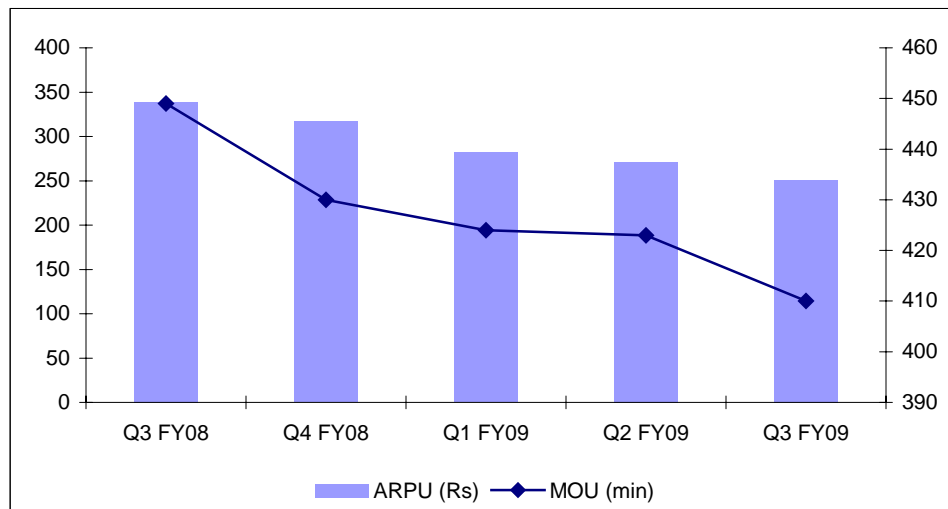


January 27, 2009

RCOM - Q3FY09 Result Review
Disappointing numbers almost in line with our expectations
Subscribers grow, but operational metrics worsen

RCOM's revenues in 3Q FY09 grew 20% yoy and 3.64% qoq supported by a 49.7% yoy and 9.5% qoq growth in its subscriber base, which reached ~66 million, including 61 mn of mobile subscribers. The revenue growth was 2% below our expectations, as MOU as well as ARPU declined in the mobile business and the Global business of the company posted a lackluster performance in the quarter. MOU declined 3.1% qoq to 410 minutes on the company's penetration into rural areas and the acquisition of low-end subscribers. Due to these reasons, ARPU declined steeply by 7.4% qoq to Rs 251. It was even sharper than its competitors, as Bharti's ARPU declined 4%, while Idea reported a rise of 2%. RCOM's ARPM declined 5.8% qoq to Rs 0.61 from Rs 0.65 on sharp decline in ARPU. As a result, RCOM's wireless business, which contributed 75% of its revenues in Q3 FY09, grew by just 1.7% qoq. RCOM's global business declined 0.8% qoq due to a 2% decline in ILD minutes to 1906 mn minutes. However, there was a sharp increase in NLD minutes. In January 2008, RCOM aggressively launched its cheap GSM plans across India and initiated a price war in the telecom industry. However, the company did not disclose any details on subscriber additions or increase in the number of towers associated with this massive launch. We believe the company's strategy is to launch the GSM plan and gain an additional spectrum of 1.8 MHz free of cost by rapidly gaining 500,000 subscribers in a circle and take the subscriber base to 100 million. With already 60 million subscribers (50 mn CDMA + 10 mn existing GSM subscribers), the company has to rope in 40 million more subscribers. We believe the launch of GSM services at extremely low rates could add subscribers rapidly, but erode the ARPU significantly and spoil the quality of subscribers. In this quarter, RCOM's market share declined 10 bps to 18%, while other companies managed to grow.

ARPU v/s MOU

EBITDA margins decline

EBITDA grew 11.7% yoy and 2.2% qoq in line with the subdued qoq growth in the topline. But, this was 1.4% below our expectations as the network opex and access charge expenses were higher than our figures. RCOM's EBITDA margins declined by 56 bps to 40.2% due to the increase in network opex and access charges. Network opex as a percentage of sales and access charges increased from 18.2% to 19.9% and 14.7% to 14.9% respectively on a qoq basis. Segment-wise, mobile business EBITDA declined by 1.4% qoq, while its margins declined by 123 bps. Broadband business EBITDA margins plummeted 664 bps to 42.19% qoq, while absolute EBITDA from this segment declined 6.2% qoq. Going forward, we believe EBITDA margins will come under pressure due to the company's aggressive drive of to increase its subscriber base by offering very cheap GSM service.

