

Telecom

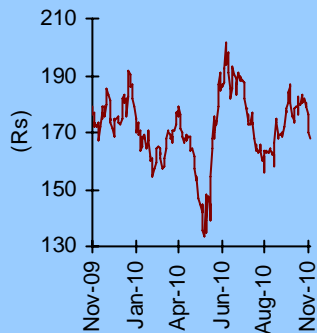
Target price Rs160

Shareholding pattern

	Mar '10	Jun '10	Sep '10
Promoters	68.0	68.1	68.1
Institutional investors	17.6	17.4	17.8
MFs and UTI	1.9	1.4	1.3
Insurance Cos.	8.0	8.0	8.0
FII's	7.7	8.1	8.5
Others	14.5	14.4	14.1

Source: NSE

Price chart



Vikash Mantri, CFA

vikash.mantri@icicisecurities.com
+91 22 6637 7161

Satish Kothari

satish.kothari@icicisecurities.com
+91 22 6637 7510

INDIA

Reliance Communications

SELL
 Maintained
Rs168

3G pain ahead

Reason for report: Q2FY11 results review

Reliance Communications' (RCom) Q2FY11 results were in line with expectations – the Mobility business grew in tandem with peers and RCom was able to maintain yields as per its strategy of reducing free minutes on the network. ARPMs were at 44paise, in line with peers, Idea Cellular and Bharti Airtel (BAL). Mobility revenues rose 0.2% QoQ – BAL (0.6)% and Idea (0.4)% – and EBITDA margin improved marginally to 29.1%. RCom continues to be highly leveraged with net debt at Rs292bn. The company is likely to witness higher cost burden with the launch of 3G services. After RCom's attempt to demerge its tower business failed, we anticipate equity raising to reduce leverage. We maintain SELL at a target price of Rs160/share as the dual network strategy continues to strain financials along with the added burden of 3G.

- ▶ **Wireless KPIs in line.** Wireless revenues grew 0.2% QoQ to Rs41.6bn (I-Sec: Rs43.3bn). Wireless KPIs were down with ARPU's decreasing 6.5% QoQ to Rs122/month and MoUs declining 6.4% QoQ to 276mins/month (I-Sec: 289mins/month). However, on the positive side, the ARPM decline was arrested (flat QoQ at Rs0.44/min). RCom's strategy of curtailing free minutes is finally paying off with the ARPM discount vis-à-vis peers reducing to almost nil.
- ▶ **Non-wireless revenues.** Globalcom revenues rose 1.4% QoQ to Rs18,391mn (I-Sec: Rs18,500mn) and broadband revenues fell 2.2% QoQ and 14.1% YoY to Rs6,617mn (I-Sec: Rs7,101mn). Others segment revenues rose 19% QoQ to Rs3,984mn, largely due to the revenue rise from Reliance web stores, DTH services and third-party IT services.
- ▶ **Consolidated EBITDA increased 1.7% QoQ** but fell 17.8% YoY to Rs16,595mn (I-Sec: Rs17,030mn). EBITDA margin expanded 50bps QoQ to 32.4%. SG&A costs declined 10.3% QoQ to Rs7.6bn due to the absence of one-off costs relating to the T20 sponsorship. Wireless EBITDA margin rose 20bps QoQ to 29.1% in Q2FY11.
- ▶ **Maintain SELL** with a revised target price of Rs160/share. High debt on books and monetisation of tower assets are the key factors to watch out for.

