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TP: Rs 1,860 | ▲ 18%

RELIANCE INDUSTRIES

Oil & Gas

19 January 2020

RJio and Retail drive earnings; cyclicals struggle

Key highlights from Reliance Industries' (RIL) Q3 financials: (a) Cyclicals under-performed on low GRMs (US\$9.2/bbl, Vs US\$10.7 ests); and tepid petchem margins (US\$100/MT EBITDA, -23% QoQ); (b) higher than expected earnings from retail – Rs27 bn (+62% YoY, 6% margins) and (c) lower than estimates earnings from RJIO – Rs58 bn (+9.6% YoY). We trim earnings estimates for RIL by 4%/5% for FY21/22, on cut in RJio earnings (set off by higher retail earnings), as unchanged Mar'21 TP of Rs 1860.

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Wait continues for GRM surge from IMO: RIL's GRMs remain muted at US\$9.2/bbl, as diesel cracks have not expanded. The company has increased use of FO to take advantage of low cracks (-US\$30/bbl), to maximise diesel output, placing itself in a favorable position to cash in whenever diesel spreads expand.

Petchem too beaten down: Crash in polymer and polyester spreads have led to a decline in Petchem EBITDA to Rs73 bn (-19% QoQ), marginally above our estimates on lower costs. However, recovery in the Chinese economy, followed by easing trade tension between US and China, is expected to lead to some recovery in integrated polyester margins from Q4 FY20.

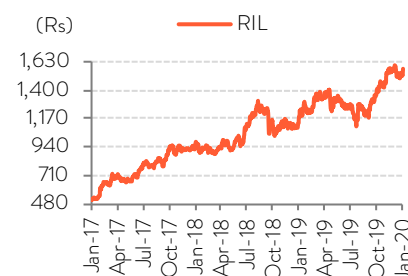
RJio – tepid ARPU expansion: As we had highlighted in our [recent report](#), RJIO's restated (incl. IUC revenues) ARPUs were muted at Rs128.4 (+0.7% QoQ). We now build in a more staggered expansion in ARPUs to Rs165 (incl. IUC) over FY20-22, that leads to ~18%/22%/13% cut in FY20/21/22 EBITDA estimates.

Retail momentum to continue: Retail business EBITDA at Rs27 bn (+62% YoY) outperformed on better margins and higher revenues (Rs453 bn, +27% YoY). EBITDA margins in consumer retail segments surged to 9.6% (+160bps YoY), on sustain like for like sales growth (>20%).

Ticker/Price	RIL IN/Rs 1,581
Market cap	US\$ 141.0bn
Shares o/s	6,339mn
3M ADV	US\$ 180.9mn
52wk high/low	Rs 1,618/Rs 1,095
Promoter/FPI/DII	50%/24%/26%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	4,082,650	5,810,200	5,452,811	6,127,632	6,086,989
EBITDA (Rs mn)	641,760	839,180	957,625	1,257,035	1,539,078
Adj. net profit (Rs mn)	352,869	398,370	466,865	648,476	855,988
Adj. EPS (Rs)	59.6	67.2	73.6	102.3	135.0
Adj. EPS growth (%)	17.4	12.8	9.6	38.9	32.0
Adj. ROAE (%)	12.7	11.7	11.4	14.1	16.1
Adj. P/E (x)	26.5	23.5	21.5	15.5	11.7
EV/EBITDA (x)	18.5	14.2	12.8	10.2	8.1

Source: Company, BOBCAPS Research

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Important disclosures, including any required research certifications, are provided at the end of this report.



