

Some improvement, but lagging peers

Rationality returns, but lagging peers; retain Underperform

We maintain our Underperform rating for Reliance Com (RCom) and PO at Rs95/sh. Displaying profit focus and a shift from its historically contrarian stance on many industry issues, RCom has announced tariff hikes similar to other GSM majors. This reinforces our expectation of uplift in industry EBITDA margins over the next 2-3 qtrs. However, we expect RCom's earnings upside to lag other majors, both on timing and magnitude, due to much weaker subscriber quality. We think RCom's valuations will remain at a discount to peers owing to much lower RoE.

FY12 EBITDA trimmed; FY13 raised by ~5%

In 1Q FY12, RCom's EBITDA was flat YoY & QoQ as wireless EBITDA grew 2% QoQ, lagging peers, and the global enterprise unit's EBITDA contracted QoQ. Factoring 1Q trends, we have trimmed FY12 EBITDA by ~2%, largely due to lower revenues in global enterprise. Material impact of recent tariff hikes will likely become visible only by 4Q FY12, and this drives the 4.5% EBITDA upgrade for FY13.

Free cash high on agenda; likely in FY12 but unsustainable

RCom's net debt has been flattish for the last 3 quarters, with net debt/annualized EBITDA at ~5x. Along with results the Co reiterated readiness to redeem US\$1bn of foreign currency bonds in Mar '12. We believe the Co is focused on meeting its commitments and will generate free cash in FY12 owing to sharp capex cutback (-60% YoY). Longer term, FY12 capex/sales of ~8% looks unsustainably low.

Mgt. call highlights - price stability; Infratel stake sale; 3G

On its post results call, RCom's top mgt. said it expects tariff stability going forward as the industry should focus on EBITDA mkt. share rather than revenue share. Due diligence for stake sale in the tower arm (R-Infratel) is on. The Co has 2mn 3G subs (1% of sub base) & expects the 3G ecosystem to evolve in 3-4 qtrs

Estimates (Mar)

(Rs)	2010A	2011A	2012E	2013E	2014E
Net Income (Adjusted - mn)	46,685	13,334	8,809	9,488	9,710
EPS	21.68	6.19	4.27	4.60	4.71
EPS Change (YoY)	-18.6%	-71.4%	-31.1%	7.7%	2.3%
Dividend / Share	0.850	0.500	0.500	0.500	0.500
Free Cash Flow / Share	17.46	(17.56)	16.75	2.32	3.96

Valuation (Mar)

	2010A	2011A	2012E	2013E	2014E
P/E	3.58x	12.52x	18.17x	16.87x	16.48x
Dividend Yield	1.10%	0.645%	0.645%	0.645%	0.645%
EV / EBITDA*	5.86x	5.03x	6.73x	6.09x	5.81x
Free Cash Flow Yield*	22.51%	-22.65%	21.60%	2.99%	5.10%

* For full definitions of *iQmethod*SM measures, see page 7.

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Stock Data

Price	Rs77.55
Price Objective	Rs95.00
Date Established	30-May-2011
Investment Opinion	C-3-7
Volatility Risk	HIGH
52-Week Range	Rs74.65-Rs188.50
Mrkt Val / Shares Out (mn)	US\$3,529 / 2,063.7
Market Value (mn)	Rs160,040
Average Daily Volume	8,937,364
BofAML Ticker / Exchange	RLCMF / BSE
Bloomberg / Reuters	RCOM IN / RLCM.BO
ROE (2012E)	2.4%
Net Dbt to Eqty (Mar-2011A)	87.6%
Est. 5-Yr EPS / DPS Growth	10.0% / 10.0%
Free Float	32.1%

Key Changes

(Rs)	Previous	Current
2012E Rev (m)	215,767.6	202,948.4
2013E Rev (m)	224,210.6	219,789.6
2014E Rev (m)	243,364.9	231,571.5
2012E EPS	5.26	4.27
2013E EPS	3.64	4.60
2014E EPS	4.54	4.71

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Refer to important disclosures on page 8 to 10. Analyst Certification on Page 5. Price Objective Basis/Risk on page 5. Link to Definitions on page 5. 11080649

iQprofileSM Reliance Communication Ltd.

