

## Reliance Communications

### Finance income boosts profits

Reliance Communications' (Rcom's) Q3FY10 result fell short of our estimates at the revenue and EBITDA level by 6%. However, the company's PAT, at Rs 11.1bn, stood significantly ahead of the estimated Rs 5.5bn. The variation in PAT stemmed from a finance income of Rs 4.1bn reported by Rcom as against a finance charge of Rs 4bn anticipated by us. We are marginally pruning our FY11 numbers but maintaining our Sell rating on Rcom. Financial transparency, poor operating matrices and capital productivity coupled with weak balance sheet are key reasons for our sell rating.

**Topline slides 6.9% QoQ:** Rcom's consolidated revenue dropped 6.9% QoQ (decline of Rs 3.6bn) as the Globalcom business plummeted 12.5% QoQ to Rs 19.8bn. The management attributed the decline in this business to rupee appreciation (against US\$) and booking of a one-time revenue in Q2FY10. The poor performance of the Globalcom business surprised us negatively as the company's long-distance minutes grew 23% QoQ to 16.4bn (NLD +22% QoQ, ILD + 30% QoQ). Revenues from the broadband business, however, dipped 8.5% QoQ to Rs 7bn which the management attributed to pricing pressure.

**EBITDA declines 10.3% QoQ:** Rcom's EBITDA slumped 10.3% QoQ due to a 128bps contraction in the EBITDA margin. This contraction was led by a sharp increase in access charges (up 15.3% QoQ or 199bps) and network costs (up 5% QoQ or 355bps). The drop in margins, however, was restricted by lower SG&A costs (lower 33.6% QoQ or 473bps), which the management attributed to cost optimisation measures like rationalisation of office spaces and outsourcing of contracts / manpower.

**PAT grows 56.6% QoQ:** Despite lower revenues and EBITDA, Rcom's PAT improved 56.6% QoQ purely due to the booking of finance income. During the quarter, Rcom had a finance income of Rs 4bn against a finance charge of Rs 6.5bn in Q2FY10. Appreciation of the rupee against the US\$ also had a positive impact of ~Rs 6.5bn in Q3FY10.

**Management call highlights:** Rcom has trimmed its FY10 capex guidance to Rs 45bn against its earlier estimate of Rs 100bn (Rs 150bn estimated at the beginning of the year); its guidance for FY11 stands at Rs 30bn (excluding 3G). The management has indicated good traction for its new Simply Reliance and SMS plan; however, lower-than-competition subscribers and poor growth in minutes of usage suggest the contrary.

**Maintain Sell:** We maintain our Sell rating with revised target price of Rs 180 (from Rs160 earlier) due to lower capex assumption and moving forward in terms of time period. We have reduced our FY11 revenue, EBITDA and PAT estimates by 5.5%, 9.7% and 4.6% respectively. The expected in PAT stands lower than in revenue and EBITDA due to the lower capex assumption and thus depreciation.

#### Financial highlights

(Rs mn)	FY09	FY10	FY11E	FY12E
Revenue	227,891	226,235	249,888	280,324
Growth (%)	19.5	(0.7)	10.5	12.2
EBITDA	91,453	80,888	87,512	101,925
Growth (%)	11.3	(11.6)	8.2	16.5
FDEPS (Rs)	21.2	18.8	14.0	17.5
Growth (%)	(15.7)	(10.9)	(25.6)	24.5

#### Profitability and return ratios

(%)	FY09	FY10	FY11E	FY12E
EBITDA margin	40.1	35.8	35.0	36.4
EBIT margin	24.3	20.0	18.8	21.0
Adj PAT margin	20.0	17.9	12.1	13.4
ROE	19.8	15.9	10.5	13.2
ROIC	9.6	6.0	5.9	7.5
ROCE	10.1	6.8	6.6	8.4

#### What's New? Target Rating Estimates

CMP	TARGET	RATING	RISK
Rs 174	Rs 180	SELL	HIGH

BSE	NSE	BLOOMBERG
532712	RCOM	RCOM IN

#### Company data

Market cap (Rs mn / US\$ mn)	358,414/7,729
Outstanding equity shares (mn)	2,064
Free float (%)	32.5
Dividend yield (%)	0.5
52-week high/low (Rs)	362/131
2-month average daily volume	6,775,492

#### Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
Rcom	174	0.8	(1.3)	(37.0)
Sensex	16,356	(6.3)	2.9	4.4

