

**HOLD**

TP: Rs 2,520 | ▲ 8%

**RELIANCE INDUSTRIES**

Oil &amp; Gas

14 February 2022

## Derisking the O2C business

- RIL plans to restructure a part of its O2C business to address climate risks and open up new opportunities for value addition
- Approach involves (i) conversion of carbon-intense feedstock into chemicals & clean energy and (ii) potential strategic partnerships
- We maintain our HOLD rating and TP of Rs 2,520

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**Announces blueprint for embracing new energy in O2C:** With the development of a renewable energy portfolio (solar, use of biomass and hydrogen), RIL plans to repurpose syngas for the production of blue hydrogen and also aims to capture and monetise carbon in phase-1. As the company evolves its electrolyser ecosystem with cost-effective green hydrogen, it aims to once again repurpose syngas as a feedstock for chemicals.

**Syngas subsidiary to involve strategic partners and investors:** RIL is carving out a gasification business with a net asset value of US\$ 9.6bn as a separate subsidiary. It aims to structure the arm as a job work contractor to produce syngas, hydrogen and carbon for RIL and also to provide a minimum offtake guarantee. Management has guided for an initial valuation of US\$ 4bn for this subsidiary.

**Upside from use of H2 as fuel:** In the first stage, RIL expects the subsidiary to see valuation upsides from better utilisation of the syngas plant via production of blue hydrogen and carbon capture. RIL too will derive upsides from the shift away from fossil fuel as well as from monetising hydrogen and carbon.

**Upside from use of syngas as feedstock:** As green hydrogen becomes competitive and RIL's electrolyser ecosystem develops, the subsidiary will derive higher prices for syngas as a feedstock as against fuel use. Management plans to add value by expanding into the specialty chemicals chain, involving strategic partners and technology licensors.

**Front-loading of value unlocking:** RIL aims to tie up with strategic partners and investors to derisk the use of new technologies. The approach also helps unlock value at an early stage, as seen in the company's telecom and retail businesses.

**Maintain HOLD:** We retain our SOTP-based TP of Rs 2,520 which values RIL's refining business at 7.5x FY24E EV/EBITDA, petrochemicals at 8.5x, telecom (Jio Infocomm) at 10x and retail at 32x. Our TP includes Rs 111 for the value of its venture into digital services and Rs 47 for the new energy division.

## Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	RIL IN/Rs 2,339
Market cap	US\$ 209.4bn
Free float	49%
3M ADV	US\$ 205.8mn
52wk high/low	Rs 2,751/Rs 1,877
Promoter/FPI/DII	50%/25%/14%

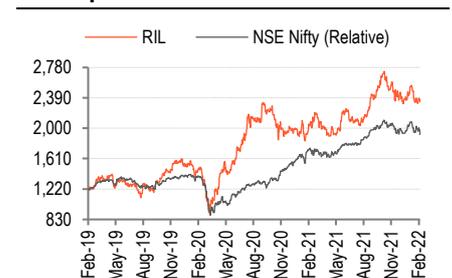
Source: NSE | Price as of 14 Feb 2022

## Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	46,69,240	68,85,377	79,00,553
EBITDA (Rs mn)	8,07,370	11,38,765	13,75,862
Adj. net profit (Rs mn)	4,36,628	5,82,093	7,18,765
Adj. EPS (Rs)	67.7	90.3	106.2
Consensus EPS (Rs)	67.7	87.7	112.3
Adj. ROAE (%)	7.6	8.0	9.1
Adj. P/E (x)	34.5	25.9	22.0
EV/EBITDA (x)	23.0	16.1	13.3
Adj. EPS growth (%)	(0.3)	33.3	17.6

Source: Company, Bloomberg, BOBCAPS Research

## Stock performance



Source: NSE



## Embracing new energy in O2C operations

### Syngas subsidiary to involve strategic partners, investors

RIL is separating its syngas business into a subsidiary from 31 Mar 2022 to create the flexibility of involving strategic partners and investors. Management has guided for an initial valuation of Rs 300bn or US\$ 4bn for this arm while it plans to transfer net assets worth Rs 720bn or close to US\$ 10bn.