Key Income Statement Data (Mar)	2010A	2011A	2012E	2013E	2014E
(Rs Millions)					
Sales	221,075	231,077	202,948	219,790	231,571
Gross Profit	77,965	90,815	67,889	75,024	78,623
Sell General & Admin Expense	NA	NA	NA	NA	NA
Operating Profit	40,495	25,777	25,891	28,989	29,737
Net Interest & Other Income	11,860	(10,724)	(13,197)	(14,914)	(14,983)
Associates	NA	NA	NA	NA	NA
Pretax Income	52,355	15,053	12,693	14,075	14,753
Tax (expense) / Benefit	(4,450)	(118)	(2,285)	(2,745)	(2,972)
Net Income (Adjusted)	46,685	13,334	8,809	9,488	9,710
Average Fully Diluted Shares Outstanding	2,153	2,153	2,064	2,064	2,064

Key Cash Flow Statement Data

Net Income	46,550	13,457	8,809	9,488	9,710
Depreciation & Amortization	37,470	65,038	41,998	46,035	48,886
Change in Working Capital	(5,750)	(78,160)	(2,592)	3,457	2,418
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	(621)	650	1,600	1,842	2,071
Cash Flow from Operations	77,649	985	49,814	60,821	63,086
Capital Expenditure	(41,619)	(37,234)	(15,245)	(56,041)	(54,924)
(Acquisition) / Disposal of Investments	1,658	110	0	0	0
Other Cash Inflow / (Outflow)	(8,448)	(91,574)	0	0	0
Cash Flow from Investing	(48,409)	(128,697)	(15,245)	(56,041)	(54,924)
Shares Issue / (Repurchase)	0	0	0	0	0
Cost of Dividends Paid	(2,050)	(1,231)	(1,196)	(1,196)	(1,196)
Cash Flow from Financing	(90,096)	125,053	(14,804)	6,692	16,895
Free Cash Flow	36,030	(36,249)	34,569	4,780	8,162
Net Debt	198,888	320,485	287,112	283,528	276,561
Change in Net Debt	(27,055)	128,820	(33,373)	(3,584)	(6,967)

Key Balance Sheet Data

Property, Plant & Equipment	715,395	729,408	702,655	712,662	718,700
Other Non-Current Assets	1,199	1,089	1,089	1,089	1,089
Trade Receivables	33,380	40,017	32,231	34,906	36,777
Cash & Equivalents	48,585	53,272	73,037	84,509	109,566
Other Current Assets	82,187	67,495	59,399	64,328	67,777
Total Assets	880,746	891,281	868,412	897,494	933,909
Long-Term Debt	247,473	373,757	360,149	368,037	386,127
Other Non-Current Liabilities	0	0	0	0	0
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	237,976	151,761	133,288	144,348	152,086
Total Liabilities	485,449	525,518	493,436	512,385	538,213
Total Equity	395,297	365,763	374,976	385,109	395,695
Total Equity & Liabilities	880,746	891,281	868,412	897,494	933,909

iQmethodSM - Bus Performance*

Return On Capital Employed	6.9%	3.6%	3.1%	3.4%	3.4%
Return On Equity	12.3%	3.6%	2.4%	2.6%	2.6%
Operating Margin	18.3%	11.2%	12.8%	13.2%	12.8%
EBITDA Margin	35.3%	39.3%	33.5%	34.1%	34.0%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	1.7x	0.1x	5.7x	6.4x	6.5x
Asset Replacement Ratio	1.1x	0.6x	0.4x	1.2x	1.1x
Tax Rate (Reported)	8.5%	0.8%	18.0%	19.5%	20.1%
Net Debt-to-Equity Ratio	50.3%	87.6%	76.6%	73.6%	69.9%
Interest Cover	NA	2.1x	1.7x	1.7x	1.6x

Key Metrics

* For full definitions of iQmethodSM measures, see page 7.