FIG 1 – QUARTERLY PERFORMANCE (STANDALONE)

(Rs mn)	Q3FY20A	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	9MFY20	9MFY19	YoY (%)
Gross revenue	937,410	1,098,082	(14.6)	944,460	(0.7)	2,845,710	3,122,122	(8.9)
Less: Excise duty	38,630	27,827	38.8	36,230	6.6	118,590	97,907	21.1
Less: GST recovered	35,890	38,411	(6.6)	36,860	(2.6)	110,230	119,111	(7.5)
Net sales	862,890	1,070,255	(19.4)	871,370	(1.0)	2,616,890	2,943,515	(11.1)
Raw material costs	618,440	575,300	7.5	600,420	3.0	1,868,950	1,982,680	(5.7)
% of sales	71.7	53.8	-	68.9	-	71.4	67.4	-
Other expenditure	115,740	348,665	(66.8)	134,290	(13.8)	346,170	514,085	(32.7)
% of sales	13.4	32.6	-	15.4	-	13.2	17.5	-
EBITDA	128,710	146,289	(12.0)	136,660	(5.8)	401,770	446,749	(10.1)
EBITDA margin (%)	14.9	13.7	-	15.7	-	15.4	15.2	-
Depreciation & amortization	25,510	20,308	25.6	23,170	10.1	70,430	75,378	(6.6)
Interest	25,200	24,811	1.6	27,230	(7.5)	79,440	70,361	12.9
Other income	39,540	20,000	97.7	36,290	9.0	109,280	60,800	79.7
PBT	117,540	121,170	(3.0)	122,550	(4.1)	361,180	361,810	(0.2)
Provision for tax	21,690	30,293	(28.4)	25,530	(15.0)	77,950	94,143	(17.2)
Adj. PAT	95,850	90,878	5.5	97,020	(1.2)	283,230	267,668	5.8
Other comprehensive income	(12,880)	-	-	-	-	(22,830)	(14,990)	52.3
Total Income	82,970	90,878	(8.7)	97,020	(14.5)	260,400	252,678	3.1
Adj. EPS (Rs)	15.1	14.3	5.4	15.3	(1.2)	44.7	42.2	5.9
GRMs (US\$/bbl)	9.2	8.7	5.7	9.4	(2.1)	9.0	9.5	(5.5)
Refining throughput (mmt)	18.1	17.5	3.4	16.7	8.4	52.3	51.8	1.0
Petrochemical production (mmt)	9.9	9.2	7.6	9.9	-	28.5	27.8	2.5

Source: Company, BOBCAPS Research

FIG 2 – QUARTERLY PERFORMANCE (CONSOLIDATED)

(Rs mn)	Q3FY20A	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	9MFY20	9MFY19	YoY (%)
Gross revenues	1,688,580	1,713,360	(1.4)	1,638,540	3.1	5,056,680	4,693,260	7.7
Less: Excise duty	38,630	39,020	(1.0)	36,230	6.6	118,590	109,100	8.7
Less: GST recovered	120,560	110,370	9.2	117,050	3.0	353,680	299,400	18.1
Net sales	1,529,390	1,563,970	(2.2)	1,485,260	3.0	4,584,410	4,284,760	7.0
EBITDA	223,860	213,170	5.0	221,520	1.1	658,530	630,860	4.4
EBITDA margin (%)	14.6	13.6	-	14.9	-	14.4	14.7	-
Depreciation & amortisation	55,450	52,370	5.9	53,150	4.3	158,710	156,390	1.5
Interest	54,040	41,190	31.2	54,500	(0.8)	159,630	116,010	37.6
Other income	36,450	24,600	48.2	36,140	0.9	104,050	54,880	89.6
PBT	150,820	144,210	4.6	150,010	0.5	444,240	413,340	7.5
Provision for tax	31,210	40,690	(23.3)	37,030	(15.7)	110,490	119,590	(7.6)
Adj. PAT	120,180	103,760	15.8	113,520	5.9	334,570	294,100	13.8
Other comprehensive income	(21,560)	6,760	418.9	(7,860)	(174.3)	(22,370)	(29,130)	(23.2)
Share of P&L from associate	570	240	137.5	540	5.6	820	350	134.3
Minority Interest	-	(330)	(100.0)	-	-	-	(920)	(100.0)
Total Income	96,850	110,190	(12.1)	105,660	(8.3)	312,200	264,050	18.2
Adj. EPS (Rs)	19.0	17.5	8.4	17.9	5.9	56.5	49.6	13.9

