August 24, 2007

IDBI capital

COMPANY REPORT

Reliance Communications Ltd.

Rs.495 | Buy

Towering new heights

Analyst
Sayali Mahashur
+91-20-6623 8315
e.info@idbicapital.com

Nifty: 4115; Sensex: 14164

Key Stock Data

Sector	Telecom
Bloomberg/Reuters	RCOM@IN/RLCM.BO
Shares o/s (m)	2,045
Market cap (Rs bn)	1,013
Market cap (US$ m)	24,704
3-m daily average vol.	16,30,296

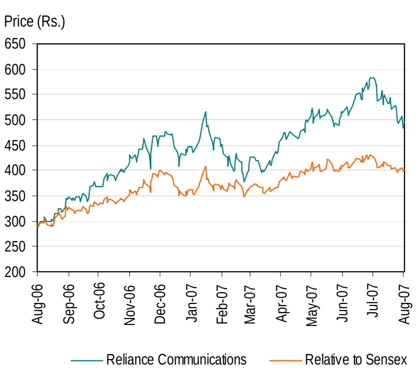
Price Performance

52-week high/low			Rs592/285
	-1m	-3m	-12m
Absolute (%)	(15.1)	(5.3)	70.6
Rel to Sensex (%)	(5.7)	(3.9)	46.7

Shareholding Pattern (%)

Promoters	66.75
FIIs/NRIs/OCBs/GDR	14.84
MFs/Banks/FIs	7.17
Govt. Holding	0.18
Non Promoter Corporate	1.66
Public & Others	9.41

Stock vs Relative to Sensex



Source: Capitaline

Note: Price as on 22 August, 2007

Summary

With around 17.2% share in India's mobile subscribers, Reliance Communications Ltd. (RCOM) is India's second largest telecom operator. RCOM is a diversified telecom play with a strong presence in data and ILD/NLD market. Re-focusing on CDMA business, monetization of towers business and proposed listing of the undersea assets are the main drivers of growth in the near future.

Our DCF valuation gives us the value of core business at Rs.534. We value the tower subsidiary at Rs.135/share on EV/tenant basis on peer group comparison. There will be further upside from FLAG listing which we currently haven't included in the valuation in the absence of enough clarity. At our target price of Rs.669 and CMP of Rs.495, we rate RCOM as a 'Buy'.

Investment highlights

- **Execution ramped up**

  Post management change last year, there has been a rapid evolution at RCOM. The focus is on establishing a global presence, while increasing market share in the rapidly growing domestic telecom market. Global acquisitions and unlocking of shareholder value show the inclination in the same direction.

- **Gaining market share**

  The domestic telecom market grew by 58% YoY in FY07 itself, where-in 66.51m subscribers were added, taking the total subscriber base to 225.21m. RCOM, which has 17.2% market-share currently, is targeting a 21% market-share by FY09. More subscriber additions are planned through wider coverage, cheapest in class handsets and attractive plans. The focus is to drive growth on its CDMA platform, while keeping options open in GSM.

- **Create global presence – Yipes acquisition**

  Yipes, based in San Francisco was acquired for US$ 300m, providing RCOM with high-speed data network access to 1,000 customers in 14 US cities, operates optic fiber network of more than 22,000Km. Yipes has operating margin of 55% and is cash positive.

- **Tower subsidiary – Creating value**

  RCOM hived off its tower subsidiary into a separate division in April 2007. Recently it sold a 5% stake in its tower subsidiary at US$ 337.5m to a consortium of 7 investors. This puts valuation of the subsidiary at Rs.270,000m.

- **Listing of FLAG**

  RCOM also plans to list its global subsidiary FLAG in a couple of quarters. FLAG is the largest private submarine cable system in the world. RCOM's global division revenues are around Rs.52bn for FY07 and the EBITDA margin stood at around 20-22%. Considering the global peers trading at 2x revenue, this business should get valuation of around Rs.80bn.

Table 1: Financial snapshot (Rs. m)

Year-end: March	Dec. '05 (9M)	Mar. '07 (15M)	Mar. '08E	Mar. '09E
Total revenues	86,540	174,387	202,960	277,778
EBITDA	14,310	67,685	86,565	116,308
PAT	420	35,666	49,590	64,173
EPS (Rs)	0.2	17.4	24.3	31.4
P/E (x)	2,385.8	23.9	27.6	21.3

Source: Company reports; IDBI Capital Market Services

Investment positives

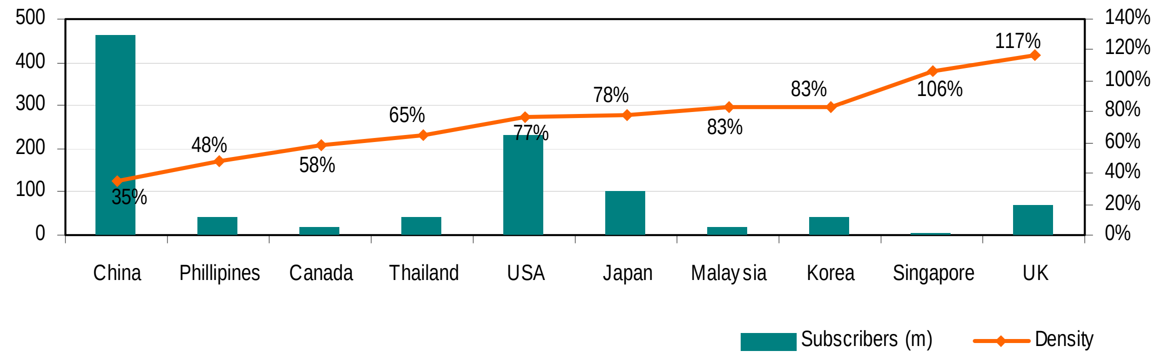
Rapid Indian consumer acceptance and high popularity of cellular