Company Description

Reliance Communications ranks among the largest private telecom operators in India. It has dominant wireless, long-distance and enterprise businesses in India. RCom also owns 100% of the global undersea cable FLAG. RCom was listed in Mar '06 as a result of the de-merger of Reliance Industries. The Anil D. Ambani group is the promoter-shareholder of RCom.

Investment Thesis

RCom's subscriber quality seems weaker than peers and poses challenges for top-line growth and margins, in our view. The Co's 3G footprint is restricted relative to peers and could limit returns from its 3G investments. Balance sheet remains stretched and deleveraging visibility is low pending tower demerger. These factors, coupled with full low returns on equity, drive our Underperform rating.

Stock Data

Price to Book Value 0.4x

Table 1: Reported 1Q FY12 segmental trends

Year ending 31 March (Rs mn)	1Q FY11	4Q FY11*	1Q FY12	YoY (%)	QoQ (%)
Consolidated Revenues	51,091	53,310	49,401	-3%	-7%
Consolidated EBITDA	16,320	15,920	16,021	-2%	1%
Consolidated EBITDA margin (%)	31.9%	29.9%	32.4%		
Wireless Revenues	41,528	41,978	43,267	4%	3%
Wireless EBITDA	11,989	11,490	11,727	-2%	2%
Wireless EBITDA margin (%)	28.9%	27.4%	27.1%		
Global Enterprise*					
Revenue	24,900	26,213	22,916	-8%	-13%
EBITDA	5,794	6,083	5,643	-3%	-7%
EBITDA margin (%)	23.3%	23.2%	24.6%		
Other income	3348.0	3,643	2,780	-17%	-24%
EBITDA	-1350	(949)	(1,284)	-5%	35%

*Adjusted for IRU accounting, Source: Company

Table 2: Reported 1Q FY12 results summary

Yr-ending 31 March (Rs mn)	1Q FY11	4Q FY11*	1Q FY12	YoY (%)	QoQ (%)
Total Revenue	51,091	53,310	49,400	-3%	-7%
Access, interconnect & licence fees	9,712	9,261	9,342	-4%	1%
Net Revenue	41,379	44,049	40,058	-3%	116%
Network operations cost	13,079	15,331	13,335	2%	-13%
Selling and general costs	8,446	8,881	7,192	-15%	-19%
Employee cost	3,535	4,067	3,511	-1%	-14%
Total Operating expenses	25,060	28,129	24,038	-4%	-15%
EBITDA	16,320	15,920	16,020	-2%	1%
EBITDA Margin (%)	31.9%	29.9%	32.4%		
Depreciation and amortisation	9,648	10,200	9,760	1%	-4%
EBIT	6,672	5,720	6,260	-6%	9%
Net Interest	4,397	2,234	4,050	-8%	81%
PBT	2,275	3,486	2,210	-3%	-37%
Tax expense/(income)	(719)	1,711	(24)		
Recurring net profit before minorities	2,994	1,775	2,234	-25%	26%
Minority interests	486	212	650	34%	207%
Recurring net profit post minorities	2,508	1,563	1,584	-37%	1%
Extraordinary expense/(income)		-123	10		
Reported net profit	2,508	1,686	1,574	-37%	-7%

*Adjusted for IRU accounting, Source: Company

Table 3: Key performance indicators - RCom vs Bharti

Yr to March	1QFY11	4QFY11	1QFY12	YoY (%)	QoQ (%)
ARPU (Rs/month)					
Bharti	215	194	190	-12%	-2%
RCom	130	107	103	-21%	-4%
Revenue per minute					
Bharti	0.45	0.43	0.43	-5%	-1%
RCom	0.44	0.44	0.44	0%	0%
MoU (minutes/ month)					
Bharti	480	449	445	-7%	-1%
RCom	295	241	233	-21%	-4%
Share of Industry net adds (%)					
Bharti	17.6%	16.4%	17.4%		
RCom	16.4%	17.0%	18.8%		
Churn (%)					
Bharti	5.8%	7.6%	6.4%		
RCom	3.5%	4.1%	4.0%		

