

COMMENT

Reliance Communication (RLCM.BO) Rs579.30

Positive surprise on tower subsidiary valuation

News

Reliance Communications (RCOM) has privately placed a 5% equity holding in its tower subsidiary (RTIL) for a consideration of US\$337.5 mn, thereby valuing RTIL at US\$6.75 bn (Rs135/share for RCOM). RCOM plans to book a US\$280 mn capital gain from the sale in 2QFY2008. RTIL plans to add 23,000 towers to its network at a cost of about Rs80 bn (~US\$2 bn), which will be debt funded, likely via a loan from the parent company. Management estimates RTIL's FY2008 EV at US\$9 bn, based on the valuation of RTIL implied by this deal and the increase in debt. Bloomberg quoted the RCOM Chairman as saying that RTIL's operating margins would range between 20%-40%.

Analysis

The realized value of Rs135/share for RTIL is over 75% higher than our estimated value of Rs76/share. Relative to our assumptions in RTIL's earnings model, management has guided towards (1) lower operating margins, (2) a higher tower rollout and capex in FY2008, but lower tower rollout in subsequent years, and (3) higher tenancy (internal and external) on account of 3G and Wimax services.

Implications

Price discovery of RTIL's tower business has surprised us positively. With management suggesting the possibility of another round of stake sales in the towerco, this stock catalyst may not have played out fully as yet. Further, RTIL's price discovery augurs well for Bharti Airtel's (BRTI.BO, Buy, 12-m SOTP-based TP of Rs990, Risks: Competition, slow tower network expansion, weakening wireless operating metrics) towerco potential valuation as well.

In respect of (1) the recently released FY2007 annual report, (2) acquisition of Yipes Holdings earlier this week, and (3) price discovery of RTIL and guidance on certain tower business metrics, we are putting our estimates and price target for RCOM under review.

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Exhibit 1: 5% stake sale in RTIL – Our estimate vs. management disclosure

	GS	RCOM*
Implied Market Cap. (US\$ bn)	3.40	6.75
Value (Rs/Share for RCOM)	76	135
Incremental Towers (Mar-08)	20,000	23,000
Incremental Towers (Mar-10)	64,000	50,000
Capex FY08 (US\$ bn)	1.4	1.9 - 2.0
Operating Profit Margin (%)	42% - 56%	20% - 40%

Notes: * Management estimates

Source: Company Data, Goldman Sachs Research Estimates.

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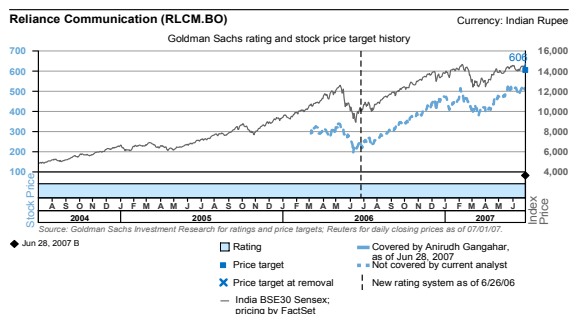
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