

Buy CL

# Reliance Industries (RELI.BO)

1QFY19 preview: Petchems to shine again, refining margins set to grow ahead; CL-Buy

<b>RELI.BO</b>	12m Price Target: <b>Rs1,340.00</b>	Price: <b>Rs1,025.75</b>	Upside: <b>30.6%</b>
<b>RELIq.L</b>	12m Price Target: <b>\$41.57</b>	Price: <b>\$28.60</b>	Upside: <b>45.4%</b>

We expect 1QFY19 EBITDA for Reliance to grow 45% yoy (+2% qoq) with petchem growth more than offsetting slight decline in refining margins. We believe investors will continue to get surprised by the stability of new and improved chemical business earnings even amid rising oil prices and lower polyethylene spreads, while volumes will also grow qoq due to ramp-up of the new projects. On refining, while margins may sequentially decline (but still well ahead of benchmark and peers), we believe stage is set for margin expansion in subsequent quarters driven by: (1) ramp-up of petcoke gasification project boosting GRMs by c.\$2/bbl with full impact likely in 4QFY19 (1QCY19) and (2) IMO 2020 sulphur regulations to drive GRMs higher starting 2QFY20 (3QCY19) with peak GRM potential of US\$18-19/bbl (+\$5/bbl) in CY2020. We see 31% upside to our 12-month SOTP-based target price.

**Exhibit 1: We see 31% upside to our SOTP-based TP of Rs1,340**  
RIL SOTP

	EBITDA Rs bn	Multiple x	EV Rs bn	Per share Rs	EV %
Chemicals	366	8.0	2,930	453	26%
Refining & Marketing	424	8.0	3,395	525	30%
E&P			511	79	4%
Treasury stock			526	81	5%
Organized Retail			1,089	168	10%
Telecom (Jio)			2,916	451	26%
<b>Total</b>			<b>11,367</b>	<b>1,759</b>	
Net debt			1,747	270	
<b>Implied equity value</b>			<b>9,620</b>	<b>1,489</b>	
<b>Conglomerate Discount(10%)</b>				<b>149</b>	
<b>FY20E based SOTP valuation</b>				<b>1,340</b>	

Source: Goldman Sachs Global Investment Research

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## Key Data

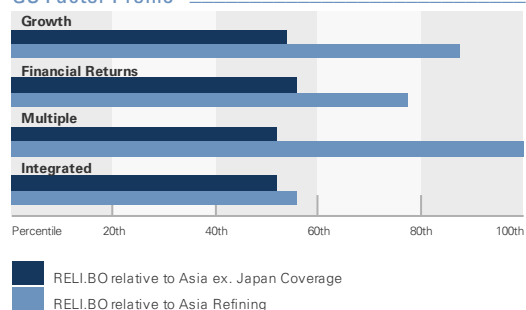
Market cap: Rs6.7tr / \$97.6bn  
Enterprise value: Rs8.1tr / \$117.7bn  
3m ADTV: NA  
India  
Asia Refining  
M&A Rank: 3  
Asia ex. Japan Conviction List

## GS Forecast

	3/18	3/19E	3/20E	3/21E
<b>Revenue (Rs mn) New</b>	<b>4,082,650.0</b>	<b>5,686,365.6</b>	<b>5,702,789.1</b>	<b>5,853,825.3</b>
Revenue (Rs mn) Old	4,082,650.0	5,729,356.6	5,683,560.7	5,835,574.0
EBITDA (Rs mn)	642,350.0	830,184.2	1,091,280.4	1,267,231.6
<b>EPS (Rs) New</b>	<b>55.83</b>	<b>70.99</b>	<b>90.46</b>	<b>108.35</b>
EPS (Rs) Old	55.83	74.27	90.61	108.57
P/E (X)	14.8	14.4	11.3	9.5
P/B (X)	1.8	2.0	1.7	1.5
Dividend yield (%)	0.7	0.6	0.7	0.7
CROCI (%)	7.9	10.1	12.3	13.3

	3/18	6/18E	9/18E	12/18E
EPS (Rs)	14.60	15.28	17.37	18.52

## GS Factor Profile



Source: Company data, Goldman Sachs Research estimates.  
See disclosures for details.