Source: Company

Table 4: Comparison of GEM wireless majors

Co Name	BofAML Tickers	Market Cap US\$ mn	Sh Price (LC)	P/E (x)		EPS CAGR (10-12)	EV/EBITDA (x)		EBITDA CAGR (10-12)	ROE (%) CY11	Dividend Yield (%) CY11	FCF Yield (%) CY11	Net debt/EBITDA (x) CY11E	Capex/Sales CY11E
				CY11E	CY12E		CY11E	CY12E						
Bharti	BHTIF	33151	396	22.8	18.8	9.2%	8.6	7.4	21.2%	13.3	0.91	5.0	2.4	21.1%
Idea	IDEAF	6736	92.5	34.2	26.2	15.6%	9.0	7.4	25.7%	7.3	0.00	1.1	2.2	21.8%
RCom	RLCMF	3530	78	18.3	17.0	-13.8%	6.6	5.9	-9.1%	2.4	0.64	21.6	4.2	7.5%
China Mobile	CHLKF	192360	75	9.8	9.7	3.0%	3.9	3.8	3.2%	20.6	5.11	8.5	-1.2	25.2%
China unicom	CHUFF	43783	14	46.1	19.9	95.9%	5.2	4.3	18.0%	2.9	1.12	3.5	1.0	35.9%
China Telecom	CHJHF	49224	5	18.6	16.3	12.4%	4.7	4.4	4.0%	7.1	1.81	5.7	0.5	20.8%
Singtel	SNGNF	39873	3	12.1	11.4	4.6%	7.5	7.2	3.0%	16.5	6.54	7.5	0.7	11.9%
Axiata	XLMTF	14132	5	13.4	12.1	15.6%	6.3	5.9	8.4%	18.7	3.35	7.8	0.3	19.4%
Maxis	MAXSF	13453	5	16.8	16.5	2.9%	10.0	9.8	2.9%	27.6	5.98	6.2	0.9	13.2%
Digi.com	DIGBF	7831	30	21.7	20.7	-2.1%	8.8	8.3	8.6%	119.9	5.43	7.1	-0.1	10.8%
PLDT	ZHPLF	10126	2300	11.2	11.4	-4.7%	6.4	6.4	-1.6%	41.2	9.00	8.0	0.7	23.9%
GLOBE	GTMEF	2911	933	11.0	10.6	13.7%	4.7	4.6	4.5%	23.3	6.65	9.0	1.2	32.7%
AIS	XVDIF	11200	113	13.0	12.2	11.0%	6.0	5.7	6.6%	61.9	7.22	9.3	0.3	9.1%
DTAC	TACPF	5352	68	13.3	14.3	4.3%	5.3	5.5	3.0%	17.1	12.77	10.4	-0.4	8.3%
TRUE	TCPJF	1875	4	225.6	NM	-29.2%	6.2	6.6	-1.5%	1.2	0.00	-0.2	2.6	18.3%
PT Telkom	TLKMF	17001	7200	12.1	11.4	3.8%	4.5	4.3	1.0%	24.8	4.54	9.8	0.2	22.7%
Indosat	PTITF	3469	5450	32.8	19.5	53.1%	5.3	5.0	3.1%	5.0	1.83	2.3	2.2	30.1%
XL Axiata	XAESF	5288	5300	13.5	11.0	19.2%	5.4	5.1	6.6%	25.9	2.97	7.2	0.7	31.3%
INDIA Average				24.2	19.8	8.3%	8.5	7.2	19.4%	11.5	0.75	5.8	2.5	20.1%
ASIA -(EMERGING) AVERAGE				17.6	13.2	14.3%	5.4	5.0	6.3%	19.6	4.22	7.3	0.0	22.8%
Cellcom	XLECF	2159	76	7.7	7.3	-6.8%	4.9	4.8	-4.9%	338.5	13.06	14.5	1.4	10.2%
ECMS Mobinil	EGYMF	1508	90	23.8	13.7	-28.8%	3.3	3.1	-0.4%	9.8	4.44	10.7	1.8	19.1%
Mobily	XEHTE	9753	52	7.5	7.0	11.2%	6.0	5.5	13.2%	28.3	5.74	9.1	0.5	19.0%
Zain	XOMBF	14981	1	8.0	10.0	-39.3%	9.9	9.4	5.8%	19.7	10.53	11.2	-1.1	14.8%
MTN Group	MTNOF	36926	139	12.6	10.9	18.7%	6.2	5.5	10.7%	25.6	5.03	7.0	-0.3	17.9%
MTS	MBT	17317	17	9.6	7.7	22.9%	4.2	3.9	8.1%	38.6	6.53	11.7	1.1	21.1%
Orascom Telecom	XORSF	2882	3	7.1	4.7		3.1	3.1	6.3%	12.0	0.00	14.5	1.4	13.7%
Partner	PTNRF	1731	39	7.2	7.0	-16.1%	4.5	4.4	-15.0%	126.5	11.26	15.5	2.4	11.4%
Turkcell	TKCZF	9761	8	11.8	9.6	-7.0%	4.1	3.7	1.7%	12.9	4.36	5.4	-0.8	11.5%
VimpelCom	VIP	17780	11	7.0	6.4	15.2%	4.8	3.9	46.9%	17.4	7.31	4.8	2.6	19.5%
Vodacom	XVDFE	17665	84	11.6	10.4	14.6%	5.9	5.4	9.7%	66.0	7.14	8.0	0.4	11.4%
Wataniya	XNNMF	3654	2	9.0	9.5	19.3%	3.9	3.8	22.9%	20.4	3.36	12.1	0.3	16.4%
America Movil	AMX	93553	24	11.3	9.6	20.8%	5.3	5.0	17.1%	32.1	1.36	8.2	0.7	15.3%
GEM AVERAGE (Including Asia)				15.3	11.9	13.9%	5.4	5.1	9.2%	24.4	4.27	7.6	0.2	20.6%