Current tele-density at 19% provides a large room for further scale up

Difficult access to fixed line telephones, declining cost of ownership coupled with increasing affordability and wide coverage has fueled a rapid growth of cellular subscribers in India. From a mere 6.6m subscribers in FY02 (GSM + CDMA), the mobile subscriber base hit 166m at the end of March 2007, growing at a compounded rate (CAGR) of 90% from FY02 to FY07. According to TRAI, the subscriber base of fixed and mobile services reached above 225.21m at the end of June 2007; of this 40.09m fixed-line subscribers and 185.13m mobile subscribers. A total of 66.51m subscribers were added during 2006-07 registering the highest ever annual growth of 58%.

Going forward, while the growth momentum may soften somewhat, but we expect the mobile subscriber base to continue growing at a robust pace. At over 19-20%, the tele-density in India is still low compared to other countries in the world (see chart below), offering further scope for strong subscriber additions. RCOM with presence in all the circles is well poised to benefit from burgeoning growth in telecom subscribers.

Figure 1: Worldwide telecom subscribers and teledensity



Source: TRAI

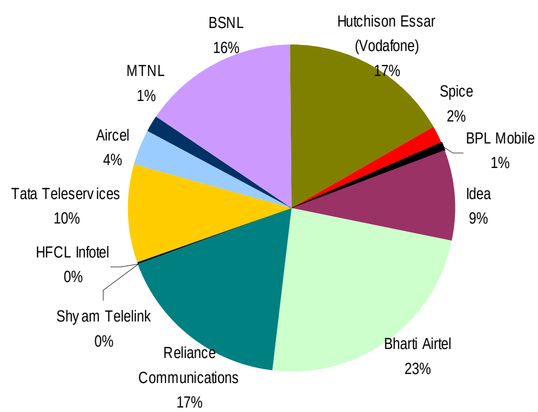
Gaining market share

Aggressive ramp up for gaining market share

RCOM's wireless business is its largest revenue contributor, accounting for 68% of total revenues. The company provides CDMA services in all 23 circles in India and GSM services in 8 circles. With over 31.9m subscribers at the end of June 2007, RCOM is India's leading wireless service provider with a market share of 17.2% among the total wireless subscriber base.

The Indian telecom sector consists of 7 fixed-line and 12 mobile operators. Bharti Airtel is the leader with BSNL and RCOM closely following the suit. However, we believe RCOM is well poised to gain a market share of 21% by FY09 following the launch of low priced handsets, clearing 5m customers due to regulatory reason and aggressive expansion plans to cover 85% of Indian population.

Figure 2: Market share of mobile subscribers (June 2007)



Source: TRAI

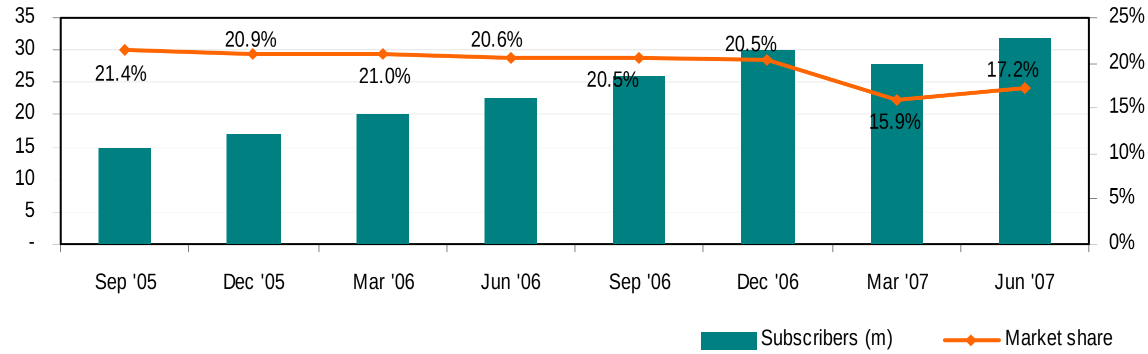
Flexibility on cards – Plans to offer both CDMA and GSM

The flexibility in use of SIM cards / mobile handsets and lower upfront cost have made GSM the preferred mobile platform in India. The all India GSM subscriber base stood at 135.9m at the end of March 2007 as against the CDMA base of 48.8m. Thus CDMA constitutes just 26% of total cellular connections.

To counter this, RCOM's strategy has been to capture the mass market through low price offerings. The introduction of low priced handsets (At Rs.777, the *Classic* handsets are 70% cheaper than the entry level phones for GSM) is enabling RCOM to ramp up subscriber additions. *Classic* has become second largest selling telephone brand after Nokia. Additionally, RCOM has started issuing newer connections with SIM cards. Although disconnecting of 5m subscribers in the previous quarter led to a dip in RCOM's market share, we believe the company is well poised to capture it in the coming quarters.

