

## BUY

**Rs318.3**

**Sensex: 10,804, Nifty: 3,203**

### Stock data

Bloomberg	RCVL IN
Reuters	RCVL.BO/ RCVL.NS
Shares outstanding (mn)	2,045*
Market cap (Rs bn)	648
Market cap (US\$ bn)	14.6
Daily avg vol (mn)	20.9

\* post restructuring

### Share price performance\*\*

52-week high/low (Rs)	328/276		
	-1m	-3m	-12m
Abs (%)	9.5	n/a	n/a
Rel* (%)	9.2	n/a	n/a

\*to Nifty

\*\* since listing on March 6, 2006

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## Reliance Communication Ventures

March 13, 2006

### First-cut valuation is Rs358; restructuring a positive trigger

Reliance Communication Ventures (RCoVL) has finalised an equity restructuring plan, making its structure simple and transparent, far earlier than expectations. We expect the market to build in expectations of more such quick moves towards transparency – like greater financial disclosures; and do not rule out further re-rating on the back of the same.

RCoVL is an integrated telecom operator and has created low-cost infrastructure with economies of scale using state-of-the-art technology. It provides CDMA local access along with national and international long distance services.

The lack of historical financial details has left us with little choice but to value RCoVL using a) not so detailed calculations of RCoVL's FY07E EBITDA, and b) use Bharti's FY07E EV/EBITDA as a proxy. Based on the same, we have arrived at our first-cut valuation of Rs358. However, our valuation number could change significantly once sufficient financial details are available for a detailed model.

RCoVL's key strengths are:

- ◆ **Unparallel coverage and reach:** RCoVL boasts of India's largest private telecom network with access to 54% of India's total population, and covers 50% of national highways, 58% of rail routes and over 238,700 towns and villages. It has a backbone network of over 60,000 route kms. In contrast, Bharti covers 38% of India's population and has 30,000 route kms of backbone network.
- ◆ **Along with CDMA, technology gives it unparallel economies of scale:** RCoVL has a CDMA network configured for a massive 30 million customer capacity and accrues economies of scale far in excess of GSM operators. Thus, RCoVL's cost per capacity of erlang (a unit of telecom traffic) of USD684 is about a third of GSM competitors. Therefore, as the company adds subscribers in excess of its current 19.4 million subscribers – incremental margins would improve.
- ◆ **Network designed with futuristic services in mind:** Using an IP-based backbone technology, RCoVL plans to leverage broadband capabilities of CDMA access to provide consumers with a range of futuristic services including launch of IP-TV in less than a year's time. These would enable RCoVL to emerge as an infotainment service provider over time.
- ◆ **Methodology for first-cut valuation of Rs358:** Using Bharti's FY07E EV/EBITDA of 13.5X as a proxy, we have arrived at RCoVL's valuation of Rs358. We have used the total number of shares after restructuring (2,045mn) and made corresponding adjustments in the financials.

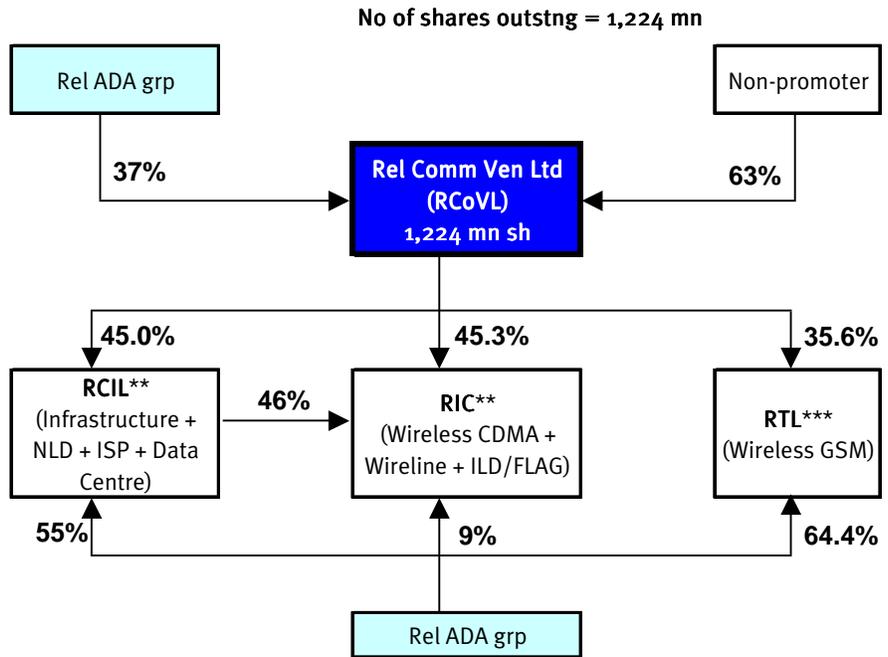
### **IMPACT OF THE EQUITY RESTRUCTURING (see charts 1 and 2)**

