



Q3FY10 Result Update

February 05, 2010

RCOM recently declared its Q3FY10 results. It reported revenues of Rs.5,309.8 cr down by 9.2% Yo-Y and down 6.9% Q-o-Q. EBIDTA for the quarter fell by 23% Yo-Y and 10.3% Q-o-Q to Rs.1,812.6 cr. PAT margins dipped by 320 bps Y-o-Y but rose by 790 bps Q-o-Q to 20.9%.

Quarterly Financials - Consolidated

Particulars	Q3FY10	Q3FY09	% Chg	Q2FY10	% Chg	9MFY10	9MFY09	% Chg	Rs.Cr.
Service & Sales	5309.8	5850.2	-9.2%	5702.6	-6.9%	17157.6	16817.4	2.0%	
Operating Expenses									
- Access Charges & License Fees	833.7	869.3	-4.1%	768.5	8.5%	2386.7	2617.6	-8.8%	
- Network Operations	1670.8	1166.6	43.2%	1591.9	5.0%	4648.3	3006.0	54.6%	
- Personnel Expenses	367.7	438.3	-16.1%	381.6	-3.6%	1160.5	1248.9	-7.1%	
- SG&A	625.0	1023.5	-38.9%	940.7	-33.6%	2677.1	3040.6	-12.0%	
Total Operating Expenditure	3497.2	3497.7	0.0%	3682.7	-5.0%	10872.6	9913.1	9.7%	
EBIDTA	1812.6	2352.5	-23.0%	2019.9	-10.3%	6285.0	6904.3	-9.0%	
EBIDTA Margins %	34.1%	40.2%		35.4%		36.6%	41.1%		
Interest	-407.5	-149.6	172.4%	655.1	-162.2%	-372.9	-618.9	-39.7%	
Depreciation	833.1	1006.9	-17.3%	714.4	16.6%	2661.9	2788.7	-4.5%	
Amortisation of compensation under ESOP	22.1	35.8	-38.3%	2.9	662.1%	36.1	164.5	-78.1%	
PBT	1364.9	1459.4	-6.5%	647.5	110.8%	3959.9	4570.0	-13.4%	
PBTM %	25.7%	24.9%		11.4%		23.1%	27.2%		
Tax	200.3	15.3	1209.2%	-173.9	-215.2%	253.1	-60.8	-516.3%	
Effective Tax Rate %	14.7%	1.0%		-26.9%		6.4%	-1.3%		
Share of minority and associates	56.9	33.9	67.8%	81.1	-29.8%	222.2	177.4	25.3%	
PAT	1107.7	1410.2	-21.5%	740.3	49.6%	3484.6	4453.4	-21.8%	
PATM %	20.9%	24.1%		13.0%		20.3%	26.5%		
Equity	1032.0	1032.0	0.0%	1032.0	0.0%	1032.0	1032.0	0.0%	
EPS	5.4	6.8	-21.5%	3.6	49.6%	16.9	21.6	-21.8%	

(Source: Company Press Release)

