Reliance Industries

Downstream woes offset by JIO/Retail momentum

Buy

Target Price: Rs1,770
Price: Rs1,581
Forecast return: 12%

RIL reported earnings reached a new high of Rs118.4bn, up 14% yoy, with EBITDA of Rs224bn also a new record (CenE EBITDA/PAT at Rs226/113.7bn). The performance was despite Petchem EBIT at a 9 quarter low and Refining margins also declining US$0.2/bbl qoq. The PAT boost was driven by a stellar performance from Retail/JIO segments – EBITDA from these 2 segments grew 62/38% yoy and is now 37% of consol EBITDA vs ~25% a year earlier. Petchem earnings remain flattish, with a sharp jump in volumes to 9.9mt offset by a US$25/t reduction in EBITDA/t to US$103/t. Overall another strong quarter, continuing the transition to a balanced conglomerate with material consumer portfolio from a downstream focused energy company. BUY

JIO/Retail – Strength to Strength

JIO revenue/EBITDA grew 6/8% qoq, helped primarily by ARPU of Rs128.4, higher than CenERs123 offset by lower net subs addition of 15m vs Est 22m. This quarter saw JIO start to include IUC revenue in ARPU but the higher tariff and IUC has driven 22m Subs out of the network. Management has stated these were subs which were using disproportionately high voice/data hence pressuring the network so their exit helps optimise the network and subs addition should normalise over FY21E. Similarly, the Retail business is sustaining growth momentum, with 27/62% Revenue/EBITDA growth yoy and core retail growing faster at 37/62% yoy. Share of these two businesses in consol EBITDA is at 37% and will grow faster over H2FY20.

Downstream businesses – Refining resilient, Petchem remains weak

GRMs for RIL declined US$0.2/bbl qoq, driven by Singapore GRMs hitting a 12 quarter low of US$1.7/bbl. However, given the majority of decline in benchmarks is due to sharply lower FO spreads (>20% of benchmark slates, NIL for RIL) and the sharply higher thruput of 18.1mt (up 1.4mt qoq), segment EBIT of Rs56.6bn still rose 12/14% yoy/qoq. Petchem segment however saw EBIT hit a 8 quarter low, with EBITDA/t hit a 9 quarter low of US$103/t due to record lows seen in Segment deltas. Going forward, we expect GRMs to improve helped by IMO and the Petcoke Gasifier but Petchem margins should remain subdued over the next 12-18 months, with over capacity globally weighing on prospects.

Valuation and View: BUY

The strength in earnings for RIL will sustain over the next 2-3 years, complemented by a steady reduction in net debt and improving prospects across business segments. The JIO/Retail segments continue to beat estimates, with ARPU for JIO also likely to benefit from the ~30% tariff increase w.e.f Dec 2019 and IUC while Retail business steadily widens its lead over peers. The Petchem business has muted prospects, we see earnings being soft over FY20-21E. We have factored weaker downstream margins over FY20-22E driving a10/1/2% reduction in EPS and a 2% reduction in TP to Rs1770. Even at these numbers. FY20-22E EBITDA/EPS CAGR of 19/22% remains market leading, with a 190/155bps improvement in RoE/ROCE by FY22 also a positive. BUY.

Market Data

Bloomberg:	RIL IN
52 week H/L:	1618/1095
Market cap:	Rs10022.3bn
Shares outstanding:	6339.2mn
Free float:	42.3%
Avg. daily vol. 3mth:	8,730,625

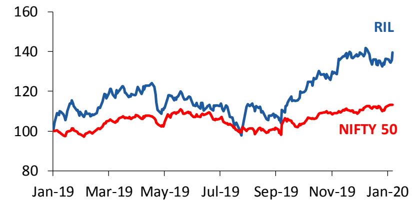
Source: Bloomberg

Changes in the report

Rating:	NIL
Target price:	-2%
EPS:	FY20E -10%, FY21E -1% FY22E -2%

Source: Centrum Research

RIL relative to Nifty 50



Source: Bloomberg

Shareholding pattern

	Sep-19	Jun-19	Mar-19	Dec-18
Promoter	50.1	47.3	47.3	47.2
FIIs	23.7	24.3	24.3	23.9
DIIs	12.2	11.7	11.9	12.3
Public/oth	14.0	16.7	16.6	16.6

Source: BSE

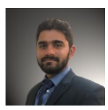
Financial and valuation summary

YE Mar (Rs bn)	Q3FY20	YoY (%)	QoQ (%)	FY19	FY20E	FY21E	FY22E
Revenue	1,529	-2.5%	2.4%	5,671	5,351	6,550	7,543
EBITDA	224	5.0%	1.1%	839	931	1,123	1,326
EBITDA margin (%)	14.6%			14.8%	17.4%	17.2%	17.6%
EBIT	168	4.7%	0.0%	630	716	871	1,029
Adj. PAT	11.0%			11.1%	13.4%	13.3%	13.6%
Diluted EPS (Rs)	120	15.8%	5.9%	398	485	611	721
PE (x)	19.0	15.8%	5.9%	62.8	76.5	96.4	113.7
EV/EBITDA (x)				25.2	20.7	16.4	13.9
P/BV (x)				15.1	13.8	11.3	9.3
RoE (%)				2.6	2.3	2.1	1.8

Source: Company, Centrum Research estimates | **No. of shares adjusted to include Treasury shares, as per new reporting by Company**

Oil & Gas Team

Probal Sen
Analyst, Oil & Gas
+91 22 4215 9001
probal.sen@centrum.co.in



Akshay Mane
Associate, Oil & Gas
+91 22 4215 9265
Akshay.mane@centrum.co.in

Thesis Snapshot

Estimate revisions

YE Mar (Rs bn)	FY20E New	FY20E Old	% chg	FY21E New	FY21E Old	% chg
Revenue	5,351	5,405	-1.0%	6,550	6,699	-2.2%
EBITDA	931	963	-3.3%	1,123	1,132	-0.8%
EBITDA margin (%)	17.4%	17.8%		17.2%	16.9%	
Adj. PAT	485	536	-9.5%	611	618	-1.1%
Diluted EPS (Rs)	76.5	84.6	-9.6%	96.4	97.6	-1.2%

Source: Centrum Research estimates

Centrum estimates vs Actual results

YE Mar (Rs bn)	Centrum Q3FY20	Actual Q3FY20	Variance (%)
Revenue	1,678	1,529	-8.9%
EBITDA	226	224	-1.0%
EBITDA margin (%)	13.5%	14.6%	
Adj. net profit	114	120	5.6%

Source: Bloomberg, Centrum Research estimates

RIL versus NIFTY 50

	1m	6m	1 year
RIL IN	(1.8)	26.6	33.5
NIFTY 50	0.7	8.2	13.3

Source: Bloomberg, NSE

Key assumptions

YE Mar	FY20E	FY21E	FY22E
Brent (USD/bbl)	63.9	65.0	70.0
INR/USD	70.0	70.0	70.0
RIL refinery throughput (mmt)	67.3	68.2	68.2
RIL average GRM (USD/bbll)	9.6	10.5	11.1
Retail EBITDA	100.4	133.1	166.3
Petchem EBIT	282	284	288
Jio EBITDA	212	331	475

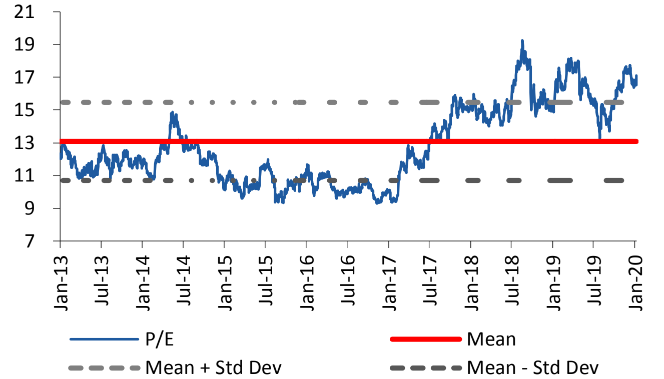
Source: Centrum Research estimates

Valuations

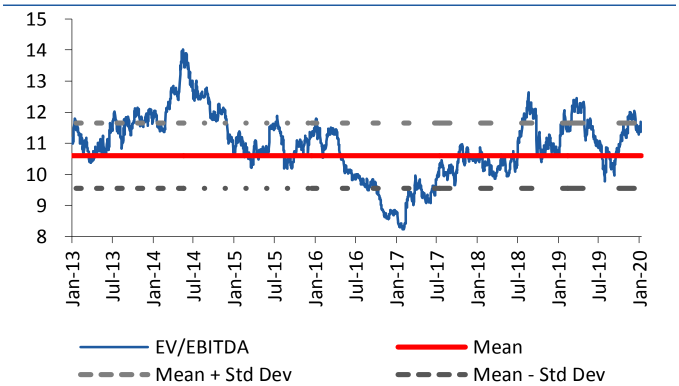
We employ EV/EBITDA multiples for valuing the downstream energy, Retail and Telecom business segments, in line with peers and historical practices. Upstream is valued using DCF for producing assets and EV/boe for unproduced reserves. The range of multiples used for different segments has been explained when discussing relevant segments.