The subsidiary will operate as a job work contractor for RIL to produce syngas, hydrogen and carbon dioxide with a minimum guaranteed offtake. It is intended to improve operating efficiency and to capture value from other embedded industrial gases (oxygen, nitrogen, argon and crypton). The main upside in the first stage will be from full utilisation of syngas production capability (16-18mmcmd) for conversion to blue hydrogen and carbon capture. In the second stage, upsides should emerge from the discovery of prices of syngas as a feedstock in contrast to its use as a fuel.

### RIL's blueprint for shifting to blue and green hydrogen

#### Step 1: Use available syngas to produce blue hydrogen

After startup in 2019, RIL's syngas plant has been helping to lower energy cost volatility for the Jamnagar complex. However, the plant has been operating at partial capacity due to the availability of cheaper fuel alternatives such as LNG in 2020 and RIL's own KG-D6 gas in 2021.

RIL aims to progressively replace fossil fuels in Jamnagar operations with renewables (solar, biomass-based fuel, hydrogen) and battery energy storage systems. Given this shift, the company plans to repurpose syngas for the production of blue hydrogen by deploying carbon capture and storage technology. Management sees a possibility of producing hydrogen at a competitive cost of US\$ 1.2-1.5/kg.

Production of blue hydrogen with syngas generates carbon and RIL sees the potential to capture 15mmtpa of CO<sub>2</sub> at 30% of the typical cost of carbon. This can be monetised with manufacturers of (i) urea using green ammonia, (ii) e-products and fuels using green hydrogen, (iii) synthetic aviation fuel, (iv) construction mineralisation, dry ice, and (v) algal oil and super-proteins made through synthetic biology pathways.

#### Step 2: Shift to syngas as a feedstock once green hydrogen becomes cost-effective

As RIL develops an electrolyser ecosystem and green hydrogen becomes cheaper, the company aims to replace blue hydrogen with green hydrogen and spare syngas for use as a feedstock. While developing feedstock use, it aims to keep the development approach balance sheet-light and tie up with technology licensors and strategic investors to derisk investments.

With syngas as a feedstock, the company plans to build an integrated Acetyls Complex including methanol, acetic acid and derivatives. Management also flagged the possibility of extending into specialty chemical value chains as below:

- Chemicals with 'Oxygen' (MEG and Oxo-Alcohols)
- Methanol to Olefins complex
- Downstream specialty chemicals chain such as (i) MMA and PMMA (end-use: paints, adhesives), (ii) formic acid (end-use: preservative, anti-bacterial agent in livestock feed), (iii) n-Paraffin, Cyclohexane, MDI, TDI (end-use: household products like detergents, foam, sealants), and (iv) polycarbonate (end-use: agro, building, automobiles)

### Ongoing repurposing of other O2C assets

Separately, RIL is also continuing to repurpose some existing assets to maximise value from the market environment. It has started producing needle coke from the coker at Jamnagar and has revived the ACN plant at Vadodara for conversion to carbon fibre. In addition, it is planning to repurpose PX (para xylene) and PTA (purified terephthalic acid) at the Patalganga complex to produce MX (mixed xylene) and PIA (purified isophthalic acid).

## Valuation methodology

We maintain our HOLD rating and SOTP target of Rs 2,520 for RIL which is based on FY24 valuations. Given that consumer-facing businesses form ~50% of the company's EBITDA and have high growth potential, our valuation implies a target FY23E P/E of 22x and FY24E P/E of 18x.