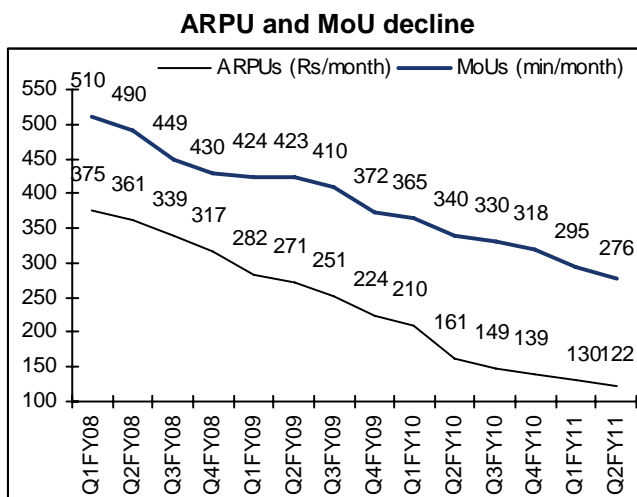
Market Cap	Rs346.9bn/US\$7.7bn
Reuters/Bloomberg	RLCM.BO/RCOM IN
Shares Outstanding (mn)	2,064
52-week Range (Rs)	208/132
Free Float (%)	31.9
FII (%)	8.5
Daily Volume (US\$/000)	13,910
Absolute Return 3m (%)	12.5
Absolute Return 12m (%)	19.2
Sensex Return 3m (%)	2.7
Sensex Return 12m (%)	(6.3)

Year to Mar	2009	2010	2011E	2012E
Revenue (Rs mn)	222,506	223,647	215,033	239,146
Net Income (Rs mn)	60,524	45,952	14,733	21,264
EPS (Rs)	29.3	22.3	7.1	10.3
% Chg YoY	47.0	(24.1)	(67.9)	44.3
P/E (x)	5.7	7.5	23.5	16.3
CEPS (Rs)	46.8	46.5	27.4	31.9
EV/E (x)	7.3	6.3	8.2	6.9
Dividend Yield (%)	0.5	-	-	-
RoCE (%)	7.9	6.2	4.2	4.9
RoE (%)	17.0	10.3	3.1	4.3

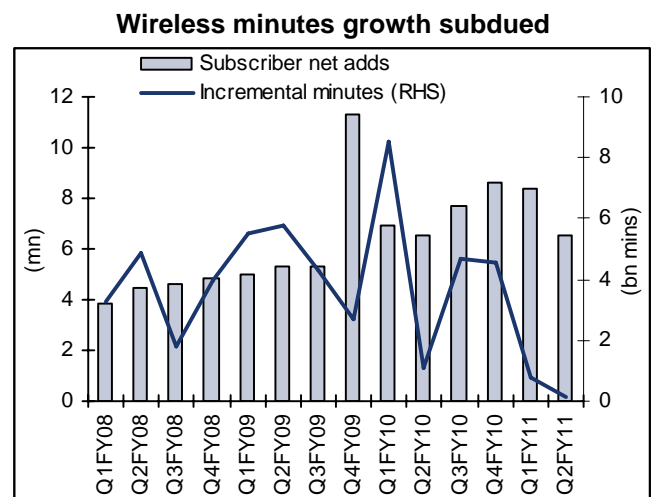
Wireless revenues up 0.2% QoQ

- Wireless revenues grew only 0.2% QoQ and 3.8% YoY to Rs41.6bn (I-Sec: Rs43.3bn), in spite of 6.5mn quarterly net adds. Revenues declined owing to low growth in minutes on the network on account of seasonal impact.
- Wireless KPIs were down, with ARPUs decreasing 6.5% QoQ to Rs122/month, MoUs dipping 6.4% QoQ to 276mins/month (I-Sec: 289mins/month) and ARPMS flat QoQ at Rs0.44/min. The MoU decline was in line after BAL and Idea reported an MoU decline in Q2FY11 (BAL 5.5%, Idea 5.1%). Total wireless minutes were flat QoQ at 94.5bn.
- Over the past two quarters, RCom has taken steps to curtail free minutes and hence, Q2FY11 ARPMS were flat at Rs0.44 and the discount vis-à-vis peers vanished. EBITDA/min in Q2FY11 remained constant at Rs0.13/min in spite of a 13% decline in MoUs from March '10. The management has stated that it will focus more on the quality of usage than quantity.