Valuations	Rs/share
Refining + Petchem (7.5x EV/E FY22E)	767
E&P (DCF + EV/boe)	1.5
JIO (8.5x FY22E EBITDA)	675
Retail (19.8x FY22E EBITDA)	518
US shale (0.5x BV)	53
Total EV	**2,019**
Net Debt	**250**
Target price	**1,770**
Upside/(downside) (%)	**11.9**

P/E mean and standard deviation



EV/EBITDA mean and standard deviation



Source: Bloomberg, Centrum Research estimates

Peer comparison

Company	Mkt Cap	EPS CAGR (FY19-21E)	PE (x)			P/Bv (x)			EV/EBITDA (x)			RoE (%)	RoCE (%)
	(Rs mn)	(%)	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY21E	FY21E
RIL	10,022,117	21.9%	25.2	20.7	16.4	2.6	2.3	2.1	15.1	13.8	11.3	12.7	10.0
HPCL	385,549	-6.3%	6.4	8.3	7.3	1.4	1.3	1.2	5.0	7.6	7.2	15.8	9.1
IOCL	1,143,040	0.9%	7.1	9.1	7.0	1.1	1.0	0.9	5.5	7.8	6.7	13.2	10.2
BPCL	925,515	-1.1%	13.0	15.5	13.3	2.5	2.4	2.2	9.7	12.6	11.1	16.6	10.6

Source: Company, Centrum Research estimates

Quarterly financials

Fig 1: Quarterly financials

(Rs bn)	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20
Net sales	1,169	1,288	1,433	1,569	1,387	1,570	1,493	1,529
Other operating income								
Total income	1,169	1,288	1,433	1,569	1,387	1,570	1,493	1,529
Accretion to stocks in trade & work in progress	(14)	(48)	(56)	73	(16)	(46)	9	(14)
Raw material consumed	608	683	767	682	621	709	636	684
Purchase of semi/finished goods/traded goods	228	266	294	358	322	437	357	385
Employee expenses	25	30	29	33	33	33	31	39
Other expenses	137	151	188	210	218	224	238	212
Operating profit (core EBITDA)	185	207	211	213	208	213	222	224
Depreciation	49	52	52	52	53	50	53	55
EBIT	136	155	159	161	155	163	168	168
Interest	26	36	39	41	49	51	55	54
Other revenue/income	22	18	13	25	31	31	36	36
Other excep. items (restructuring, asset sales etc)	-	-	-	-	-	-	-	(2)
Profit before tax	133	137	132	144	138	143	150	149
Tax	38	42	36	41	34	42	37	31
Tax rate (%)	28.6%	30.9%	27.7%	28.2%	24.9%	29.5%	24.7%	20.9%
Net profit	95	95	95	104	104	101	113	118
Less: Minority interest in income								
Add/(less) - share in the profit/(loss) of associates	(0.1)	0.1	0.0	0.2	0.7	0.3	0.5	0.6
Profit/(loss) from discontinued ops	-	-	-	-	-	-	-	(2)
PAT attributable to consolidated group	95	95	95	104	104	101	114	120
Adjusted net profit for the group	95	95	95	104	104	101	114	120
Growth (%)								
Net Sales	17.1%	10.1%	11.3%	9.5%	-11.6%	13.2%	-4.9%	2.4%
EBITDA	5.1%	11.8%	2.2%	1.0%	-2.3%	2.3%	3.9%	1.1%
Adj. PAT	0.3%	0.2%	0.7%	8.7%	0.5%	-2.7%	11.9%	5.9%
Margin (%)								
EBITDA	15.8%	16.0%	14.7%	13.6%	15.0%	13.6%	14.8%	14.6%
EBIT	11.7%	12.0%	11.1%	10.2%	11.2%	10.4%	11.3%	11.0%
Net profit (reported bef minority interest)	8.1%	7.4%	6.7%	6.6%	7.5%	6.4%	7.6%	7.7%
Key drivers								
Brent (USD/bbl)	66.8	74.4	75.3	67.2	63.1	68.6	61.9	62.4
INR/USD	64.6	67.0	70.0	72.0	70.5	69.6	70.4	71.2
RIL refinery throughput (mmt)	16.7	16.6	17.7	18.0	16.0	17.5	16.7	18.1
RIL average GRM (USD/bbll)	11.0	10.5	9.5	8.8	8.2	8.1	9.4	9.2
Singapore GRMs (USD/bbl)	7.0	6.0	6.1	4.3	3.2	3.5	6.5	1.6
KG-D6 Gas (mmscmd)	4.3	4.1	3.7	1.9	1.8	1.8	1.7	1.5

Source: Company, Centrum Research estimates

Fig 2: Key metrics

	Q2FY20	Q3FY20	Comments
GRMs	In Q2, benchmark GRMs saw an improvement due to IMO driven stock piling. Management expects RIL's GRMs to improve with petcoke gasification integration successfully completed.	Limited delta seen from IMO so far except in FO which is a surprise. Management expects some impact of the same to play out over the next few quarters and Petcoke gasification to also help GRMs over FY21E	We expect GRMs to improve in FY21E, with some impact of IMO to be visible in Diesel spreads and Petcoke Gasifier to deliver US$0.7-US$0.8/bbl benefit to overall GRMs
Refinery Ops	Refinery throughput in Q2 was lower than anticipated due to shutdown at one of the refineries in Jul'19. Expect throughput to normalise going forward.	Thruput increased sharply to 18.1mt this quarter and should sustain at ~18mt quarterly over FY21E.	The shutdowns in Q2 made the refinery ready for IMO, with higher coker capacity to improve heavy crude sourcing capability and also some reconfiguration to directly take HSFO as fuel in refinery
Petchem	Management expects pressure to sustain on petchem segment over FY20-21E given new capacity expected, weak demand prospects and pressure on margins	Management expects pressure to sustain on petchem segment over FY20-21E given new capacity expected, weak demand prospects and pressure on margins	RIL Guidance seems more muted for Petchem prospects than earlier - even though the efficiency in costs and flexibility on inputs is expected to drive outperformance to peers
E & P	Maintains production guidance from R-cluster, Satellite cluster and MJ fields	Maintains production guidance from R-cluster, Satellite cluster and MJ fields	RIL expects to bring ~25-30mmscmd of gas flow over FY19-24E from these assets
Retail	RIL added 337 stores in Q2. Management expects to continue strong growth momentum, driven by higher penetration in the Tier 3/4 markets coupled with margin improvement through cost optimisation and improved efficiencies	RIL added 456 stores in Q3 and has added 1057 stores in 9M to a total of 11316 till date. Management expects to continue strong growth momentum, driven by higher penetration in smaller towns, increasing share of private label brands and cost efficiencies	Exponential growth from retail segment to contribute significantly to overall RIL's earnings
Capex	Capex cycle for mobility has broadly been completed with FTTH the only major capex for JIO – With downstream expansions also winding down, capex run rate annually will slow down over FY21-22E	Capex of Rs140bn for the quarter with bulk being concentrated on JIO and balance being in Shale/Retail	Capex guidance has been stopped across segments since last 2-3 qtrs – Q3 total capex at 140bn, will sustain at this run rate of 140-150bn per quarter for next few qtrs, sharply lower than quarterly averages of Rs250-260bn over FY18-19
JIO	JIO remains on track to achieve 500mn subscribers. IUC receipts help ARPU but company does not see this as a tariff increase but a pass thru of costs only	JIO Subs addition of 14-15mn for the qtr; Management does not see runrate getting impacted even post tariff increase	Management has consistently guided to a focus on value proposition for customers aa the priority rather than raising ARPU
JIO FTTH launch	JIO continues to expand its fibre network across the country with short term target of 20mn Households and 15mn enterprise customers maintained.	Current focus is on onboarding the 0.5mn of Test customers to the commercial plans – Management retains focus on onboarding 35m Subscribers in the medium term across categories (Retail + Enterprise)	We continue to monitor the FTTH segment and remains a key monitorable for incremental profitability for the Digital business segment

Source: Company, Centrum Research

Key highlights for Q2

- RIL reported consol PAT of Rs118.4bn (up +14% yoy), ahead of CenE Rs113.8bn, driven by higher earnings from Retail and JIO and higher other income, offset by weak Petchem earnings.
- Reported GRMs of US$9.2/bbl (+5/-2% yoy/qoq), in line, with refining throughput of 18.1mt (+1/8% yoy/qoq), well above CenE 17.5mt due to strong thruput in December 2019. Resultant, refining EBIT of Rs56.6bn (+12/14% yoy/qoq), above CenE Rs51.8bn.
- JIO reported strong result with revenue/EBITDA of Rs139.7bn/56bn vs CenE Rs135/55bn supported by robust ARPU of Rs128 (Est RS123) despite a decline in Net Subs addition to 15m to 370m (CenE 377m). Reported PAT at Rs13.5bn (-15% qoq, CenE Rs11.5bn).
- Retail segment continued its outperformance with Revenue/EBITDA at Rs453/Rs27bn, up +27/+62% yoy. EBITDA margins for the retail segment expanded to 6% in Q3 (vs 5.6% in Q2FY20 and 4.7% in Q3FY19).
- Petchem EBIT of Rs59bn (-28/-23% yoy/qoq), was well below estimates, with a 9 quarter low of US$103/t in EBITDA, supported somewhat by highest-ever volumes of 9.9mt (vs CenE 9.8mt).
- Gross debt of Rs3.1trn, Net debt of Rs2trn (including suppliers credit of Rs580bn). Capex of Rs140bn, a 10 quarter low.

Digital Services (JIO) – Tariff uptick, FTTH, IUC to drive a strong FY21E

JIO reported EBITDA/PAT at Rs56/Rs13.5bn, up 8/36% qoq, (CenE EBITDA/PAT at Rs55.6/Rs11.5bn), driven by higher revenues of Rs139.7bn (+6% qoq). ARPU improved to Rs128.4 (+7% qoq, CenE Rs123) but numbers are not comparable as JIO has started to include IUC in ARPU from this quarter. Net subscriber addition was muted at 15m due to 22m Subs going off the network due to the higher tariffs and IUC being charged by RIL, taking the total subscribers to 370mn (+4% qoq, CenE 377mn). EBITDA margin improved 80bps qoq to 40.1% while EBIT margins rose to 27.2%, up 140bps qoq.