Source: Company, BOBCAPS Research

FIG 3 – QUARTERLY PERFORMANCE SEGMENT-WISE (CONSOLIDATED)

(Rs mn)	Q3FY20A	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	9MFY20	9MFY19	YoY (%)
Petrochemicals revenues	369,090	462,460	(20.2)	385,380	(4.2)	1,130,580	1,302,780	(13.2)
% Sales	17.7	21.7	-	19.0	-	36.3	22.4	-
EBITDA	72,520	95,960	(24.4)	89,270	(18.8)	249,890	282,840	(11.6)
EBITDA margins (%)	19.6	20.7	-	23.2	-	22.1	21.7	-
% Total RIL EBITDA	32	45	-	40	-	38	45	-
EBIT	58,800	82,210	(28.5)	76,020	(22.7)	455,610	241,980	88.3
Refining revenues	1,037,180	1,117,380	(7.2)	972,290	6.7	3,026,680	3,061,440	(1.1)
% Sales	49.6	52.5	-	47.8	-	98.5	52.7	-
EBITDA	65,300	58,490	11.6	56,590	15.4	173,410	180,740	(4.1)
EBITDA margins (%)	6.3	5.2	-	5.8	-	5.7	5.9	-
% Total RIL EBITDA	29	27	-	26	-	26	29	-
EBIT	56,570	50,550	11.9	49,570	14.1	300,330	156,920	91.4
Oil & Gas	8,730	11,820	(26.1)	7,900	10.5	25,860	39,360	(34.3)
% Sales	0.4	0.6	-	0.4	-	0.8	0.7	-
EBITDA	640	5,110	(87.5)	1,280	(50.0)	3,990	16,025	(75.1)
EBITDA margins (%)	7.3	43.2	-	16.2	-	15.4	40.7	-
% Total RIL EBITDA	0	2	-	1	-	1	3	-
EBIT	(3,660)	(1,850)	(97.8)	(3,060)	19.6	(19,940)	(11,120)	(79.3)
Organized Retail	453,270	355,770	27.4	412,020	10.0	1,247,250	939,030	32.8
% Sales	21.7	16.7	-	20.3	-	41.2	16.2	-
EBITDA	27,270	16,800	62.3	23,220	17.4	70,980	42,780	65.9
EBITDA margins (%)	6.0	4.7	-	5.6	-	5.7	4.6	-
% Total RIL EBITDA	12	8	-	10	-	11	7	-
EBIT	23,890	15,120	58.0	20,350	17.4	97,120	38,250	153.9
Digital Service	175,550	122,520	43.3	156,190	12.4	480,840	328,470	46.4
% Sales	8.4	5.8	-	7.7	-	15.9	5.7	-
EBITDA	58,330	40,530	43.9	53,240	9.6	160,650	107,730	49.1
EBITDA margins (%)	33.2	33.1	-	34.1	-	33.4	32.8	-
% Total RIL EBITDA	26	19	-	24	-	24	17	-
EBIT	38,570	23,620	63.3	33,220	16.1	157,210	61,190	156.9
Others revenues	46,380	57,070	(18.7)	98,820	(53.1)	253,070	142,120	78.1
% Sales	2.2	2.7	-	4.9	-	7.3	2.4	-
EBITDA	(200)	(3,720)	94.6	(2,080)	(90.4)	(390)	745	(152.4)
EBITDA margins (%)	(0.4)	(6.5)	-	(2.1)	-	(0.2)	0.5	-
Total Revenues	2,090,200	2,127,020	(1.7)	2,032,600	2.8	6,164,280	5,813,200	6.0
Less: Inter segment transfers	401,620	414,160	(3.0)	394,060	1.9	1,107,600	1,120,440	(1.1)
Reported Gross Sales	1,688,580	1,712,860	(1.4)	1,638,540	3.1	5,056,680	4,692,760	7.8
Less: GST recovered	120,560	110,370	9.2	117,050	3.0	353,680	299,400	18.1
Reported Net Sales	1,568,020	1,602,490	(2.2)	1,521,490	3.1	4,703,000	4,393,360	7.0
Total Reported EBITDA	223,860	213,170	5.0	221,520	1.1	658,530	630,860	4.4

