Q4FY10 Result Update

May 19, 2010

RCOM recently declared its Q4FY10 results. It reported revenues of Rs.5,092.8 cr down by 16.8% Y-o-Y and down 4.1% Q-o-Q. EBIDTA for the quarter fell by 32.8% Y-o-Y and by 11.6% Q-o-Q to Rs.1,602 cr. PAT margins improved by 10 bps Y-o-Y and by 300 bps Q-o-Q to 23.9%.

Quarterly Financials - Consolidated

Rs.Cr.

Particulars	Q4FY10	Q4FY09	% Chg	Q3FY10	% Chg	FY10	FY09	% Chg
Service & Sales	5092.8	6123.7	-16.8%	5309.8	-4.1%	22250.4	22941.1	-3.0%
Operating Expenses								
- Access Charges & License Fees	896.1	950.6	-5.7%	833.7	7.5%	3282.8	3568.2	-8.0%
- Network Operations	1525.1	1358.2	12.3%	1670.8	-8.7%	6173.4	4364.2	41.5%
- Personnel Expenses	339.6	421.3	-19.4%	367.7	-7.6%	1500.1	1670.2	-10.2%
- SG&A	730.0	1010.4	-27.8%	625.0	16.8%	3407.1	4051.0	-15.9%
Total Operating Expenditure	3490.8	3740.5	-6.7%	3497.2	-0.2%	14363.4	13653.6	5.2%
EBIDTA	**1602.0**	**2383.2**	-32.8%	**1812.6**	-11.6%	**7887.0**	**9287.5**	-15.1%
EBIDTA Margins %	*31.5%*	*38.9%*		*34.1%*		*35.4%*	*40.5%*	
Interest	-813.4	-167.8	384.7%	-407.5	99.6%	-1186.3	-786.7	50.8%
Depreciation	1084.7	1142.6	-5.1%	833.1	30.2%	3746.6	3931.3	-4.7%
Amortisation of compensation under ESOP	1.5	-157.0	-101.0%	22.1	-93.2%	37.6	7.5	401.3%
PBT	1329.2	1565.4	-15.1%	1364.9	-2.6%	5289.1	6135.4	-13.8%
PBTM %	*26.1%*	*25.6%*		*25.7%*		*23.8%*	*26.7%*	
Tax	192.3	48.5	296.5%	200.3	-4.0%	445.4	-12.3	-3721.1%
Effective Tax Rate %	*14.5%*	*3.1%*		*14.7%*		*8.4%*	*-0.2%*	
Share of minority and associates	-82.6	62.5	-232.2%	56.9	-245.2%	139.6	239.9	-41.8%
PAT	**1219.5**	**1454.4**	-16.2%	**1107.7**	10.1%	**4704.1**	**5907.8**	-20.4%
PATM %	*23.9%*	*23.8%*		*20.9%*		*21.1%*	*25.8%*	
Equity	1032.0	1032.0	0.0%	1032.0	0.0%	1032.0	1032.0	0.0%
EPS	**5.9**	**7.0**	-16.2%	**5.4**	10.1%	**22.8**	**28.6**	-20.4%

(Source: Company Press Release)

Quarterly Financials – Segmental

Rs.Cr.

Segmental	Q4FY10	Q4FY09	% Chg	Q3FY10	% Chg	FY10	FY09	% Chg
Revenues								
- Wireless	4090.0	4501.5	-9.1%	4022.5	1.7%	16915.6	17367.7	-2.6%
- Global	2027.8	1880.3	7.8%	1981.8	2.3%	8158.3	6776.1	20.4%
- Broadband	679.8	707.5	-3.9%	704.5	-3.5%	2838.5	2524.3	12.4%
- Others	284.5	313.2	-9.2%	316.0	-10.0%	1179.6	1009.8	16.8%
Eliminations	-1989.4	-1278.9	55.6%	-1715.1	16.0%	-6841.8	-4736.9	44.4%
Total revenues	**5092.7**	**6123.7**	-16.8%	**5309.7**	-4.1%	**22250.2**	**22941.1**	-3.0%
PBIT								
- Wireless	1181.5	1662.9	-28.9%	1254.5	-5.8%	5598.1	6672.7	-16.1%
- Global	355.5	502.5	-29.3%	419.4	-15.2%	1749.1	1617.0	8.2%
- Broadband	252.6	316.0	-20.1%	275.5	-8.3%	1147.4	1157.5	-0.9%
- Others	-175.9	-97.7	80.0%	-125.5	40.2%	-563.9	-128.1	340.2%
Eliminations	-11.7	-0.5	2240.0%	-11.8	-0.8%	-44.3	-31.8	39.3%
PBT	**1602.0**	**2383.2**	-32.8%	**1812.1**	-11.6%	**7886.4**	**9287.3**	-15.1%
PBIT Margins %								
- Wireless	28.9%	36.9%		31.2%		33.1%	38.4%	
- Global	17.5%	26.7%		21.2%		21.4%	23.9%	
- Broadband	37.2%	44.7%		39.1%		40.4%	45.9%	
- Others	-61.8%	-31.2%		-39.7%		-47.8%	-12.7%	
Eliminations	0.6%	0.0%		0.7%		0.6%	0.7%	
PBIT Margins %	**31.5%**	**38.9%**		**34.1%**		**35.4%**	**40.5%**	