#### Valuation matrix

(x)	FY09	FY10	FY11E	FY12E
P/E @ CMP	8.2	9.2	12.4	10.0
P/E @ Target	8.5	9.5	12.8	10.3
EV/EBITDA @ CMP	7.0	7.5	6.5	5.2





## Result highlights

Fig 1 - Actual vs. estimated performance

(Rs mn)	Actual	Estimate	% Variance
Revenue	53,098	56,724	(6.4)
EBITDA	18,126	19,286	(6.0)
EBITDA margin	34.1	34.0	14 bps
Reported PAT	11,080	5,448	103.4
Rep PAT margin	20.9	9.6	1126 bps

Source: RHH, Company

Fig 2 - Quarterly performance

(Rs mn)	Q3FY10	Q2FY10	% Var QoQ	Q3FY09	% Var YoY
<b>Revenue</b>	<b>53,098</b>	<b>57,026</b>	<b>(6.9)</b>	<b>56,718</b>	<b>(6.4)</b>
Access cost	5,501	4,772	15.3	5,633	(2.4)
% of revenue	10.4	8.4	199 bps	9.9	43 bps
License cost	2,836	2,913	(2.6)	3,059	(7.3)
% of revenue	5.3	5.1	23 bps	5.4	-5 bps
Network cost	16,708	15,919	5.0	11,666	43.2
% of revenue	31.5	27.9	355 bps	20.6	1090 bps
Staff cost	3,677	3,816	(3.7)	4,383	(16.1)
% of revenue	6.9	6.7	23 bps	7.7	-80 bps
SG & A	6,250	9,407	(33.6)	10,235	(38.9)
% of revenue	11.8	16.5	-473 bps	18.0	-627 bps
<b>Total Cost</b>	<b>34,971</b>	<b>36,827</b>	<b>(5.0)</b>	<b>34,977</b>	<b>(0.0)</b>
% of revenue	65.9	64.6	128 bps	61.7	419 bps
<b>EBITDA</b>	<b>18,126</b>	<b>20,199</b>	<b>(10.3)</b>	<b>21,742</b>	<b>(16.6)</b>
% of revenue	34.1	35.4	-128 bps	38.33	-419 bps
Depreciation	8,331	7,144	16.6	10,069	(17.3)
% of revenue	15.7	12.5	316 bps	17.8	-206 bps
<b>EBIT</b>	<b>9,796</b>	<b>13,055</b>	<b>(25.0)</b>	<b>11,673</b>	<b>(16.1)</b>
% of revenue	18.4	22.9	-444 bps	20.6	-213 bps
Finance charges (net)	(4,076)	6,551	(162.2)	(1,496)	172.4
% of revenue	(7.7)	11.5	-1916 bps	(2.6)	-504 bps
<b>Profit before tax</b>	<b>13,871</b>	<b>6,504</b>	<b>113.3</b>	<b>13,169</b>	<b>5.3</b>
% of revenue	26.1	11.4	1472 bps	23.2	291 bps
Tax	2,003	(1,739)	(215.2)	153	1,212.3
% of revenue	3.8	(3.0)	682 bps	0.3	350 bps
% of PBT	5.7	(4.7)	1045 bps	0.4	529 bps
<b>Reported PAT</b>	<b>11,279</b>	<b>7,204</b>	<b>56.6</b>	<b>12,545</b>	<b>(10.1)</b>
% of revenue	21.2	12.6	861 bps	22.1	-88 bps

Source: RHH, Company

Revenue and EBITDA disappoint due to poor operating performance of Globalcom and broadband businesses

SG&A cost declines due to cost optimisation

PAT surges on finance gain of Rs 4.1bn against the estimated finance charge of Rs 4bn

Finance income on account of rupee appreciation (+3.5% QoQ) against USD yields positive impact of ~Rs 6.5bn



Fig 3 - Revision in estimates

**FY10 estimates revised upwards due to higher finance income in Q3**

**PAT decline lower in FY11 than revenue / EBITDA due to lower depreciation charges on expectations of lower capex**

	FY10			FY11		
	Revised	Earlier	% Chg	Revised	Earlier	% Chg
Revenue (Rs mn)	226,235	236,009	(4.1)	249,888	264,498	(5.5)
EBITDA (Rs mn)	80,888	84,516	(4.3)	87,512	96,895	(9.7)
EBITDA margin %	35.8	35.8	-6 bps	35.0	36.6	-161 bps
PAT (Rs mn)	40,583	32,666	24.2	30,199	31,642	(4.6)
PAT margin %	17.9	13.8	410 bps	12.1	12.0	12 bps
EPS (Rs)	18.8	15.2	24.2	14.0	14.7	(4.6)