Chart 1: Wireless KPIs fall

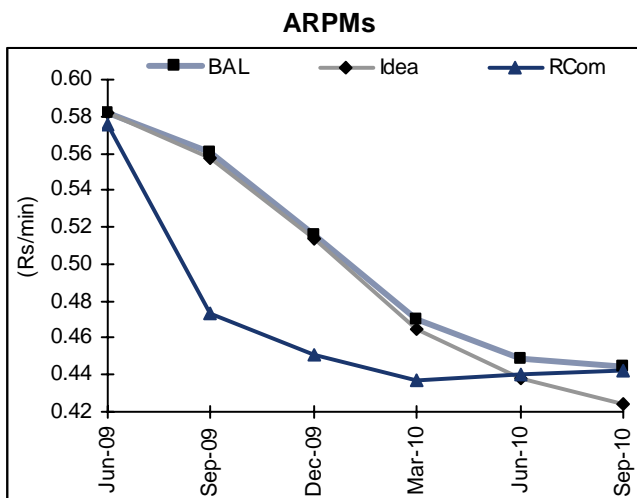


Source: Company data, I-Sec Research

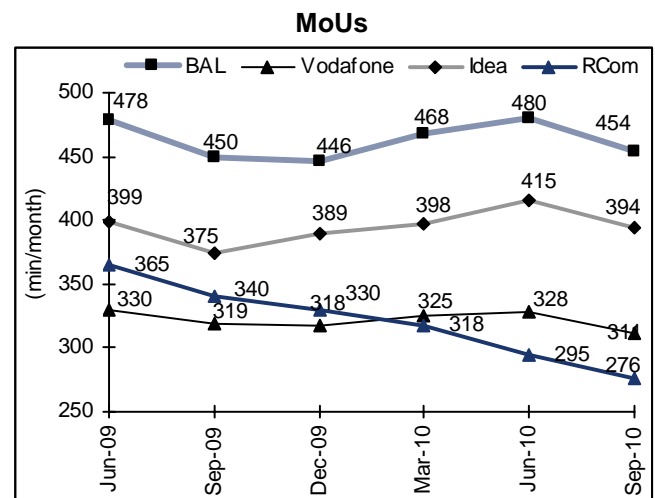


Source: Company data, I-Sec Research

Chart 2: RCom – ARPMS decline arrested; now at par with peers



Source: Company data, I-Sec Research



Source: Company data, I-Sec Research

Non-wireless revenues

- Globalcom revenues rose 1.4% QoQ to Rs18,391mn (I-Sec: Rs18,500mn) and Broadband revenues fell 2.2% QoQ and 14.1% YoY to Rs6,617mn (I-Sec: Rs7,101mn).
- Others segment revenues rose 19% QoQ to Rs3,984mn, largely due to increase in revenues from reliance web stores, DTH services and third-party IT services. Cost in others segment rose 13.4% QoQ, leading to an EBITDA loss of Rs1,343mn.
- At present, Reliance Big TV has 2.9mn subscribers, accounting for 11% of the DTH market. On the other hand, Airtel DTH has 3.9mn subscribers with 15% market share. The management hinted at an ARPU of Rs200/month as compared with the industry standard of Rs160/month