**Fig 1 – Valuation summary**

Business	Fair Value (US\$ bn)	Fair Value (Rs bn)	Value/share (Rs)	Valuation basis
<b>Energy</b>				
Refining	31	2,301	362	7.5x FY24E EBITDA
Petrochem	32	2,430	383	8.5x FY24E EBITDA
Upstream	8	587	92	Combination of DCF and reserve multiple
New energy	4	300	47	Option value
<b>Energy total</b>	<b>75</b>	<b>5,618</b>	<b>884</b>	-
Jio	55	4,132	650	10x FY24E EBITDA, RIL share
Digital services	9	705	111	6x FY25E Sales, discounted to FY23, RIL share
Reliance Retail	82	6,123	964	32x FY24E EBITDA, RIL share
<b>Enterprise value</b>	<b>221</b>	<b>16,578</b>	<b>2,610</b>	-
Net Debt	8	573	90	-
<b>Equity value</b>	<b>213</b>	<b>16,005</b>	<b>2,520</b>	<b>18.4x FY24E EPS</b>

Source: BOBCAPS Research

**Fig 2 – RIL: EBITDA mix**

	FY20	FY21	FY22E	FY23E	FY24E	FY21-24E CAGR (%)
<b>EBITDA (Rs bn)</b>	-	-	-	-	-	-
Petrochemicals	309	296	324	292	286	-
Refining	245	119	222	277	307	-
Oil & Gas	13	2	54	97	87	-
<b>Cyclical subtotal</b>	<b>567</b>	<b>416</b>	<b>601</b>	<b>665</b>	<b>680</b>	-
Digital Services	225	334	378	511	623	-
Retail	97	98	118	157	225	-
<b>Consumer subtotal</b>	<b>322</b>	<b>432</b>	<b>496</b>	<b>668</b>	<b>848</b>	-
Others	2	(40)	42	42	42	-
<b>Consolidated business EBITDA</b>	<b>890</b>	<b>807</b>	<b>1,139</b>	<b>1,376</b>	<b>1,570</b>	-
<b>EBITDA YoY growth (%)</b>	-	-	-	-	-	-
Petrochemicals	(18.3)	(4.4)	9.6	(10.0)	(1.9)	(1.1)
Refining	(6.1)	(51.4)	86.8	24.6	10.9	37.2
Oil & Gas	(41.3)	(87.9)	3402.9	78.4	(10.0)	283.1
<b>Cyclical subtotal</b>	<b>(14.3)</b>	<b>(26.6)</b>	<b>44.4</b>	<b>10.8</b>	<b>2.2</b>	<b>17.8</b>
Digital Services	46.8	48.2	13.4	35.2	21.9	23.1
Retail	55.7	1.4	20.3	33.2	43.3	31.9
<b>Consumer subtotal</b>	<b>49.3</b>	<b>34.1</b>	<b>14.9</b>	<b>34.7</b>	<b>26.9</b>	<b>25.3</b>
<b>Consolidated</b>	<b>5.8</b>	<b>(9.3)</b>	<b>41.0</b>	<b>20.8</b>	<b>14.1</b>	<b>24.8</b>
<b>EBITDA composition (% of total)</b>	-	-	-	-	-	-
Petrochemicals	34.8	36.6	28.5	21.2	18.2	-
Refining	27.5	14.7	19.5	20.1	19.5	-

	FY20	FY21	FY22E	FY23E	FY24E	FY21-24E CAGR (%)
Oil & Gas	1.4	0.2	4.8	7.1	5.6	-
<b>Cyclical subtotal</b>	<b>63.7</b>	<b>51.5</b>	<b>52.7</b>	<b>48.4</b>	<b>43.3</b>	-
Digital Services	25.3	41.3	33.2	37.2	39.7	-
Retail	10.8	12.1	10.3	11.4	14.3	-
<b>Consumer subtotal</b>	<b>36.1</b>	<b>53.5</b>	<b>43.6</b>	<b>48.6</b>	<b>54.0</b>	-