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Buy

## Reliance Industries (RELI.BO)

Rating since Feb 6, 2012

## Ratios &amp; Valuation

	3/18	3/19E	3/20E	3/21E
P/E (X)	14.8	14.4	11.3	9.5
P/B (X)	1.8	2.0	1.7	1.5
FCF yield (%)	(1.2)	5.9	6.5	9.2
EV/EBITDA (X)	13.3	9.8	7.1	5.7
CROCI (%)	7.9	10.1	12.3	13.3
ROE (%)	12.9	14.6	16.2	16.6
Net debt/equity (%)	59.7	42.2	26.3	10.0
Interest cover (X)	5.9	6.6	9.6	12.3
Days inventory outst, sales	49.1	44.9	50.6	50.0
Receivable days	11.5	11.7	12.1	12.0
Days payable outstanding	110.9	107.5	133.7	136.4
DuPont ROE (%)	12.1	13.6	14.9	15.3
Turnover (X)	0.5	0.7	0.7	0.7
Leverage (X)	2.7	2.5	2.2	2.0

## Growth &amp; Margins (%)

	3/18	3/19E	3/20E	3/21E
Total revenue growth	33.7	39.3	0.3	2.6
EBITDA growth	39.4	29.2	31.5	16.1
EPS growth	20.6	27.2	27.4	19.8
DPS growth	9.1	8.3	7.7	7.1
EBIT margin	11.6	10.9	14.1	16.4
EBITDA margin	15.7	14.6	19.1	21.6
Net income margin	8.8	8.1	10.2	12.0

## Price Performance



Source: FactSet. Price as of 10 Jul 2018 close.

## Income Statement (Rs mn)

	3/18	3/19E	3/20E	3/21E
Total revenue	4,082,650.0	5,686,365.6	5,702,789.1	5,853,825.3
Cost of goods sold	(3,018,645.4)	(4,227,956.8)	(3,887,045.9)	(3,866,045.0)
SG&A	(421,654.6)	(628,224.6)	(724,462.9)	(720,548.7)
R&D	—	—	—	—
Other operating inc./ (exp.)	—	—	—	—
<b>EBITDA</b>	<b>642,350.0</b>	<b>830,184.2</b>	<b>1,091,280.4</b>	<b>1,267,231.6</b>
Depreciation & amortization	(167,060.0)	(213,038.0)	(288,965.0)	(309,243.6)
<b>EBIT</b>	<b>475,290.0</b>	<b>617,146.1</b>	<b>802,315.4</b>	<b>957,988.0</b>
Net interest inc./ (exp.)	1,070.0	(20.2)	2,541.7	7,381.9
Income/(loss) from associates	7,030.0	7,030.0	7,030.0	7,030.0
<b>Pre-tax profit</b>	<b>483,390.0</b>	<b>624,156.0</b>	<b>811,887.0</b>	<b>972,399.9</b>
Provision for taxes	(122,590.0)	(165,401.3)	(227,328.4)	(272,272.0)
Minority interest	(50.0)	(50.0)	(50.0)	(50.0)
Preferred dividends	—	—	—	—
<b>Net inc. (pre-exceptionals)</b>	<b>360,750.0</b>	<b>458,704.6</b>	<b>584,508.7</b>	<b>700,078.0</b>
Post-tax exceptionals	—	—	—	—
<b>Net inc. (post-exceptionals)</b>	<b>360,750.0</b>	<b>458,704.6</b>	<b>584,508.7</b>	<b>700,078.0</b>
<b>EPS (basic, pre-exception) (Rs)</b>	<b>55.83</b>	<b>70.99</b>	<b>90.46</b>	<b>108.35</b>
<b>EPS (diluted, pre-exception) (Rs)</b>	<b>55.83</b>	<b>70.99</b>	<b>90.46</b>	<b>108.35</b>
<b>EPS (basic, post-exception) (Rs)</b>	<b>55.83</b>	<b>70.99</b>	<b>90.46</b>	<b>108.35</b>
<b>EPS (diluted, post-exception) (Rs)</b>	<b>55.83</b>	<b>70.99</b>	<b>90.46</b>	<b>108.35</b>
DPS (Rs)	6.00	6.50	7.00	7.50
Div. payout ratio (%)	10.7	9.2	7.7	6.9