Before this restructuring – the holding structure was complicated with cross-holdings. On March 12, 2006, RCoVL finalised the much-awaited simplification of this holding structure. The 100% ownership ensures that there would be no cross-holding adjustments to be made – a big positive for minority shareholders. Further, the restructuring has been done in a way that does not seem to be earnings dilutive as the resultant increased number of shares (from 1,224mn to 2,045mn) would be accompanied by a proportionate increase in financials – as 100% of revenues would accrue to the listed entity.

The key conclusions are:

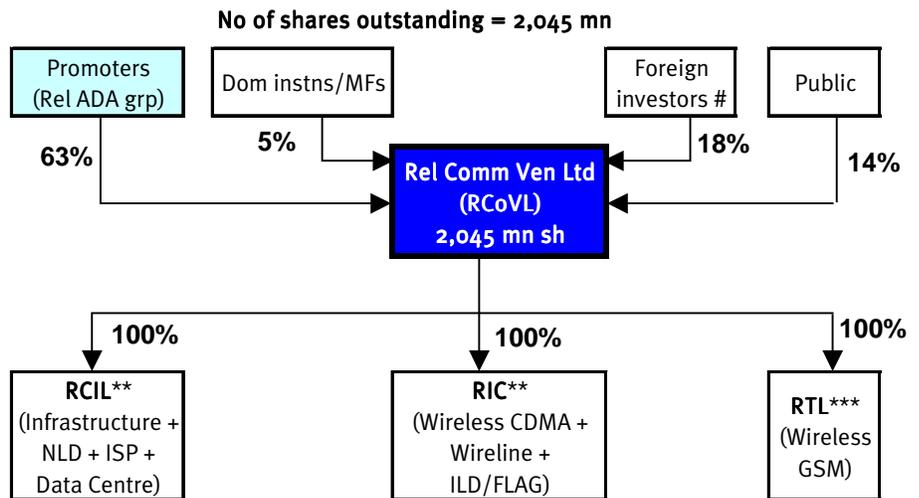
- ◆ All financials of each of the operating companies would now reflect in the RCoVL numbers, the listed entity. This is against the 60% that was attributed to the listed entity under the old structure. The new ownership structure allows the attribution of 100% revenues to the listed entity.
- ◆ Simultaneously, the number of equity shares of RCoVL would increase from 1,224mn to 2,045mn because of the direct holding of the ADA promoter group in the holding company is now being converted into new shares of RCoVL.
- ◆ While the direct holdings of the promoters (ADA group) in the operating companies would be extinguished, the direct holding in RCoVL would increase from 37% to 63%.
- ◆ In its press release, the company has stated that the free float of 750mn shares in RCoVL would remain unchanged.
- ◆ The company expects the entire regulatory process to take a total of 120 days beginning March 13, 2006. However, it is to be effective from April 1, 2006.

**Chart 1: Shareholding structure pre restructuring of RCoVL**



\*\*RCIL = Reliance Communication Infrastructure Ltd  
\*\*RIC = Reliance InfoComm Ltd  
\*\*\*RTL = Reliance Telecom Ltd

**Chart 2: Shareholding structure post restructuring of RCoVL**



# Foreign investors = 14% FIIs + 4% GDR and others = 18%  
\*\*RCIL = Reliance Communication Infrastructure Ltd  
\*\*RIC = Reliance InfoComm Ltd  
\*\*\*RTL = Reliance Telecom Ltd

### VALUING RCoVL AT Rs358

We have valued RCoVL using a) not so detailed calculations of RCoVL's FY07E EBITDA, and b) use Bharti's FY07E EV/EBITDA as a proxy. Based on the same, we have arrived at our first-cut valuation of Rs358 as described below.