Source: BofA Merrill Lynch Global Research estimates

Price objective basis & risk

RCVL (RLCMF)

We have a price objective of Rs95/sh for RCom. Our PO is based on sum-of-parts and DCF. Reliance Infratel (towerCo) is valued based on recent acquisition deals in the towerCo space. We value RCom's non-wireless businesses at 4.5x FY13E EV/EBITDA while RCom's wireless business is rough-stab valued at around 5x FY13E EV/EBITDA (post-towers), implying valuation at par with GEM wireless majors. Upside surprise could be led by asset sales at strong premiums. Downside risk to our outlook could stem from continued failure to monetize the tower business and unforeseen margin pressures post 3G.

Link to Definitions

Media & Telecom

Click [here](#) for definitions of commonly used terms.

Analyst Certification

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APR - Telecommunications Coverage Cluster

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
BUY				
	Advanced Info	XVDIF	ADVANC TB	Thitithep Nophaket
	Axiata Group	XLMTF	AXIATA MK	B. Roshan Raj
	China Telecom	CHA	CHA US	Sydney Zhang, CFA
	China Telecom-H	CHJHF	728 HK	Sydney Zhang, CFA
	China Unicom	CHUFF	762 HK	Sydney Zhang, CFA
	China Unicom -A	CHU	CHU US	Sydney Zhang, CFA
	ChinaCache International Holdings Ltd	CCIH	CCIH US	Clara Fan
	KT	KT	KT US	Sean Oh
	KT	KTCNF	030200 KS	Sean Oh
	M1	MBOFF	M1 SP	B. Roshan Raj
	Telkom	TLKMF	TLKM IJ	B. Roshan Raj
	Total Access	TACJF	DTAC SP	Thitithep Nophaket
	Total Access Communication	TACPF	DTAC TB	Thitithep Nophaket
	XL Axiata	XAESF	EXCL IJ	B. Roshan Raj
NEUTRAL				
	Bharti	BHTIF	BHARTI IN	Reena Verma Bhasin, CFA
	China Mobile	CHLKF	941 HK	Sydney Zhang, CFA
	China Mobile - A	CHL	CHL US	Sydney Zhang, CFA
	DiGi	DIGBF	DIGI MK	B. Roshan Raj
	Idea Cellular	IDEAF	IDEA IN	Reena Verma Bhasin, CFA
	Indosat	PTITF	ISAT IJ	B. Roshan Raj
	LG Uplus	LTCLF	032640 KS	Sean Oh
	SingTel	SNGNF	ST SP	B. Roshan Raj
