

BUY

TP: Rs 1,860 | ▲ 23%

RELIANCE INDUSTRIES | Oil & Gas

| 01 January 2020

RJio and Retail neutralise uncertainty over cyclicals

Key highlights of recent developments at Reliance Industries (RIL): (a) RJio's ARPU expansion from the recent ~25% tariff hikes is likely to be staggered over FY21 and FY22; (b) debt reduction plans for FY21 hinge on the Aramco deal, which management is confident of executing despite recent concerns; and (c) the outlook on cyclicals remains mixed with a bias towards higher GRMs in FY21. We raise earnings estimates for RJio and roll forward to a Mar'21 TP of Rs 1,860 (from Rs 1,670).

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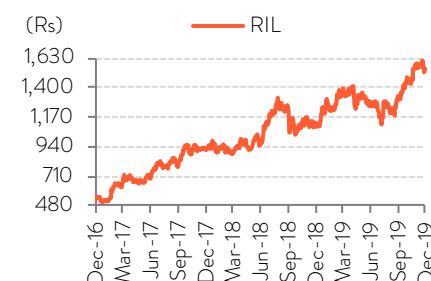
Deleveraging plans delayed: RIL's 20% stake sale in its Oil2Chemicals business to Saudi Aramco (at an EV of US\$ 75bn; US\$ 15bn inflow to RIL) appears hindered by a regulatory web. But RIL's strong legal standing will see the matter through. Also, IPO plans for the retail business in FY21/ FY22 (which we value at US\$ 56bn) can potentially fetch US\$ 14bn in cash – nearly as much as the Aramco deal and a hedge against stake sale uncertainties.

Ticker/Price	RIL IN/Rs 1,514
Market cap	US\$ 134.6bn
Shares o/s	6,339mn
3M ADV	US\$ 175.0mn
52wk high/low	Rs 1,618/Rs 1,081
Promoter/FPI/DII	47%/24%/28%

Source: NSE

RJio – lateral offerings to enhance value: ARPU expansion in RJio's conventional wireless business is likely to be staggered over FY21 and FY22. Despite a slow start, RIL could add a million subscribers every month for its new GigaFiber broadband product from Q1FY21. Other lateral offerings (advertisement/subscription revenues from Jio applications and cloud services) should scale up over FY22-FY23 – an IPO for RJio thus looks remote.

STOCK PERFORMANCE



Source: NSE

Retail momentum to continue: The company intends to continue with its strategy of store-count expansion and integration of online-offline channels – a much-needed counter to global retail heavyweights.

Refining – awaiting IMO-led GRM bump-up: RIL's GRMs remain muted at ~US\$ 10/bbl (vs. \$ 13-14 est.) as diesel cracks have not expanded. We expect diesel cracks to improve over FY21 as IMO compliance picks up globally.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	4,082,650	5,810,200	5,425,940	6,045,442	5,927,036
EBITDA (Rs mn)	641,760	839,180	980,450	1,312,828	1,594,729
Adj. net profit (Rs mn)	352,869	398,370	467,750	677,329	903,259
Adj. EPS (Rs)	59.6	67.2	73.8	106.9	142.5
Adj. EPS growth (%)	17.4	12.8	9.8	44.8	33.4
Adj. ROAE (%)	12.7	11.7	11.4	14.7	16.8
Adj. P/E (x)	25.4	22.5	20.5	14.2	10.6
EV/EBITDA (x)	17.9	13.7	12.0	9.4	7.5

Source: Company, BOBCAPS Research

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Key developments

RJio – lateral offerings to enhance value proposition

We expect ARPU expansion from the recent ~25% tariff hikes in RJio's conventional wireless business to be staggered over FY21 and FY22, before stagnating. Subscriber additions for the recently launched GigaFiber broadband offering have been slower than anticipated. Management expects significant ramp-up from Q1FY21 with plans to add about a million subscribers every month (and ~20mn retail & ~15mn enterprise subscribers cumulatively over FY21-FY23).

RJio's fibre infrastructure connectivity now extends to 80-90mn households. Other lateral offerings such as advertisement and/or subscription revenues from Jio applications and cloud services via the Microsoft JV could become significant contributors over FY22-FY23. Hence, the possibility of an IPO for RJio looks quite remote.