- ◆ Our starting point for projecting RCoVL's numbers is the quarterly P&L as provided in the information memorandum (IM).
- ◆ We have assumed an 11.0% QoQ growth in revenues in each of the quarters – evenly spread out between Q4FY06E to Q4FY07E, giving us a YoY growth of 56.4% in FY07E.
- ◆ We have assumed EBITDA margins to rise by 135 basis points every quarter from Q4FY06E to Q4FY07E to arrive at an average of 30.4% in FY07E as against the 25.5% in Q3FY06. This gives us an FY07E EBITDA of Rs58,669mn.
- ◆ Using Bharti's FY07E EV/EBITDA of 13.5X as a proxy, we have arrived at RCoVL's valuation of Rs358. We have used the total number of shares after restructuring (2,045mn) and made corresponding adjustments in the financials (see table 1).

**Our reasons for valuing RCoVL on par with Bharti:** We believe that RCoVL's drawbacks relative to Bharti's are insufficient historical financial data/level of disclosures, and a complicated holding structure. We believe that these issues are being/likely to be addressed over the next few months. Also, RCoVL is ahead in its preparedness to introduce broadband services at a faster speed in larger towns due to the scale of operations. The latter also gives it significant cost advantages in terms of economies of scale. Hence, the drawbacks seem negated.

**Table 1: RCoVL's valuation based on Bharti's FY07E EV/EBITDA**

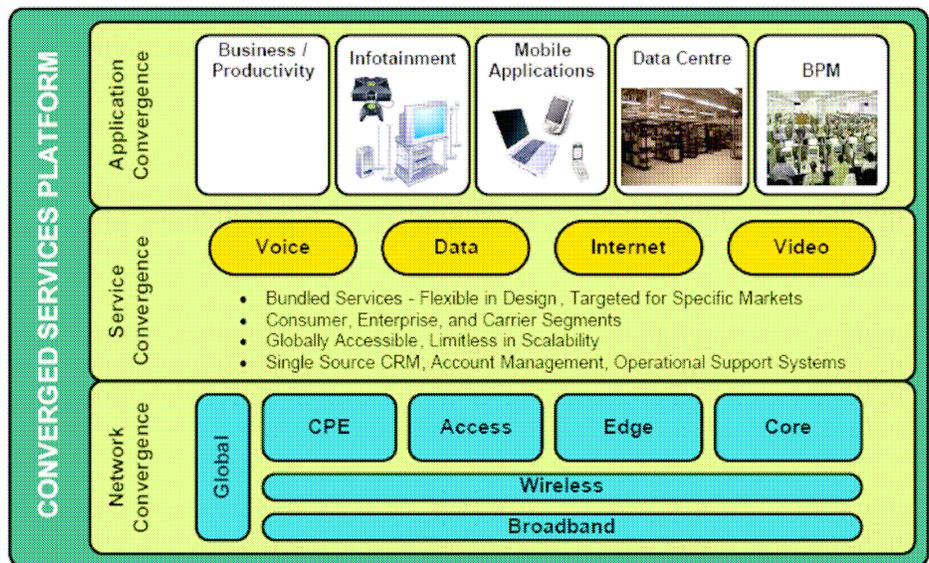
	Rs mn
Bharti's EV/EBITDA (x)	13.5
RCoVL's FY07E EBITDA	58,669
Implied FY07E EV	792,036
Net debt outstanding assumed (FY07E end)	60,000
Equity value	732,036
Shares outstanding (mn) (Rs 5 FV)	2,045
<b>Equity value/share (Rs)</b>	<b>358</b>
Implied EV/Sub-RCoVL (Rs)	40,827
EV/Sub-Bharti (Rs)	41,475
<b>Discount to Bharti</b>	<b>-1.6%</b>
RCoVL's subscribers (mn) - as on 28 Feb 06	19.4
<u>Bharti's subscribers (mn) - as on 28 Feb 06</u>	<u>19.7</u>

Source: IIL research, company

**BUSINESS ANALYSIS**

RcoVL can be looked at from two perspectives – business offerings packaged together but being provided by various operating companies, and the stand-alone businesses of operating companies. The structure of the latter has been driven largely by regulatory licensing norms and has been explained in chart 2. In contrast, the business offerings at the front end are unified and spelt out in chart 4. The bedrock of the diverse and cross-service offerings is its widely spread state-of-the-art infrastructure – the scale of which gives RCoVL economies of scale and, thus, opex and capex competitiveness (chart 3).