## Balance Sheet (Rs mn)

	3/18	3/19E	3/20E	3/21E
Cash & cash equivalents	618,530.0	641,882.4	688,986.2	1,165,379.5
Accounts receivable	175,550.0	189,545.5	190,093.0	195,127.5
Inventory	608,370.0	789,773.0	792,054.0	813,031.3
Other current assets	435,410.0	435,410.0	435,410.0	435,410.0
<b>Total current assets</b>	<b>1,837,860.0</b>	<b>2,056,610.9</b>	<b>2,106,543.3</b>	<b>2,608,948.3</b>
Net PP&E	5,909,070.0	6,037,648.9	6,028,558.9	5,962,802.8
Net intangibles	—	—	—	—
Total investments	62,340.0	62,340.0	62,340.0	62,340.0
Other long-term assets	354,210.0	354,210.0	354,210.0	354,210.0
<b>Total assets</b>	<b>8,163,480.0</b>	<b>8,510,809.8</b>	<b>8,551,652.1</b>	<b>8,988,301.0</b>
Accounts payable	1,068,610.0	1,421,591.4	1,425,697.3	1,463,456.3
Short-term debt	746,640.0	746,640.0	746,640.0	746,640.0
Other current liabilities	1,323,270.0	1,223,270.0	1,073,270.0	923,270.0
<b>Total current liabilities</b>	<b>3,138,520.0</b>	<b>3,391,501.4</b>	<b>3,245,607.3</b>	<b>3,133,366.3</b>
Long-term debt	1,643,850.0	1,323,850.0	973,850.0	873,850.0
Other long-term liabilities	410,660.0	410,660.0	410,660.0	410,660.0
<b>Total long-term liabilities</b>	<b>2,054,510.0</b>	<b>1,734,510.0</b>	<b>1,384,510.0</b>	<b>1,284,510.0</b>
<b>Total liabilities</b>	<b>5,193,030.0</b>	<b>5,126,011.4</b>	<b>4,630,117.3</b>	<b>4,417,876.3</b>
Preferred shares	—	—	—	—
Total common equity	2,935,060.0	3,349,358.3	3,886,044.7	4,534,884.6
<b>Minority interest</b>	<b>35,390.0</b>	<b>35,440.0</b>	<b>35,490.0</b>	<b>35,540.0</b>
<b>Total liabilities &amp; equity</b>	<b>8,163,480.0</b>	<b>8,510,809.7</b>	<b>8,551,652.0</b>	<b>8,988,300.9</b>
Gross cash invested (ex cash)	6,535,460.0	6,819,494.1	7,248,091.7	7,629,831.9
Net debt, adjusted	1,771,960.0	1,428,607.6	1,031,503.8	455,110.5
Average capital employed	4,486,610.0	4,777,908.0	4,883,222.2	4,989,286.8
BVPS (Rs)	454.26	518.38	601.44	701.86

## Cash Flow (Rs mn)

	3/18	3/19E	3/20E	3/21E
Net income	360,750.0	458,704.6	584,508.7	700,078.0
D&A add-back	167,060.0	213,038.0	288,965.0	309,243.6
Minority interest add-back	—	—	—	—
Net (inc)/dec working capital	275,990.0	57,582.9	(148,722.6)	(138,252.7)
Other operating cash flow	(77,211.0)	(6,959.8)	(9,521.7)	(14,361.9)
<b>Cash flow from operations</b>	<b>726,589.0</b>	<b>722,365.7</b>	<b>715,229.4</b>	<b>856,706.9</b>
Capital expenditures	(792,530.0)	(332,275.0)	(279,875.0)	(243,487.5)
Acquisitions	0.0	0.0	0.0	—
Divestitures	—	—	—	—
Others	31,554.9	100,429.5	93,083.1	92,423.4
<b>Cash flow from investing</b>	<b>(760,975.1)</b>	<b>(231,845.5)</b>	<b>(186,791.9)</b>	<b>(151,064.1)</b>
Dividends paid (common & pref)	(40,990.5)	(44,406.4)	(47,822.2)	(51,238.1)
Inc/(dec) in debt	222,380.0	(320,000.0)	(350,000.0)	(100,000.0)
Other financing cash flows	(131,303.4)	(102,761.5)	(83,511.5)	(78,011.5)
<b>Cash flow from financing</b>	<b>50,086.1</b>	<b>(467,167.8)</b>	<b>(481,333.7)</b>	<b>(229,249.5)</b>
<b>Total cash flow</b>	<b>15,700.0</b>	<b>23,352.4</b>	<b>47,103.9</b>	<b>476,393.2</b>
Free cash flow	(65,941.0)	390,090.7	435,354.4	613,219.4

Source: Company data, Goldman Sachs Research estimates.