Retail business – growth momentum to continue with margin expansion

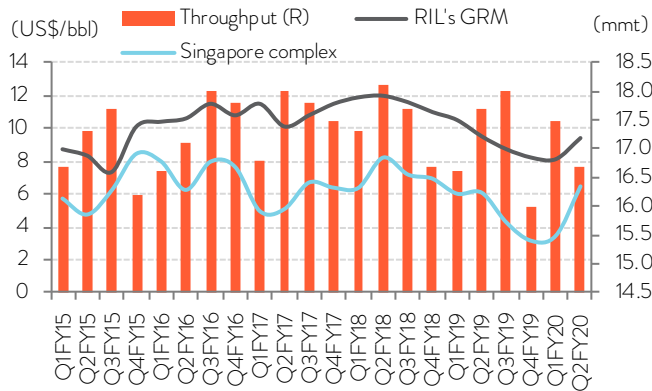
While RIL is yet to disclose plans for its retail IPO, we believe the time is ripe for a listing in FY21 considering the business has achieved massive scale (with >Rs 2tn in revenues expected in FY21) and become a self-funding engine. The company intends to continue with its strategy of store-count expansion and integration of online-offline channels – a much-needed counter to global retail heavyweights such as Amazon and Walmart (which owns Flipkart in India). Recent media reports suggest RIL also has plans to launch a grocery application that would bring a large number of unorganised local shops onto its ecommerce platform.

Management expects to sustain same-store sales growth (SSSg) at ~20% in FY20. For FY19, the fashion segment grew 10%, consumer durables 23% and grocery 26%.

Refining – awaiting IMO-led GRM bump-up

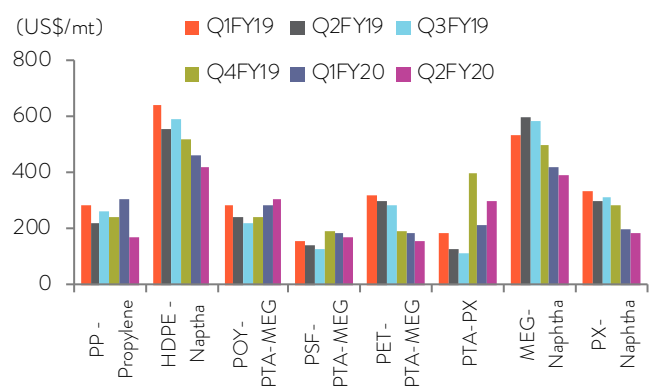
RIL's current GRMs remain muted at ~US\$ 10/bbl, well below earlier anticipated levels of US\$ 13-14 as diesel cracks have not expanded beyond ~US\$ 15/bbl. We expect diesel cracks to improve in FY21 as IMO compliance picks up globally. All the company's petcoke gasifiers (carrying Rs 540bn in CWIP) are scheduled to be commissioned by end-FY20, but sustained low LNG prices could limit effective GRM benefits therefrom to ~US\$ 1.5/bbl.

FIG 1 – REFINING BUSINESS OPERATIONAL TRENDS



Source: Company, BOBCAPS Research

FIG 2 – PETROCHEMICAL BUSINESS DELTAS



Source: Company, BOBCAPS Research

Valuation methodology

RIL is trading at 14.5x/11x FY21E/FY22E EPS which looks undemanding considering its earnings growth traction and positive outlook on balance sheet deleveraging. Valuations could rerate to higher multiples as the contribution of cyclical businesses to overall EBITDA is expected to shrink to <50% by FY22.

In the near term, IMO regulations offer earnings upgrade potential if they bolster RIL's GRM to >US\$ 12/bbl. Every US\$ 1/bbl improvement in GRM could drive our fair value up by ~Rs 50/sh (~3% move). Our assumption of US\$ 12/bbl GRMs in FY21/FY22 includes diesel-FO spreads of US\$ 40/bbl, which is conservative considering we have seen historical highs of ~US\$ 75/bbl in phases of high diesel demand growth.

We raise EBITDA assumptions for RJio and roll over to a revised Mar'21 target price of Rs 1,860 for RIL (from Rs 1,670). Our SOTP valuation is outlined below:

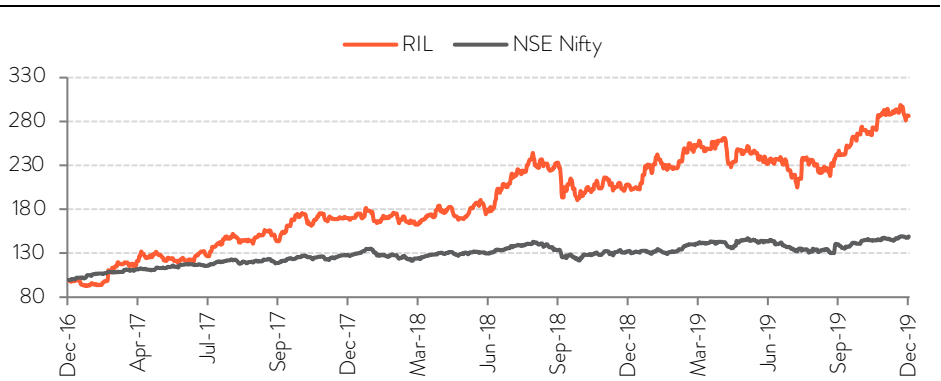
- **Cyclicals:** Refining (Rs 408/sh) and petrochemical (Rs 517/sh) businesses valued at 7x and 8x FY22E EBITDA respectively (at par with global peers)
- **RJio:** Valued at Rs 626/sh (from Rs 578) based on 6x FY22E EBITDA of Rs 618bn (increased from Rs 526bn). We estimate FY20/FY21/FY22 ARPU's at Rs 128/Rs 144/Rs 150 (raised from Rs 120/Rs 130/Rs 135)
- **Retail:** Valued at 20x FY22E EBITDA
- **E&P:** DCF value of the KG-D6 block and development of oil & gas reserves in the R-series block factored in; PMT field valued at 7x FY22E EV/EBITDA and shale business assessed on residual reserves at US\$ 2/boe