Source: RHH, Company

Fig 4 - Wireless business KPI's

	Q3FY10	Q2FY10	% Var QoQ	Q3FY09	% Var YoY
Subs (in 000's)	93,796	86,118	8.9	61,345	52.9
ARPU (in Rs)	149	161	(7.4)	251	(40.6)
MOU/Sub	330	340	(2.9)	410	(19.5)
RPM (in Rs)	0.45	0.47	(4.6)	0.61	(26.2)
EBITDA/Min (in Rs)	0.14	0.16	(9.3)	0.23	(38.8)
EBIT/Min (in Rs)	0.10	0.12	(21.4)	0.13	(28.9)

Source: RHH, Company

Fig 5 - Overall business KPI's

	Q3FY10	Q2FY10	% Var QoQ	Q3FY09	% Var YoY
MOUs (in mn)	105,466	97,870	7.8	82,582	27.7
Revenue (in Rs)	53,098	56,781	(6.5)	56,718	(6.4)
EBITDA (in Rs)	18,126	20,199	(10.3)	21,762	(16.7)
EBIT (in Rs)	9,796	13,055	(25.0)	11,673	(16.1)
RPM (in Rs)	0.50	0.58	(13.2)	0.69	(26.7)
EBITDA/Min (in Rs)	0.17	0.21	(16.7)	0.26	(34.8)
EBIT/Min (in Rs)	0.09	0.13	(30.4)	0.14	(34.3)

Source: RHH, Company

Fig 6 - Minutes of usage trend

(in mn)	Q3FY10	Q2FY10	% Var QoQ	Q3FY09	% Var YoY
Wireless	89,000	84,500	5.3	72,100	23.4
NLD	13,643	11,205	21.8	8,576	59.1
ILD	2,823	2,165	30.4	1,906	48.1
<b>Total</b>	<b>105,466</b>	<b>97,870</b>	<b>7.8</b>	<b>82,582</b>	<b>27.7</b>

Source: RHH, Company

Fig 7 - Segment-wise revenue

(Rs mn)	Q3FY10	Q2FY10	% Var QoQ	Q3FY09	% Var YoY
Mobile	40,225	40,100	0.3	44,119	(8.8)
Globalcom	19,818	22,643	(12.5)	15,827	25.2
Broadband	7,045	7,700	(8.5)	6,542	7.7
Others	3,160	2,515	25.6	2,355	34.2
<b>Gross revenue</b>	<b>70,248</b>	<b>72,958</b>	<b>(3.7)</b>	<b>68,843</b>	<b>2.0</b>
Less: Intersegment	(17,150)	(16,178)	6.0	(12,126)	41.4
<b>Net revenue</b>	<b>53,098</b>	<b>56,781</b>	<b>(6.5)</b>	<b>56,718</b>	<b>(6.4)</b>

Source: RHH, Company



Fig 8 - Segment-wise EBITDA

(Rs mn)	Q3FY10	Q2FY10	% Var QoQ	Q3FY09	% Var YoY
Mobile	12,545	13,132	(4.5)	16,616	(24.5)
Globalcom	4,194	5,227	(19.8)	4,315	(2.8)
Broadband	2,755	3,199	(13.9)	2,760	(0.2)
Others	(1,250)	(1,244)	0.5	(1,869)	(33.1)
<b>Gross EBITDA</b>	<b>18,244</b>	<b>20,314</b>	<b>(10.2)</b>	<b>21,822</b>	<b>(16.4)</b>
Less: Intersegment	(118)	(115)	2.6	(60)	96.7
<b>Net EBITDA</b>	<b>18,126</b>	<b>20,199</b>	<b>(10.3)</b>	<b>21,762</b>	<b>(16.7)</b>

Source: RHH, Company

Fig 9 - Segment-wise EBITDA margin

%	Q3FY10	Q2FY10	% Var QoQ	Q3FY09	% Var YoY
Mobile	31.2	32.7	(156 bps)	37.7	(647 bps)
Globalcom	21.2	23.1	(192 bps)	27.3	(610 bps)
Broadband	39.1	41.5	(244 bps)	42.2	(308 bps)
Others	(39.6)	(49.5)	989 bps	(79.4)	3,980 bps
<b>Net revenue</b>	<b>34.1</b>	<b>35.6</b>	<b>(144 bps)</b>	<b>38.4</b>	<b>(423 bps)</b>