### Our expectations for key earnings segments

**Refining:** We expect 1QFY19 GRM of US\$10/bbl, a sequential decline by US\$1/bbl. Margin decline will be driven by lower margins for light distillates in the quarter and higher oil price impacting petcoke margins. We expect GRM to improve in 2HFY19 with ramp-up of petcoke gasification project.

**Petchem:** We expect petchem EBITDA to grow by 6% qoq mainly driven by improving margins for PP and polyester chains more than offsetting weakness in PE margins. Reliance diversified feedstock mix (off gas, naphtha and imported ethane) provides further insulation from decline in PE margins.

**Jio:** We expect 4Q Jio revenues of Rs 72 bn (up 1% qoq) with subscriber of 210 mn (+13% qoq) and ARPU of Rs 121 (-12% qoq). We expect ARPU to come down qoq driven by price cuts and lack of prime ARPU of existing customer base. Our discussions with investors suggest three key focus areas for Jio in 4Q will be (1) direction of pricing action for the smartphone tariffs, (2) future capex program and (3) launch of FTTH business.

**Valuation:** We continue to value RIL on an SOTP basis. We use EV/EBITDA to value the core refining and petchem business, and we use DCF to value the high-growth telecom and retail business. Refining, petrochemical and telecom are the key drivers of our valuation, accounting for c.80% of EV. We tweak our 12-month FY20 SOTP based TP on changes in FY20 earnings. We see 31% upside to our TP of Rs1,340 (previously Rs1,345). We tweak RIL GDR TP from US\$41.73 to US\$41.57.

We update our FY19-21E EPS by -4.4%/-0.2%/-0.2% mainly on lower GRMs for FY19. Our FY19/20/21 EPS estimates move to Rs70.99/90.46/108.35 from Rs74.27/90.61/108.57.

**Key risk:** Key risks include lower-than-expected refining/chemical margins, lower-than-expected ARPU, project delays and higher future capex.

#### Exhibit 2: We expect petchem growth to be partially offset by GRM weakness in 1QFY19

RIL quarterly EBITDA, Rs bn

	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19E	QOQ	YOY
Refining	74	77	72	67	63	-5%	-15%
Chemical	50	60	70	77	82	6%	62%
Retail	4	5	6	11	9	-16%	119%
Telecom	0	14	26	27	27	1%	NM
Others	-3	0	1	3	7	NM	NM
<b>Total</b>	<b>126</b>	<b>156</b>	<b>176</b>	<b>185</b>	<b>188</b>	<b>2%</b>	<b>50%</b>

Source: Company data, Goldman Sachs Global Investment Research

**Exhibit 3: Benefit from petcoke gasification improve with higher oil and lower coke prices**

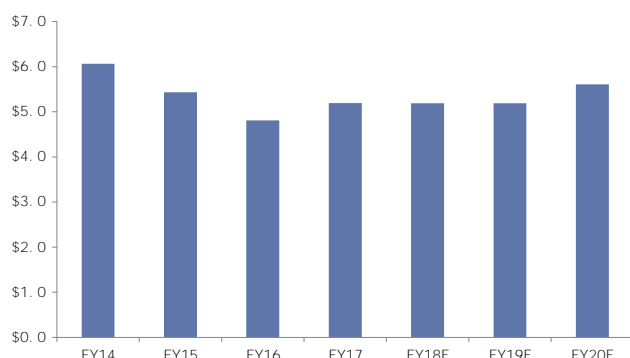
Sensitivity of petcoke gasification benefits

		Petcoke price (US\$/bbl)				
		\$70	\$80	\$90	\$100	\$110
Oil (US\$/bbl)	\$40	\$0.9	\$0.7	\$0.6	\$0.4	\$0.3
	\$50	\$1.4	\$1.2	\$1.0	\$0.9	\$0.7
	\$60	\$1.8	\$1.7	\$1.5	\$1.4	\$1.2
	\$70	\$2.3	\$2.2	\$2.0	\$1.9	\$1.7
	\$80	\$2.8	\$2.6	\$2.5	\$2.3	\$2.2

