

November 2, 2008

Rating	BUY
Price	Rs221
Target Price	Rs459
Implied Upside	108.2%
Sensex	9,788

(Prices as on October 31, 2008)

Trading Data

Market Cap. (Rs bn)	465.2
Shares o/s (m)	2,108.3
Free Float	33.9%
3M Avg. Daily Vol ('000)	2,716.7
3M Avg. Daily Value (Rs m)	929.6

Major Shareholders

Promoters	66.1%
Foreign	9.4%
Domestic Inst.	11.5%
Public & Others	13.0%

Stock Performance

(%)	1M	6M	12M
Absolute	(35.7)	(60.7)	(71.9)
Relative	(13.9)	(16.3)	(20.9)

Price Performance (RIC: RLCM.BO, BB: RCOM IN)



Source: Bloomberg

- **Results:** Reliance Communications (RCom) reported inline revenues, 6% QoQ growth at Rs 56.4bn and higher than expected PAT at Rs15.3bn. Absolute EBITDA grew slower by 2.3% QoQ to Rs 23.0bn primarily due to higher network operating cost and surge in employee cost to Rs 4.6bn (increase by 30% QoQ) due to Vanco group integration. Net interest income of Rs 2.35bn for the quarter facilitated in stable PAT.
- **ARPU slides 3.9%, MOU flattish QoQ:** ARPU slid 3.9% QoQ to Rs 271, dropping slower vis-à-vis Bharti & Idea. The company hinted that the elasticity in terms of MOU is picking up (on fall of tariffs) and was flattish in the quarter due to seasonality impact.
- **Commercial launch of GSM in key select cities by Dec'08 and pan India operations by June'09:** RCom has indicated commercial launch of its GSM network in key cities by Dec'08 and full-fledged rollout of its GSM network pan India by June'09. Company expects significant traction in its GSM venture across the entire telecom eco-system including various range of handsets, roaming and on-net calls with its CDMA subscribers.
- **Outlook & valuation:** RCom's GSM launch (congestion free network) shall result in garnering higher net additions and improvement in subscriber market share for the next couple of years. However, network operating costs shall rise on operating dual networks simultaneously. Intense competition and faster drops in ARPU's have made us downgrade our revenues & earnings estimates by 9.5% and 20% to Rs 295bn and Rs 65bn respectively for FY10. However, at the CMP of Rs 220, we continue to like RCom on its integrated business model and the synergies that may accrue in the foreseeable future due to them. Maintain BUY.

Key financials (Y/e March)	FY07	FY08	FY09E	FY10E
Revenue (Rs m)	144,683	190,678	236,373	295,198
Growth (%)	34.4	31.8	24.0	24.9
EBITDA (Rs m)	57,210	81,992	98,118	118,079
PAT (Rs m)	31,638	54,012	59,574	64,568
EPS (Rs)	15.5	25.6	28.3	30.6
Growth (%)	442.6	65.6	10.3	8.4
Net DPS (Rs)	0.5	0.8	1.5	2.0

Source: Company Data; PL Research

Profitability & valuation	FY07	FY08	FY09E	FY10E
EBITDA margin (%)	39.5	43.0	41.5	40.0
RoE (%)	18.2	20.8	18.8	16.2
RoCE (%)	10.4	11.0	10.1	10.6
EV / sales (x)	3.3	3.2	2.9	2.2
EV / EBITDA (x)	8.3	7.4	6.9	5.6
PE (x)	14.3	8.6	7.8	7.2
P / BV (x)	2.0	1.6	1.4	1.1
Net dividend yield (%)	0.2	0.3	0.7	0.9

Source: Company Data; PL Research

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Q2FY09 result overview (post quarterly sheet Rcom)

(Rs m)