RCOM also continues to persue expanding its GSM presence, with plans to go pan-India as against its current GSM presence in 8 circles. RCOM is getting set to roll out its GSM strategy in FY08 through a capex of US$ 1bn out of US$ 2.5bn capex planned for the existing businesses. The only major hindrance likely to crop up is spectrum availability in the short term. The dual technology offering strategy is likely to be well accepted, Indian subscribers being largely technology neutral. Circles in which it operates CDMA and GSM both have 50:50 customer mix on technology platform.

Figure 3: RCOM wireless growth

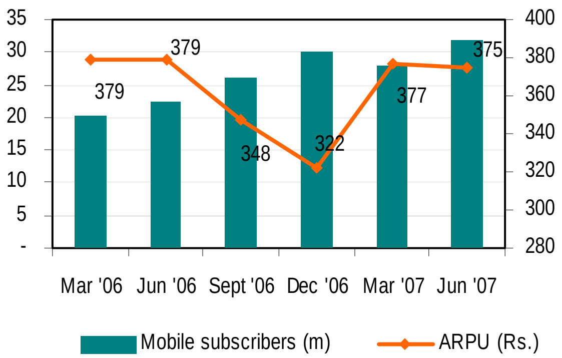


Source: Company reports; IDBI Capital Market Services

Healthy margins; ARPU's improving

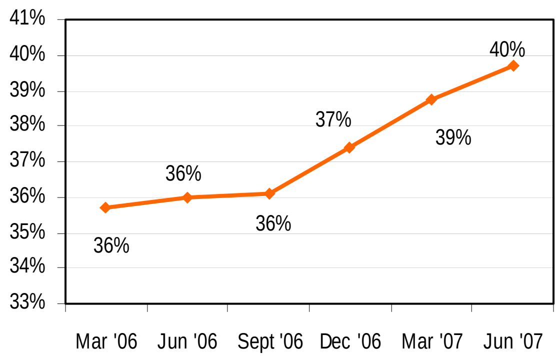
Best in the industry margins

Figure 4: Subscriber numbers and ARPUs



Source: Company reports; IDBI Capital Market Services

Figure 5: Wireless EBITDA



Source: Company reports; IDBI Capital Market Services

CDMA ARPU as at end of March 2007 stood at Rs.202 whereas GSM ARPU stood at Rs.298 for the same period. However, CDMA ARPU has shown a marginal increase from the previous quarter and GSM ARPU has declined.

RCOM has managed to maintain its ARPUs at Rs.375, a marginal 0.5% reduction QoQ. After discontinuation of 5m marginal customers, the company has actually managed to increase its ARPUs from 322 to 377 in a quarter. Thus the stable ARPUs along with increasing subscriber base has enabled RCOM to increase EBITDA margins from around 36% till a year ago to over 39% in the recently concluded quarter.

The broadband segment has also reported strong margins, thus enabling RCOM to achieve one of the best industry margins at 42.2% in the quarter ended June 2007.

B and C circles - future growth drivers

Expanding cellular market

RCOM intends to cover 85% of India's population by FY08. More subscriber additions are expected from B and C circles going ahead, as metros and A circles saturate. Currently there is a wide disparity in rural/urban teledensity, urban teledensity at 52.27 v/s rural tele density a dismal 6.45. Even within the urban area, Mumbai, Delhi, Chennai and Kolkata have a tele density of 68.1, 90.5, 81.6, 49.2 respectively. As majority of Indian population is in non-urban areas, a large section of the Indian population has largely remained untouched by the 'mobile revolution' that has swept the country over the past few years.

Diagram 1: Circle-wise tele-density as at June 2007

Source: Company reports; IDBI Capital Market Services

Monetizing assets creating shareholder value

Unlocking value – Hiving off the towers division

Indian telecom giants like RCOM and Bharti, are hiving off their tower divisions into separate subsidiaries and have plans to share the passive infrastructure. This will enable the companies to reduce their capex/ op ex and at the same time convert the pure cost centers into revenue centers by renting out the towers to the third parties. (Please see Page 10)

Reliance hived off its tower subsidiary, Reliance Telecom Infrastructure Ltd., in April 2007. The management is aggressively expanding the tower business. With 23,000 new towers planned (capex US$ 1bn-1.2bn) as part of its widening coverage for its CDMA platform and expanding its GSM network, RCOM would be a formidable player with 34,000-35,000 towers by end-FY08 and 50,000 towers by FY09, next only to Bharti. With this expansion, the company plans to add 100,000 more tenancy slots.

As a first step, RCOM has already started monetizing the tower assets by placing 5% of the tower company with a consortium of 7 foreign investors for US$ 337.5m. This puts the valuation of whole business at Rs.270,000m (Rs.135/ share). The company intends to borrow US$ 2bn to build the network further. The operating margins of this business are pegged at 15-20%. RCOM intends to further unlock the value of this business through IPO or strategic sale of additional stake.