**Chart 3 - Business model – fully integrated IP-enabled infrastructure platform**

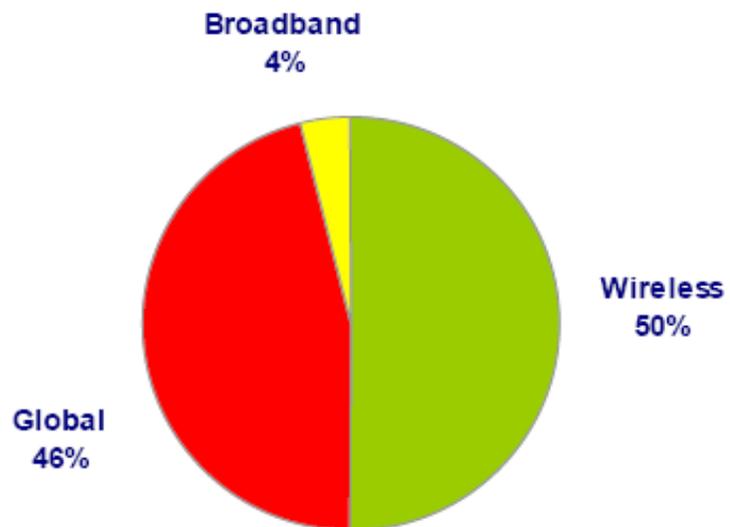


**Chart 4: Business focus areas**

<b>Wireless</b>	▶	<ul style="list-style-type: none"> <li>▶ Product innovation</li> <li>▶ Network coverage</li> <li>▶ Distribution reach</li> </ul>
<b>Global</b>	▶	<ul style="list-style-type: none"> <li>▶ FLAG + FALCON</li> <li>▶ Managed data services</li> <li>▶ OneIndia</li> </ul>
<b>Broadband</b>	▶	<ul style="list-style-type: none"> <li>▶ Metros and IDC expansion</li> <li>▶ Customer up-sell</li> <li>▶ Consumer multi-play</li> </ul>
<b>Cross-business</b>	▶	<ul style="list-style-type: none"> <li>▶ Integrated product bundles</li> <li>▶ Out-sourcing – M-NOC, contact centre</li> <li>▶ Leveraging distribution, experience centers</li> </ul>

The businesses can be widely divided into three – wireless, global and broadband, with certain segments of the market like enterprise being offered as a bouquet of services. This offers RCoVL cross-business opportunities.