Y/e March	Q2FY09	Q1FY09	QoQ gr. (%)	Q2FY08	H1FY09	H1FY08	YoY gr. (%)
Key wireless Matrix							
Avg. revenue per user (ARPU) in (Rs)	271	282	(3.9)	361	277	368	(24.9)
Minutes of use/Subscriber (MOU)	423	424	(0.2)	490	424	500	(15.3)
No. of wireless subscribers EOP* (m)	56	51	10.4	36	56	51	10.4
Segmental revenue							
Wireless	43,356	41,187	5.3	37,230	84,543	70,960	19.1
Global	16,915	15,260	10.8	13,161	32,175	26,194	22.8
Broadband	6,023	5,603	7.5	4,371	11,626	8,204	41.7
Others	2,346	1,437	63.3	1,087	3,783	2,077	82.1
Less: inter-segmental	(12,190)	(10,265)		(10,064)	(22,455)	(18,613)	
Net revenue	56,450	53,222	6.1	45,785	109,672	88,822	23.5
Expenditure							
Access charges & License fee	8,324	9,159	(9.1)	9,746	17,483	19,433	(10.0)
<i>% of Net sales</i>	<i>14.7</i>	<i>17.2</i>		<i>21.3</i>	<i>15.9</i>	<i>21.9</i>	
Network operating cost	10,266	8,128	26.3	5,662	18,394	10,000	83.9
<i>% of Net sales</i>	<i>18.2</i>	<i>15.3</i>		<i>12.4</i>	<i>16.8</i>	<i>11.3</i>	
Employee cost	4,589	3,517	30.5	3,056	8,106	5,520	46.8
<i>% of Net sales</i>	<i>8.1</i>	<i>6.6</i>		<i>6.7</i>	<i>7.4</i>	<i>6.2</i>	
SG&A expenses	10,255	9,916	3.4	7,703	20,171	16,109	25.2
<i>% of Net sales</i>	<i>18.2</i>	<i>18.6</i>		<i>16.8</i>	<i>18.4</i>	<i>18.1</i>	
Total Operating Expenditure	33,434	30,720	8.8	26,167	64,154	51,062	25.6
EBIDTA	23,016	22,502	2.3	19,618	45,518	37,760	20.5
<i>EBIDTA margin (%)</i>	<i>40.8</i>	<i>42.3</i>		<i>42.8</i>	<i>41.5</i>	<i>42.5</i>	
Depreciation/Amortisation	9,180	8,638	6.3	6,754	17,818	12,946	37.6
<i>% of Net sales</i>	<i>16.3</i>	<i>16.2</i>		<i>14.8</i>	<i>16.2</i>	<i>14.6</i>	
EBIT	13,836	13,864	(0.2)	12,864	27,700	24,814	11.6
Interest and Finance Charge	(2,353)	(2,340)	0.6	(1,125)	(4,693)	(2,399)	95.6
<i>% of Net sales</i>	<i>(4.2)</i>	<i>(4.4)</i>		<i>(2.5)</i>	<i>(4.3)</i>	<i>(2.7)</i>	
Exceptional Items	647	640		(12,203)	1,287	(12,218)	
Profit/(Loss) before Tax	16,189	16,204	(0.1)	13,989	32,393	27,213	19.0
Total Tax provision	(567)	(194)	192.3	698	(761)	1,729	(144.0)
<i>Effective Tax Rate (%)</i>	<i>(3.5)</i>	<i>(1.2)</i>		<i>5.0</i>	<i>(2.3)</i>	<i>6.4</i>	
Share of profit of Associates	800	635		12,448	1,435	12,448	
Net Profit/ (Loss) after Tax	15,309	15,123	1.2	13,046	30,432	25,254	20.5

Highlights

Key wireless matrix - Revival on the cards

Wireless revenues showed a 5.3% QoQ growth helped by subscriber net additions of ~5.3 million for the quarter. However, margins slipped by 150bps QoQ due to soaring network operating costs which rose close to 300bps for the quarter to 18% of revenues. Test trials of GSM launch in key cities resulted in higher operating costs. Management has hinted of rolling commercial operations in major metro cities by Dec'08 and Pan-India launch by June'09.