Key highlights of the quarter for JIO (digital services segment)

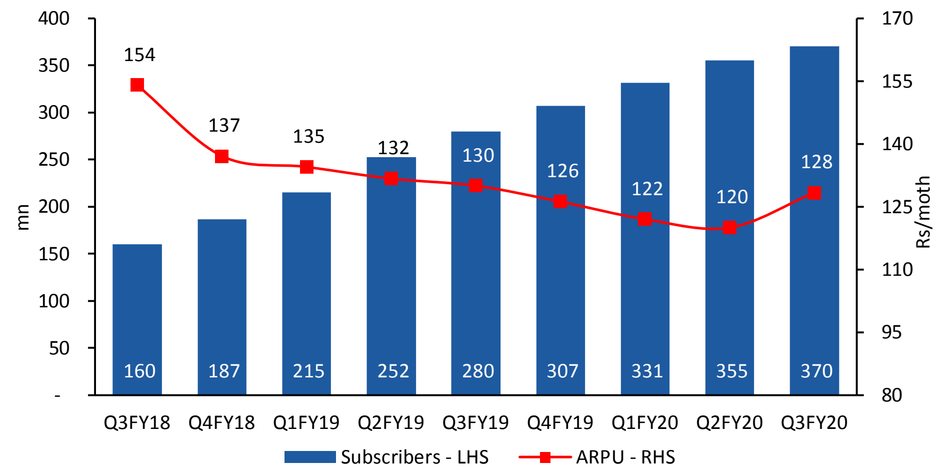
- Revenue (net of GST) for the quarter came in at Rs139.7bn, with EOP subscriber base of ~370mn and a monthly ARPU of Rs128.4 (up from restated ARPU of Rs127.8 in Q2).
- Average data consumption at 11.1GB per user per month (-5% QoQ) and average voice consumption at 760 minutes per user per month.
- Affordable tariff, wider network presence, JioPhone and attractive bundling of digital services are key drivers.
- The company reported EBITDA margin of 40.1% in Q3FY20. Network and license cost marginally increased this quarter to 11.1% and 32% of the revenues in Q3FY20 compared with Q2FY20.
- JIO has now seen its offnet outgoing to incoming calls change in its favour – from 62:38 Outgoing: incoming to 47:53% in Q3, implying that IUC is now a net EBITDA accretive charge for JIO.
- Transaction for subscription of units worth Rs252.2bn of Tower InvIT by Brookfield Infrastructure Partners and affiliates in final stages and to be completed soon. Proceeds from the investment will be used to repay existing financials liabilities of Reliance Jio Infratel (RJIPL), including loans extended by RIL.
- Discussions are ongoing with potential investors for subscription of Fibre InvIT units.

Fig 3: RJio quarterly financials

YE Mar (Rs mn)	Q3FY20	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	FY19	FY20E	FY21E	FY22E
Revenue	1,39,680	1,08,840	28.3%	1,31,300	6.4%	3,88,380	5,65,020	7,82,318	10,21,600
Interconnection & access costs	14,420	15,060	-4.2%	14,310	0.8%	42,070	99,184	90,286	1,06,818
License and spectrum fee	14,830	11,360	30.5%	13,740	7.9%	41,590	40,245	81,560	1,14,222
Network costs	44,230	31,900	38.7%	41,230	7.3%	1,13,380	1,51,816	1,99,548	2,19,295
SG&A costs	7,230	5,740	26.0%	6,930	4.3%	23,800	41,852	58,178	80,146
Employee costs	3,140	4,260	-26.3%	3,700	-15.1%	16,580	20,150	22,100	25,900
EBITDA	56,010	40,530	38.2%	51,660	8.4%	1,51,020	2,11,773	3,30,646	4,75,219
EBITDA margin (%)	40.1%	37.2%		39.3%		38.9%	37.5%	42.3%	46.5%
DD&A	17,960	16,840	6.7%	17,750	1.2%	63,980	64,800	81,280	99,408
EBIT	38,050	23,690	60.6%	33,910	12.2%	87,040	1,46,973	2,49,366	3,75,811
EBIT margin (%)	27.2%	21.8%		25.8%		22.4%	26.0%	31.9%	36.8%
Finance cost	19,530	10,910	79.0%	18,710	4.4%	41,480	56,162	63,151	81,218
PBT	16,750	12,780	31.1%	15,200	10.2%	45,560	90,811	1,86,215	2,94,594
Tax	3,250	4,470	-27.3%	5,300	-38.7%	15,920	27,243	55,864	88,378
Adj. PAT	13,500	8,310	62.5%	9,900	36.4%	29,640	63,568	1,30,350	2,06,216
ARPU (Rs/month)	128	130	-1.2%	120	7.0%	131	128	143	158
Subscribers (mn)	370	280	32.1%	355	4.2%	307	392	470	536

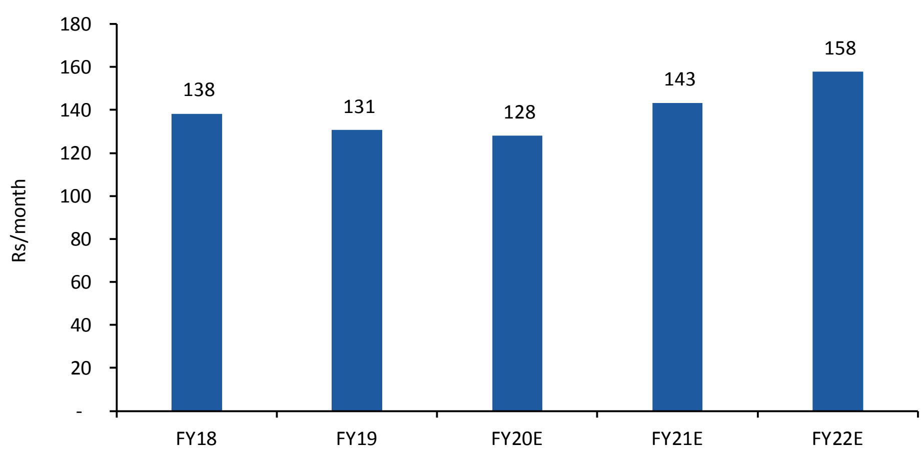
Source: Company, Centrum Research estimates

Fig 4: Growth in subscriber base remains strong; ARPU sees some moderation



Source: Company, Centrum Research

Fig 5: Higher tariffs to drive steady improvement in ARPU over FY20-22E



Source: Company presentation, Centrum Research

FTTH – a key monitorable

RIL received around 15mn registrations from nearly 1,600 towns since last year after they invited registrations of interest for availing FTTH services.Based on the registrations, RIL has drawn a plan to penetrate 20mn residences and 15mn business establishments over the next 12-15M. RIL has built significant momentum in JioFiber roll out and expects to complete the network rollout within the next 12 months. Until last year, JIO had already connected 0.5mn houses for testing. RIL's basic plans for the FTTH starts with 100mbps speed going up to 1Gbps, pricing ranging from Rs700 per month to Rs10,000 per month.

Fig 6: JIO Fiber plan remains competitive among peers

Jio Fiber Prepaid Plans

Plan Name	Bronze	Silver	Gold	Diamond	Platinum	Titanium
Monthly Plan	₹699	₹849	₹1,299	₹2,499	₹3,999	₹8,499
Speed	100 Mbps	100 Mbps	250 Mbps	500 Mbps	1 Gbps	1 Gbps
Data	Unlimited (100 GB+50 GB)	Unlimited (200 GB+200 GB)	Unlimited (500 GB+250 GB)	Unlimited (1250 GB+250 GB)	Unlimited (2,500 GB)	Unlimited (5,000 GB)
Voice	Free					
TV Video Calling	Included (worth ₹1,200/year)					
Gaming	Included (worth ₹1,200/year)					
Home Networking	Included					
Device Security	Up to 5 devices (Worth ₹999/Year)					
VR Experience (IMMERSIVE)				Platform Access Included		
Premium Content				Platform Access Included (First-day first-show movies, special sports content)		
Welcome Offer Home Devices	Included Jio home gateway (worth ₹5,000) +Jio 4K set top box (worth ₹6,000)					
OTT Applications	3 Months JIOCINEMA & JIOSAAVN	3 Months OTT Apps	Annual subscription OTT & apps			

Source: Company presentation, Centrum Research

RIL's acquisition of Hathway, DEN and GTPL to give access to 30,000 LCOs who have direct relationship with these Cable Operators. JIO has also designed a set top box that will accept the broadcast cable TV signals from the LCO partners. This will enable the LCOs to continue to generate steady revenues for their broadcast TV business.

RIL also plans to tap the Small and Medium enterprises along with large business enterprises for the FTTH connections, which will empower them to succeed in the market place. RIL to also provide digital platforms and solutions to these business enterprises by setting up block chain technology across the country, Edge computing and Virtual Reality/Mixed Reality and cloud computing technology.

For cloud computing, RIL has entered into a long term alliance with Microsoft to accelerate the digital transformation in India. RIL will set up data centres across the country and Microsoft will bring their Azure cloud platform into JIO's datacentres.

RIL has set aggressive targets to connect 20mn houses and 15mn commercial establishments which potentially can add Rs275bn in revenue by FY22E (assuming Rs700p.m of ARPU). However, we build in conservative estimates for the FTTH segment with FY20/21/22E ARPU of Rs545/Rs600/Rs660 per month with subscribers in FY20 at 5.8mn to grow to 11.9mn and 18.3mn by FY21E and FY22E.

