

RESULT UPDATE

Share Data

Reuters code	RLCM.BO		
Bloomberg code	RCOM IN		
Market cap. (US\$ mn)	23,359		
6m avg. daily turnover (US\$ mn)	84.8		
Issued shares (mn)	2,045		
Performance (%)	1m	3m	12m
Absolute	18	(4)	41
Relative	8	(1)	25

Valuation Ratios

Year to 31 Mar.	FY08E	FY09E
EPS (Rs.)	22.4	31.1
+/- (%)	44.4	39.4
PER (x)	21.0	15.1
Dividend/Yield (%)	0.0	0.1
EV/Sales (x)	4.7	3.5
EV/EBITDA (x)	11.7	8.4

Major shareholders (%)

Promoters	77
FII's (Incl. ADRs/GDRs)	12
FI's/MFs	2
Institutions	4
Public & Others	15

Financial highlights

(Rs. mn)	3QFY07	4QFY07	QoQ (%)	4QFY06	YoY (%)	9MFY06	FY07	YoY (%)	FY08E	YoY (%)	FY09E	YoY (%)
Net Sales	37,553	39,369	4.8	29,704	32.5	84,834	144,683	70.5	216,806	49.8	287,286	32.5
EBITDA	15,241	16,380	7.5	10,476	56.4	23,226	56,908	145.0	86,939	52.8	118,362	36.1
EBITDA Margin (%)	40.6	41.6	2.5	35.3	18.0	27.4	39.3	43.7	40.1	2.0	41.2	2.7
Interest	(657)	(392)	(40.4)	479	(181.7)	2,409	6	(99.7)	1,084	17,106.8	1,436	32.5
Depreciation	6,524	6,378	-2.2	5,457	16.9	13,227	24,652	86.4	37,941	53.9	49,700	31.0
PBT	9,374	10,394	10.9	4,540	128.9	7,590	32,250	324.9	47,914	48.6	67,225	40.3
Extraordinary income	-	-	-	(374)	(100.0)	-	-	-	-	-	-	-
Tax	130	149	14.9	137	9.1	277	611	120.5	2,217	263.0	3,542	59.7
Reported PAT	9,244	10,244	10.8	4,029	154.3	7,313	31,639	332.6	45,697	44.4	63,683	39.4
Adj. PAT	9,244	10,244	10.8	4,403	132.7	7,313	31,639	332.6	45,697	44.4	63,683	39.4
Adj. PAT margin (%)	24.6	26.0	5.7	14.8	75.5	8.6	21.9	153.7	21.1	(3.6)	22.2	5.2
EPS (Rs.)	4.5	5.0	10.8	2.2	132.7	3.6	15.5	332.6	22.4	44.4	31.1	39.4
P/E (x)	-	-	-	-	-	132	30	-	21	-	15	-

Reliance Communication

Maintain BUY

Price: Rs. 470

BSE Index: 13934

7th May 2007

4QFY07 Results – Ever increasing margins, though lower revenue growth

The quarter was a mixed one for Reliance Communication (RCOM) with good news in the form of improved margins but marred by subscriber re-verification which led to a disconnection of more than 15% of the subscriber base (Subscriber base at end March 2007 stands at 28 mn as against 32.4 mn at end February 2007). Though, ARPU has increased by 15% q-o-q, the revenue growth suffered. We have revised the subscriber base and ARPU projections for RCOM taking into account the significant impact of subscriber re-verification. However, the resulting change in revenue and PAT projections is minimal.

The revenue for 4QFY07 stood at Rs. 39.4 bn, up 5% q-o-q and 33% y-o-y. EBITDA margin improved by 100 bps q-o-q to 41.6%, same as that of Bharti Airtel.

For the year FY07, RCOM clocked revenue of Rs. 144.7 bn with EBITDA margin at 39.3% as against 27.4% for the previous year.

According to our DCF calculations, we have arrived at the target price of Rs. 540. Maintain BUY.