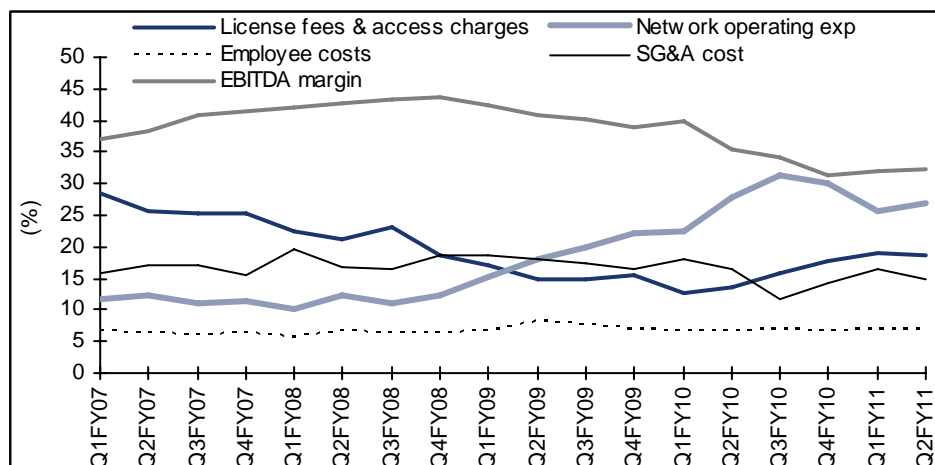
Table 1: Non-wireless segment results

Globalcom	Q2FY09	Q3FY09	Q4FY09	Q1FY10	Q2FY10	Q3FY10	Q4FY10	Q1FY11	Q2FY11
NLD mins	7,856	8,576	9,090	10,349	11,205	13,643	16,086	15,265	16,383
% growth	18.3	9.2	6.0	13.9	8.3	21.8	17.9	(5.1)	7.3
ILD mins	1,946	1,906	1,983	2,209	2,165	2,823	2,656	3,123	3,753
% growth	12.7	(2.1)	4.0	11.4	(2.0)	30.4	(5.9)	17.6	20.2
Revenues	16,915	16,783	18,803	18,844	22,643	19,818	20,278	18,137	18,391
% growth	10.8	(0.8)	12.0	0.2	20.2	(8.0)	2.3	(10.6)	1.4
Operating expenses	13,307	12,468	13,778	14,329	17,416	15,624	16,723	14,820	14,998
EBITDA	3,608	4,315	5,025	4,515	5,227	4,194	3,555	3,317	3,393
EBITDA margin (%)	21.3	25.7	26.7	24.0	23.1	23.1	21.2	17.5	18.3
Broadband									
Access lines	1,259	1,335	1,385	1,422	1,439	1,455	1,469	1,470	1,484
Net adds	112	76	50	37	17	16	14	1	14
ARPL	1,668	1,681	1,735	1,626	1,794	1,642	1,551	1,534	1,494
% growth	(2.7)	0.8	3.2	(6.3)	10.3	(8.5)	(5.5)	(1.1)	(2.6)
Revenues	6,023	6,541	7,075	6,842	7,700	7,045	6,798	6,763	6,617
% growth	7.5	8.6	8.2	(3.3)	12.5	(8.5)	(3.5)	(0.5)	(2.2)
Operating expenses	3,082	3,781	3,915	3,848	4,501	4,290	4,272	4,286	4,136
EBITDA	2,941	2,760	3,160	2,994	3,199	2,755	2,526	2,477	2,481
EBITDA margin (%)	48.8	42.2	44.7	43.8	41.5	39.1	37.2	36.6	37.5
Others									
Revenues	2,346	3,183	3,132	3,031	2,760	3,160	2,845	3,348	3,984
% growth	63.3	35.7	(1.6)	(3.2)	(8.9)	9.0	(10.0)	17.7	19.0
Operating expenses	2,544	3,288	4,109	4,412	4,005	4,410	4,604	4,698	5,327
EBITDA	(198)	(105)	(977)	(1,381)	(1,244)	(1,250)	(1,759)	(1,350)	1,343
EBITDA margin (%)	(8.4)	(3.3)	(31.2)	(45.6)	(45.1)	(39.6)	(61.8)	(40.3)	(33.7)

Source: Company data, I-Sec Research

Consolidated EBITDA rose 1.7% QoQ

- Consolidated EBITDA rose 1.7% QoQ but fell 17.8% YoY to Rs16,595mn, lower than our estimates of Rs17,030mn.
- EBITDA margin expanded 50bps QoQ to 32.4%. SG&A costs declined 10.3% QoQ to Rs7.6bn due to the absence of one-off costs relating to the T20 sponsorship in Q2FY11. Wireless EBITDA margin expanded 20bps QoQ to 29.1% in Q2FY11.