Fig 7: Our estimates for FTTH segment

(Rs mn)	FY20E	FY21E	FY22E
FTTH Revenue	22,285	31,860	59,747
# cities for FTTH service	14.0	20.0	25.0
Homes passed (mn)	16.5	26.5	36.5
Penetration (%)	35%	45%	50%
FTTH subs (mn)	5.8	11.9	18.3
ARPU (Rs/ month)	545	600	660

Source: Centrum Research estimates

Overall, we expect the momentum to regain strength over FY20-22E delivering an estimated CAGR of 38/47/63% over FY19-22E in revenue/EBITDA/EBIT, respectively. We value the segment at 9x FY22E EV/EBITDA, a material premium to peers, which delivers an EV of Rs675/sh in our SoTP.

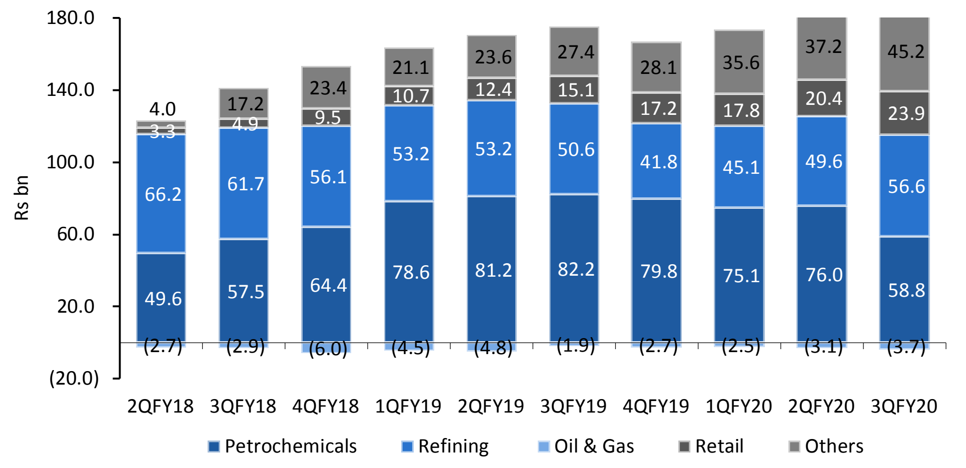
Downstream energy – Petchem sees weakest quarter in 3 years

In Q2FY20, refining + petchem business declined 7% yoy (second consecutive decline)

In Q2FY20, EBIT earnings from refining + petchem business declined 13% yoy, driven by sharp weakness in the Petchem segment. RIL refining EBIT of Rs56.6bn, (+12% yoy, CenE Rs51.8bn), driven by a US$0.6/bbl yoy improvement in GRMs to US$9.2/bbl (qoq decline of US$0.2/bbl but helped by a sharp 1.4mt qoq and 0.1mt qoq improvement in Refining thruput.

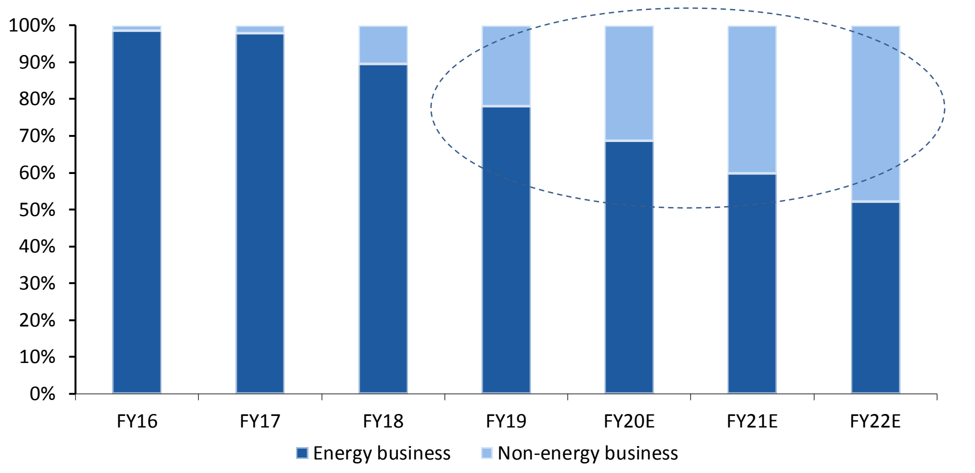
However, Petchem earnings have been a drag on profitability, with a 28/23% yoy/qoq decline in segment EBIT, driven by record low realisations/margins across the value chain. Material oversupply of Petchem globally is driving weakness in spreads and is likely to keep margins subdued over the next 12M.

Fig 8: Segment wise EBIT trend



Source: Company, Centrum Research

Fig 9: Contribution of non-energy business has grown significantly in the past two years



Source: Company, Centrum Research estimates

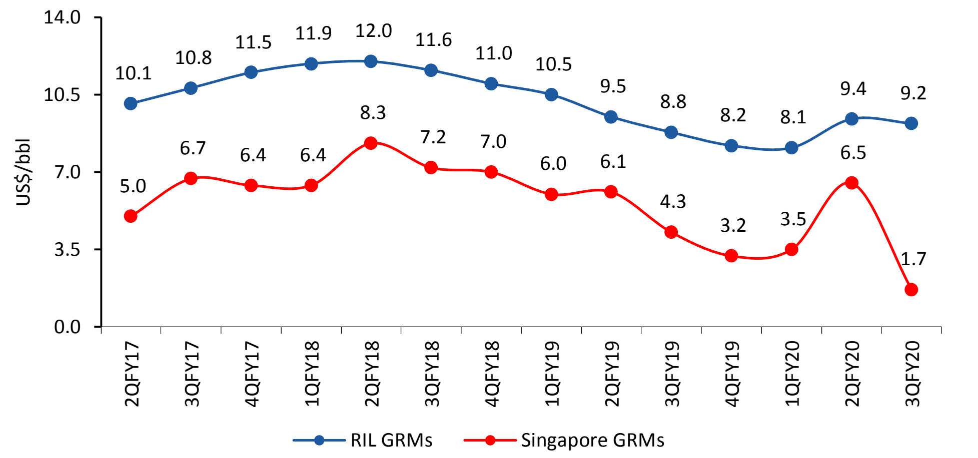
Consumer segments' contribution to reach 45% of consol EBIT by FY22E

In the past two years, the non-energy businesses' EBIT contribution has grown to significant levels. RIL's Chairman Mukesh Ambani had stated his grand ambition to grow the non-energy businesses to as much as all energy segments combined over the next few years and FY19 has been a precursor to that transition. We expect the consumer segments' contribution growing to almost 45% of consolidated EBIT by FY22E and it could cross 50% over FY23-24E, well in line with management's vision and guidance.

Refining – GRMs improve; operating earnings miss driven by lower refining throughput

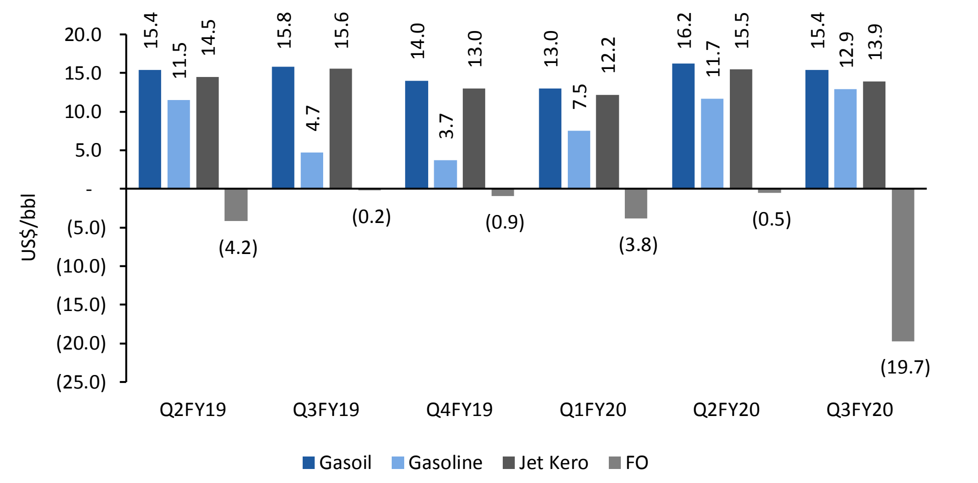
RIL reported GRMs of US$9.2/bbl for the quarter, down US$0.2/bbl QoQ, implying a record premium of US$7.5/bbl over Singapore benchmark (Highest premium in 11 years). GRMs were resilient despite weakness seen in Diesel/ATF spreads offset by better Gasoline spreads. Gasoline spreads improved to US$12.9/bbl (+US$1.2/bbl qoq) while Gasoil cracks averaged at US$15.4/bbl (-US$0.8/bbl qoq). Jet kero spreads also dipped US$1.9/bbl qoq to US$13.9/bbl, and naphtha spreads averaged at a discount of US$2.2/bbl (up from –US$7.8/bbl in Q2).

Fig 10: GRMs dipped qoq…



Source: Company, Centrum Research

Fig 11: …driven by lower Diesel/ATF spreads



Source: Company, Centrum Research

For FY21E, RIL should see a recovery in GRMs, led by IMO and Petcoke gasifier

FY21 should see improved margins for RIL. Driven by some traction via the IMO regulations and the commissioning of the Petcoke Gasifier for RIL.