Highlights

- The revenue growth was muted across all segments. A fall in revenue of Global segment is, however, a cause of concern.
- The wireless and broadband segments saw an increase in margins while the global segment witnessed a drop in margins during the quarter. This was the similar trend as Bharti Airtel.

Segment-wise revenue break-up and growth is given below

Gross Revenue* (Rs. mn)	4QFY07	3QFY07	QoQ (%)	4QFY06	YoY (%)
Wireless revenues	29,686	27,520	8	21,200	40
% total revenue	75	73	–	71	–
Broadband	3,291	3,161	4	1,948	69
% total revenue	8	8	–	7	–
Global	12,940	13,335	(3)	14,158	(9)
% total revenue	33	36	–	48	–

*Doesn't include inter-segment eliminations.

- Mobile services – The quarter ending March 2007 was not a good one for RCOM due to subscriber re-verification leading to write-off of 5.6 mn subscribers. It was one of the bigger casualties (Bharti Airtel lost less than 1% of its subscriber base) of subscriber verification. However, management has stated that these subscribers contributed negligible to the turnover. Hence, the effect of disconnecting them only improved the operating metrics (ARPU and MoU).

Operating metrics – Mobile segment

	4QFY07	3QFY07	QoQ (%)	4QFY06	YoY (%)
Total subscribers ('000)	28,007	29,980	(7)	20,211	39
Prepaid subscribers (%)	84.7	82.9	–	79.3	–
Subscribers added ('000)	(1,973)	4,001	(149)	3,181	(162)
ARPU (Rs)	377	328	15	375	1
EBITDA per user per month (Rs.)	146	120	22	132	11
MoU (min)	541	454	19	532	2

- Broadband segment – This segment is similar to the Enterprise (Corporate) segment of Bharti Airtel. Due to the B2B nature of this segment, we feel that the margins would be volatile. However, given the superiority of CDMA technology for data applications, the sustainable margins for this segment can be higher than that for Airtel.

Operating metrics – Fixedline & broadband segment

	4QFY07	3QFY07	QoQ (%)	4QFY06	YoY (%)
Access lines ('000)	620	530	17	256	142
Access lines added ('000)	90	105	(14)	39	131
ARPL (Rs.)	1,932	2,206	(12)	2,742	(30)
EBITDA per access line per month (Rs.)	866	935	(7)	789	10
Presence in towns (No.)	40	30	–	30	–

- Global segment – This segment includes the NLD backbone (80k rKms), metro Ethernet network of 20k rKm as well as the ILD assets (both FLAG & FALCON). Despite such a huge asset base, the number of voice minutes carried is growing at a very slow pace compared to Bharti Airtel (hence losing the market share). The fall in revenue is a cause of concern. The management has stated the reason as a drop in VCC prices coupled with adverse Re/US\$ movement.

Long distance metrics

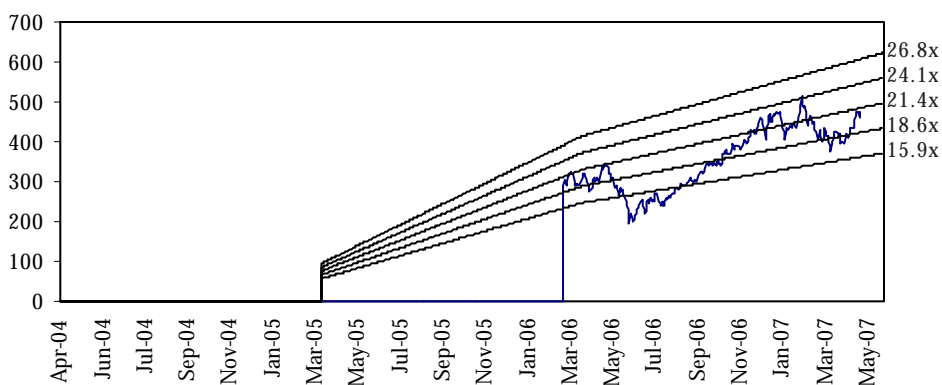
	4QFY07	3QFY07	QoQ (%)	4QFY06	YoY (%)
NLD minutes (mn mins)	4,873	4,715	3	2,755	77
ILD minutes (mn mins)	1,503	1,472	2	1,188	27
Gross revenue per minute (Rs.)	2.03	2.16	(6)	3.59	(43)
EBITDA per minute (Rs.)	0.49	0.57	(15)	0.67	(27)