Acquisitions to create global presence – Yipes acquisition

Going global

RCOM acquired Yipes, based in San Francisco, for US$ 300m with intentions of becoming international player in data communications. Yipes provides high-speed data network access to 1,000 customers in 14 US cities, operates optic fiber network of more than 22,000Km. Yipes has operating margin of 55% and is cash positive. Yipes will operate as strategic business unit of Flag. RCOM would spend Rs.10,000m to roll out Yipes services in India, Asia, Africa, Middle East and Europe in next 1-year. The company expects to synergize Yipes and Flags operations given its complementary products, services and networks.

Listing of FLAG

Flag listing - the next value driver

RCOM plans to list FLAG in overseas markets, diluting roughly a 15% stake. The revenues of global division amounted to around Rs.52bn and the EBITDA margin stood at around 20-22% for FY07. Considering the global peers trading at 2x revenue, this business should get valuation of around Rs.80bn even with some discount. This could get a further upside through incremental benefits arising from the Yipes acquisition. Currently, we do not add any additional value from the FLAG listing given lack of information and volatility of the business. But this listing will provide further upside to our valuation.

RCOM has plans for US$ 1.5bn capex for the N-G-N (next generation network) over the next 3-years, covering Asia, Africa, the Mediterranean and the Trans-Pacific markets. This project would make it the largest fully undersea cable-system operator, reaching 80% of the world's population, and would cater to the 50 largest telecoms markets from 30 at present.

RCOM is the market leader in the ILD voice market

With over 200 global carriers and over 400 large corporates, RCOM is the leader in the ILD voice market, commanding an impressive 40% market share. The company has around 1m customers for its Reliance IndiaCall service, which accounts for 40% of total retail market calls from the US to India. This market is poised for strong growth going forward. Currently it offers calling cards service to UK, US and Canada customers.

In last four quarters of FY07, the company's ILD minutes stood at around 5.6bn and we expect this to grow at a CAGR of ~ 20% through to FY09. In the NLD market, the company's minutes of use stood at around 17bn in the last four quarters of FY07. The management claims to have a 22% market share in NLD.

Growing bandwidth demand

Broadband, is the highest margin business for RCOM, contributing 7.7% of revenue. The current strategy is to target large corporates, small and medium enterprises (SME) for national and IPLC's, broadband internet access, audio and video conferencing, through solutions such as MPLS-VPN, Centrex, and internet data centre (IDC) services. In a very less time company has managed to gain leadership position in VPN, Centrex and IDC product segment. RCOM claims its market share to be 62% in IDC segment. Broadband services were launched in first half of 2005 with initial focus on top 30 cities leveraging on its metro optic fiber network. Currently it has more than 488,600 buildings directly connected to the network and over 620,000 access lines.

Asian Bandwidth demand is expected to grow at an average CAGR of 27% from 2005 to 2012. The cumulative bandwidth demand from India and the Middle East is expected to cross 750 gigabytes (GB) by 2010, up from 114 GB in 2005, giving an impressive CAGR of nearly 46% in that period. RCOM, with ownership of the largest private submarine cable system in the world, FLAG, is poised to benefit from the same. FLAG telecom connects 28 countries globally, from the US to Europe, the Middle East, India, South and East Asia, through to Japan. The company also envisaged the FALCON cable system, which connects 12 countries in the Middle East, Africa and the Mediterranean region to the rest of the word through the FLAG Global Network.

Valuation

Sum of parts method

We value RCOM's core business on DCF basis and the tower business on EV/subscriber basis. Our DCF valuation gives us the core business value at Rs.534/share. Adding to this the value of tower business at Rs.135/share, we arrive at a fair value of Rs.669/share, upside of 35% from the current price of Rs.495. At the CMP Rs.495, the stock is trading at a PE multiple of 20.4x on FY08E EPS of Rs.24.3 and 15.8x of FY09E EPS of Rs.31.4/share.

Table 2: DCF for core business

	FY08	FY09	FY10-FY17E
EBIT (1-T)	46,596	63,351	6,04,755
Free cash flow to firm	(75,025)	5,476	6,71,693
NPV			
Discounted terminal value	9,38,493		
Discounted cash flows	2,55,139		
EV	11,93,632		
Net debt	1,02,377		
Value per share (discounted to present)	534		

Ke 13.5; Terminal value @ 3.5% growth, B= 1.0 Rf.10 year yield = 7.5%; Risk pr 6%

s/o :2045 m

Source: Company reports; IDBI Capital Market Services

Tower company valuation

Table 3: Global competition

	American Towers	Crown Castle
No. of towers	22,000	23,500
Tenants per tower	2.4	2.5
Total tenants	52,800	58,750
Market capitalization	$15,280	$9,990
Debt	3,525	2,921
EV	$18,805	$12,911
Debt as % of EV	18.7	22.6
EV per tenant (US $)	356,151	219,765
EV per tenant (Rs.)	14,246,049	8,790,587

Source: Company reports; IDBI Capital Market Services

Table 4: Reliance Communications

	FY08	FY09
Number of towers	30,000	50,000
Tenants per tower	1.05	1.1
Total tenants	31,500	55,000
EV per tenant (Rs.)	61,53,411	61,53,411
Total EV (m)	1,93,832	3,38,438
Debt as % of EV	18	18
Market cap (Rs. m)	1,58,943	2,77,519
Per share value (Rs.)	77.74	135.73

Source: Company reports; IDBI Capital Market Services

Comparative EV per subscriber

On EV/subscriber basis, we believe RCOM is closing in towards the EBIDTA margins of the market-leader, which we believe should close the valuation gap gradually.