Source: Company, BOBCAPS Research

Key takeaways

Refining

- RILs GRMs at \$9.2/bbl were well below expectations. This was also due to diesel cracks not expanding as per IMO expectations, while FO cracks reflect IMO impact.
- But it still performed relatively better to its benchmark and relative to its peers, as it increased its throughput to take advantage of the favorable margins from higher use of fuel oil as raw material. Refining operating costs were well below estimates at ~US\$2.3/bbl
- GRMs could improve from H1 FY21, as global diesel demand picks up from increased compliance for IMO (by ports) and normalization of US-China trade relations.

Petrochemicals

- RIL's better than estimated EBITDA performance, amid crash in spreads across polymer and polyester chain, seems to be driven by optimizing fuel mix (especially in polymers - ~48% ethane, ~52% naphtha)
- Chinese demand for polyester could normalize from Q4 FY20, as US-China trade tensions ease. Integrated polyester margins (down 43% YoY) could recover then.
- PE margins (down 30% QoQ) could remain depressed in the near term on increased supplies from US (~2.6 mmt in CY2019)

RJio

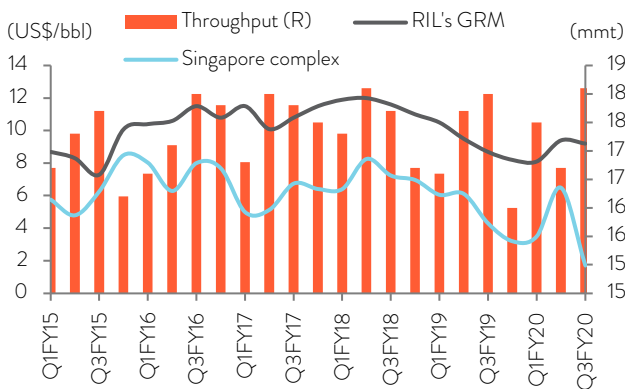
- RJio added 37 mn subscribers in Q3 FY20, however net subscriber additions were well below estimates at 15 mn as heavy voice users (~22mn subscribers) migrated out, on implementation of IUC charges on voice usage.
- However, IUC charges have helped RJIO become net receiver of IUC revenues as the outgoing calls proportion declined to 47.5% from 61.8%.

Retail business

- Margin continued to expand due to double digit same-store sales growth (SSSg). Management expects to sustain same-store sales growth at 15%.
- One of the major reasons for sales to pick up this particular quarter was also due to consumer offers during the festive period.

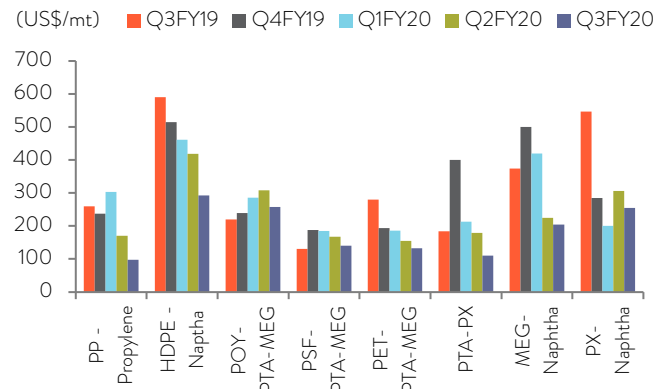
- The company intends to continue with its strategy of store-count expansion (opened over ~450 stores during the quarter) and integration of online-offline channels – a much-needed counter to global retail heavyweights such as Amazon and Walmart (which owns Flipkart in India).
- While RIL is yet to disclose 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.