Particulars	Q3 FY09E	Q3 FY 09A	Divergence (%)
Total income	59,513	58,502	(1.7)
EBITDA	23,856	23,525	(1.4)
Net profits	14,008	14,102	0.7

Net profits decline qoq

RCOM's net profits declined 7.9% qoq, while on a yoy basis, it grew by just 2.7%. This was due to the strong increase of 9.68% qoq and 38.9% yoy in depreciation and amortization. In this quarter, the company cancelled 250 Foreign Currency Convertible Bonds (FCCBs) of the face value of USD 1,00,000 each, which amounted to some savings that impacted positively on the company's net financial charges. In the absence of this FCCB cancellation, the qoq decline in net profits would have been steeper. The company has reported an MTM loss of Rs 9.8 bn in this quarter. Had it been accounted in the income statement, the net profit fall would have been very sharp.

Outlook & Valuation

RCOM's Q3 FY09 results were disappointing. Revenue growth was subdued due to sharp declines in ARPU and MOU, while net profits de-grew on a qoq basis. The company's mobile business contributed 75% of the total revenues in the quarter. Even its global business reported a de-growth qoq. The launch of GSM business in January will add pressure on the company's already sinking ARPUs. The poor quality of subscribers will also remain a major concern for the company. Although the company could gain more than 500,000 subscribers per circle to earn the 1.8 MHz spectrum free of cost, we need to see whether this business model is sustainable. At the current price the GSM prepaid scheme is on a temporary basis. Once the price is hiked, the majority of subscribers may move to other operators if the new scheme proves expensive. The company seems to have reached the peak of its Capex cycle, with its capital WIP increasing from Rs 148 bn to Rs 191 bn and current liabilities increasing from Rs 199 bn to Rs 273 bn in the quarter. The company has however, reduced its Capex guidance from Rs 30,000 crores to Rs 25,000 crores for FY2009 and Rs 15,000 crores for FY 2010. With increasing network opex and access charges, margins will come under pressure going forward. The company has managed to maintain a net debt to equity ratio of 0.64x, but this is high compared to its peers Bharti (0.28x) and Idea (0.3x). The management claims the GSM launch received an overwhelming response, but refused to give details. The company has expanded its coverage to 14,000 towns and 400,000 villages till date from 11,000 towns at the end of December 2008, which is a very fast rate. Though the GSM launch may add pressure on ARPUs, it may help garner huge volumes. At the CMP of Rs 172 the stock trades at EV/EBITDA multiples of 6.05x and 5.91x times its EBITDA. We accord the stock a NEUTRAL rating with a target price of Rs 152/ share.

Segment-wise breakup

Particulars (Rs. Mn)	Revenues			EBITDA		
	Q3 FY09	Q2 FY09	qoq % change	Q3 FY09	Q2 FY09	qoq % change
Wireless	43356	44119	-1.73%	16859	16616	1.46%
Global	16915	16783	0.79%	3608	4315	-16.38%
Broadband	6023	6542	-7.93%	2941	2760	6.56%
Others	2346	3183	-26.30%	-198	-106	86.79%
Sub total	68640	70627	-2.81%	23210	23585	-1.59%
Eliminations	-12190	-12125	N/A	-194	-60	N/A
Total	56450	58502	-3.51%	23016	23525	-2.16%

Financial statements

Particulars (Rs. Mn)	Q3 FY09	Q3 FY08	% yoy	Q2 FY09	% qoq	FY09E	FY10E
Revenues	58,502	48,742	20.0%	56,450	3.64	228,702	257,119
Total operating expenditure	34,977	27,677	26.4%	33,434	4.62	135,699	156,817
EBITDA	23,525	21,065	11.7%	23,016	2.21	93,003	100,302
<i>EBITDA margins</i>	<i>40.21%</i>	<i>43.22%</i>	<i>(201 bps)</i>	<i>40.77%</i>	<i>(56 bps)</i>	<i>40.67%</i>	<i>39.01%</i>
Depreciation & Amortization	10,069	7,252	38.8%	9,180	9.68	38,237	43,451
Finance cost	(1,496)	(1,518)	N/A	(2,353)	N/A	(7,581)	(5,004)
Amortization of compensation under employee stock option	358	0	N/A	647	N/A	2,005	1,620
Tax	153	1,379	-88.9%	(567)	(126.98)	(784)	(775)
PAT	14,441	13,952	3.5%	16,109	(10.35)	61,125	61,010
Minority interests	339	223	52.0%	800	(57.63)	2,113	1,817
PAT after minority	14,102	13,729	2.7%	15,309	(7.88)	59,012	59,193
<i>PAT margins</i>	<i>24.11%</i>	<i>28.17%</i>	<i>(406 bps)</i>	<i>27.12%</i>	<i>(301 bps)</i>	<i>25.80%</i>	<i>23.02%</i>

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