With acquisition of Hutchison Essar, Voadafone is the latest entrant in the market, which promises to heat up further. We believe a phase of consolidation will start across industry with a lot of mergers and acquisitions.

Globally, Vodafone is trading at EV/subscriber of Rs.33,341 with a customer base of 232m. China Unicom, with a customer base of 152m, commands EV per subscriber of Rs.25,210. Although Indian companies are commanding a higher EV per subscriber currently, it is mainly on account of very high margins and expected high growth.

Table 5: Comparative EV per subscriber

	Bharti Airtel	Idea Cellular	Reliance Communications
Last price (Rs.)	848	109	495
Current market cap (Rs. m)	1,608,118	290,680	1,012,084
EBITDA margin quarterly (June '07) (%)	43	35	42
Trail 12M EBITDA (Rs. m)	85,318	15,102	63,289
EBITDA margin FY07 (%)	40	34	40
FY07 net margin (%)	23	11	22
EV (Rs. m)	1,654,596	322,044	1,068,440
TTM EBITDA (Rs. m)	75,884	11,742	65,827
EV TO T12M EBITDA	21.8	27.4	16.2
Mobile subscribers June '07 (m)	42.7	16.1	32.4
EV/Subscriber (Rs.) latest	38,749	20,003	33,017
TTM Sales (Rs. m)	197,236	29,655	169,189
EV/ Sales TTM	8.4	10.9	6.3
ARPU (Rs.)	398	317	375

Source: Company reports; IDBI Capital Market Services

Concerns

- RCOM has lower ARPUs as compared to its peers, given its CDMA base.
- GSM continues to be consumer preferred choice, reflected in the higher subscriber expansion ; CDMA still lagging.

Business profile

Reliance communication Ltd. (RCOM) was started as a part of a conglomerate – Reliance Industries. After the division of businesses, now the company is headed by Chairman Mr. Anil D. Ambani. RCOM currently has a 4 member board of directors – Mr. Anil D. Ambani, Prof. J. Ramchandran, Mr. S. P. Talwar and Mr. Deepak Shourie. This has resulted in the company becoming more focused on the business. Currently promoters hold 67.5% of the shares.

RCOM has a diverse portfolio of services ranging from wireless, wireline, data, video, International long Distance/National long distance (ILD/NLD) and International Private Leased Circuits (IPLC).

Table 6: RCOM's revenue distribution by segment (FY06-09) (Rs. m)

Particulars	Dec. '05 (9M)	Mar. '07 (15M)	Mar. '08E	Mar. '09E
Wireless	53,200	128,476	164,038	229,315
Global	48,900	65,929	54,668	62,926
Broadband	3,300	13,388	18,803	28,913
Others	0	4,312	4,461	5,644
Eliminations	(18,860)	(37,719)	(39,010)	(49,020)
Total	86,540	174,387	202,960	277,778
Revenues as a % of total				
Wireless	61.5	73.7	80.8	82.6
Global	56.5	37.8	26.9	22.7
Broadband	3.8	7.7	9.3	10.4
Others	0.0	2.5	2.2	2.0
Eliminations	(21.8)	(21.6)	(19.2)	(17.6)
Total	100	100	100	100

Source: Company Reports and our estimates

Currently it is #2 wireless (CDMA+GSM) player in terms of subscribers and #1 in CDMA based wireless services. It has strong presence in ILD/NLD segment with #1 in US-India voice market (40% market share) and 45% market share in total ILD. Through FLAG it provides IPLC services and has currently 35% market share in total Indian bandwidth supply.

Table 7: RCOM Advantage – Presence across telecom value-chain + Pan-India presence

Wireless
- Pan India coverage – (CDMA pan-india , GSM – 8 circles)
- Applied for GSM license in ….circles
- Brands – Reliance Mobile, Reliance Hello, R-World, R-Connect

Global
- National and international long distance calling services – 40% market share in ILD inbound
- Retail virtual card calling services in US, Canada, Australia and UK
- FLAG – 65,000 RKm.(including recently commissioned 11,500 RKm FALCON) across 5 continents, 40 countries

Broadband
- IDC – India's largest internet data center (IDC) with 4 world class Level III (highest) IDC facilities
- Two IDCs — of 35,000 sq ft (IDC1) and 100,000 sq ft (IDC2) — functioning in Mumbai and another two — of 20,000 sq ft (IDC1) and 50,000 sq ft (IDC2) — functioning at Bangalore. Reliance also setting up world-class data centers in four other major cities in India (Chennai, Hyderabad, Delhi and Kolkata) making a total of more than 500,000 sq ft of hosting space available over the next year.
- 620,000 access lines connecting 488,600 buildings

Source:

Wireless service providers in India offer services through CDMA and GSM based technologies. RCOM and Tata Teleservices are largest CDMA based mobile service providers while GSM based service providers include Bharti, BSNL, Hutch, MTNL, Idea, Aircel and Reliance. Bharti and RCOM have presence in all the 23 circles in country.