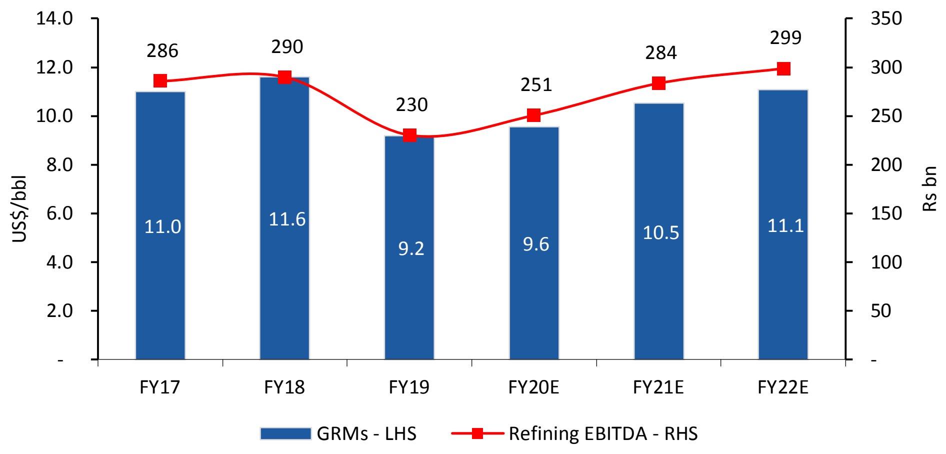
Fig 12: New IMO norms from 2020

Period	Specification
Prior to 1 January 2012	4.50% m/m
On and after 1 January 2012	3.50% m/m
On and after 1 January 2020	0.50% m/m

Source: Company, Centrum Research

We note however that the IMO impact in Diesel spreads is far less than earlier estimated, with Refineries globally able to optimise supply of Very Low Sulphur FO (VLSFO) which has served to substitute for the anticipated jump in global Diesel demand. In this backdrop we have revised downwards our estimates of Diesel spreads for FY21/22E to US$16.5/17.3 per bbl from US$17.5/18 per bbl earlier.

Fig 13: RIL refining performance to pick up over FY21/22E



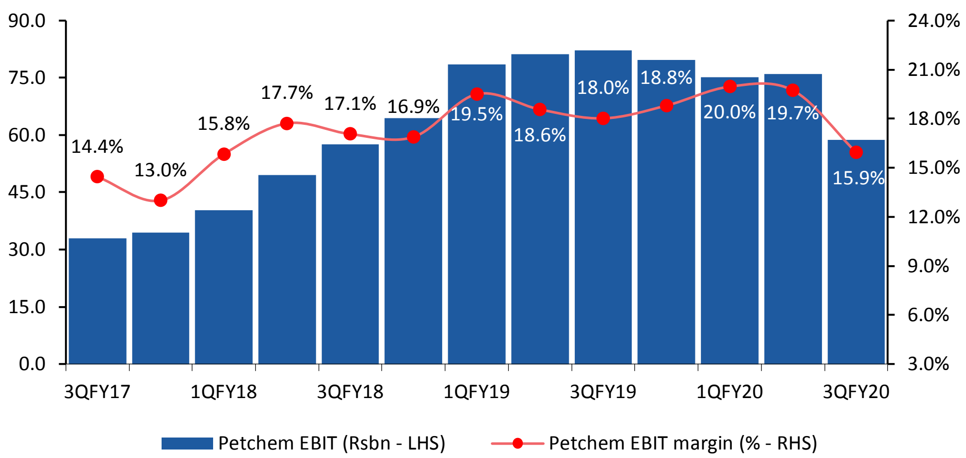
Source: Company, Centrum Research estimates

We expect the Petcoke Gasifier to also start making an impact in GRMs post FY20E. Some recovery in LNG prices should aid economics for the Gasifier and we expect a GRMs boost of US$1.9/bbl in FY21-22E over FY19 from the same for RIL.

Petchem – Highest ever production at 9.9mt; offset by very weak realisations

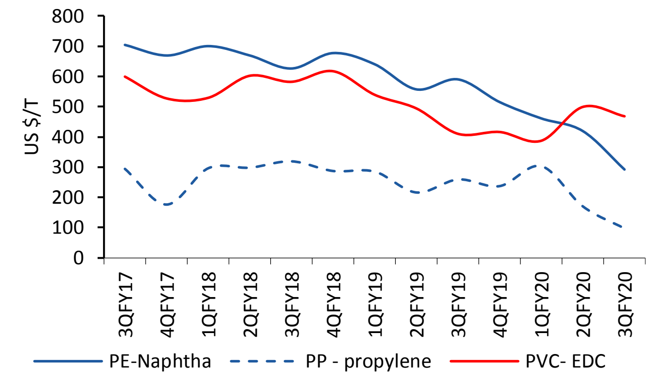
Petchem EBIT at Rs59bn (-28/-23% yoy/qoq), came well below estimates, with higher production of 9.9mt (+2% yoy), in line but lower EBITDA/t of US$103/t, -US$25/t lower qoq and well below estimates of US$118/t . Decade lows seen in Key product prices and margins in major products - Paraxylene (PX), Monoethylene Glycol (MEG), Polyethylene (PE) and Polypropylene (PP) impacted margins.

Fig 14: RIL petchem Strong production cant offset margin weakness



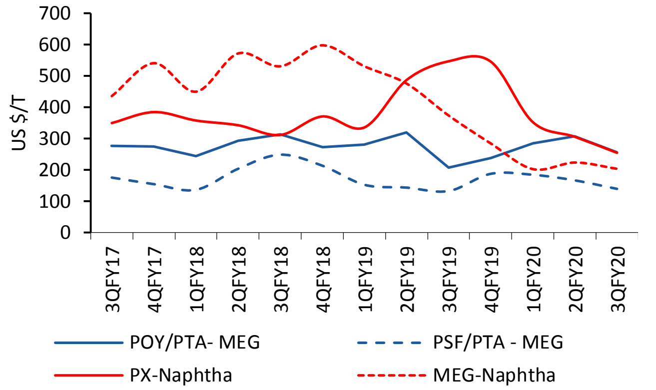
Source: Company, Centrum Research

Fig 15: PE and PP spreads decline



Source: Company, Centrum Research

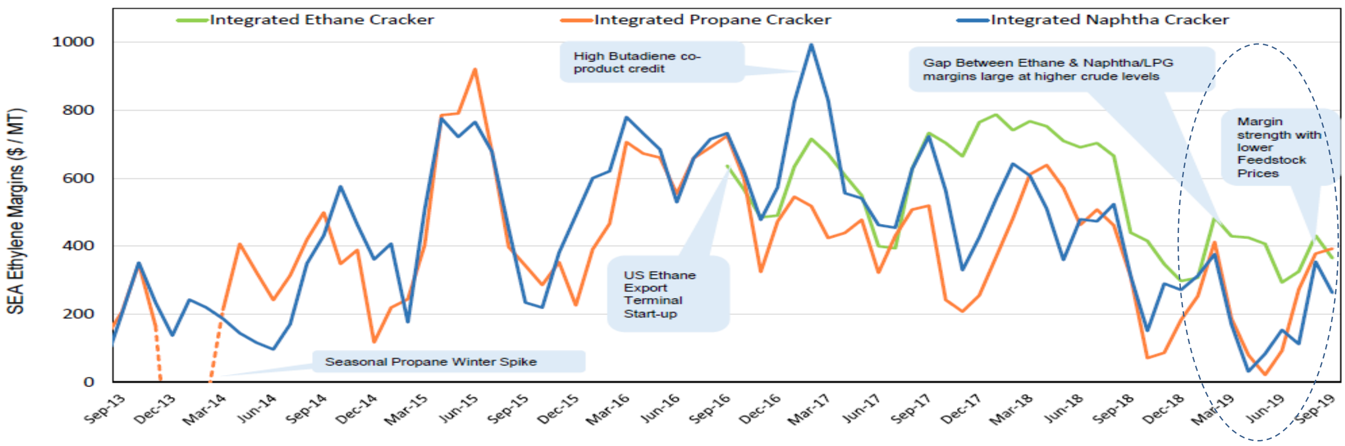
Fig 16: Polyester spreads weak as well



Source: Company, Centrum Research

Despite the sharp decline in PE/PP spreads and a decline seen in PX/MEG – naphtha spreads as well, RIL has managed to report steady earnings from this segment thanks to the gradual shift to US ethane over the last 3-4 quarters from a predominantly naphtha based cracking facility. Ethane crackers have opened up a very wide advantage over traditional Naphtha crackers in the last few months and that has reflected in better margins for RIL as well.

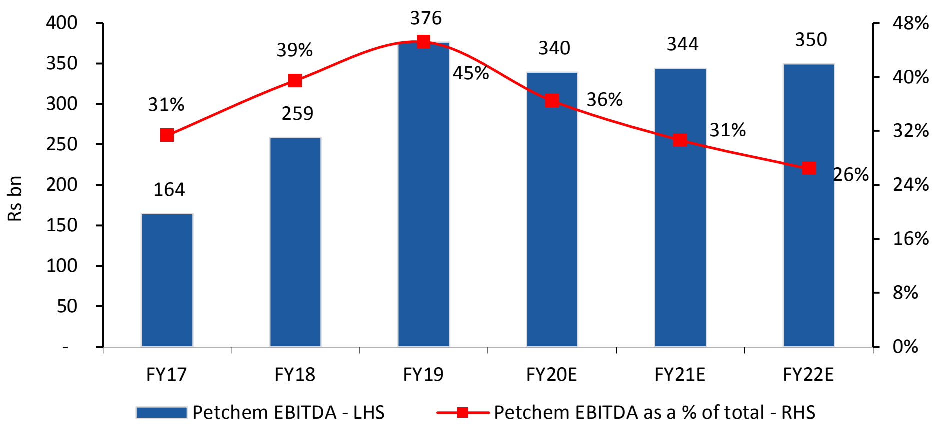
Fig 17: Ethane crackers have opened up a wide gap with Propane/Naphtha based crackers



Source; Company presentation, Centrum research

Due to the weakness persisting in key products spreads and driven by threats of significant capacity additions of 18mtpa globally over the next 3 years, we moderate our assumptions for Petchem segment EBITDA earnings for FY21/22E by ~5-7%.