FIG 3 – SOTP VALUATION SUMMARY

Business	Fair Value		Value/share	Comments
	(US\$ bn)	(Rs bn)	(Rs)	
Refining	37	2,414	408	7x FY22E EBITDA
Petrochem	48	3,066	517	8x FY22E EBITDA
Cyclical business value	85	5,480	925	
E&P business	2	108	18	Includes KG-D6, shale and PMT
Jio	58	3,710	626	6x FY22E EBITDA
Reliance Retail	56	3,592	606	20x FY22E EBITDA
Enterprise value	200	12,891	2,175	
Net Debt	29	1,855	313	FY21E consol. net debt
Equity value	171	11,036	1,860	13x FY22E EPS

Source: BOBCAPS Research

FIG 4 – 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 aggressive ramp-up in RJio’s subscriber numbers (>500mn) and ARPUs (~Rs 150/mth) by FY22. Operating margins could trend well below our estimates if the pricing war among telecom operators resumes. The telecom business also carries regulatory risks pertaining to tariffs and spectrum usage that could hamper RJio’s earnings outlook.
- **Lower growth in retail revenues:** RIL has been significantly outperforming estimates on retail business revenue growth. The 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	5,425,940	6,045,442	5,927,036
EBITDA	641,760	839,180	980,450	1,312,828	1,594,729
Depreciation	(167,060)	(209,340)	(279,191)	(323,398)	(342,281)
EBIT	474,700	629,840	701,259	989,430	1,252,447
Net interest income/(expenses)	(80,520)	(164,950)	(214,586)	(214,795)	(179,756)
Other income/(expenses)	88,620	86,350	138,365	136,775	136,020
Exceptional items	10,870	0	0	0	0
EBT	482,800	551,240	625,038	911,410	1,208,711
Income taxes	(133,460)	(153,900)	(157,288)	(234,081)	(305,453)
Min. int./Inc. from associates	590	1,030	0	0	0
Reported net profit	360,800	398,370	467,750	677,329	903,259
Adjusted net profit	352,869	398,370	467,750	677,329	903,259

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	1,068,610	1,083,090	1,095,468	940,828	943,447
Other current liabilities	1,688,780	1,442,530	1,442,530	1,442,530	1,442,530
Provisions	41,380	41,820	53,930	60,874	68,949
Debt funds	1,816,040	2,719,420	3,019,420	1,969,420	1,969,420
Other liabilities	498,280	687,620	701,635	723,017	753,710
Equity capital	59,220	59,260	63,390	63,390	63,390
Reserves & surplus	2,871,300	3,813,090	4,237,286	4,880,685	5,743,069
Shareholders' fund	2,930,520	3,872,350	4,300,676	4,944,075	5,806,459
Total liabilities and equities	8,079,000	9,929,630	10,696,458	10,163,543	11,067,316
Cash and cash eq.	42,550	75,120	59,782	104,362	547,340
Accounts receivables	175,550	300,890	320,040	297,564	297,011
Inventories	608,370	675,610	681,802	604,441	605,751
Other current assets	514,840	744,760	849,030	790,073	789,135
Investments	828,620	2,354,880	2,354,880	2,354,880	2,054,880
Net fixed assets	3,980,720	3,863,770	4,950,283	4,514,382	5,265,358
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	10,696,458	10,163,543	11,067,316