Fixed wireline

India's fixed-line segment is dominated by two state-run operators – Bharat Sanchar Nigam Ltd. (BSNL) and Mahanagar Telephone Nigam Ltd. (MTNL) – which, together, commanded a market share of over 90% at the end of FY07. MTNL operates in Mumbai and Delhi, while BSNL provides services in the rest of the country. After 2001, fixed-line telephony was opened for competition, and there are now five other service providers offering these services in different parts of the country. The other five operators – Tata, Bharti, RCOM, HFCL Infotel, and Shyam – together had a market share of 8.2% at the end of FY06.

Table 8: Fixed-line market share

Operator	Area of operation	Market share (%) (FY06-07)	Market share (%) (FY05-06)	Market share (%) (FY04-05)
BSNL	All India (except Delhi and Mumbai)	82.7	80.2	74.8
MTNL	Delhi and Mumbai	9.1	8.8	7.7
Tata Teleservices	Maharashtra, AP, Tamil Nadu, Karnataka, Gujarat, Delhi and Chennai	1.3	5.6	8.0
Bharti	MP, Delhi, Haryana, Tamil Nadu including Chennai and Karnataka	4.6	1.9	2.7
RCOM	AP, Bihar, Delhi, Gujarat, Haryana, HP, Karnataka, Kerala, MP, Maharashtra, Mumbai, Orissa, Punjab, Rajasthan, Tamil Nadu, West Bengal, Kolkata	1.4	2.8	6.0
HFCL Infotel	Punjab	0.5	0.4	0.5
Shyam Telelink	Rajasthan	0.4	0.3	0.3

Source: TRAI, COAI and AUSPI

Value-added Services (VAS)

The mobile VAS market in India is growing at around 40% annually. The contribution of VAS to total telecom revenues has been increasing over the last 2-3 years from 2-3% to 8-10% currently. This figure is expected to reach 60% in the next 10-years. This is attracting wireless operators, handset manufacturers, content developers, music and film companies, cartoon artists, game makers and musicians for ring tones, music, gaming, sports, mobile imagery, WAP, wall papers, logos, SMS based contests and streaming audio and video.

According to the 'Mobile Value Added Services Report' jointly prepared by the Internet and Mobile Association of India (IAMAI) and IMRB International, The Mobile Value Added Services (MVAS) industry could be worth of Rs.45,600m by the end of 2007, from its current size of Rs.28,500m.

The total market size of Rs.28,500m is further divided as – P2P (person to person) SMS or Text Messaging – Rs.11,400m, Ringtones, including Caller Ring Back Tones (CRBT) – Rs.10,260m; P2A (Person to Application) and A2P (Application to Person) – Rs.4,280m; Games and Data – Rs.1,710m and others (MMS etc) at Rs.860m according to the report.

Regulatory developments

On the regulatory front, the telecom regulator, TRAI, has taken consistent initiatives to reduce regulatory costs, such as license fees and access deficit charge (ADC), for telecom companies. The license fees have been steadily brought down over the past few years, and a further reduction is possible. On the ADC front as well, TRAI has recommended that this should be brought down to nil by FY09. The latest budget envisages the formation of a committee to decide upon the future course of action in this regard. All these initiatives augur well for the industry, which is actually one of the most heavily taxed industries in the world, and could have a positive impact on margins and industry profitability in the near future.

Telecom tower business emerging as a new star

The new trend among Indian telecom operators is establishment of separate subsidiaries for setting up and sharing of passive infrastructure – namely towers. These companies undertake building of the towers, operations and maintenance, security arrangements and emergency back-up. According to industry estimates, India has about 85,000 towers and will need over 1,80,000 by end of FY08.

The cell sites are either ground-based or mounted on roof-tops. The ground based sites cost around Rs.3m, while the latter costs Rs.0.7m. The usual pay back period for telecom operators is 12-13 years. Tower companies usually have three business models: built-to-suit sites, green-field sites and buying sites from operators and leasing them out. In the first model, operators provide locations of cell sites to tower companies. In this case, the operator is called the anchor tenant. The tower company builds, owns and operates the site and gives them plug and play. Then, it gets other operators to share the site.

In green-field projects, tower companies pick up sites, undertake planning and construction and offer them to interested parties. The monthly rent ranges from Rs.40,000 in rural areas to upwards of Rs.1 lac in metros. According to industry estimates, with every additional operator sharing the tower, incremental costs go up only 10%, however revenues increase by 80% as the rent charged from subsequent operators is only slightly less than the anchor tenant. Further, rentals are revised upwards annually.

With passive infrastructure sharing, operators are expected to save close to 30% on capex and opex when it comes to passive infrastructure management. Right now, sharing among operators is limited to two in most cases, whereby tower companies are aiming at an average of 2.5 to 2.7 carriers per tower. Furthermore, only 30% of sites are being shared-tower companies expect it to take this number higher with a focused approach

The maximum money is made by the tower company when it adds an operator to an existing tower. So with four operators sharing a site, a tower company is likely to recover its capex in about 6-7 years.

Financials

FY07 results

RCOM had a 5-quarters year for year ending March 2007. The company added in total 9m customers during the 5-quarters, even after discontinuing 5m customers for regulatory reasons. Surprisingly, ARPU remained at Rs.375 at the end of March 2007, from Rs.379 a year earlier. Compared to industry ARPU of Rs.202, RCOM's ARPU stood at Rs.377. For the year ended March 2007, revenues stood at Rs.174,387m and EBITDA margins stood at 38.8%.