Fig 18: Petchem profitability to remain muted over FY20-22E



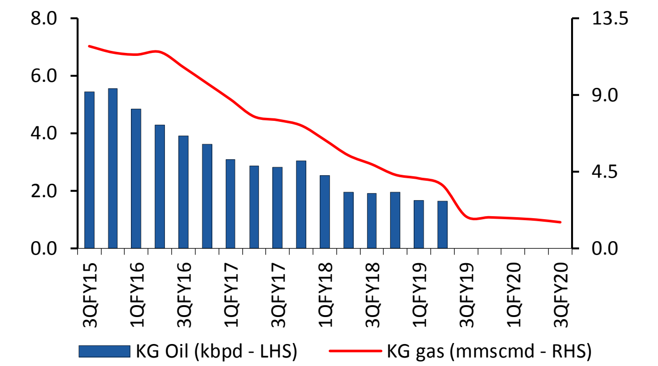
Source: Company, Centrum Research Estimates

E&P – new projects could improve dynamics from FY20-22E

KG D6 gas output fell sharply to 1.5mmscmd, a decline of 18% yoy, and no oil output over the quarter post closure of MA field in Q2FY19. The Panna Mukta fields have seen a decline of 12% yoy in oil, while gas output dipped 5% yoy for the quarter. The CBM fields continue to see gradual ramp up, with an average output of ~0.94 mmscmd for the quarter, which is likely to ramp up steadily over FY21E. CBM phase II activities at advance stages and expected to commission by Q4FY20.

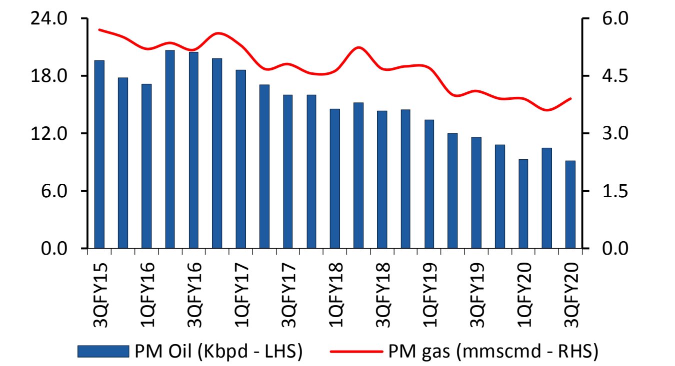
On exploration project updates, the R series fields are part of three major proposed projects in the KG D6 block, which collectively are estimated to produce 3tcf (~0.5bn boe) of incremental gas over the next 5-7 years. R-Cluster development is on track and RIL expects first gas in mid-CY20. Subsequent to this, RIL's board has also approved the development of the second series of fields (Satellite cluster, estimated output of 6-7 mmscmd), with the FDP of the third project MJ1 (estimated output 10-12 mmscmd) also approved. The production from the first of these projects is expected from mid CY20, with subsequent start-ups by CY21-22E.

Fig 19: KG production trend remains muted



Source: Company, Centrum Research

Fig 20: PMT production trends

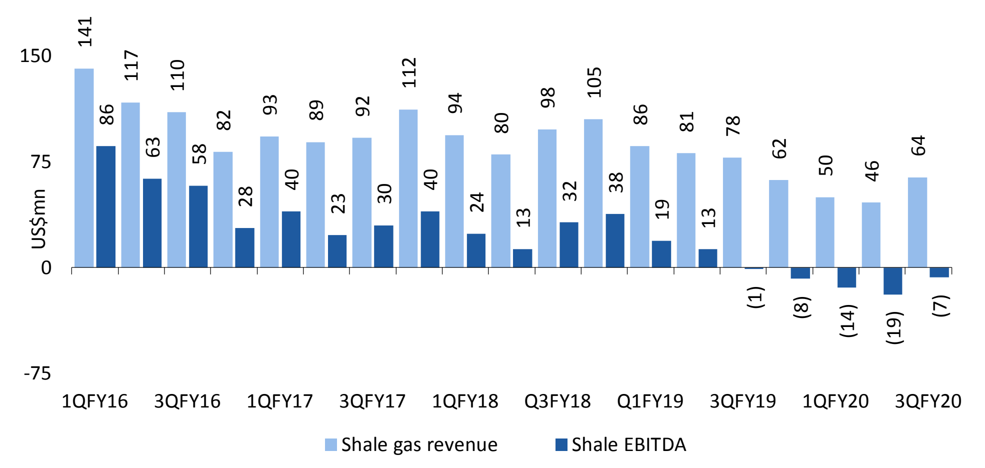


Source: Company, Centrum Research

US shale – Lower volumes keep profitability muted

Gas production from the shale gas business declined 12% qoq, as some new wells came online. Realisations for both oil and gas declined qoq but production is expected to increase further during 1QCY20. We have an overall value of Rs53/sh coming from shale in our SoTP, with shale contribution to our FY20/21E EBITDA at <1%.

Fig 21: US shale – EBITDA losses continue

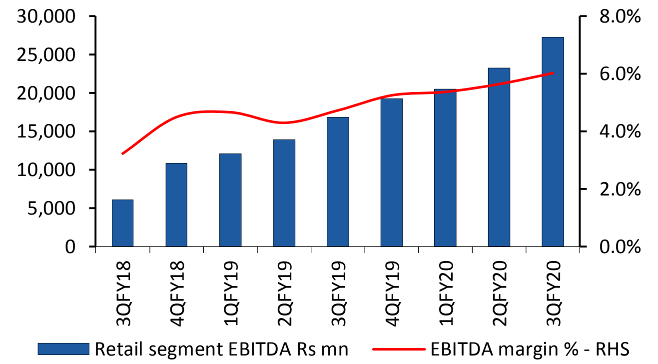


Source: Company, Centrum Research

Retail – Strong growth prospects

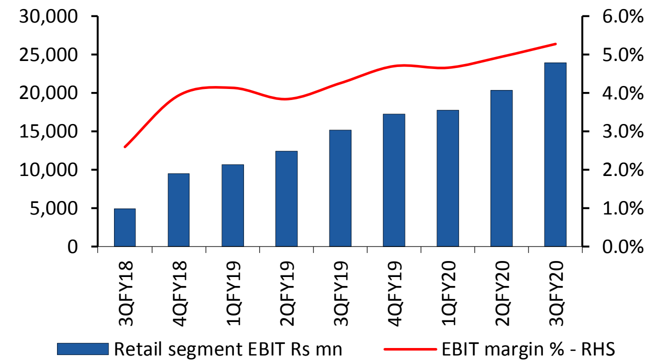
RIL's retail profitability has improved significantly over the past few years. We expect this momentum to sustain at least over the next 2-3 years given the developments highlighted by RIL. Q2 revenue and EBITDA have grown at 27% and 62% yoy, respectively, to Rs453bn/Rs27.3bn. Operating leverage and efficiencies driving significant improvement in EBITDA margins, therefore, expanding by approx. 150bps in the past eight quarters.

Fig 22: Retail EBITDA margins expand…



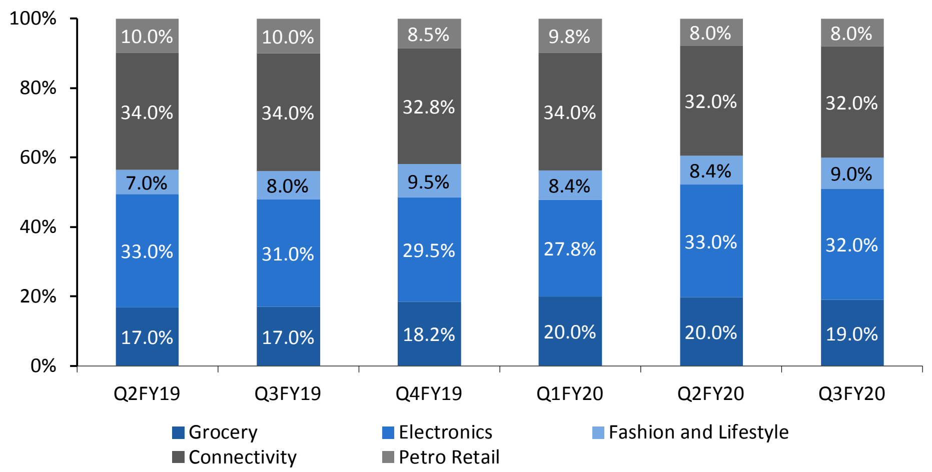
Source: Company, Centrum Research

Fig 23: …so do EBIT margins



Source: Company, Centrum Research

Fig 24: Segment wise Retail Revenue mix; core retail contribution is material



Source: Company, Centrum Research

This quarter has seen RIL Retail cross 11,316 stores pan-India, with 456 stores added during the quarter. The company operates the most extensive store network in the country across 6,900 cities and towns.

RIL Retail to focus on revenue growth drivers by expanding physical store presence and deepening roots in Tier 3/4 markets. Additionally, focus to also on improving EBITDA margins through scale and operational efficiencies in sourcing and supply chain.

We expect the retail business to also gain traction from the gradual build-up of the online profile to complement the strong offline presence already in place. The online portal AJIO now has >0.13mn options in its product catalogue and saw 126mn visits in Q2FY20.

Overall, we believe Retail segment will continue its strong growth momentum and assume ~26% CAGR for RIL Retail revenues over FY19-22E, well below the near 100% growth seen over the past two years as we expect growth from new store openings slowing down as coverage is already at ~98%. Nevertheless, strong LFL growth, which is well ahead of peers, should still propel industry leading growth for RIL Retail over FY20-21E.