**Chart 5: Total service revenues in Q3FY06**



**Note: Revenue pre-eliminations and excluding equipment sales**

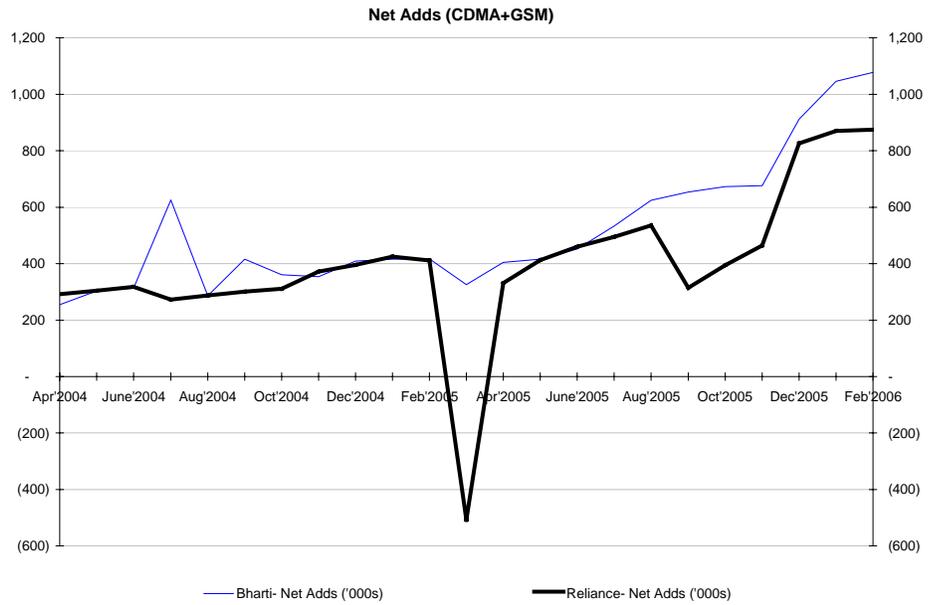
### **THE WIRELESS BUSINESS – THE LARGEST REVENUE CONTRIBUTOR**

The wireless business is the single largest contributor to RCoVL's top line – 50% before inter-company eliminations and excluding equipment sales. It consists of a total subscriber base of 19.4 million (14.6mn CDMA wireless, 1.8mn GSM wireless and 3.0mn fixed) and has been adding more than 1 million net subscribers per month in the last three months. It covers 3,700 towns as against 3,300 towns covered by Bharti – thus having the highest coverage among private operators. RCoVL's wireless business caters to a population of 520 million across India and covers 97% of the urban and 42% of the rural population. It also has 5.3 million wireless multimedia users, 350,000 wireless internet customers and handles 320 million minutes of wireless traffic per day.

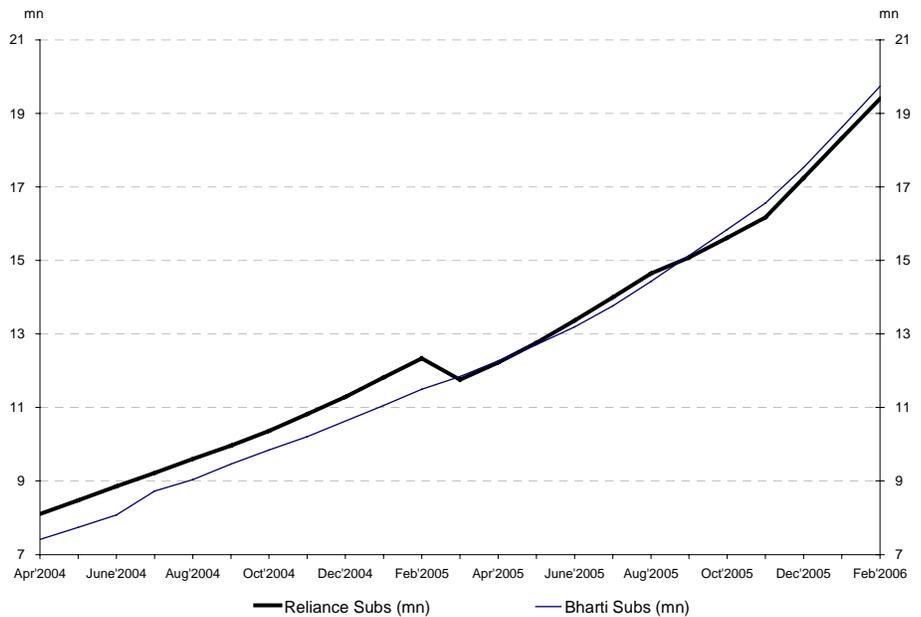
#### **Wireless subscriber base – the most visible part of the business**

The key driver in this segment has been rapid wireless subscriber growth that has exceeded 1 million per month over the last three months. The increased subscriber addition has seen its subscriber base growing to 19.4 million subscribers a shade under Bharti's 19.7 million. Its prepaid customers are 77.5% of the total wireless subscribers, the same as that of Bharti.