Concall highlights

- The capex for FY07 was US\$ 1.6 bn and that proposed for FY08E is US\$ 2.5 bn. This capex number doesn't include that required by subsidiaries FLAG (for upgrading capacity) and RTIL (to set up 20k towers in FY08E).
- All 12k towers have been transferred to the 100% subsidiary (Reliance Telecom Infrastructure Ltd. (RTIL). RTIL has a networth of Rs. 30 bn and no debt. Going forward, RTIL will fund its expansion plans on its own without any recourse to RCOM.
- RCOM has already expanded its presence to 8,000 cities in the existing 8 circles where it is providing GSM service. Estimated cost of rolling out a pan India GSM network would be approximately US\$ 1 bn (excluding the cost of tower setup which would be undertaken by RTIL separately).
- Management has indicated that there might be value unlocking for FLAG and RTIL in the next six months. As for RTIL, different strategies (IPO/private equity/strategic partners) are being examined.
- Test runs for IPTV are still going on and commercial launch is expected in some cities in FY08E. Also, DTH services are scheduled to be launched in FY08E.

The management has recommended a dividend of 10% aggregating to Rs. 1,196 mn incl. of dividend tax. This is the first instance of a telecom operator declaring dividend.

PER Band



Outlook & Valuations

After the recent write-offs of around 5.6 mn subscribers, we have revised our subscriber and ARPU projections. Our new estimates stand at 45.2 mn subscribers (17.5% market share) at the end of FY08E and 61.6 mn (18.5% market share) by end FY09E. The average ARPU is expected to be Rs. 359 and Rs. 316 for FY08E and FY09E, respectively. However, the impact on both revenue and profitability is minimal.

We expect the mobile segment to be the major growth driver for other segments (especially the carrier segment) as well. We have projected earnings till FY17 with the following assumptions for DCF:

DCF assumptions

CoE	CoD	Rf	Rp	D/E ratio	Beta	WACC	Terminal growth
14.5	8.0	9	5	0.8	1.1	11.6	5%

Earnings (for core business) projected till FY17E

Year	FY07	FY08E	FY09E	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E	FY16E	FY17E
EBITDA	56,908	86,939	118,362	142,537	157,741	165,685	177,580	189,122	202,856	215,505	226,280
Tax	(611)	(2,217)	(3,542)	(6,626)	(11,428)	(14,712)	(27,109)	(26,567)	(29,591)	(41,347)	(53,676)
Chg in NWC	(14,969)	27,901	(6,662)	(8,228)	(4,278)	7,948	5,722	4,921	4,183	3,681	3,313
Capex	(68,205)	(104,354)	(96,006)	(86,405)	(75,173)	(62,393)	(56,154)	(51,100)	(46,501)	(44,641)	(44,730)
FCF	(26,877)	8,269	12,153	41,278	66,863	96,527	100,039	116,376	130,947	133,198	131,187

Fair value – Core business

PV of Cash Flow	396,048
PV of Terminal value	674,684
Value	1,070,732
Net Debt	18,238
Value of Equity	1,052,494
RCOM Shares	2,045
Fair Value (Rs/share)	515

We have also done DCF for the tower subsidiary and have arrived at fair value of Rs. 25/ share. Hence, the fair value for the entire business comes to be **Rs. 540/share**. We maintain BUY rating