Source: RHH, Company

Fig 10 - Segment-wise EBIT

(Rs mn)	Q3FY10	Q2FY10	% Var QoQ	Q3FY09	% Var YoY
Mobile	8,480	10,240	(17.2)	9,657	(12.2)
Globalcom	1,806	2,797	(35.4)	1,308	38.1
Broadband	1,580	2,039	(22.5)	1,926	(18.0)
Others	(2,069)	(2,267)	(8.7)	(391)	429.2
<b>Gross EBITDA</b>	<b>9,797</b>	<b>12,809</b>	<b>(23.5)</b>	<b>12,500</b>	<b>(21.6)</b>

Source: RHH, Company

Fig 11 - Segment-wise EBIT margin

%	Q3FY10	Q2FY10	% Var QoQ	Q3FY09	% Var YoY
Mobile	21.1	25.5	(445 bps)	21.9	(81 bps)
Globalcom	9.1	12.4	(324 bps)	8.3	85 bps
Broadband	22.4	26.5	(406 bps)	29.4	(701 bps)
Others	(65.5)	(90.1)	2,464 bps	(16.6)	(4,888 bps)
<b>Overall</b>	<b>18.5</b>	<b>22.6</b>	<b>(411 bps)</b>	<b>22.0</b>	<b>(359 bps)</b>

Source: RHH, Company



## Consolidated financials

### Profit and Loss statement

Y/E March (Rs mn)	FY09	FY10	FY11E	FY12E
<b>Revenues</b>	<b>227,891</b>	<b>226,235</b>	<b>249,888</b>	<b>280,324</b>
Growth (%)	19.5	(0.7)	10.5	12.2
<b>EBITDA</b>	<b>91,453</b>	<b>80,888</b>	<b>87,512</b>	<b>101,925</b>
Growth (%)	11.3	(11.6)	8.2	16.5
Depreciation & amortisation	36,075	35,532	40,544	42,967
EBIT	55,378	45,355	46,968	58,958
Growth (%)	2.4	(18.1)	3.6	25.5
Interest	8,318	(1,630)	9,237	10,889
Other income	-	-	-	-
EBT	47,061	46,985	37,730	48,069
Income taxes	(518)	3,584	4,905	7,210
Effective tax rate (%)	(1.1)	7.6	13.0	15.0
Extraordinary items	14,906	(116)	-	-
Min into / inc from associates	2,036	2,817	2,626	3,269
Reported net income	60,449	40,468	30,199	37,590
Adjustments	14,906	(116)	-	-
<b>Adjusted net income</b>	<b>45,543</b>	<b>40,583</b>	<b>30,199</b>	<b>37,590</b>
Growth (%)	(15.7)	(10.9)	(25.6)	24.5
Shares outstanding (mn)	2,064.0	2,064.0	2,064.0	2,064.0
<b>FDEPS (Rs) (adj)</b>	<b>21.2</b>	<b>18.8</b>	<b>14.0</b>	<b>17.5</b>
Growth (%)	(15.7)	(10.9)	(25.6)	24.5
DPS (Rs)	0.8	-	-	-

### Cash flow statement

Y/E March (Rs mn)	FY09	FY10	FY11E	FY12E
Net income + Depreciation	94,119	76,000	70,743	80,557
Non-cash adjustments	(8,788)	-	-	-
Changes in working capital	(20,255)	3,015	(2,071)	(18,692)
Cash flow from operations	65,075	79,015	68,672	61,865
Capital expenditure	(122,426)	(44,547)	(34,424)	(29,666)
Change in investments	15,567	92,800	-	-
Other investing cash flow	6,779	-	-	-
Cash flow from investing	(100,079)	48,253	(34,424)	(29,666)
Issue of equity	-	239	(657)	3,269
Issue/repay debt	75,084	(35,916)	(39,717)	(70,627)
Dividends paid	(1,792)	-	-	-
Other financing cash flow	(30,861)	-	-	-
Change in cash & cash eq	7,427	91,591	(6,126)	(35,159)
Closing cash & cash eq	16,829	108,420	102,293	67,135