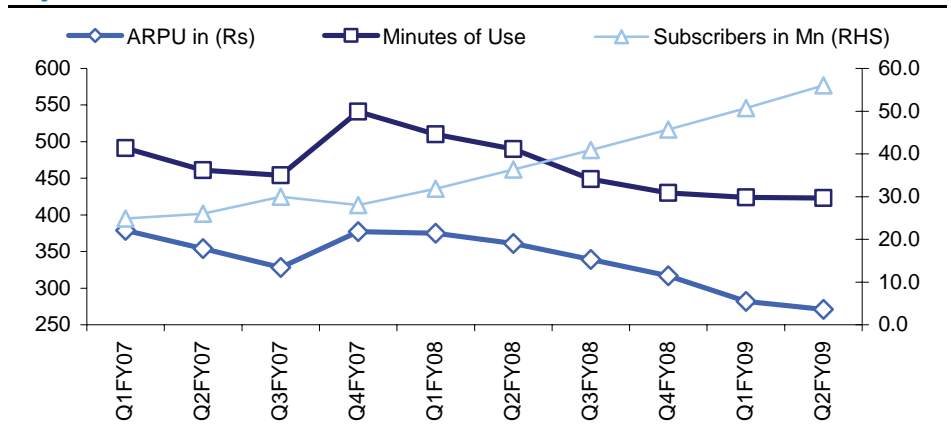
Mobility services

(Rs m)

Y/e March	Q2FY09	Q1FY09	QoQ gr (%)	Q2FY08	YoY gr (%)
Revenue	43,356	41,187	5.3	37,230	16.5
EBITDA	16,859	16,623	1.4	14,873	13.4
<i>EBITDA/revenue (%)</i>	<i>38.9</i>	<i>40.4</i>		<i>39.9</i>	
Traffic (m mins)	67,777	61,416	10.4	50,000	35.6
ARPU (Rs)	271	282	(3.9)	361	(24.9)
ARPM (Rs)	0.64	0.66	(4.6)	0.74	(14.1)
MOU (in mins)	423	424	(0.2)	490	(13.7)
<i>Non-voice revenue as % of mobile revenue</i>	<i>7.3</i>	<i>7.6</i>		<i>6.2</i>	

Source: Company Data, PL Research

Key wireless indicators



Source: Company Data, PL Research

Broadband & Teleservices continue to impress

Broadband business continued to impress both on profitability and revenue front for yet another quarter with a QoQ growth of 7.5% in revenues and EBITDA margin improvement of 30bps to 48.7%. Access lines grew by 112k lines, i.e. 28.7% growth YoY and Average Revenue Per Line (ARPL) of Rs1,668 (2.7% decline QoQ). Higher net additions resulted in some dilution of ARPL.

Broadband and telephone services

	(Rs m)				
Y/e March	Q2FY09	Q1FY09	Q4FY08	Q3FY08	Q2FY08
Revenue	6,023	5,603	5,100	4,564	4,371
EBITDA	2,941	2,714	2,492	2,222	2,102
<i>EBITDA / revenue (%)</i>	<i>48.7</i>	<i>48.4</i>	<i>48.9</i>	<i>48.7</i>	<i>48.1</i>
Access lines (m)	1.26	1.14	1.03	0.90	0.79
Buildings connected via network	8,57,982	8,21,638	7,87,567	7,27,229	6,66,368
ARPL (Rs)	1,668	1,715	1,760	1,797	1,948

Source: Company Data, PL Research

Global segment margins subdued, one time settlement of ~Rs 910mn with Tata Communications was booked

In the quarter, streamlining operations of Vanco group (MVNO operator which RCom acquired for US\$76m in the previous Quarter) continued to have a negative impact on the segmental numbers. Vanco headcount has been streamlined to 700 employees, and management expects to turn Vanco around in a couple of quarters. We understand from the management that the final settlement amount from Tata Communications for Rs 910m was booked in the quarter. Margins are expected to pick up in the coming quarters due to fully integrated operations of Vanco group and Yipes communications. NLD traffic grew by 18% QoQ to 7.8bn minutes which is quite encouraging.