FIG 4 – REFINING BUSINESS OPERATIONAL TRENDS



Source: Company, BOBCAPS Research

FIG 5 – PETROCHEMICAL BUSINESS DELTAS



Source: Company, BOBCAPS Research

Valuation methodology

RIL is trading at 13.5x/10.6x 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 cut EBITDA estimates for RJio on lower ARPUs in the near term and low subscriber additions to 450 mn (from 500 mn). However, we raise EBITDA estimates for retail (~15% over FY21/22). We trim earnings estimates for RIL by 4%/5% for FY21/22, on cut in RJio earnings (set off by higher retail earnings)

Our Mar'21 TP remains unchanged at Rs1860. Our SOTP valuation is outlined below:

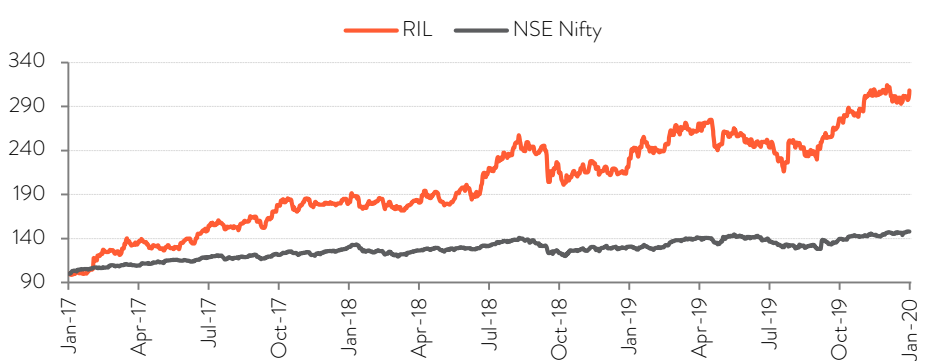
- **Cyclicals:** Refining (Rs 408/sh) and petrochemical (Rs 517/sh) businesses valued at 7x and 8x FY22E EBITDA respectively (at par with global peers)
- **RJio:** Valued at Rs 626/sh (from Rs 578) based on 6x FY22E EBITDA of Rs 618bn (increased from Rs 526bn). We estimate FY20/FY21/FY22 ARPU's at Rs 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 6 – SOTP VALUATION SUMMARY

Business	Fair Value		Value/share (Rs)	Comments
	(US\$ bn)	(Rs bn)		
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 7 – 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 (>450 mn) and ARPUs (~Rs 165mth) 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	5,452,811	6,127,632	6,086,989
EBITDA	641,760	839,180	957,625	1,257,035	1,539,078
Depreciation	(167,060)	(209,340)	(260,018)	(307,057)	(342,281)
EBIT	474,700	629,840	697,607	949,978	1,196,797
Net interest income/(expenses)	(80,520)	(164,950)	(216,265)	(217,995)	(179,756)
Other income/(expenses)	88,620	86,350	138,365	135,722	132,594
Exceptional items	10,870	0	0	0	0
EBT	482,800	551,240	619,706	867,705	1,149,636
Income taxes	(133,460)	(153,900)	(152,841)	(219,229)	(293,648)
Min. int./Inc. from associates	590	1,030	0	0	0
Reported net profit	360,800	398,370	466,865	648,476	855,988
Adjusted net profit	352,869	398,370	466,865	648,476	855,988

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	4,236,401	4,850,947	5,666,061
Shareholders' fund	2,930,520	3,872,350	4,299,791	4,914,337	5,729,451
Total liabilities and equities	8,079,000	9,929,630	10,695,574	10,133,805	10,990,307
Cash and cash eq.	42,550	75,120	39,724	39,110	434,818
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	4,969,456	4,549,896	5,300,871
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	10,695,573	10,133,805	10,990,307

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	507,120	605,860	726,883	955,533	1,198,269
Changes in working capital	598,380	(653,830)	(105,125)	11,098	10,876
Other operating cash flows	(70,660)	116,700	(124,350)	(114,340)	(101,901)
Cash flow from operations	1,034,840	68,730	497,409	852,291	1,107,244
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	135,722	432,594
Cash flow from investing	(714,350)	(1,393,020)	(782,080)	251,025	(650,662)
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	(35,396)	(614)	395,707
Closing cash and cash eq.	42,550	75,120	39,724	39,110	434,818