### Economic Value Added (EVA) analysis

Y/E March	FY09	FY10	FY11E	FY12E
WACC (%)	12.5	12.5	12.5	12.5
ROIC (%)	9.6	6.0	5.9	7.5
Invested capital (Rs mn)	708,770	698,319	677,846	666,844
EVA (Rs mn)	(20,402)	(45,706)	(44,477)	(33,651)
EVA spread (%)	(2.9)	(6.5)	(6.6)	(5.0)

### Balance sheet

Y/E March (Rs mn)	FY09	FY10	FY11E	FY12E
Cash and cash eq	16,829	108,420	102,293	67,135
Accounts receivable	39,618	34,090	37,654	42,241
Inventories	5,427	5,536	5,646	5,759
Other current assets	85,271	68,180	75,309	84,481
Investments	95,657	2,857	2,857	2,857
Gross fixed assets	755,101	807,324	847,120	881,889
Net fixed assets	613,957	612,092	594,809	570,077
CWIP	113,096	107,441	102,069	96,966
Intangible assets	52,215	52,215	52,215	52,215
Deferred tax assets, net	(281)	(365)	(475)	(617)
Other assets	-	-	-	-
<b>Total assets</b>	<b>1,021,789</b>	<b>990,466</b>	<b>972,379</b>	<b>921,113</b>
Accounts payable	159,718	144,046	148,780	142,654
Other current liabilities	-	-	-	-
Provisions	41,096	37,189	41,077	42,241
Debt funds	391,623	355,706	315,990	245,363
Other liabilities	6,549	9,350	11,976	15,244
Equity capital	10,320	10,320	10,320	10,320
Reserves & surplus	412,483	433,855	444,236	465,291
Shareholder's funds	422,803	444,175	454,556	475,611
<b>Total liabilities</b>	<b>1,021,789</b>	<b>990,466</b>	<b>972,379</b>	<b>921,113</b>
BVPS (Rs)	81	99	112	130

### Financial ratios

Y/E March	FY09	FY10	FY11E	FY12E
<b>Profitability &amp; Return ratios (%)</b>				
EBITDA margin	40.1	35.8	35.0	36.4
EBIT margin	24.3	20.0	18.8	21.0
Net profit margin	20.0	17.9	12.1	13.4
ROE	19.8	15.9	10.5	13.2
ROCE	10.1	6.8	6.6	8.4
<b>Working Capital &amp; Liquidity ratios</b>				
Receivables (days)	54	59	52	52
Inventory (days)	8	9	8	7
Payables (days)	79	67	57	44
Current ratio (x)	1.2	1.2	1.2	1.1
Quick ratio (x)	0.8	0.8	0.8	0.6
<b>Turnover &amp; Leverage ratios (x)</b>				
Gross asset turnover	0.5	0.4	0.4	0.4
Total asset turnover	0.4	0.4	0.4	0.5
Interest coverage ratio	6.7	15.6	4.5	5.4
Adjusted debt/equity	1.2	0.9	0.6	0.7
<b>Valuation ratios (x)</b>				
EV/Sales	2.8	2.7	2.3	1.9
EV/EBITDA	7.0	7.5	6.5	5.2
P/E	8.2	9.2	12.4	10.0
P/BV	2.2	1.8	1.5	1.3



### Quarterly trend

Particulars	Q3FY09	Q4FY09	Q1FY10	Q2FY10	Q3FY10
Revenue (Rs mn)	57,865	61,078	61,207	57,026	53,098
YoY growth (%)	18.7	15.0	15.0	2.8	(6.4)
QoQ growth (%)	4.3	5.6	0.2	(6.8)	(6.9)
EBITDA (Rs mn)	22,888	23,673	24,280	20,199	18,126
EBITDA margin (%)	39.6	38.8	39.7	35.4	34.1
Adj net income (Rs mn)	14,103	14,544	16,366	7,403	11,080
YoY growth (%)	2.7	(3.2)	8.2	(51.6)	49.7
QoQ growth (%)	(7.9)	3.1	12.5	(54.8)	(11.7)

### DuPont analysis

(%)	FY08	FY09	FY10E	FY11E	FY12E
Tax burden (Net income/PBT)	76.3	73.5	86.6	80.0	78.2
Interest burden (PBT/EBIT)	130.8	111.9	103.3	80.3	81.5
EBIT margin (EBIT/Revenues)	28.4	24.3	20.0	18.8	21.0
Asset turnover (Revenues/Avg TA)	44.4	41.3	36.5	40.5	46.9
Leverage (Avg TA/Avg equity)	186.8	239.9	243.2	214.9	209.1
<b>Return on equity</b>	<b>23.5</b>	<b>19.8</b>	<b>15.9</b>	<b>10.5</b>	<b>13.2</b>

### Company profile

Reliance Communications (Rcom) is India's second largest integrated communications service provider with 96mn wireless customers and an 18.1% market share. With the launch of its GSM services in January 2009 across 14 remaining circles, Rcom enjoys the twin advantage of CDMA and GSM.