Chart 3: EBITDA margin rose 50bps QoQ on lower SG&A costs

Source: Company data, I-Sec Research

Interest and finance charges increased PAT

- Reported PAT increased 77.7% QoQ to Rs4.46bn (I-Sec: Rs2.12bn) on account of lower interest and finance charges and negative tax rate.
- RCom reported net finance & interest expenses of Rs2.8bn as compared with Rs4.4bn in Q1FY11, largely on account of lower forex losses. Forex losses reduced to Rs500mn in Q2FY11 from Rs2,000mn in Q1FY11.
- Depreciation was flat QoQ at Rs9.6bn.
- Reported PAT would have been higher on account of foreign exchange gain of Rs7,351mn, which was used to offset foreign exchange loss of Rs7,799mn in Q1FY11.

Net debt increased marginally

- Cash-on-books as of end-Q2FY11 was Rs86bn and debt was Rs378bn, implying net debt of Rs292bn as of end-Q2FY11 versus Rs285bn as of end-Q1FY11. Net debt/EBITDA was at 4.4x as of end-Q2FY11.
- CWIP remained high at Rs174bn as of end-Q2FY11 owing to 3G licence fee. As and when the CWIP is moved to gross block, depreciation would increase, thereby impacting the bottomline.
- Current liabilities declined from a peak of Rs273bn as of end-Q3FY09 to Rs167bn as of end-Q2FY11. Unwinding of current liabilities would lead to significant cash outflows.

Table 2: Q2FY11 results review (consolidated)

(Rs mn, year ending March 31)

	I-Sec estimates	Q2FY11	Q2FY10	Q1FY11	YoY (%)	QoQ (%)	YTDFY11	YTDFY10	YoY (%)
Wireless	43,276	41,613	40,100	41,528	3.8	0.2	83,141	88,031	(5.6)
Global	18,500	18,391	22,643	18,137	(18.8)	1.4	36,528	41,487	(12.0)
Broadband	7,101	6,617	7,700	6,763	(14.1)	(2.2)	13,380	14,542	(8.0)
Less: Intersegment eliminations	(18,941)	(19,422)	(16,177)	(18,684)	20.1	3.9	(38,106)	(31,373)	21.5
Other operational income	3,118	3,984	2,760	3,348	44.3	19.0	7,332	5,791	26.6
Total revenues	53,053	51,183	57,026	51,092	(10.2)	0.2	102,275	118,478	(13.7)
Licence fees & access charges	10,080	9,605	7,685	9,712	25.0	(1.1)	19,317	15,530	24.4
Network operating costs	14,324	13,813	15,919	13,079	(13.2)	5.6	26,892	29,775	(9.7)
Employee costs	3,661	3,596	3,816	3,535	(5.8)	1.7	7,131	7,928	(10.1)
SG&A costs	7,958	7,574	9,407	8,446	(19.5)	(10.3)	16,020	20,521	(21.9)
Total operating expenses	36,023	34,588	36,827	34,772	(6.1)	(0.5)	69,360	73,754	(6.0)
EBITDA	17,030	16,595	20,199	16,320	(17.8)	1.7	32,915	44,724	(26.4)
Depreciation & Amortisation	9,937	9,553	7,144	9,648	33.7	(1.0)	19,201	18,288	5.0
Net interest & finance charges	4,000	2,797	6,551	4,396	(57.3)	(36.4)	7,193	346	1978.9
PBT	3,093	4,245	6,504	2,276	(34.7)	86.5	6,521	26,090	(75.0)
Exceptional items	-	-	29	-	-	-	-	140	(100.0)
Less: Provision for Tax	464	(661)	(1,739)	(719)	(62.0)	(8.1)	(1,380)	528	(361.3)
Minority interest	500	447	811	486	(44.9)	(8.1)	933	1,653	(43.6)
Reported PAT	2,129	4,459	7,403	2,509	(39.8)	77.7	6,968	23,769	(70.7)
Adjusted PAT	2,129	4,459	7,432	2,509	(40.0)	77.7	6,968	23,909	(70.9)
Operating Margin (%)	32.1	32.4	35.4	31.9			32.2	37.7	
Personnel exp to Revenues (%)	15.0	14.8	16.5	16.5			15.7	17.3	
Effective tax rate (%)	15.0	(15.6)	(26.7)	(31.6)			(21.2)	2.0	
NPM (%)	4.0	8.7	13.0	4.9			6.8	20.2	

