest burden (PBT/EBIT)	104.0	87.5	91.5	85.8	88.9
EBIT margin (EBIT/Revenue)	11.6	10.8	11.5	15.4	19.8
Asset turnover (Revenue/Avg TA)	53.7	64.5	57.6	61.6	59.8
Leverage (Avg TA/Avg Equity)	2.7	2.6	2.5	2.2	2.0
Adjusted ROAE	12.7	11.7	11.2	13.3	15.5

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Revenue	33.7	42.3	0.1	7.0	(0.6)
EBITDA	38.9	30.8	12.4	34.3	22.8
Adjusted EPS	17.4	12.8	14.5	33.1	32.8
Profitability & Return ratios (%)					
EBITDA margin	15.7	14.4	16.2	20.4	25.2
EBIT margin	11.6	10.8	11.5	15.4	19.8
Adjusted profit margin	8.6	6.9	7.8	9.8	13.0
Adjusted ROAE	12.7	11.7	11.2	13.3	15.5
ROCE	7.3	7.9	7.2	10.1	12.5
Working capital days (days)					
Receivables	12	15	19	18	17
Inventory	73	58	62	63	61
Payables	97	79	77	68	69
Ratios (x)					
Gross asset turnover	0.9	1.0	0.9	0.9	0.8
Current ratio	0.4	0.6	0.6	0.7	0.8
Net interest coverage ratio	5.9	3.8	3.4	3.9	4.8
Adjusted debt/equity	0.6	0.7	0.6	0.3	0.3

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

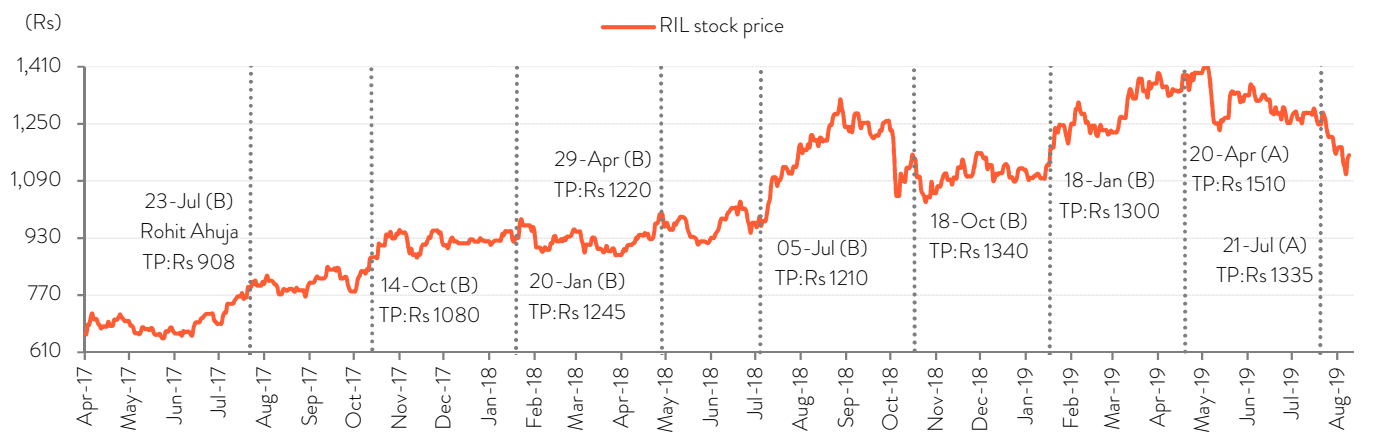
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

HISTORICAL RATINGS AND TARGET PRICE: RELIANCE INDUSTRIES (RIL IN)



B – Buy, A – Add, R – Reduce, S – Sell

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