Income Statement

Yr.ended31Mar.(Rs.m)	9MFY06	FY07	FY08E	FY09E
Net sales	84,834	144,683	216,806	287,286
Growth (%)	–	70.5	49.8	32.5
Operating expenses	(61,608)	(87,775)	(129,867)	(168,924)
Operating profit	23,226	56,908	86,939	118,362
EBITDA	23,226	56,908	86,939	118,362
Growth (%)	–	145.0	52.8	36.1
Depreciation	(13,227)	(24,652)	(37,941)	(49,700)
EBIT	9,999	32,256	48,998	68,661
Interest paid	(2,409)	(6)	(1,084)	(1,436)
Pre-tax profit	7,590	32,250	47,914	67,225
(before non-recurring items)				
Non-recurring items	(374)	–	–	–
Pre-tax profit	7,216	32,250	47,914	67,225
(after non-recurring items)				
Tax (current + deferred)	(277)	(611)	(2,217)	(3,542)
Net profit	6,939	31,639	45,697	63,683
Adjusted net profit	7,313	31,639	45,697	63,683
Growth (%)	–	332.6	44.4	39.4
Net income	6,939	31,639	45,697	63,683

Balance Sheet

Yr.ended31Mar.(Rs.m)	9MFY06	FY07	FY08E	FY09E
Current assets	105,355	196,263	239,568	281,646
Investments	121	11,925	24,446	29,776
Net fixed assets	214,263	330,423	421,993	482,780
Total assets	319,739	538,611	686,007	794,202
Current liabilities	109,247	179,186	229,423	271,772
Total debt	92,976	155,438	206,397	209,199
Total liabilities	202,223	334,624	435,820	480,972
Share capital	10,223	10,220	10,223	10,223
Reserves & surplus	107,292	193,708	239,965	303,007
Shareholders' funds	117,515	203,928	250,188	313,230
Minorities interests	–	59	–	–
Total equity & liabilities	319,738	538,611	686,007	794,202

Cash Flow Statement

Yr.ended31Mar.(Rs.m)	9MFY06	FY07	FY08E	FY09E
Pre-tax profit	7,216	32,250	47,914	67,225
Depreciation	47,573	8,367	37,941	49,700
Chg in working capital	44,639	32,311	16,719	11,770
Total tax paid	19,014	23,271	8,576	5,471
Cash flow from oper. (a)	118,442	96,199	111,150	134,166
Capital expenditure	(261,836)	(124,527)	(129,511)	(110,487)
Chg in investments	(121)	(11,804)	(12,521)	(5,329)
Cash flow from inv. (b)	(261,957)	(136,331)	(142,033)	(115,817)
Free cash flow (a+b)	(143,515)	(40,132)	(30,882)	18,349
Equity raised/(repaid)	117,515	(107,295)	3	–
Chg in minorities	–	59	(59)	–
Debt raised/(repaid)	92,976	62,462	50,959	2,803
Dividend (incl. tax)	–	(204)	(409)	(613)
Cash flow from fin. (c)	210,491	(44,978)	50,494	2,189
Net chg in cash (a+b+c)	66,976	(85,111)	19,611	20,539

Key Ratios

Yr. ended 31 Mar. (%)	9MFY06	FY07	FY08E	FY09E
EPS (Rs.)	3.6	15.5	22.4	31.1
EPS growth	–	332.6	44.4	39.4
EBITDA margin	27.4	39.3	40.1	41.2
EBIT margin	11.8	22.3	22.6	23.9
ROCE	9.5	11.3	12.0	14.0
Net debt/Equity	28.0	8.9	19.4	9.9

Valuations

Yr. ended 31 Mar. (x)	9MFY06	FY07	FY08E	FY09E
PER	131.4	30.4	21.0	15.1
PCE	46.8	17.1	11.5	8.5
Price/Book	8.2	4.7	3.8	3.1
Yield (%)	–	0.0	0.0	0.1
EV/Net sales	11.7	6.8	4.7	3.5
EV/EBITDA	42.8	17.2	11.6	8.4

Du Pont Analysis – ROE

Yr. ended 31 Mar. (x)	9MFY06	FY07	FY08E	FY09E
Net margin (%)	8.6	21.9	21.1	22.2
Asset turnover	0.5	0.3	0.4	0.4
Leverage factor	2.7	2.7	2.7	2.6
Return on equity (%)	12.4	19.7	20.1	22.6

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