Source: Company data, I-Sec Research

Other highlights

- Negotiations between RCom and GTL Infrastructure to create the world's largest independent telecom infrastructure company failed. RCom is now mulling certain strategic investors for its tower assets.
- Reportedly, RCom plans to raise US\$500mn through sale of bonds to European investors. The funds will be utilised to meet debt obligations, including US\$200mn worth of convertible bonds held by overseas investors due in May '11.

Maintain SELL at Rs160 target price

We maintain SELL at a target price of Rs160/share. High debt on books and monetisation of tower assets are the key factors to watch out for.

Financial Summary

Table 3: Profit & Loss statement

(Rs mn, year ending March 31)

	FY09	FY10	FY11E	FY12E
Operating Income (Sales)	222,506	223,647	215,033	239,146
Operating Expenses	136,435	124,308	138,720	148,556
EBITDA	86,070	99,338	76,313	90,590
% margins	38.7	44.4	35.5	37.9
Depreciation & Amortisation	36,077	50,025	41,745	44,505
Net Interest	(5,070)	(910)	17,058	19,204
Other Income	6,979	-	-	-
Recurring PBT	62,042	50,224	17,510	26,881
Add: Extraordinaries	(75)	(376)	-	-
Less: Taxes	(518)	4,454	2,733	5,448
- Current tax	490	4,454	2,733	5,448
- Deferred tax	(1,008)	-	-	-
Less: Minority Interest	2,036	(182)	45	168
Net Income (Reported)	60,449	45,576	14,733	21,264
Recurring Net Income	60,524	45,952	14,733	21,264

Source: Company data, I-Sec Research

Table 4: Balance sheet

(Rs mn, year ending March 31)

	FY09	FY10	FY11E	FY12E
Assets				
Total Current Assets	147,145	164,152	201,098	205,853
of which cash & cash eqv.	16,829	48,585	102,365	100,434
Total Current Liabilities & Provisions	200,814	237,976	197,794	194,173
Net Current Assets	(53,669)	(73,824)	3,304	11,680
Investments				
of which	95,657	1,199	1,199	1,199
Strategic/Group				
Other Marketable	95,657	1,199	1,199	1,199
Net Fixed Assets	727,053	715,395	733,044	736,101
of which				
Capital Work-in-Progress	113,096	119,517	101,743	96,717
Goodwill	52,215	-	-	-
Total Assets	821,256	642,770	737,547	748,980
Liabilities				
Borrowings	391,623	247,473	327,473	317,473
Deferred Tax Liability	-	-	-	-
Minority Interest	6,549	7,472	7,517	7,685
Equity Share Capital	10,320	10,320	10,320	10,320
Face Value per share (Rs)	5	5	5	5
Reserves & Surplus*	419,032	465,531	480,309	501,741
Net Worth	422,803	468,380	483,112	504,376
Total Liabilities	821,256	723,325	818,102	829,534

Source: Company data, I-Sec Research

Table 7: Quarterly trend

(Rs mn, year ending March 31)