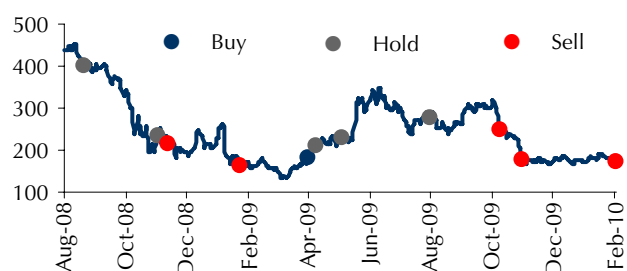
### Shareholding pattern

(%)	Jun-09	Sep-09	Dec-09
Promoters	67.3	67.2	67.5
FIs	10.8	10.0	8.3
Banks & FIs	9.2	9.8	9.7
Public	12.8	13.0	14.6

### Recommendation history

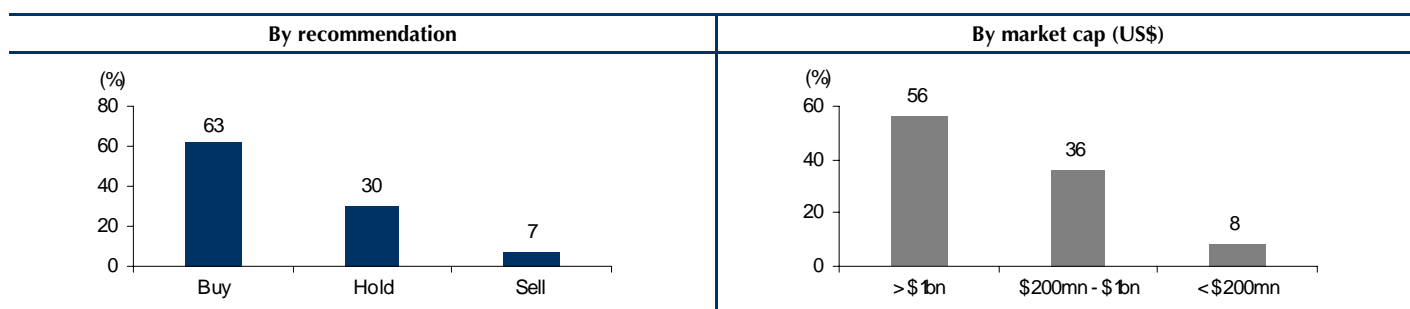
Date	Event	Reco price	Tgt price	Reco
21-Aug-08	RHH Compendium	398	498	Hold
5-Nov-08	Results Review	233	268	Hold
14-Nov-08	Sector Update	216	241	Sell
25-Jan-09	Results Review	160	241	Sell
6-Apr-09	Quarterly Preview	170	241	Buy
15-Apr-09	Sector Update	212	241	Hold
4-May-09	Results Review	229	241	Hold
1-Aug-09	Results Review	276	310	Hold
8-Oct-09	Sector Update	247	226	Sell
2-Nov-09	Results Review	176	160	Sell
1-Feb-10	Results Review	174	180	Sell

### Stock performance





### Coverage Profile



### Recommendation interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and -5%
Sell	Less than -5%

Recommendation structure changed with effect from March 1, 2009

Expected absolute returns are based on share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

### Religare Capital Markets Ltd

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*"Religare Enterprises Limited proposes, subject to receipt of requisite approvals, market conditions and other considerations, to make a rights issue of its equity shares to its existing shareholders and has filed a draft letter of offer ("DLOF") with the Securities and Exchange Board of India ("SEBI"). The DLOF is available on the website of SEBI at [www.sebi.gov.in](http://www.sebi.gov.in) as well as on the websites of the lead manager at [www.enam.com](http://www.enam.com). Investment in equity shares involves a high degree of risk and for details relating to the same, please refer to the section titled "Risk Factors" of the DLOF."*