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	60.9	67.2	73.6	102.3	135.0
Adjusted EPS	59.6	67.2	73.6	102.3	135.0
Dividend per share	6.0	7.7	7.1	8.0	9.1
Book value per share	494.9	653.5	678.3	775.3	903.8

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	2.9	2.1	2.2	2.1	2.0
EV/EBITDA	18.5	14.2	12.8	10.2	8.1
Adjusted P/E	26.5	23.5	21.5	15.5	11.7
P/BV	3.2	2.4	2.3	2.0	1.7

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	71.5	72.3	75.3	74.7	74.5
Interest burden (PBT/EBIT)	104.0	87.5	88.8	91.3	96.1
EBIT margin (EBIT/Revenue)	11.6	10.8	12.8	15.5	19.7
Asset turnover (Revenue/Avg TA)	53.7	64.5	52.9	58.8	57.6
Leverage (Avg TA/Avg Equity)	2.7	2.6	2.5	2.3	2.0
Adjusted ROAE	12.7	11.7	11.4	14.1	16.1

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	(6.2)	12.4	(0.7)
EBITDA	38.9	30.8	14.1	31.3	22.4
Adjusted EPS	17.4	12.8	9.6	38.9	32.0
Profitability & Return ratios (%)					
EBITDA margin	15.7	14.4	17.6	20.5	25.3
EBIT margin	11.6	10.8	12.8	15.5	19.7
Adjusted profit margin	8.6	6.9	8.6	10.6	14.1
Adjusted ROAE	12.7	11.7	11.4	14.1	16.1
ROCE	7.3	7.9	7.5	9.9	12.1
Working capital days (days)					
Receivables	12	15	21	18	18
Inventory	73	58	59	65	61
Payables	97	79	88	76	76
Ratios (x)					
Gross asset turnover	0.9	1.0	0.8	0.9	0.8
Current ratio	0.4	0.6	0.6	0.5	0.6
Net interest coverage ratio	5.9	3.8	3.2	4.4	6.7
Adjusted debt/equity	0.6	0.7	0.7	0.4	0.3

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

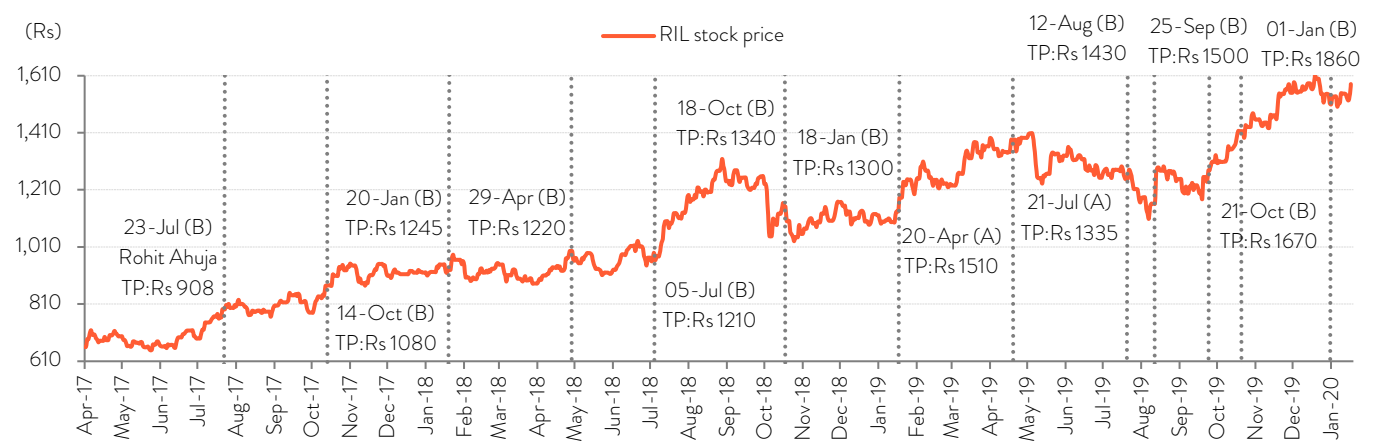
ADD – Expected return from >+5% to +15%

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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