Q1FY08 results

RCOM came out with very good Q1FY08 results. The company ramped up subscriber addition, adding 5.5m subscribers during the quarter. The subscriber addition share grew from 18% to 20% QoQ. ARPUs remained almost same at Rs.373. Consolidated revenues were up 32% YoY and 9.3% QoQ, the highest in the last four quarters. EBITDA margin was up 504bps YoY and 62bps QoQ at 42.2%, the highest in the Indian telecom industry. Net profit was up 131% YoY and 19% QoQ to Rs.12.2bn. Global segment had a subdued quarter however broadband was once again on track.

RCOM has guided total capex of US$ 4bn for FY08, including the tower business. The capex for NGN and the tower division would be met through monetizing the balance sheet. Other capex would be financed through a mix of internal accruals and debt.

Going forward, we expect a 33.6% CAGR in revenue, following a 54% rise in the number of subscribers. The company will be able to maintain EBITDA margin around 42%.

Table 9: Quarter history (Rs. m)

Year-end: March	Q1FY08	Q1FY07	YoY Change (%)	Q2FY07	Q3FY07	Q4FY07
Net total revenues	51,586	39,959	29	42,740	44,785	46,876
QoQ growth (%)	*10*	*6*		*7.0*	*4.8*	*4.7*
Operating profit	18,142	12,062	50	13,525	15,271	16,351
QoQ growth (%)	*11*	*145*		*12*	*13*	*7*
Depreciation	(6,192)	(5,514)	12	(6,237)	(6,524)	(6,378)
EBIT	11,950	6,548	82	7,289	8,747	9,973
Pre-tax profits	13,224	5,549	138	7,233	9,404	10,364
QoQ growth (%)	*28*	*(1,747)*		*30.3*	*30.0*	*10.2*
Prov for taxation	(1,031)	(272)	279	(59)	(130)	(148)
Extraordinary items	(1,031)	(272)	279	(59)	(130)	(148)
Reported net profit	12,208	5,127	138	7,023	9,244	10,243
QoQ growth (%)	*19.2*	*(1,221.9)*		*37.0*	*31.6*	*10.8*

Source: Company reports; IDBI Capital Market Services

Financial summary

Profit and loss account

(Rs. m)

Year-end: March	Dec. '05 (9M)	Mar. '07 (15M)	Mar. '08E	Mar. '09E
Wireless	53,200	128,476	164,038	229,315
Global	48,900	65,929	54,668	62,926
Broadband	3,300	13,388	18,803	28,913
Others	0	4,312	4,461	5,644
Total revenues	105,400	212,105	241,970	326,798
Eliminations	-18860	-37,719	-39,010	-49,020
Net revenues	86,540	174,387	202,960	277,778
Operating expenses	33%	28%	24%	23%
Access charges and license fee	28,660	48,114	48,015	62,724
Network operating cost	43,570	20,086	22,646	38,316
Employee cost	-	10,904	12,059	16,111
Selling and general cost	-	27,597	33,674	44,319
Total operating expenses	72,230	106,701	116,395	161,470
EBITDA	14,310	67,685	86,565	116,308
Depreciation and amortization	11,530	30,110	32,383	42,644
EBIT	2,780	37,576	54,181	73,664
Net interest	2,170	486	325	2,361
Profit before tax and extraordinary items	610	37,090	53,856	71,303
Tax	190	746	4,282	7,130
Extraordinary items	-	677	(15.00)	-
Profit after tax	420	35,666	49,590	64,173
Cash profit from operations	11,950	65,776	81,973	106,816
EPS (Rs.)	0.2	17.4	24.3	31.4
Wtd avg # of shares outstanding	2,045	2,045	2,045	2,045

Source: Company reports; IDBI Capital Market Services

Balance sheet

(Rs. m)

Year-end: March	Dec. '05 (9M)	Mar. '07 (15M)	Mar. '08E	Mar. '09E
Sources of funds				
Share capital	6,116	10,223	10,223	10,223
Reserves and surplus	147,834	219,083	267,651	330,801
Shareholders fund	153,950	229,307	277,874	341,024
Minority interest	-	56	56	56
Loan funds	-	174,383	219,383	189,383
Deferred tax liability	-	26	26	26
Current liabilities and provisions	43	161,482	131,924	172,223
Current liabilities	11	114,334	103,509	136,111
Provisions	32	47,149	28,414	36,111
Total	153,993	565,254	629,263	702,712
Application of funds				
Gross block	1,981	349,442	469,442	589,442
Depreciation	319	55,926	88,309	130,953
Net block	1,662	293,515.6	381,132	458,489
Capital work in progress	-	36,906.8	36,907	36,907
Total fixed assets	1,662	330,422.4	418,039	495,395
Goodwill	-	26,588	26,588	26,588
Investments	120,741	77,114	77,114	77,114
Current assets				
Inventories	-	4,821	5,262	7,078
Debtors	-	18,316	33,363	53,273
Cash and bank balances	0.46	72,006	43,953	17,550
Loans and advances	31,589	22,103	22,103	22,103
Other current assets	-	13,884	2,841	3,611
Current assets	31,590	131,130	107,522	103,615
Total	153,993	565,254	629,263	702,712

Source: Company reports; IDBI Capital Market Services

Cashflow statement

(Rs. m)

