

FITCH AFFIRMS RELIANCE INDUSTRIES' LOCAL CURRENCY IDR; REVISES OUTLOOK TO STABLE

Fitch Ratings-Mumbai/Singapore-01 December 2014: Fitch Ratings has affirmed India-based Reliance Industries Limited's (RIL) Long-Term Foreign Currency Issuer Default Rating (IDR) at 'BBB-' with a Stable Outlook. The agency has also affirmed the Long-Term Local Currency IDR at 'BBB' and revised the Outlook on the rating to Stable from Positive.

RIL's operating and financial performance continues to be very strong, which is captured in the affirmation of the ratings. The change of the Outlook on the Local Currency IDR, which is not constrained by India's Country Ceiling of BBB-, to Stable reflects Fitch's revised expectations on RIL's medium-term credit metrics and the revenue contribution of the upstream oil & gas business. We now believe the company is not likely to meet the levels articulated in Fitch's earlier research in the next two to three years, at which we would take positive rating action.

KEY RATING DRIVERS

Strong Operating Profile: RIL's ratings are supported by the company's scale, asset quality and position as a leading Indian refiner and a petrochemical producer, with approximately 1.4 million barrels per day (bpd) of throughput capacity; integrated business with upstream as well as downstream petrochemical operations; strong operating cash flows and ample liquidity. The company continues to consistently out-perform the regional refining margin benchmarks. Fitch expects the profitability of the company's refining and mid-stream operations to improve further once the ongoing investments to increase capacity and improve efficiencies is completed over the next two to three years.

Challenges with Domestic E&P Business: The domestic upstream business continues to face geological challenges, with gas production from the KG D6 basin falling to 12.8 million metric standard cubic meter per day (mmscmd) in the first half of the financial year ending 31 March 2015 (FY15) from 13.8mmscmd in FY14 and 26mmscmd in FY13. This is however counterbalanced by the 38% volume growth in the US shale gas business. US shale gas's contribution to the earnings of the exploration and production (E&P) business has risen to INR10.5bn, out of the segmental EBIT of INR18.6bn in 1H FY15.

Gas Pricing Uncertainty: In October 2014, the Indian government determined a new gas pricing formula, which would be a volume weighted average of various geographic gas prices including Henry Hub and Alberta. As a result, consumers in India started paying USD5.6/ million British thermal units (mmbtu) for gas from 1 November 2014, compared with USD4.2/mmbtu previously. The new price, however, is much lower than the USD8.4/mmbtu that the previous Indian government recommended in June 2013; this price was not implemented. There is also uncertainty about whether there would be a premium for the price of deep water and ultra-deep water gas reserves.

Reliance would not benefit from the increase to USD5.6/mmbtu for its D1 & D3 fields, which accounted for 60% of its KG D6 gas production for 1H FY15. Matters relating to cost recovery for these fields are under arbitration, and the differential between USD4.2 and USD5.6 would be deposited in an escrow account until conclusion of the arbitration. Under these circumstances, it is unlikely that RIL will expand its domestic gas production, as earlier expected by Fitch. The agency had highlighted a greater share of revenues coming from upstream operations as an important factor that it would consider before upgrading the company's Long-Term Local Currency IDR to 'BBB+'.

Capex and Investments: RIL will likely invest less in its domestic upstream operations given the lower than anticipated increase in gas price. However, the company is now investing a higher than previously guided amount in its Indian telecom operations (over USD11bn through FY16). The Indian telecoms sector is highly competitive; we expect RIL's entry to add further pressure on tariffs, especially for data.

Credit Profile: Fitch expects that RIL will continue to generate strong operating cash flows of USD6bn-8bn a year. However, the high capex needs will lead to negative free cash flows (FCF) for the next two years and likely to lead to an increase in the net leverage, as measured by adjusted net debt to EBITDA, from 2.0x in FY14. Net leverage, though, is likely to remain well under 3.0x, which is comfortable for the company's ratings. The previous Positive Outlook on RIL's Long-Term Local Currency IDR was also based on the expectation that it would maintain financial leverage at below 1.5x. The company has very strong liquidity with adjusted cash and cash equivalents of INR777bn (USD12.9bn). RIL also has very good access to domestic and international capital markets and banks.

RATING SENSITIVITIES

Positive: Future developments that may, individually or collectively, lead to positive rating action include

RIL's Long-Term Local Currency IDR can to be upgraded if the company

- maintains its financial leverage below 1.5x (as measured by net adjusted debt to Operating EBITDAR) on a sustained basis; and
- generates positive FCF; and
- there is no material increase in the overall business risk profile of the company

Negative: Future developments that may, individually or collectively, lead to negative rating action include

- The ratings could be negatively affected if the net adjusted leverage is sustained above 3x, which could arise due to sustained substantial negative FCF.

Provided RIL's Local Currency IDR of 'BBB' is maintained, any change in India's (Foreign Currency IDR: BBB-/Stable) Country Ceiling of 'BBB-' will have a similar effect on RIL's Foreign Currency IDR.

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Applicable criteria, "Corporate Rating Methodology: Including Short-Term Ratings and Parent and Subsidiary Linkage", dated 28 May 2014 are available at www.fitchratings.com

Applicable Criteria and Related Research:

Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=749393

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