Quarterly Financials - Segmental

Segmental	Q3FY10	Q3FY09	% Chg	Q2FY10	% Chg	9MFY10	9MFY09	% Chg	Rs.Cr.
Revenues									
- Wireless	4022.5	4411.9	-8.8%	4010.0	0.3%	12825.6	12866.2	-0.3%	
- Global	1981.8	1678.3	18.1%	2264.3	-12.5%	6130.5	4895.8	25.2%	
- Broadband	704.5	654.2	7.7%	770.0	-8.5%	2158.7	1816.8	18.8%	
- Others	316.0	318.3	-0.7%	276.0	14.5%	895.1	696.6	28.5%	
Eliminations	-1715.1	-1212.5	41.5%	-1617.7	6.0%	-4852.4	-3458.0	40.3%	
Total revenues	5309.7	5850.2	-9.2%	5702.6	-6.9%	17157.5	16817.4	2.0%	
PBIT									
- Wireless	1254.5	1685.9	-25.6%	1313.2	-4.5%	4416.6	5009.8	-11.8%	
- Global	419.4	360.8	16.2%	522.7	-19.8%	1393.6	1114.5	25.0%	
- Broadband	275.5	294.1	-6.3%	319.9	-13.9%	894.8	841.5	6.3%	
- Others	-125.5	-19.8	533.8%	-124.4	0.9%	-388.0	-30.4	1176.3%	
Eliminations	-11.8	-19.4	-39.2%	-11.6	1.7%	-32.6	-31.3	4.2%	
PBT	1812.1	2301.6	-21.3%	2019.8	-10.3%	6284.4	6904.1	-9.0%	
PBIT Margins %									
- Wireless	31.2%	38.2%		32.7%		34.4%	38.9%		
- Global	21.2%	21.5%		23.1%		22.7%	22.8%		
- Broadband	39.1%	45.0%		41.5%		41.5%	46.3%		
- Others	-39.7%	-6.2%		-45.1%		-43.3%	-4.4%		
Eliminations	0.7%	1.6%		0.7%		0.7%	0.9%		
PBIT Margins %	34.1%	39.3%		35.4%		36.6%	41.1%		

(Source: Company Press Release)

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

- RCom reported a 9.2% y-o-y and 6.9% q-o-q degrowth in revenues to Rs.5,309.8 cr.
- Wireless revenues fell 8.8% y-o-y but was flat q-o-q at Rs.4,022.5 cr despite strong subscriber growth of 53.3% y-o-y and 8.9% q-o-q to 93.8 mn. The management attributed the poor performance in the wireless business to lower ARPUs on the back of pressure put by use of multiple SIMs. Despite hyper competition and pressure on tariffs, RPM has declined only by 2 paise q-o-q. Wireless PBIT margin fell 700 bps y-o-y and 150 bps q-o-q to 31.2% on account of sharp 43.2% y-o-y jump in network costs owing to GSM rollout. RCom saw weakest minute growth among listed peers at 5.3% q-o-q to 89bn. Wireless ARPUs crashed to Rs.149 in Q3FY10 vs. Rs.161 in Q2FY10.
- The global business segment revenues improved by 18.1% y-o-y to Rs.1,981.8 cr but fell by 12.5% q-o-q. NLD traffic grew by 59.1% y-o-y to 13.6 bn minutes while ILD traffic rose by 48.1% y-o-y to 2.82 bn minutes. PBIT margins dipped q-o-q by 190 bps whereas on y-o-y basis they fell by 190 bps to 21.2% in Q3FY10.
- Broadband segment revenues sharply improved by 7.7% y-o-y but dropped by 8.5% q-o-q to Rs.704.5 cr with ARPL flat y-o-y and down by 8.5% q-o-q to Rs.1,642. PBIT margins declined to 39.1% from 41.5% in Q2FY10. It has bagged 22 projects in the enterprise data segment from global and domestic players.
- RCom has said that the poor show by global and broadband divisions reflects the gaps observed by its vendors before renewing the annual contracts. The divisions are likely to resume growth in the coming quarters and it claims that it has not lost any of the clients.
- RCom had 2.23 mn DTH subscribers in Q3FY10 and market share of 12%.
- Consolidated EBIDTA margins dipped by 610 bps y-o-y and 130 bps q-o-q to 34.1% on the back of high network operating costs. Network costs increased by 1160 bps yo-y and 360 bps as a percentage of sales to 31.5%. Another reason for fall in EBIDTA margins was the sharp drop in wireless revenues.
- SG&A cost declined by 34% q-o-q. The management indicated that the reason for this fall was reduction in outsourced manpower; reduction in losses/costs pertaining to Vanco restructuring and lower costs in globalcom business.
- Depreciation and amortization charges dropped sharply by 18% yo-y due to assumed increase in useful life of certain telecommunication equipment to 18 years. Q3FY10 witnessed interest income of Rs.407.5 cr vis-à-vis income of Rs.149.6 cr in Q1FY10. RCom reported tax of Rs.200.3 cr during the quarter. Lower revenues and higher tax outflow led to net profit moving down by 21.5% y-o-y to Rs.1,107.7 cr in Q3FY10.
- RCom has guided for a capex of Rs.4,500 cr excluding of a provision for cash outgo towards the upcoming auction of 3G spectrum in FY10. Excluding 3G spectrum and Wi-max, the capex for FY11 stands at Rs.3,000 cr. Till 9MFY10, RCom has incurred capex of Rs.3,200 cr of which 80% is for wireless. 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.
- RCom's net debt now stands at Rs.189 bn and cash at Rs.43.8 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.
- RCom has signed 3 new deals through its wholly owned subsidiary Globalcom. RCom has won contracts worth ~Rs.400 cr through this subsidiary. The new deals include a NLD lease contract worth Rs.210 cr, and another contract worth Rs.170 cr in the wholesale data segment.
- RCom, which has got the market regulator's approval for its proposed initial public offering (IPO) of its tower unit Reliance Infratel, has initiated pre-IPO talks with strategic and financial investors. It is looking to sell a 3-5 % stake and is hoping to rake in around Rs 1,500 to Rs 2,500 crore, depending on how much it sells. However, the management has indicated that the timing of the IPO would depend on the industry scenario.
- Etisalat DB and RCom announced a long term passive infrastructure sharing agreement which will accelerate Etisalat DB Telecom's forthcoming roll-out of telecom services in India on July 22, 2009. This deal could result in higher margins due to savings in power and fuel cost. This agreement could start booking revenues in Q4FY10/Q1FY11.
- The management has indicated that the industry consolidation could take 12-18 months to take effect given the high pressure on tariffs due to hyper competition.
- 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. The recently launched Simply Reliance Plan could have a negative impact on ARPU.
- 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 posted weak Q3FY10 results inspite of strong subscriber and minutes growth. 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 could not perform well due to gaps observed at renewal of contracts. Going forward, due to hyper intensive competition, tariffs could come under pressure for RCom.