	Dec-09	Mar-10	Jun-10	Sep-10
Net sales	53,098	50,927	51,092	51,183
% growth (YoY)	(9.2)	(16.8)	(16.9)	(10.2)
EBITDA	18,127	16,019	16,320	16,595
Margin (%)	34.1	31.5	31.9	32.4
Other income	0	0	0	(0)
Add: Extraordinaries	(221)	(15)	0	0
Net profit	11,301	12,209	2,509	4,459

Source: Company data

Table 5: Cashflow statement

(Rs mn, year ending March 31)

	FY09	FY10	FY11E	FY12E
Operating Cash flow	106,156	95,391	56,522	65,938
Working Capital Changes	(33,243)	51,911	(23,349)	(10,306)
Capital Commitments	(255,510)	(37,963)	(59,394)	(47,562)
Free Cash Flow	(182,597)	109,339	(26,220)	8,069
Cash flow from Investing				
Activities	21,319	94,458	-	-
Issue of Share Capital	-	-	-	-
Repayment of borrowing	-	-	-	-
Inc (Dec) in Borrowings	133,406	(144,150)	80,000	(10,000)
Dividend paid	(1,932)	-	-	-
Extraordinary Items	37,852	52,663	(0)	(0)
Chg. in Cash & Bank balance	8,047	112,311	53,780	(1,931)

Source: Company data, I-Sec Research

Table 6: Key ratios

(Year ending March 31)

	FY09	FY10	FY11E	FY12E
Per Share Data (in Rs.)				
Diluted Recurring EPS	29.3	22.3	7.1	10.3
Reported EPS	29.3	22.1	7.1	10.3
Recurring Cash EPS	46.8	46.5	27.4	31.9
Dividend per share (DPS)	0.8	-	-	-
Book Value per share (BV)	204.8	226.9	234.1	244.4
Growth Ratios (%)				
Operating Income	18.2	0.5	(3.9)	11.2
EBITDA	8.1	15.4	(23.2)	18.7
Recurring Net Income	47.0	(24.1)	(67.9)	44.3
Diluted Recurring EPS	47.0	(24.1)	(67.9)	44.3
Diluted Recurring CEPS	39.5	(0.6)	(41.2)	16.5
Valuation Ratios (% YoY)				
P/E	5.7	7.5	23.5	16.3
P/CEPS	3.6	3.6	6.1	5.3
P/BV	0.8	0.7	0.7	0.7
EV / EBITDA	7.3	6.3	8.2	6.9
EV / Operating Income	2.8	2.8	2.9	2.6
EV / Operating FCF	(3.4)	5.7	(23.9)	77.6
Operating Ratio				
Network costs/Sales (%)	19.8	16.3	22.2	20.9
SG&A/Sales (%)	16.0	14.7	15.2	14.8
Other Income / PBT (%)	11.2	-	-	-
Effective Tax Rate (%)	(0.8)	8.9	15.6	20.3
NWC / Total Assets (%)	(8.6)	(19.0)	(13.4)	(11.9)
Inventory Turnover (days)	8.9	8.9	7.9	7.9
Receivables (days)	54.8	59.6	46.4	33.3
Payables (days)	422.6	526.4	461.6	361.8
Net D/E Ratio (%)	66.0	42.2	46.3	42.8
Return/Profitability Ratio (%)				
Recurring Net Income Margins	26.4	20.5	6.9	8.9
RoCE	7.9	6.2	4.2	4.9
RoNW	17.0	10.3	3.1	4.3
Dividend Payout Ratio	2.7	-	-	-
Dividend Yield	47.6	-	-	-
EBITDA Margins	38.7	44.4	35.5	37.9

Source: Company data, I-Sec Research

I-Sec investment ratings (all ratings relative to Sensex over next 12 months)

BUY: +10% outperformance; **HOLD:** -10% to +10% relative performance; **SELL:** +10% underperformance

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