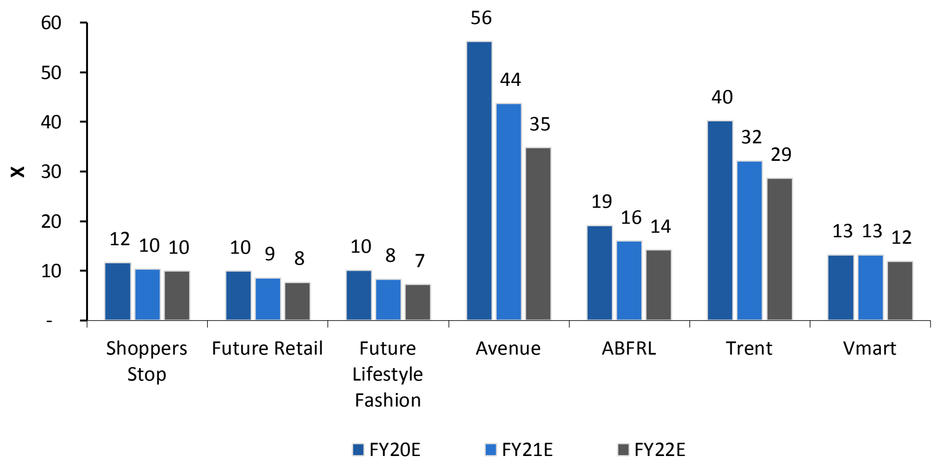
Fig 25: Retail segment summary

YE March (Rs mn)	FY18	FY19	FY20E	FY21E	FY22E
Total revenues	6,91,980	13,05,660	16,76,922	20,96,152	26,20,190
Core retail	3,62,670	7,07,207	9,40,585	11,75,731	14,69,664
Non-core retail	3,29,310	5,66,413	7,36,337	9,20,421	11,50,527
Total EBITDA	25,290	62,010	1,00,414	1,33,064	1,66,330
Core	21,880	50,337	84,517	1,13,192	1,41,490
Non-core	3,410	11,673	15,897	19,872	24,839
Margin (%)					
Core	6.0%	7.1%	9.0%	9.6%	9.6%
Non-core	1.0%	2.1%	2.2%	2.2%	2.2%

Source: Company, Centrum Research estimates

We use EV/EBITDA to value RIL Retail, taking an average of industry peers' multiples to arrive at an 22x FY22E multiple for the core retail business. For the non-core portion, we ascribe 7x multiple as the margins are one-third that of core, but the scale and growth in absolute terms are much higher. As a result, we get an EV of Rs3.3trn, translating into Rs518/sh for this segment in our SoTP.

Fig 26: Range of multiples for peers used for valuing RIL Retail

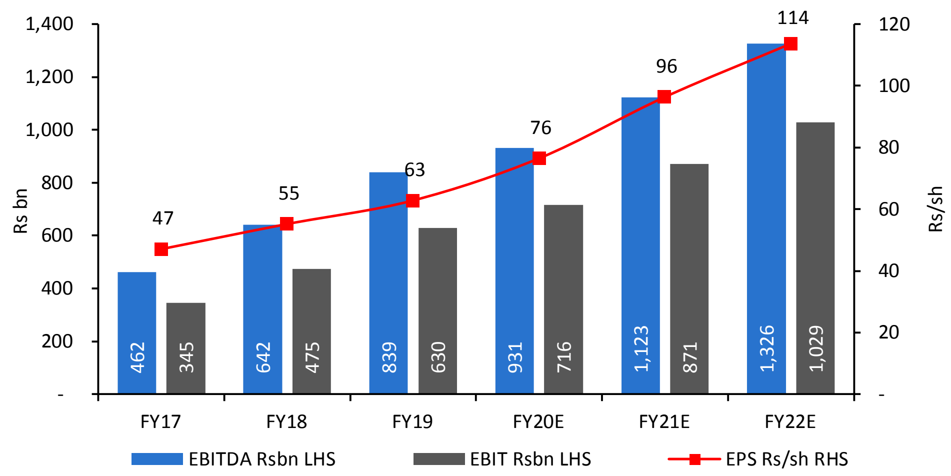


Source: Company, Centrum Research estimates | Note: FY22E EV/EBITDA multiple for Future Lifestyle Fashion not available

Financials and valuations – Earnings to remain robust

We believe JIO and the retail businesses will continue its strong growth momentum while petchem segment will see some pressure in the near term and a recovery in refining via the petcoke gasification project coupled with GRMs improvement on the back of IMO regulations, we build in a strong 22% CAGR in consolidated EPS over FY19-22E. Please note, we have changed the number of shares for previous years for comparable purposes as treasury shares have been included in the diluted share capital of the company.

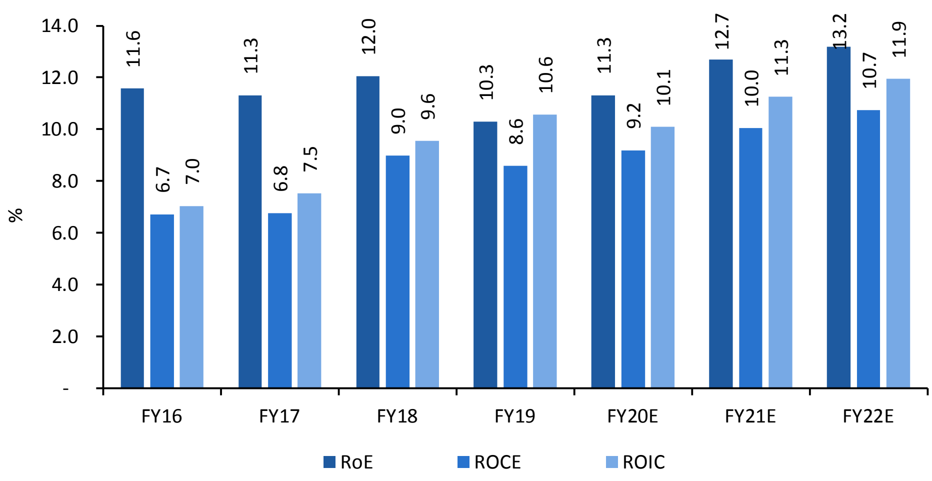
Fig 27: Strong earnings prospects over FY19-22E*



Source: Company, Centrum Research estimates * **EPS based on 6339mn shares (5926mn earlier) as per revised accounting treatment of treasury shares by Company from this quarter**

In addition to sharply higher profitability, we also expect earnings quality to improve over the next few years as reflected in the return ratios trends. Post a sustained period of RoE/RoCE hovering in a very narrow range, we expect higher earnings to reflect in improvement in key return ratios by FY22E as well.

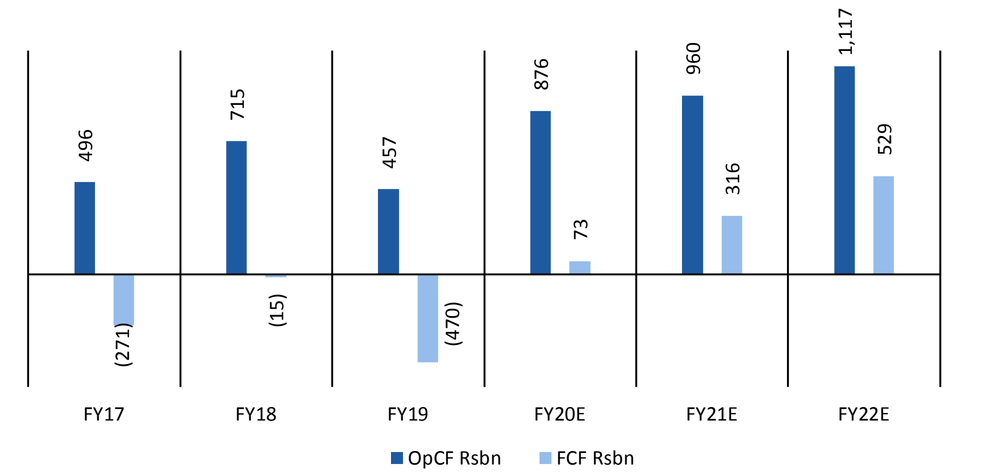
Fig 28: Material improvement in return ratios over FY21-22E



Source: Company, Centrum Research estimates

The improved earnings profile and better-quality earnings also show up in the stronger cash flow profile. We expect FCF for FY20-22E to aggregate >Rs918bn versus a negative FCF of ~Rs800bn over FY16-19.

Fig 29: Cash flows to improve materially over FY19-22E



Source: Company, Centrum Research estimates

Fig 30: RIL SoTP valuation on FY22E financials

(Rs bn)	Basis	Multiple (x)	EBITDA	EV	Rs/sh
Valuation of petchem business	EV/EBITDA	7.5	350	2624	414
Valuation of refining business (incl RPL)	EV/EBITDA	7.5	299	2241	353
Oil & gas producing (PMT and international)	EV/EBITDA	6.0	2	9	1.5
KG-D6 (D1-D3, MA, satel. fields and NEC-25)	DCF			-27	-4.3
Retail	EV/EBITDA	22/7 core/N.core		3287	518
CBM (3.5tcf)	Multiple	USD1.0/boe		55	8.7
Telecom	EV/EBITDA	9.0		4277	675
Shale gas	Multiple	0.5x BV		336	53
Total EV				12802	2019
Net debt (FY21E)				1582	250
Total equity value				**11219**	**1770**
Price (Rs)					**1581**
Upside/(downside) (%)					**11.9**

Source: Company, Centrum Research estimates

Fig 31: Key assumptions

YE March (Rs bn)	FY18	FY19	FY20E	FY21E	FY22E
Brent crude US$/bbl	57.5	71.2	63.9	65.0	70.0
INR/USD	64.6	70.0	70.0	70.0	70.0
Refining thruput mt	69.8	68.3	67.3	68.2	68.2
GRMs US$/bbl	11.6	9.2	9.6	10.5	11.1
Petchem EBITDA	258.6	376.5	339.7	344.2	349.9
Petchem EBIT	211.8	321.7	282.4	284.5	287.6
JIO subs #mn	186.6	306.7	392.0	470.0	536.0
ARPU (Rs)	138.3	130.6	128.0	143.4	157.7
JIO EBITDA	67.3	151.0	211.8	330.6	475.2
Retail revenue growth (%)	104.9%	88.7%	28.4%	25.0%	25.0%
Retail EBITDA margin (%)	3.7%	4.7%	6.0%	6.3%	6.3%
Retail EBITDA	25.3	62.0	100.4	133.1	166.3