**Chart 6: Net subscriber adds – RCoVL v/s Bharti**



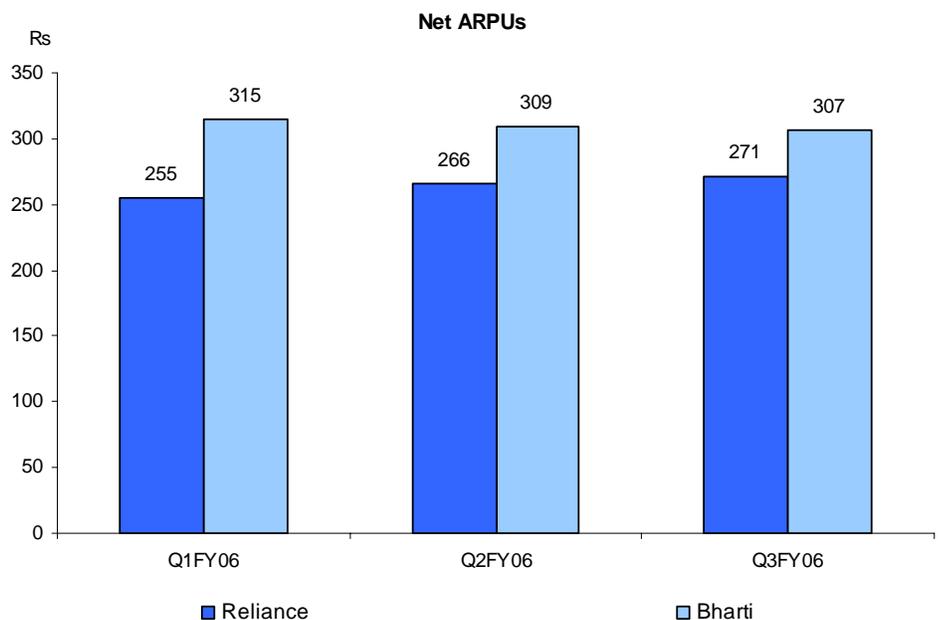
**Chart 7: Total subscriber base – RCoVL v/s Bharti**



### Comparing wireless ARPUs – RCoVL versus Bharti

For the last three quarters for which data is available, RCoVL has seen net ARPUs actually rise (see chart 8), although marginally, as compared to a fall in the case of Bharti. We believe this is because RCoVL a) is now seeing greater usage with low-end customers as usage habit picks up over time with greater perceived utility, and, b) RCoVL is beginning to focus more on the relatively higher end customers. Though minutes of use per user are high – the revenue per minute are lower than Bharti’s due to lower call charges. We believe that this could rise because of the above-mentioned reasons despite the launch of free lifetime incoming scheme.

**Chart 8: Though lower than Bharti’s, net\* ARPUs have actually risen**



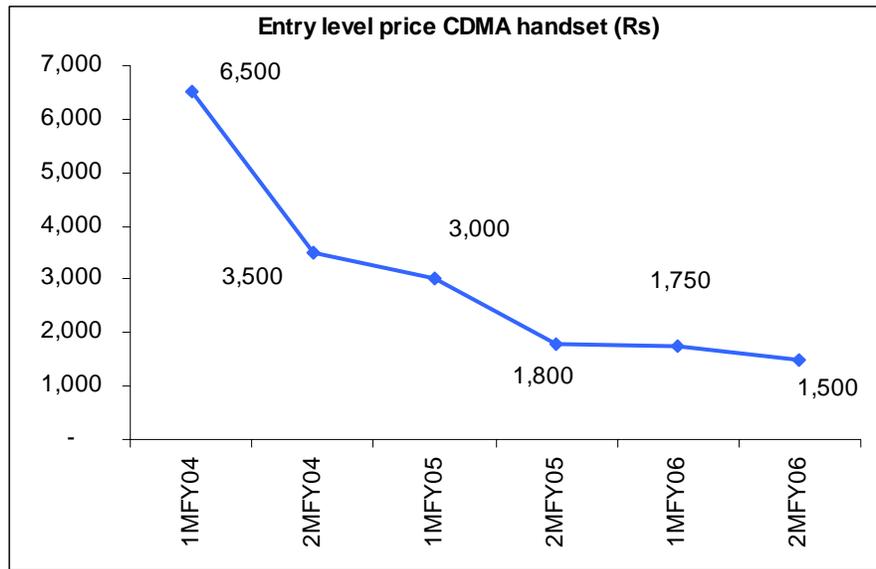
\* 'net' excludes access, interconnection and terminal costs, license fees and spectrum charges so as to strip out the impact of pass-through revenues that are largely regulatory driven.