Source: Goldman Sachs Global Investment Research

**Exhibit 5: RIL's new chemical portfolio appears highly stable**

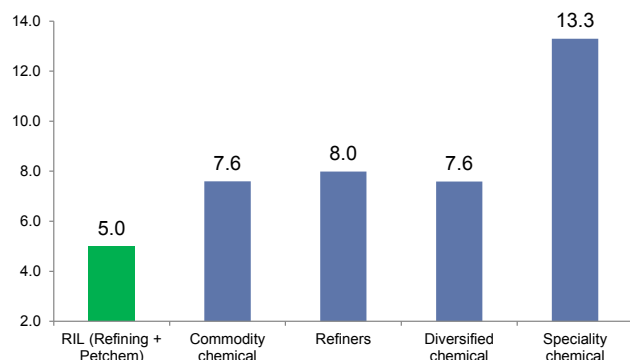
Chemical EBITDA backtested, US\$ bn (Current chemical portfolio under previous year prices/margins)



Source: Goldman Sachs Global Investment Research

**Exhibit 7: Stability of core earnings is not reflected in valuations in our view**

FY20 EV/EBITDA



Source: Goldman Sachs Global Investment Research

**Exhibit 4: We expect RIL GRM to rise meaningfully in FY21, driven by higher distillate cracks and rising discount for heavier crudes**

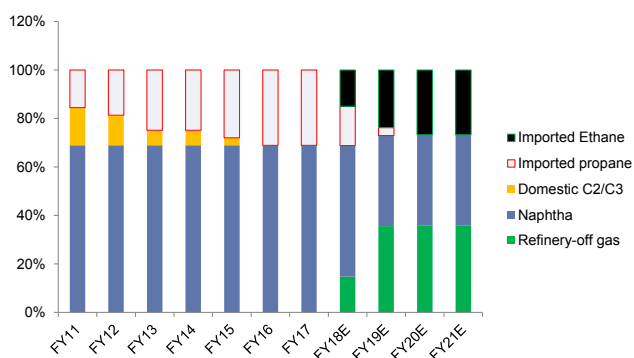
RIL GRM derivation

RIL		FY18	FY21
Naphtha	16%	\$0	(\$0)
Gasoline	20%	\$15	\$17
Diesel/Jet	46%	\$13	\$20
LPG	5%	(\$15)	(\$15)
Petcoke	5%	(\$34)	(\$34)
FO	0%	(\$5)	(\$25)
Aromatic	8%	\$30	\$34
Margin		\$9.2	\$12.8
Fuel and loss		(\$1.1)	(\$1.4)
Crude benefits		\$3.5	\$5.5
Petcoke gasification			\$1.5
<b>GRM</b>		<b>\$11.5</b>	<b>\$18.5</b>

Source: Company data, Goldman Sachs Global Investment Research

**Exhibit 6: RIL's chemical feedstock flexibility and diversity is expected to improve**

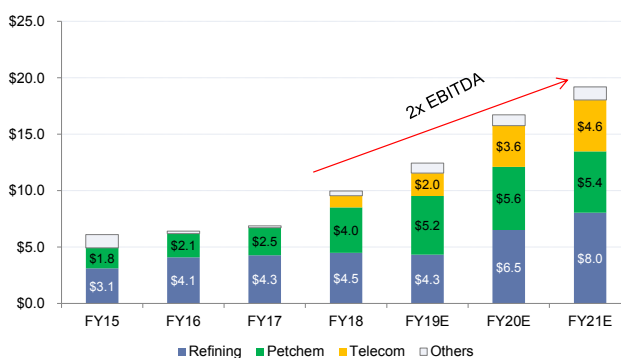
Feedstock mix (70% feed supplied from RIL's own refinery)



Source: Company data, Goldman Sachs Global Investment Research

**Exhibit 8: We expect RIL's EBITDA to double by FY21**

RIL EBITDA by segment (US\$ bn)



Source: Company data, Goldman Sachs Global Investment Research

# Disclosure Appendix

## Reg AC

We, Nikhil Bhandari and Vinit Joshi, hereby certify that all of the views expressed in this report accurately reflect our personal views about the subject company or companies and its or their securities. We also certify that no part of our compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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**Growth** is based on a stock's forward-looking sales growth, EBITDA growth and EPS growth (for financial stocks, only EPS and sales growth), with a higher percentile indicating a higher growth company. **Financial Returns** is based on a stock's forward-looking ROE, ROCE and CROCI (for financial stocks, only ROE), with a higher percentile indicating a company with higher financial returns. **Multiple** is based on a stock's forward-looking P/E, P/B, price/dividend (P/D), EV/EBITDA, EV/FCF and EV/Debt Adjusted Cash Flow (DACF) (for financial stocks, only P/E, P/B and P/D), with a higher percentile indicating a stock trading at a higher multiple. The **Integrated** percentile is calculated as the average of the Growth percentile, Financial Returns percentile and (100% - Multiple percentile).