Source: Company, BOBCAPS Research

**Fig 3 – Key assumptions**

Parameter	Unit	FY21	FY22E	FY23E	FY24E
Exchange rate	INR/USD	74.2	75.0	76.5	78.0
<b>Energy</b>					
Oil price	US\$/bbl	45.8	75.0	75.0	70.0
Refining margin	US\$/bbl	6.0	8.0	9.0	9.5
Petchem EBITDA	US\$/t	203	257	229	220
O2C throughput	mt	62.0	69.4	71.0	71.0
Gas realisation- KG D6	US\$/MMBtu	3.8	4.9	7.6	5.3
Gas production- KG D6	mmscmd	1.8	12.4	21.5	30.0
<b>Jio</b>					
No of subscribers	Mn	426	426	466	506
ARPU	Rs	144	148	167	178
<b>Retail</b>					
Revenue growth	% YoY	(5.3)	27.4	36.2	33.7
EBITDA margin	%	5.9	5.9	6.5	7.1

Source: Company, BOBCAPS Research

## Key risks

Key upside risks to our estimates are:

- **O2C and Oil & Gas businesses:** Higher-than-assumed oil price, gas price, GRM and petrochemical crack movements on tightening of demand-supply balance than our current assumptions are key risks.
- **Digital Services:** Upside risks in this business are higher growth in subscriber base, faster rise in average tariffs, better operating margin and faster pickup of digital services than our assumptions.
- **Reliance Retail:** Faster revenue growth driven by faster economic growth, gaining of market share against organised retail and competition are primary upside risks. Lower competitive intensity can also push operating margin above our current assumptions. RIL has invested more than US\$ 1bn in acquiring assets and capabilities and the pace of integration will pose additional risks.
- **New energy business:** Faster evolution of new energy businesses and integration with existing businesses than our current assumption is a key upside risk.

## Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Bharat Petroleum Corp	BPCL IN	10.4	362	460	HOLD
GAIL	GAIL IN	8.2	138	160	BUY
Hindustan Petroleum Corp	HPCL IN	5.4	290	345	BUY
Indian Oil Corp	IOCL IN	14.5	117	135	BUY
Indraprastha Gas	IGL IN	3.5	381	565	BUY
Mahanagar Gas	MAHGL IN	1.0	786	750	SELL
Petronet LNG	PLNG IN	4.3	216	330	BUY
Reliance Industries	RIL IN	209.4	2,339	2,520	HOLD