### RCoVL’s handset strategy

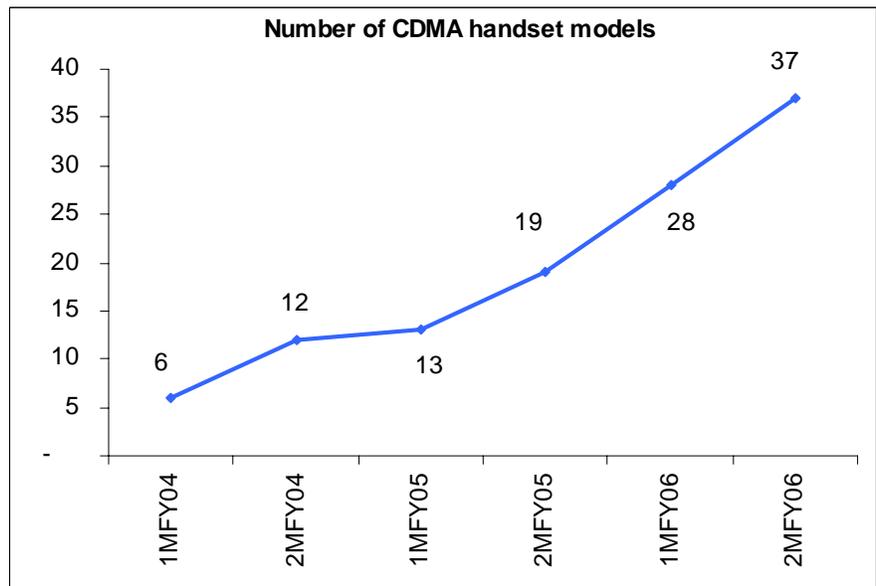
CDMA operators have traditionally had to grapple with both higher handset prices as compared with GSM operators as well as bundling handsets along with the service. RCoVL has successfully managed to address the former by not only negotiating with handset manufacturers to bring down prices sharply (see chart 9), but also increase the number of handset models being offered. The company has also been successful in increasing its distribution reach and sells handsets through 45,000 outlets across 4,300 towns, serviced by 1,463 distributors, and has a selling capacity of 20 million handsets per annum.

However, CDMA operators are likely to remain at a disadvantage to GSM operators on the handset front as handset options remain relatively limited.

**Chart 9: Falling handset prices have driven subscriber growth**



**Chart 10: Though increasing, CDMA handset choice is lower than for GSM**



**Other wireless-based services – PCOs, internet, ATM connectivity and multi-media**

The CDMA technology offers data speeds and connectivity which is higher than GSM. RCoVL is now increasingly focusing on opportunities in this arena. An example of this is providing ATM connectivity to banks.

RCoVL already has over 500 ATMs, 3,000 PoS terminals, and a 75% market share of lottery terminals. Customers include SBI, ICICI, HDFC, Euronet and HLL's Sangam. Other potential wireless data solutions include distance learning and distance medicine. It is also a leader in the prepaid wireless PCOs and has 0.7 million PCO line as against 0.45 million for Bharti and 0.33 million for Tatas.

## THE GLOBAL BUSINESS

### Acquisition of FLAG helps it become a leader in Indian ILD space

The acquisition of FLAG by Reliance in 2004 has made it a global player. FLAG is an undersea Optic Fiber Cable (OFC) network that covers 54,000 route kilometers internationally. It has PoPs (points of presence) in 28 countries across four continents and has a leadership position in Middle East Asia (MEA) and other parts of Asia. The FALCON cable being constructed by RCoVL (expected to be commissioned by mid CY06) would also help in increasing its presence in MEA as it covers 11,500 route kilometers and would be the only cable system to land in 12 MEA and Asian countries.