Global services

	(Rs m)				
Y/e March	Q2FY09	Q1FY09	Q4FY08	Q3FY08	Q2FY08
Revenue	16,951	15,260	15,257	13,299	13,161
EBITDA	3,608	3,222	4,089	3,428	3,276
<i>EBITDA / revenue (%)</i>	<i>21.3</i>	<i>21.1</i>	<i>26.8</i>	<i>25.8</i>	<i>24.9</i>
Reliance India call (m subscriber)	1.7	1.7	1.5	1.4	1.3
Traffic detail NLD (m min)	7,856	6,641	5,964	5,795	5,853
Traffic detail ILD (m min)	1,946	1,726	1,769	1,747	1,688

Source: Company Data, PL Research



Estimates Revised

We have downgraded our revenue and profitability estimates for RCom factoring in faster declines in ARPU (seen for the last two consecutive quarters) and building in higher network operating costs for operating dual networks. Upside risks to our earnings prevail on higher than anticipated subscriber growth and possible sharing of passive infrastructure with existing telcos and new entrants.

Revised Estimate

	Revised estimates		Earlier estimates		% revision	
	FY09E	FY10E	FY09E	FY10E	FY09E	FY10E
Net sales (Rs m)	236,373	295,198	249,370	326,100	-5.2%	-9.5%
Adj. PAT (Rs m)	59,574	64,568	66,452	80,704	-10.3%	-20.0%
EPS (Rs)	28.3	30.6	30.6	37.1	-7.6%	-17.4%

Outlook & valuation

RCom's GSM launch (congestion free network) shall result in garnering higher net additions and improvement in subscriber market share for the next couple of years. However, network operating costs shall rise on operating dual networks simultaneously. Intense competition and faster drops in ARPU's have made us downgrade our revenues & earnings estimates by 9.5% and 20% to Rs 295bn and Rs 65bn respectively for FY10. However, at the CMP of Rs 220, we continue to like RCom on its integrated business model and the synergies that may accrue in the foreseeable future due to them. Maintain BUY.



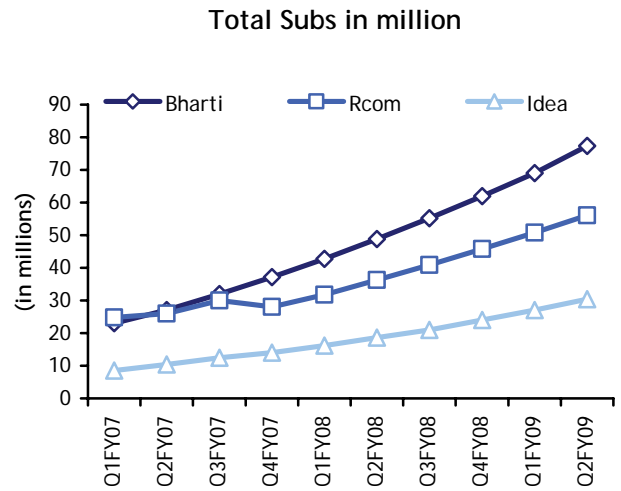
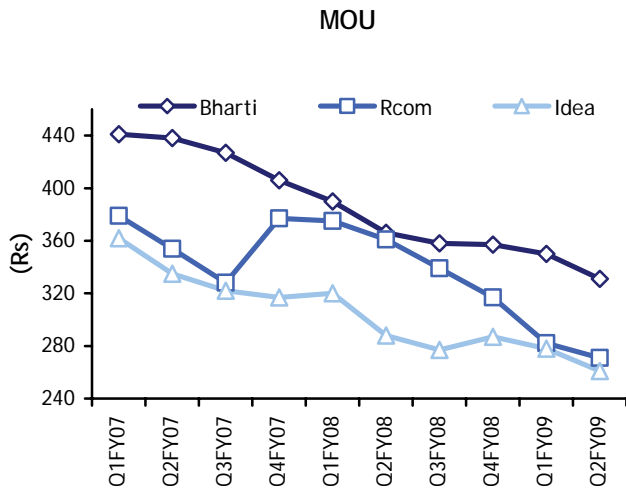
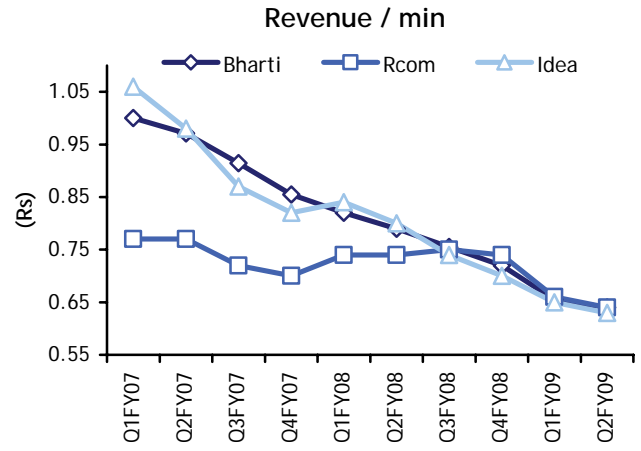
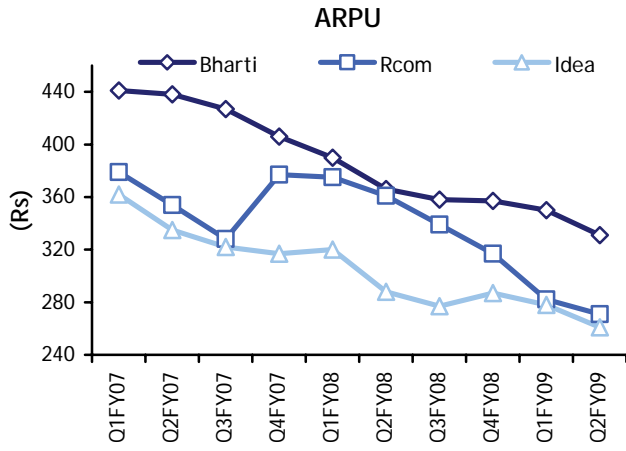
Annexure