Source: Company, Centrum Research estimates

P&L

YE March (Rs bn)	FY18	FY19	FY20E	FY21E	FY22E
Revenues	**3,917**	**5,671**	**5,351**	**6,550**	**7,543**
Materials cost	2,909	4,227	3,866	4,696	5,367
% of revenues	74.3	74.5	72.3	71.7	71.1
Employee cost	95	125	162	211	274
% of revenues	2.4	2.2	3.0	3.2	3.6
Others	271	480	391	519	576
% of revenues	6.9	8.5	7.3	7.9	7.6
EBITDA	**642**	**839**	**931**	**1,123**	**1,326**
EBITDA margin (%)	16.4	14.8	17.4	17.2	17.6
Depreciation & Amortisation	167	209	215	252	296
EBIT	**475**	**630**	**716**	**871**	**1,029**
Interest expenses	81	165	212	207	222
PBT from operations	**394**	**465**	**504**	**665**	**808**
Other income	89	86	144	152	156
Exceptional items	11	-	-	-	-
PBT	**494**	**551**	**648**	**817**	**963**
Taxes	133	154	163	206	243
Effective tax rate (%)	27.0	27.9	25.2	25.2	25.2
PAT	**360**	**397**	**485**	**611**	**721**
Minority/Associates	1	1	-	-	-
Reported PAT	**361**	**398**	**485**	**611**	**721**
Adjusted PAT	**354**	**398**	**485**	**611**	**721**

Ratios

YE March	FY18	FY19	FY20E	FY21E	FY22E
Growth (%)					
Revenue	28.3	44.8	(5.7)	22.4	15.2
EBITDA	38.9	30.8	11.0	20.6	18.0
Adjusted PAT	20.9	10.4	21.7	26.0	17.9
Margin (%)					
EBITDA	16.4	14.8	17.4	17.2	17.6
PBT from operations	12.6	9.7	12.1	12.5	12.8
Adjusted PAT	9.0	7.0	9.1	9.3	9.6
Return (%)					
ROE	12.0	10.3	11.3	12.7	13.2
ROCE	9.0	8.6	9.2	10.0	10.7
ROIC	9.6	10.6	10.1	11.3	11.9
Turnover (days)					
Gross block turnover ratio (x)	0.8	1.0	0.8	0.8	0.9
Debtors	12.0	15.3	19.3	16.4	16.8
Inventory	71.7	55.4	66.2	62.9	65.1
Creditors	85.5	69.2	76.0	71.0	72.9
Solvency (x)					
Net debt-equity	0.6	0.7	0.6	0.5	0.4
Debt-equity	0.8	0.9	0.8	0.8	0.8
Interest coverage ratio	5.9	3.8	3.4	4.2	4.6
Gross debt/EBITDA	3.7	4.1	3.8	3.4	3.1
Current Ratio	0.5	0.7	0.7	0.9	1.1
Per share (Rs)					
Adjusted EPS	55.8	62.8	76.5	96.4	113.7
BVPS	463	611	676	760	862
CEPS	82.1	95.9	110.4	136.2	160.5
DPS	6.0	6.5	10.0	10.0	10.0
Dividend payout (%)	10.5%	10.3%	13.1%	10.4%	8.8%
Valuation (x)					
P/E (adjusted)	28.3	25.2	20.7	16.4	13.9
P/BV	3.4	2.6	2.3	2.1	1.8
EV/EBITDA	18.3	15.1	13.8	11.3	9.3
Dividend yield (%)	0.4	0.4	0.6	0.6	0.6

Source: Company, Centrum Research estimates

Balance Sheet

YE March (Rs bn)	FY18	FY19	FY20E	FY21E	FY22E
Equity share capital	59	59	63	63	63
Reserves & surplus	2,876	3,812	4,221	4,756	5,400
Shareholders' fund	2,935	3,871	4,284	4,819	5,464
Total debt	2,104	3,013	3,029	3,354	3,604
Def tax liab. (net)	245	451	479	500	516
Minority Interest	35	83	83	83	83
Total liabilities	**5,319**	**7,419**	**7,876**	**8,756**	**9,667**
Gross block	5,755	5,845	7,392	8,351	9,161
Less: acc. depreciation	1,774	1,981	2,196	2,448	2,745
Net block	3,981	3,864	5,196	5,903	6,416
Capital WIP	1,870	1,795	1,051	736	515
Net fixed assets	5,851	5,658	6,247	6,639	6,931
Goodwill	58	120	120	120	120
Investments	829	2,355	2,355	2,355	2,355
Inventories	608	676	726	892	1,022
Sundry debtors	176	301	264	323	372
Cash	43	75	15	518	1,146
Loans & advances	549	791	789	817	840
Total current asset	1,375	1,843	1,795	2,550	3,379
Trade payables	1,069	1,083	1,144	1,405	1,610
Other current liab.	1,683	1,433	1,451	1,451	1,451
Provisions	41	42	46	51	58
Net current assets	(1,418)	(714)	(847)	(357)	261
Total assets	**5,319**	**7,419**	**7,876**	**8,756**	**9,667**

Cash flow

YE March (Rs bn)	FY18	FY19	FY20E	FY21E	FY22E
Op profit bef WC changes	628	831	939	1,132	1,335
Trade and other receivables	(357)	(437)	(11)	(253)	(202)
Trade payables	543	186	84	266	212
Net Change – WC	185	(251)	72	13	10
Direct taxes	(98)	(122)	(136)	(185)	(227)
Net cash from operations	**715**	**457**	**876**	**960**	**1,117**
Capital expenditure	(730)	(928)	(804)	(644)	(589)
Acquisitions, net	23	(78)	55	57	60
Others	23	16	81	87	87
Net cash from investing	**(683)**	**(990)**	**(668)**	**(500)**	**(442)**
FCF	**(15)**	**(470)**	**73**	**316**	**529**
Issue of share capital	5	2	4	-	-
Increase/(decrease) in debt	191	833	16	325	250
Dividend paid	(216)	(276)	(288)	(283)	(298)
Net cash from financing	**(20)**	**559**	**(268)**	**42**	**(48)**
Net change in cash	**12**	**26**	**(60)**	**502**	**628**

Source: Company, Centrum Research estimates

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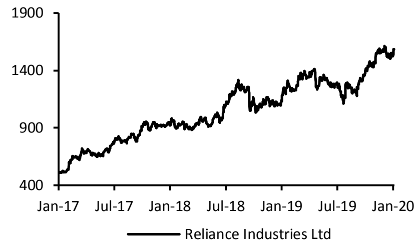
Reliance Industries



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Research Analyst
SEBI Registration No. INH000001469

Mutual Fund Distributor
AMFI REGN No. ARN- 147569

Website: www.centrum.co.in
Investor Grievance Email ID: investor.grievances@centrum.co.in

Compliance Officer Details:
Ashok D Kadambi
(022) 4215 9937; Email ID: compliance@centrum.co.in

Centrum Broking Ltd. (CIN :U67120MH1994PLC078125)

Registered Office Address
Bombay Mutual Building ,
2nd Floor, Dr. D. N. Road,
Fort, Mumbai - 400 001

Corporate Office & Correspondence Address
Centrum House
6th Floor, CST Road, Near Vidya Nagari Marg, Kalina, Santacruz (E),
Mumbai 400 098.
Tel: (022) 4215 9000 Fax: +91 22 4215 9344

Centrum Broking Institutional Equities Team Details			
Nischal Maheshwari	**CEO**	**nischal.maheshwari@centrum.co.in**	**+91-22-4215 9841**
Research Analyst	**Sector**	**E-mail**	**Phone number**
Sneha Prashant	Auto & Auto Ancillary	sneha.prashant@centrum.co.in	+91-22-4215 9928
Cyrus Dadabhoy	BFSI	cyrus.dadabhoy@centrum.co.in	+91-22-4215 9980
Gaurav Jani	BFSI	gaurav.jani@centrum.co.in	+91-22-4215 9110
Milind Suresh Raginwar	Cement & Metals	milind.raginwar@centrum.co.in	+91-22-4215 9201
Shirish Pardeshi	FMCG	shirish.pardeshi@centrum.co.in	+91-22-4215 9634
Ashish Shah	Infra & Aviation	shah.ashish@centrum.co.in	+91-22-4215 9021
Madhu Babu	IT	madhu.babu@centrum.co.in	+91-22-4215 9855
Probal Sen	Oil & Gas	Probal.sen@centrum.co.in	+91-22-4215 9001
Cyndrella Carvalho	Pharma	cyndrella.carvalho@centrum.co.in	+91-22-4215 9643
Sparsh Chhabra	Economist	sparsh.chhabra@centrum.co.in	+91-22-4215 9035
Joaquim Fernandes	Quant	Joaquim.Fernandes@centrum.co.in	+91-22-4215 9363
Equity Sales	**Designation**	**Email**	**Phone number**
Rajesh Makharia	Director	rajesh.makharia@centrum.co.in	+91-22-4215 9854
Paresh Shah	MD	paresh.shah@centrum.co.in	+91-22-4215 9617
Anil Chaurasia	Sr. VP	anil.chaurasia@centrum.co.in	+91-22-4215 9631
Himani Sanghavi	AVP	himani.sanghavi@centrum.co.in	+91-22-4215 9082
Saahil Harwani	Associate	saahil.harwani@centrum.co.in	+91-22-4215 9623