(Source: Company Press Release)

Some of the key highlights of the results are as follows:

- RCom reported a 16.8% y-o-y and 4.1% q-o-q degrowth in revenues to Rs.5,092.8 cr.
- Wireless revenues fell 9.1% y-o-y but was flat q-o-q at Rs.4,090 cr on the back of lower ARPU and MoU. RPM too declined sequentially and y-o-y to 44 paise in Q4FY10. Wireless PBIT margin fell 800 bps y-o-y and 230 bps q-o-q to 28.9% on account of sharp 12.3% y-o-y jump in network costs owing to GSM rollout. RCom saw weakest minute growth among listed peers at 5.1% q-o-q to 93.5bn. Wireless ARPUs fell to Rs.139 in Q4FY10 vs. Rs.149 in Q3FY10. RCom subscriber quality remains a concern.
- The global business segment revenues improved by 7.8% y-o-y and 2.3% q-o-q to Rs.2,027.8 cr. NLD traffic grew sharply by 77% y-o-y to 16.1 bn minutes while ILD traffic rose by 33.9% y-o-y to 2.65 bn minutes but fell by 5.9% q-o-q. PBIT margins in global business dipped q-o-q by 370 bps whereas on y-o-y basis they fell by 920 bps to 17.5% in Q4FY10. According to the management, the margin for this division fell since it had to buy extra bandwidth on lease due to a cut in its international fibre network during the quarter (costing ~Rs.1 bn). This was a one-time event and margins are expected to improve in the next quarter.
- Broadband segment revenues fell by 3.9% y-o-y and 3.5% q-o-q to Rs.679.8 cr with ARPL down by 10.6% y-o-y and 5.5% q-o-q to Rs.1,551 cr. PBIT margins declined to 37.2% from 39.1% in Q3FY10.
- The company attributed the sharp 16% increase in inter-segment eliminations to higher intercircle on-net minutes. This also reflected in the sharp 18% qoq NLD minutes growth reported by the company; however, the same failed to translate into gross revenue growth for the Globalcom segment, indicating revenue decline in other parts of the business (ILD and Data).
- RCom had 2.4 mn DTH subscribers in Q4FY10 up from 2.23 mn subscribers in Q3FY10 and a market share of 12%.
- Consolidated EBIDTA margins dipped by 740 bps y-o-y and 260 bps q-o-q to 31.5% on the back of high network operating costs y-o-y and lower revenues. Network costs increased by 770 bps y-o-y as a percentage of sales to 29.9%. SG&A cost increased by 16.8% q-o-q. Access Charges and license fees too increased in absolute terms q-o-q by 7.5%. EBIDTA of Rs.1,602 cr is the lowest in more than 3 years.
- Depreciation and amortization charges dropped by 5.1% y-o-y due to assumed increase in useful life of certain telecommunication equipment to 18 years. CWIP announced to Rs.1,1950 cr as of Match 2010, compared to Rs.1,1406 cr as of March 2009. Q4FY10 witnessed interest income of Rs.813.4 cr vis-à-vis income of Rs.407.5 cr in Q3FY10. This is due to mark-t-market forex gain based on foreign currency loans outstanding and despite net debt of Rs.199 bn. if the rupee starts to depreciate, RCom will be hit doubly. RCom reported tax of Rs.192.3 cr during the quarter. Lower revenues, but higher interest income and lower tax outflow led to net profit moving up by 10.1% y-o-y to Rs.1,219.5 cr in Q4FY10.
- RCom has guided for a capex of Rs.3,000 cr excluding of a provision for cash outgo towards the upcoming auction of 3G spectrum in FY11. In Q4FY10, RCom has incurred lower capex of Rs.8.8 bn of which 70% was for its global business partly due to slowdown in coverage-related capex requirement and delays in the clearance of Chinese equipment by the DoT. In FY10, it incurred capex of Rs.4,200 cr vis-à-vis guidance of Rs.4,500 cr. It has invested over Rs.40,000 cr in the last four years towards expansion of network and operations across businesses in India and internationally. The management has indicated that its peak capex is behind.
- RCOM reported minority share of ‘losses’ of Rs.82.6 cr in Q4FY10 as against minority share of income in previous quarters. The management attributed this to losses incurred in overseas sub-sea assets due to lower EBITDA and one-off impairment expenses.
- RCom’s net debt now stands at Rs.199 bn and cash at Rs.48.5 bn.
- The ‘Simply Reliance’ plan launched in October 2009 is doing well and was initially launched as a 50 paise plan. Now RCom is customizing plans as per needs of customers and plans to target GSM and postpaid users i.e. those with high ARPU.
- The management has indicated that under the proposed regulations by TRAI, savings on account of reduction in access license fee, would more than offset additional license fee expense on ISP revenues (at 6% of AGR). However, it also indicated that TRAI has not yet addressed applicability of license fee on VAS revenues (which RCom also reports under ISP license); the TRAI would conduct separate consultation on this issue, which could eventually bring mobile VAS companies under the ambit of license fee.
- The sector continues to witness a difficult operating environment, with more than 10-12 operators competing in each circle.
- The management has indicated higher levels of minute growth going forward and the incremental minutes generated could flow through in terms of revenue and thereby improve profitability.
- The management believes that MNP could be a growth driver given its reach in GSM and CDMA and its need based Simply Reliance plan made available to suit all customers.