Key wireless Matrix

	Q1FY07	Q2FY07	Q3FY07	Q4FY07	Q1FY08	Q2FY08	Q3FY08	Q4FY08	Q1FY09	Q2FY09
ARPU (Rs)										
Bharti	441	438	427	406	390	366	358	357	350	331
Rcom	379	354	328	377	375	361	339	317	282	271
Idea	362	335	322	317	320	288	277	287	278	261
MOU (Rs)										
Bharti	441	451	467	475	476	469	474	507	534	526
RCom	491	461	454	541	510	490	449	430	424	423
Idea	342	344	369	387	381	360	377	411	428	417
Revenue per min										
Bharti	1.00	0.97	0.91	0.85	0.82	0.79	0.76	0.72	0.66	0.64
Rcom	0.77	0.77	0.72	0.70	0.74	0.74	0.75	0.74	0.66	0.64
Idea	1.06	0.98	0.87	0.82	0.84	0.80	0.74	0.70	0.65	0.63
Total Subs in Million										
Bharti	23.07	27.06	31.97	37.14	42.70	48.80	55.20	61.98	69.00	77.40
Rcom	24.84	25.98	29.98	28.00	31.80	36.30	40.90	45.79	50.79	56.04
Idea	8.54	10.36	12.44	14.01	16.13	18.67	21.00	24.00	27.10	30.38

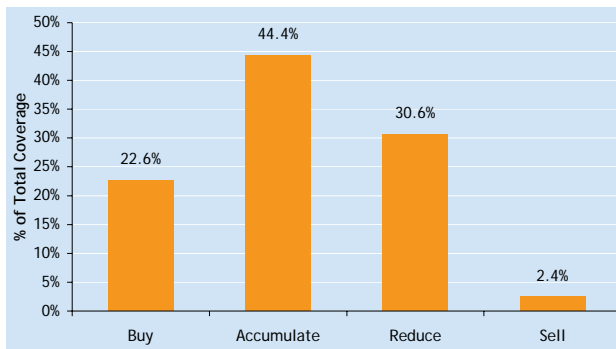
Source:

Key wireless matrix for Bharti, Rcom & Idea (bharti model charts sheet)



Source: Company data, PL research

Rating Distribution of Research Coverage



PL's Recommendation Nomenclature

BUY	: Over 15% Outperformance to Sensex over 12-months	Accumulate	: Outperformance to Sensex over 12-months
Reduce	: Underperformance to Sensex over 12-months	Sell	: Over 15% underperformance to Sensex over 12-months
Trading Buy	: Over 10% absolute upside in 1-month	Trading Sell	: Over 10% absolute decline in 1-month
Not Rated (NR)	: No specific call on the stock	Under Review (UR)	: Rating likely to change shortly

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