Year-end: March	Dec. '05 (9M)	Mar. '07 (15M)	Mar. '08E	Mar. '09E
Cashflow from operating activities				
Net profit	89	35,995	49,590	64,173
Add: Non cash expenses				
Depreciation and amortization	27	29,193	32,383	42,644
Provision for doubtful debts		1,125	-	
Interest expense (net)	-	8,645	325	2,361
(Profit)/loss on sale of assets / investments		(1,156)	-	-
Loss on sale of assets		54		
Financial income		(7,158)		
Tax expense / (income)/ exchange gains		(1,483)	4,282	7,130
Extraordinary items	0	1,093	-	-
Operating profit before working capital changes	116	66,308	86,580	116,308
Increase / (decrease) in working capital	(116)	63,409	(34,004)	17,803
Inventories		(1,565)	(440)	(1,816)
Debtors		34,749	(15,047)	(19,909)
Loans and advances			-	-
Other current assets			11,042	(770)
Current liabilities and provisions		30,225	(29,559)	40,299
Tax paid		(1,153)	(4,282)	(7,130)
Net cash from operating activities	(0)	128,564	48,294	126,981
Cashflow from investing activities				
Purchase of property, plant and equipment	-	(52,509)	(120,000)	(120,000)
Sale of fixed assest		21	-	-
Purchase of investment	-	(527,584)	-	-
Sale of investment		473,147	-	-
Financial income	-	6,550	(325)	(2,361)
Loans recovered from subsidiaries				
Net cash from investing activities	-	(100,374.10)	(120,325)	(122,361)
Cashflow from financial activities				
Proceeds from share capital / Dividend	0		(1,022)	(1,022)
Increase / (decrease) in borrowings	-	24,878	45,000	(30,000)
Financial charge		(6,535)		
Net cash from financing activities	0	18,342.4	43,978	(31,022)
Net change in cash and cash equivalents	0	46,532.7	(28,053)	(26,403)
Cash and cash equivalents at beginning	0	0.05	72,006	43,953
Cash and cash equivalents of subsidiaries acquired		25,518		
		(44)		
Cash and cash equivalents as at end	0.46	72,006.4	43,953	17,550

Source: Company reports; IDBI Capital Market Services

Key ratios

Year-end: March	Dec. '05 (9M)	Mar. '07 (15M)	Mar. '08E	Mar. '09E
Growth ratio (%)				
Revenue		102	16	37
EBITDA		373	28	34
EBIT		1252	44	36
Net profit		8392	39	29
Margin ratio (%)				
EBITDA	17	39	43	42
EBIT	3	22	27	27
Pre-tax profit	1	21	27	26
Net profit	0	20	24	23
Valuation				
P/E	2,386	28	28	21
P/B	7	4	5	4
P/S	12	6	7	5
EV/Sales	12	6	8	6
EV/EBITDA	70	16	18	13
EV/Net profit	2,386	31	31	24
EPS	0	17	24	31
Book value	75	112	136	167
Return ratio				
ROCE (%)	2	10	10	12
RONW (%)	0	20	20	21
ROE (%)	7	349	485	628
Balance sheet ratio				
D/E	0.0	0.8	0.8	0.6
Current ratio	742.8	0.8	0.8	0.6
Efficiency ratio				
Debtor (Days)		46	60	70
Inventory (Days)		17	17	16
Creditor (Days)		145	145	140
Tax rate (%)	31	2	8	10
CMP	490	490	669	669
S/O	2,045	2,045	2,045	2,045
Mcap	1,002,050	1,001,937	1,368,774	1,368,774
Net debt	(0)	102,377	175,430	171,833
EV	1,002,050	1,104,314	1,544,204	1,540,607
Assets	153,993	565,254	629,263	702,712

Source: Company reports; IDBI Capital Market Services

Technical evaluation

Source: Bloomberg

In line with the BSE Index movement, Reliance Communications (RCOM) tested its 200 days simple moving average at Rs.469 during the recent decline and has rebounded to current levels of Rs.495. Immediate resistance is seen at Rs.501, piercing this level shall take this scrip to Rs.533 – Rs.535 in the shorter term. A move past Rs.536 should take the stock to Rs.670 by year end.

Equity Sales/Dealing

Manish Agarwal	(91-22) 66371152/54	manish.agarwal@idbicapital.com
Ankur Agarwala	(91-22) 66371155	ankur.agarwala@idbicapital.com
Manoj Shettigar	(91-22) 66371157	manoj.shettigar@idbicapital.com
Rachit Shah	(91-22) 66371153	rachit.shah@idbicapital.com
Manisha Rathod	(91-22) 66371156	manisha.rathod@idbicapital.com
Charushila Parkar	(91-22) 66371154	charushila.parkar@idbicapital.com
Samit Sanyal	(91-22) 66371154	samit.sanyal@idbicapital.com

Production & Database

S. Narasimhan Rao	(91-22) 66371165	narasimhan.rao@idbicapital.com

IDBI Capital Market Services Ltd. (A wholly owned subsidiary of IDBI Ltd.)
Registered Office: 5th floor, Mafatlal Centre, Nariman Point, Mumbai – 400 021. Phones: (91-22) 6637 1212 Fax: (91-22) 2288 5848 Email: info@idbicapital.com