Source: BOBCAPS Research, NSE | Price as of 14 Feb 2022

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Total revenue</b>	<b>59,75,350</b>	<b>46,69,240</b>	<b>68,85,377</b>	<b>79,00,553</b>	<b>87,38,985</b>
EBITDA	8,90,090	8,07,370	11,38,765	13,75,862	15,70,210
Depreciation	(2,22,030)	(2,65,720)	(3,14,105)	(3,61,780)	(4,00,564)
EBIT	6,68,060	5,41,650	8,24,660	10,14,082	11,69,646
Net interest inc./(exp.)	(2,20,270)	(2,11,890)	(1,68,401)	(1,77,338)	(1,77,338)
Other inc./(exp.)	1,31,640	1,63,270	1,86,735	2,11,877	2,68,829
Exceptional items	(44,440)	56,420	0	0	0
EBT	5,79,430	4,93,030	8,42,994	10,48,621	12,61,137
Income taxes	(1,37,260)	(17,220)	(1,99,660)	(2,37,121)	(2,75,299)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	(4,190)	(40,950)	(61,242)	(92,735)	(1,25,820)
<b>Reported net profit</b>	<b>3,93,540</b>	<b>4,91,280</b>	<b>5,82,093</b>	<b>7,18,765</b>	<b>8,60,018</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>4,37,980</b>	<b>4,36,628</b>	<b>5,82,093</b>	<b>7,18,765</b>	<b>8,60,018</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	9,67,990	10,88,970	11,14,528	11,50,101	11,04,107
Other current liabilities	22,09,060	10,65,880	11,40,154	11,80,831	11,48,269
Provisions	36,800	51,290	51,290	51,290	51,290
Debt funds	31,02,210	24,53,280	27,28,280	27,28,280	27,28,280
Other liabilities	7,00,620	5,46,910	5,58,820	5,71,578	5,85,304
Equity capital	63,390	64,450	67,650	67,650	67,650
Reserves & surplus	44,28,270	69,37,270	74,62,671	81,16,372	89,06,385
Shareholders' fund	44,91,660	70,01,720	75,30,321	81,84,022	89,74,035
<b>Total liab. and equities</b>	<b>1,16,30,150</b>	<b>1,32,00,650</b>	<b>1,41,77,234</b>	<b>1,50,12,679</b>	<b>1,58,63,682</b>
Cash and cash eq.	3,09,200	1,73,970	1,60,149	6,31,093	11,95,646
Accounts receivables	1,96,560	1,90,140	1,92,440	1,93,116	1,92,794
Inventories	7,39,030	8,16,720	9,30,831	9,50,234	9,25,147
Other current assets	12,00,050	16,99,430	16,99,430	16,99,430	16,99,430
Investments	27,67,670	36,48,280	36,48,280	36,48,280	36,48,280
Net fixed assets	52,23,990	53,10,460	60,03,979	67,86,204	71,79,401
CWIP	10,91,060	12,59,530	14,30,006	9,92,201	9,10,864
Intangible assets	1,02,590	1,02,120	1,12,120	1,12,120	1,12,120
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>1,16,30,150</b>	<b>1,32,00,650</b>	<b>1,41,77,234</b>	<b>1,50,12,679</b>	<b>1,58,63,682</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Cash flow from operations</b>	<b>7,43,000</b>	<b>(12,26,220)</b>	<b>7,04,794</b>	<b>9,37,597</b>	<b>9,52,333</b>
Capital expenditures	(7,86,470)	(4,89,180)	(11,78,100)	(7,06,200)	(7,12,424)
Change in investments	(4,09,780)	(85,770)	(10,000)	0	0
Other investing cash flows	1,12,720	(6,32,040)	1,86,735	2,11,877	2,68,829
<b>Cash flow from investing</b>	<b>(10,83,530)</b>	<b>(12,06,990)</b>	<b>(10,01,365)</b>	<b>(4,94,323)</b>	<b>(4,43,595)</b>
Equities issued/Others	1,55,020	10,02,980	3,200	0	0
Debt raised/repaid	2,82,590	(6,48,910)	2,75,000	0	0
Interest expenses	0	0	0	0	0
Dividends paid	(42,820)	(45,840)	(56,692)	(65,064)	(70,006)
Other financing cash flows	(44,440)	56,420	61,242	92,735	1,25,820
<b>Cash flow from financing</b>	<b>3,50,350</b>	<b>3,64,650</b>	<b>2,82,750</b>	<b>27,671</b>	<b>55,814</b>
<b>Chg in cash &amp; cash eq.</b>	<b>9,820</b>	<b>(20,68,560)</b>	<b>(13,821)</b>	<b>4,70,944</b>	<b>5,64,553</b>
<b>Closing cash &amp; cash eq.</b>	<b>1,20,630</b>	<b>(17,59,360)</b>	<b>1,60,149</b>	<b>6,31,093</b>	<b>11,95,646</b>

### Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	62.1	76.2	86.0	106.2	127.1
Adjusted EPS	68.0	67.7	90.3	106.2	127.1
Dividend per share	5.7	6.1	8.8	9.6	10.3
Book value per share	708.6	1,086.4	1,113.1	1,209.8	1,326.5

### Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	3.0	4.0	2.7	2.3	2.1
EV/EBITDA	20.3	23.0	16.1	13.3	11.6
Adjusted P/E	34.4	34.5	25.9	22.0	18.4
P/BV	3.3	2.2	2.1	1.9	1.8

### DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	81.9	79.5	69.1	68.5	68.2
Interest burden (PBT/EBIT)	80.1	101.4	102.2	103.4	107.8
EBIT margin (EBIT/Revenue)	11.2	11.6	12.0	12.8	13.4
Asset turnover (Rev./Avg TA)	55.3	37.6	50.3	54.1	56.6
Leverage (Avg TA/Avg Equity)	2.6	2.2	1.9	1.9	1.8
Adjusted ROAE	10.5	7.6	8.0	9.1	10.0

### Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
<b>YoY growth (%)</b>					
Revenue	5.0	(21.9)	47.5	14.7	10.6
EBITDA	5.8	(9.3)	41.0	20.8	14.1
Adjusted EPS	10.6	(0.3)	33.3	17.6	19.7
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	14.9	17.3	16.5	17.4	18.0
EBIT margin	11.2	11.6	12.0	12.8	13.4
Adjusted profit margin	7.3	9.4	8.5	9.1	9.8
Adjusted ROAE	10.5	7.6	8.0	9.1	10.0
ROCE	6.9	5.8	5.8	6.7	7.3
<b>Working capital days (days)</b>					
Receivables	15	15	10	9	8
Inventory	62	95	179	205	187
Payables	74	97	70	63	57
<b>Ratios (x)</b>					
Gross asset turnover	0.9	0.6	0.8	0.9	0.9
Current ratio	0.6	1.0	1.0	1.2	1.4
Net interest coverage ratio	3.0	2.6	4.9	5.7	6.6
Adjusted debt/equity	0.6	0.3	0.3	0.3	0.2

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

## Disclaimer

### Recommendation scale: Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

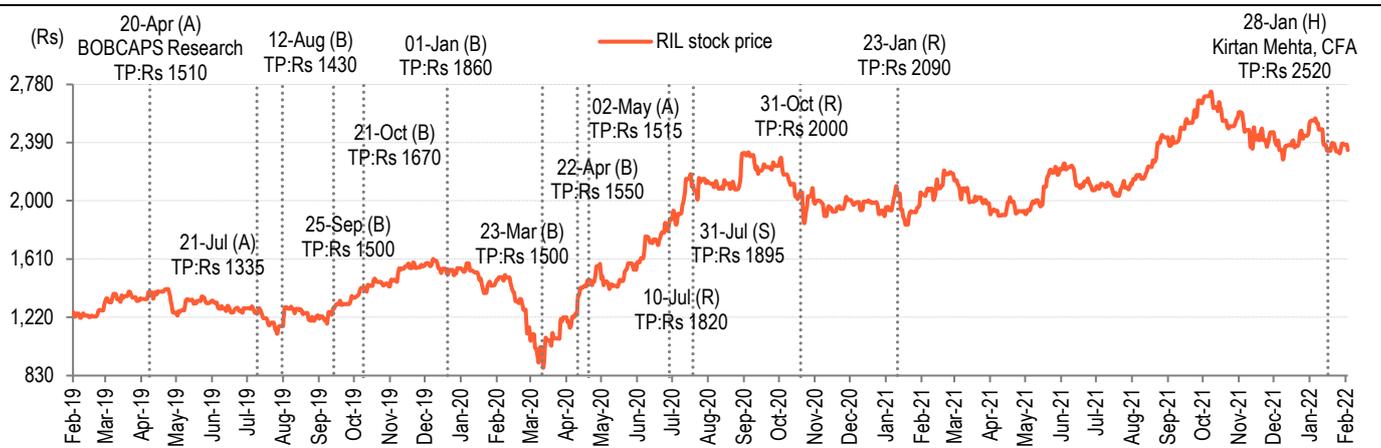
**HOLD** – Expected return from -6% to +15%

**SELL** – Expected return <-6%

**Note:** Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

### Ratings and Target Price (3-year history): RELIANCE INDUSTRIES (RIL IN)



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

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