Financial Returns and Multiple use the Goldman Sachs analyst forecasts at the fiscal year-end at least three quarters in the future. Growth uses inputs for the fiscal year at least seven quarters in the future compared with the year at least three quarters in the future (on a per-share basis for all metrics).

For a more detailed description of how we calculate the GS Factor Profile, please contact your GS representative.

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## Disclosures

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Nikhil Bhandari: Asia Chemicals, Asia Refining, India/ASEAN Oil & Gas. Vinit Joshi: India/ASEAN Oil & Gas.

Asia Chemicals: China Steel Chemical, Far Eastern New Century Corp., Formosa Chemicals & Fibre, Formosa Petrochemical Corp., Formosa Plastics, Hanwha Chemical, IRPC PCL, Kumho Petro Chemical Co., LG Chem, Lotte Chemical, Nan Ya Plastics, Petronas Chemicals Group, PTT Global Chemical, Taiwan Synthetic Rubber Corp..

Asia Refining: Bangchak Corp PCL, Bharat Petroleum, GS Holdings, Hindustan Petroleum, Indian Oil Corp., Reliance Industries, Reliance Industries (GDR), S-Oil Corp., SK Innovation, Thai Oil.

India/ASEAN Oil & Gas: First Resources, Gas Authority of India, Golden Agri-Resources Ltd., Gujarat State Petronet, Indraprastha Gas Ltd., Oil & Natural Gas Corp., Oil India, Perusahaan Gas, Petronet LNG, PTT Exploration and Production PCL, PTT Public Co., Wilmar International.

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Goldman Sachs expects to receive or intends to seek compensation for investment banking services in the next 3 months: Reliance Industries (Rs1,025.75) and Reliance Industries (GDR) (\$28.60)

Goldman Sachs had an investment banking services client relationship during the past 12 months with: Reliance Industries (Rs1,025.75) and Reliance Industries (GDR) (\$28.60)

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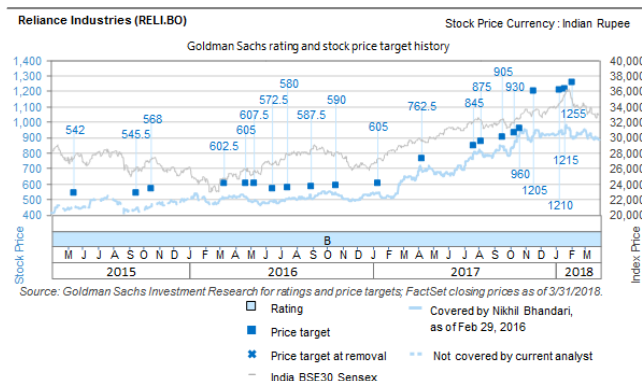
## Distribution of ratings/investment banking relationships

Goldman Sachs Investment Research global Equity coverage universe

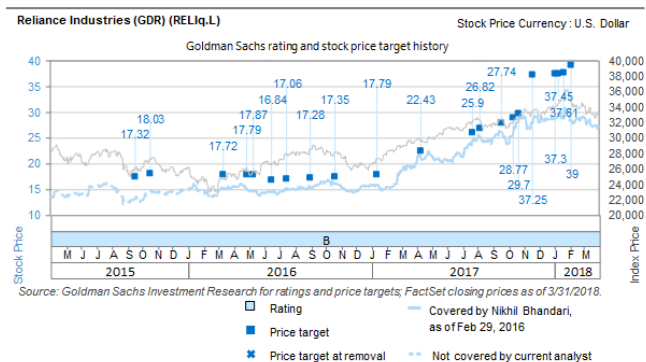
	Rating Distribution				Investment Banking Relationships		
	Buy	Hold	Sell		Buy	Hold	Sell
Global	35%	53%	12%		63%	57%	51%

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