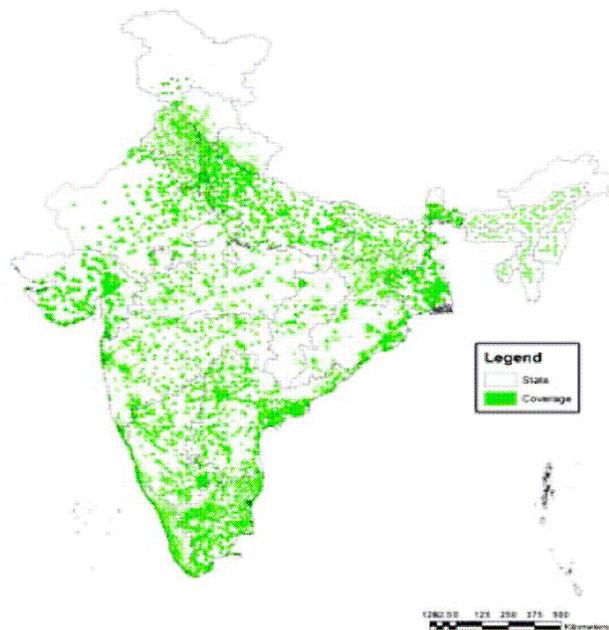
RCoVL is the leader in ILD voice market in India with 46% market share and handles 5 billion international minutes annually. It has over 50 major international carriers like Verizon, China Telecom and BT as partners for India inbound traffic, and has partnerships with most other domestic carriers for outbound traffic. The growth in the IT/ITES segment in India has also helped the company in increasing ILD volumes as it provides services to a large number of these companies.

It is also the leader in retail inbound calls from US to India with a 40% market share and 1.2 billion minutes handled annually.

### Most extensive NLD network

RCoVL has the most extensive pan-India presence among the private sector for the NLD business and has 60,000 kilometers intercity backbone as against 29,000 for VSNL and 31,000 for Bharti. More than 90% of its traffic terminates at local exchanges, and has 30% higher carriage.

### Chart 11: Extensive all-India network coverage



## THE BROADBAND BUSINESS

RCoVL's broadband business is only a year old but has been launched in 29 of India's key metros. It has over 50,000 buildings covered and over 40% market share in buildings connected. Its order book has been increasing and now stands at 2,462 at the end of Q3FY06 as against 1,939 in Q2FY06 and 1,813 in Q1FY06.

RCoVL has launched 14 products in the last four quarters with products like Centrex, PBX Trunks and Community Centrex in the voice segment and leased lines, MPLS VPN and gigabit Ethernet in the data segment.

RCoVL has huge cross-selling opportunities as 1,236 customers use only one product as against 457 that use one or more products. Some of the marquee clients of the company include Wipro, Accenture, ICICI Bank, NDTV and Coca Cola.

RCoVL also has a superior infrastructure compared to Bharti and BSNL with 200,000 square feet of multiple level three IDCs (international data centers), 170+ MPLS enabled cities and 150+ cities with BB wireless (LMDS).

**RCoVL's quarterly pro-forma consolidated financials\***

Rs mn	Q1FY06	Q2FY06	Q3FY06
<b>Sales and Other Income</b>	<b>25,400</b>	<b>27,870</b>	<b>33,270</b>
<i>% chg q-o-q</i>		9.7%	19.4%
Access and IUC costs	7,140	8,190	8,320
<i>% of sales</i>	28.1%	29.4%	25.0%
Licence fees	1,410	1,620	1,980
<i>% of sales</i>	5.6%	5.8%	6.0%
Other operating costs	15,180	13,900	14,490
<i>% of sales</i>	59.8%	49.9%	43.6%
<b>Total operating costs</b>	<b>23,730</b>	<b>23,710</b>	<b>24,790</b>
<i>% of sales</i>	93.4%	85.1%	74.5%
<b>EBITDA</b>	<b>1,670</b>	<b>4,160</b>	<b>8,480</b>
<i>EBITDA Margin</i>	6.6%	14.9%	25.5%
<i>% chg q-o-q</i>		127.0%	70.8%
Depreciation and Amrtzn	3,760	3,790	3,980
<i>% of sales</i>	14.8%	13.6%	12.0%
<i>% chg q-o-q</i>		-8.1%	-12.0%
<b>EBIT</b>	<b>(2,090)</b>	<b>370</b>	<b>4,500</b>
<i>EBIT %</i>		-	13.5%
Net Interest	350	540	1,280
<i>% of sales</i>	1.4%	1.9%	3.8%
PBT	(2,440)	(170)	3,220
Tax	60	10	120
<i>Effective tax rate</i>	-2.5%	-5.9%	3.7%
<b>PAT</b>	<b>(2,500)</b>	<b>(180)</b>	<b>3,100</b>
<i>NPM (%)</i>	-9.8%	-0.6%	9.3%

\* prior to adjustment for minority interests

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