The recent tariff cuts introduced by telecom companies, upcoming 3G auction and introduction of MNP could be key elements that could restrict the growth of companies in the industry. These could have a negative impact on EBIDTA margins and on the cash flows. Pricing pressure could increase further with the introduction of MNP and 3G spectrum, thereby affecting the business of new entrants. Only big players would be able to sustain the intensive competition.

Given the poor performance in revenues by RCom in Q3FY10, we are lowering our FY10E revenue estimates but raising the earnings due to lower interest and depreciation costs. We are introducing FY11 estimates with a view that earnings and margins would be lower due to entry of new players and pressure on tariffs. 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 and write back of tax in Q2FY10), 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. This is reflected in the fact that local Mutual Funds have brought down their holding in RCOM gradually from 1.7% in Sept 2009 to 1.4% in December 2009 and FII's reducing their exposure from 9.4% to 7.3% in the same period.

In our earlier report dated November 12, 2009 we had stated that the stock could trade in the band of Rs.141 to 188 for the next few month. Post to the issue of the report, the stock touched a low of Rs.163 on November 27, 2009 and a high of Rs.193.8 on January 18, 2010. At the CMP, the stock is trading 8.2x FY10RE EPS of Rs.20.1 and 10.4x FY11E EPS of Rs.15.8. We think the stock could trade in the Rs.142.5 (9x FY11E EPS) – Rs.174.25 (11x FY11E EPS) in the next quarter.

Particulars (Rs in Crs)	FY08	FY09	FY10 (OE)*	FY10 (RE)*	FY11 (E)*
Operating income	18827.4	22234.6	23725.6	22706.2	24018.0
PBIDT	7959.3	8580.9	8260.8	8111.3	8266.0
PBIDTM (%)	42.3%	38.6%	34.8%	35.7%	34.4%
Profit after Tax	5401.7	5907.5	3752.8	4146.7	3269.0
PATM (%)	28.7%	26.6%	15.8%	18.3%	13.6%
EPS	26.2	28.6	18.2	20.1	15.8
P/E (x)	6.3	5.8	9.1	8.2	10.4

* = Quick Estimates, OE- Original Estimates, RE- Revised Estimates

(Source: Company, HDFC Sec Estimates)

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