Risks

- Lower than expected subscriber growth or higher than anticipated pressure on realisation rates could impact margins.

- Intense competitive tariffs being offered by late entrants in the industry could be a cause of concern for RCOM and put pressure on revenues and profits.

- 3G spectrum auctions could pose a threat to RCOM. RCOM has a highly stretched balance sheet and this could result in RCOM not being able to fund the acquisition of 3G spectrum. This may not be viewed as a positive by investors.

Conclusion

RCom was the only company to post degrowth in y-o-y revenues in Q4FY10 amongst its peers. RCOM is the only player in the country to provide GSM and CDMA services. However, lower RPM and MoU led to weak wireless revenues. Other divisions like global and broadband too did not perform well. Going forward, due to hyper intensive competition, tariffs could come under pressure for RCom.

We expect pricing to remain subdued over the next few quarters, even as this drop may not necessarily translate into higher usage in the form of MoUs, as competitive forces, the increasing usage of dual SIM cards in the Indian market and a higher share of rural users who take time to ramp up usage, restrict any demand elasticity in the near term. The implementation of mobile number portability (MNP) is also likely to prove to be yet another headwind for the sector (though RCom could benefit). The steep increase in the discovered price of 3G spectrum is yet another negative and could lead to significant cash outflows, even as the date of actual receipt of spectrum is uncertain.

We believe that RCom could benefit from 3G services, given its fibre backhaul. Data cards on the CDMA platform could also allow RCom to increase its ARPU but is still too early to comment. RCom will be least affected if the latest TRAI regulations are implemented as proposed.

The management has indicated that all one time expenses have been accounted for in Q4FY10 and from Q1FY11 onwards normal growth trajectory would continue and overall profitability is also expected to increase.

Given the poor performance in revenues by RCom in Q4FY10, we are maintaining our FY11E revenue estimates though the topline and PBIDT may need downward revision going forward. We maintain RCom as an underperformer in the telecom space. Concerns on further negative surprises, constant changes in accounting policies/estimates (incl change in depreciation policies and write back of tax), frequent revaluation of assets, weakening balance sheet, and poor operating matrices could result in the stock continuing to get poor valuation compared to its peers.

In our earlier report dated February 5, 2010 we had stated that the stock could trade in the band of Rs.142.5 to 174.25 for the next few quarter. Post to the issue of the report, the stock touched a low of Rs.140.05 on May 17, 2010 and a high of Rs.181.2 on April 7, 2010. At the CMP, the stock is trading 9.2x FY11E EPS of Rs.15.8.

We think the stock could trade in the Rs.134 (8.5x FY11E EPS) to Rs.166 (10.5x FY11E EPS) band for the next quarter.

Particulars (Rs in Crs)	FY08	FY09	FY10 (E)*	FY10 (A)*	FY11 (E)*
Operating income	18827.4	22234.6	22706.2	22250.4	24018.0
PBIDT	7959.3	8580.9	8111.3	7887.0	8266.0
PBIDTM (%)	42.3%	38.6%	35.7%	35.4%	34.4%
Profit after Tax	5401.7	5907.5	4146.7	4704.1	3269.0
PATM (%)	28.7%	26.6%	18.3%	21.1%	13.6%
EPS	26.2	28.6	20.1	22.8	15.8
P/E (x)	5.5	5.1	7.2	6.4	9.2

* E = Quick Estimates, A = Actual (Source: Company, HDFC Sec Estimates)

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