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	507,120	605,860	746,941	1,000,726	1,245,540
Changes in working capital	598,380	(653,830)	(105,125)	11,098	10,876
Other operating cash flows	(70,660)	116,700	(124,350)	(115,393)	(105,327)
Cash flow from operations	1,034,840	68,730	517,466	896,431	1,151,089
Capital expenditures	(812,550)	(14,950)	(930,445)	105,303	(1,093,257)
Change in investments	13,010	(1,331,060)	10,000	10,000	10,000
Other investing cash flows	85,190	(47,010)	138,365	136,775	436,020
Cash flow from investing	(714,350)	(1,393,020)	(782,080)	252,078	(647,237)
Equities issued/Others	570	40	4,130	0	0
Debt raised/repaid	(240,930)	917,090	300,000	(1,050,000)	0
Dividends paid	(39,160)	(42,810)	(54,854)	(53,930)	(60,874)
Other financing cash flows	(28,650)	482,540	0	0	0
Cash flow from financing	(308,170)	1,356,860	249,276	(1,103,930)	(60,874)
Changes in cash and cash eq.	12,320	32,570	(15,338)	44,580	442,978
Closing cash and cash eq.	42,550	75,120	59,782	104,362	547,340

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	60.9	67.2	73.8	106.9	142.5
Adjusted EPS	59.6	67.2	73.8	106.9	142.5
Dividend per share	6.0	7.7	7.1	8.0	9.1
Book value per share	494.9	653.5	678.4	779.9	916.0

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	2.8	2.0	2.2	2.1	2.0
EV/EBITDA	17.9	13.7	12.0	9.4	7.5
Adjusted P/E	25.4	22.5	20.5	14.2	10.6
P/BV	3.1	2.3	2.2	1.9	1.7

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	71.5	72.3	74.8	74.3	74.7
Interest burden (PBT/EBIT)	104.0	87.5	89.1	92.1	96.5
EBIT margin (EBIT/Revenue)	11.6	10.8	12.9	16.4	21.1
Asset turnover (Revenue/Avg TA)	53.7	64.5	52.6	58.0	55.8
Leverage (Avg TA/Avg Equity)	2.7	2.6	2.5	2.3	2.0
Adjusted ROAE	12.7	11.7	11.4	14.7	16.8

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	(6.6)	11.4	(2.0)
EBITDA	38.9	30.8	16.8	33.9	21.5
Adjusted EPS	17.4	12.8	9.8	44.8	33.4
Profitability & Return ratios (%)					
EBITDA margin	15.7	14.4	18.1	21.7	26.9
EBIT margin	11.6	10.8	12.9	16.4	21.1
Adjusted profit margin	8.6	6.9	8.6	11.2	15.2
Adjusted ROAE	12.7	11.7	11.4	14.7	16.8
ROCE	7.3	7.9	7.5	10.2	12.6
Working capital days (days)					
Receivables	12	15	21	19	18
Inventory	73	58	59	65	61
Payables	97	79	89	79	79
Ratios (x)					
Gross asset turnover	0.9	1.0	0.8	0.8	0.8
Current ratio	0.4	0.6	0.6	0.5	0.6
Net interest coverage ratio	5.9	3.8	3.3	4.6	7.0
Adjusted debt/equity	0.6	0.7	0.7	0.4	0.2

Source: Company, BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

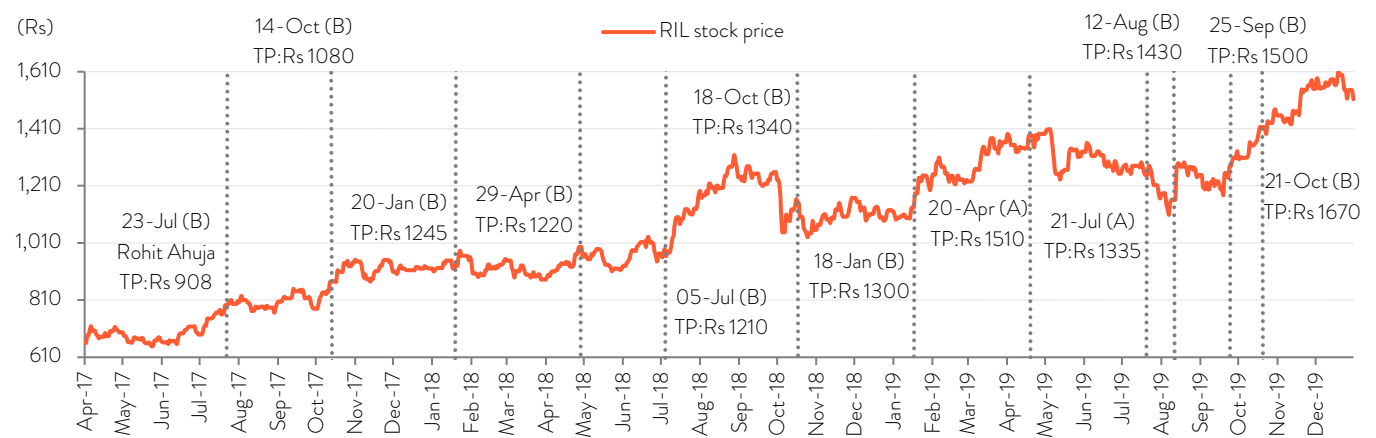
ADD – Expected return from >+5% to +15%

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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