	TM	MYTEF	T MK	B. Roshan Raj
UNDERPERFORM				
	Globe Telecom	GTMEF	GLO PM	Jidgette Velasco
	Maxis	MAXSF	MAXIS MK	B. Roshan Raj
	MTNL	XMTNF	MTNL IN	Reena Verma Bhasin, CFA
	MTNL	MTE	MTE US	Reena Verma Bhasin, CFA
	Philippine Long Distance Telephone	ZHPLF	TEL PM	Edser Trinidad
	PLDT -A	PHI	PHI US	Edser Trinidad
	RCVL	RLCMF	RCOM IN	Reena Verma Bhasin, CFA
	SK Broadband	HANTF	033630 KS	Sean Oh
	StarHub	SRHBF	STH SP	B. Roshan Raj
	Tata Communications Limited	VLSLF	TCOM IN	Reena Verma Bhasin, CFA
	Tata Communications Limited	TCL	TCL US	Reena Verma Bhasin, CFA
	TRUE Corp	TCPJF	TRUE TB	Thitithep Nophaket
RSTR				
	Funtalk China Holdings Ltd	FTLK	FTLK US	Chen Luo, CFA
	SK Telecom	SKM	SKM US	Sean Oh
	SK Telecom	SKMTF	017670 KS	Sean Oh

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales} + \text{Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

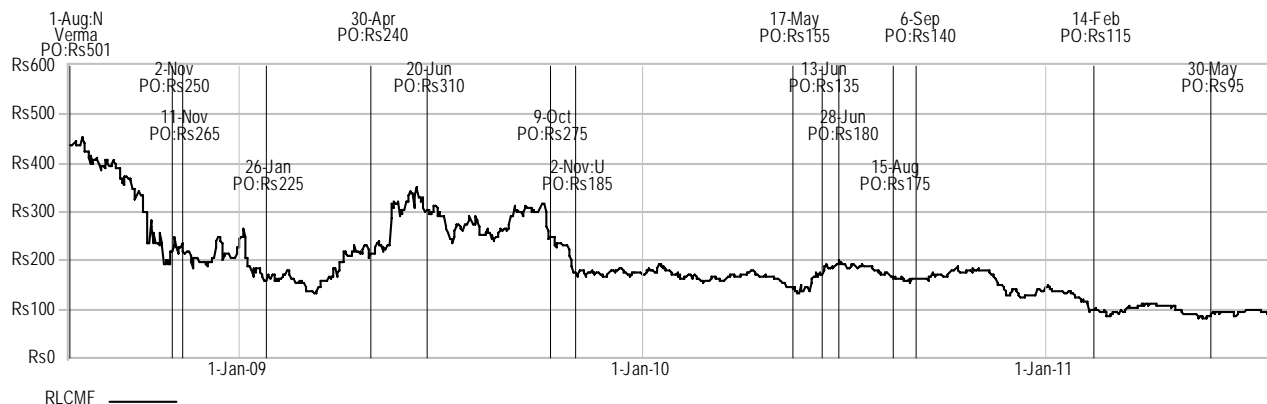
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RLCMF Price Chart



B : Buy, N : Neutral, U : Underperform, PO : Price objective, NA : No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of (July 31, 2011) or such later date as indicated.

Investment Rating Distribution: Telecommunications Group (as of 01 Jul 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	90	50.28%	Buy	43	58.90%
Neutral	53	29.61%	Neutral	28	62.22%
Sell	36	20.11%	Sell	14	46.67%

Investment Rating Distribution: Global Group (as of 01 Jul 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	2024	53.94%	Buy	935	50.68%
Neutral	944	25.16%	Neutral	442	51.64%
Sell	784	20.90%	Sell	273	37.24%

* Companies in respect of which BofA Merrill Lynch or one of its affiliates has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

* Ratings dispersions may vary from time to time where BofA Merrill Lynch Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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