

September 5, 2008

Rating	BUY
Price	Rs397
Target Price	Rs670
Implied Upside	68.5%
Sensex	14,899

(Prices as on September 4, 2008)

Trading Data

Market Cap. (Rs bn)	864.5
Shares o/s (m)	2,175.0
Free Float	33.9%
3M Avg. Daily Vol ('000)	2,525.0
3M Avg. Daily Value (Rs m)	1,151.4

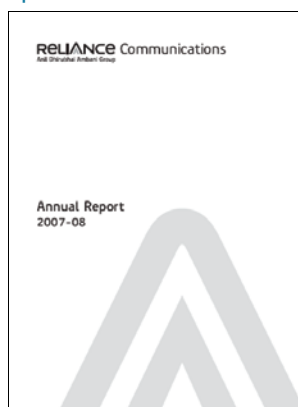
Major Shareholders

Promoters	66.1%
Foreign	10.0%
Domestic Inst.	11.5%
Public & Others	12.4%

Stock Performance

(%)	1M	6M	12M
Absolute	(11.7)	(25.9)	(27.5)
Relative	(8.9)	(13.9)	(21.7)

Annual Report 2008



- **Thrust on network expansion in FY08** : Reliance Communications (RCom) continued to focus on expanding its network in both domestic and international markets in FY08 and incurred a capital expenditure of ~US\$5bn (previous year ~US\$3bn). Most of the capex, around US\$4bn, was targeted in expanding the GSM and CDMA network on a pan-India basis by setting up ~16K towers in the year and laying ~20K route kilo metres (kms) of fibre.
- **Acquisitions continue in the global segment, synergies yet to pick up**: RCom acquired US-based ethernet service provider "Yipes Holdings" in FY08 for a consideration of US\$300m. Yipes has a strategic network presence in the top 14 US metros and nearly 1000 enterprise customers, which account for 40% of the total US datacom market.
- **Net interest income helped boost profitability**: RCom showed net interest income for the year ended FY08 to the tune of Rs4bn boosted by investment income (Rs10.4bn) and gain in foreign currency exchange fluctuation (Rs4.2bn).
- **Handset subsidy at Rs5bn for the year**: RCom continued to expand its range of classic handsets and tie-up with OEM's for offering handsets at cheap price points to lure the incremental subscribers. Subsidy per subscriber worked around Rs336 (~US\$8).
- **Valuations attractive**: At 10.7x PER and 7.6x EV/EBITDA of FY10E, the stock is attractively priced. Embedded value of Reliance Infratel and Global business will serve as a cushion for long-term investors. GSM presence pan-India by FY09 and positive impact of Mobile Number Portability, are the potential near term catalysts. Maintain BUY.

Key financials (Y/e March)	FY07	FY08	FY09E	FY10E
Revenue (Rs m)	144,683	190,678	246,865	326,719
Growth (%)	34.4	31.8	29.5	32.3
EBITDA (Rs m)	57,210	81,992	106,955	138,856
PAT (Rs m)	31,638	54,012	65,200	80,943
EPS (Rs)	15.5	24.8	30.0	37.2
Growth (%)	442.6	60.5	20.7	24.1
Net DPS (Rs)	0.5	0.8	1.5	2.0

Source: Company Data; PL Research

Profitability & valuation	FY07	FY08	FY09E	FY10E
EBITDA margin (%)	39.5	43.0	43.3	42.5
RoE (%)	18.2	20.8	20.5	19.9
RoCE (%)	10.4	11.0	11.4	13.0
EV / sales (x)	5.8	5.3	4.4	3.2
EV / EBITDA (x)	14.6	12.2	10.1	7.6
PE (x)	25.7	16.0	13.3	10.7
P / BV (x)	3.5	2.8	2.5	1.8
Net dividend yield (%)	0.1	0.2	0.4	0.5

Source: Company Data; PL Research

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Network expansion was the mantra for FY08

~US\$5bn capex for FY08 concentrated towards network expansion

RCom continued to focus on expanding its network in both domestic and international markets in FY08 and incurred a capital expenditure of ~US\$5bn (previous year ~US\$3bn). Most of the capex, around US\$4bn, was targeted in expanding the GSM and CDMA network on a pan-India basis by setting up ~16K towers in the year and laying ~20K route kms of fibre. RCom acquired "Yipes holdings", a US-based ethernet provider for a consideration of US\$300m. Yipes has strategic network presence in the top 14 US metros and nearly 1000 enterprise customers, which account for 40% of the total US datacom market.

Strong expansion over FY06- FY08 period

	FY06	FY08
Coverage	40% CDMA	90% CDMA
Towers	10K	30K
Tenancy Capacity	40K	120K
Subscribers	20	48
Fibre (Domestic + International)	165K route kms	207K route kms

Source: Company Data, PL Research

Management quite upbeat about their GSM launch, but expects competition to intensify further

Management Discussions & Analysis continued to emphasize on significant leverage available for their GSM launch by Dec 2008, both in terms of subscriber net additions and flexibility in terms of tariff plans. Their launch of GSM services in the remaining circles will enable them to effectively target ~6million GSM subscribers added every month and also address the requirements of ~220 million existing GSM subscribers.

Incremental market with GSM launch increases by a whopping ~6million subscriber per month and ~220 million existing GSM subscribers

RCom foresees strong competition with entry of new operators and renewed interest of global telcos to set-up operating footprint in one of the fastest growing telecom markets in the world and expects significant pressure on tariffs. However, they are quite upbeat about replicating the same model of dual networks, which they currently operate in six circles, on a pan-India basis and strive to maintain a market share above~20%.

Subsidy on account of handsets/accessories rose to Rs5bn

RCom continued to expand its range of classic handsets and tie-up with OEM's for offering handsets at cheap price points to lure the incremental subscribers. It added ~17m new subscribers for FY08. Assuming that 90% of subscribers are using subsidized handsets/accessories, average subsidy/subscriber works out to Rs336 (US\$8).

Cost of subsidy/subscriber for handsets close to US\$8.

Handset / Accessories subsidy @Rs5bn for FY08	(in m)
Subscribers added for the period	17
Assuming 90% subscribers use company handsets	15
Cost of subsidy/subscriber in (Rs)	336
Cost of subsidy/subscriber (in US\$)	8
Total	5,091

Source: Annual Report, PL Research

Net interest income helped boost profitability

RCom showed net interest income for the year ended FY08 to the tune of Rs4bn boosted by investment income (Rs10.4bn) and gain in foreign currency exchange fluctuation (Rs4.2bn). If we remove the foreign currency exchange fluctuation gain, then it would have resulted in net interest expense of Rs226m and over-all consolidated PAT of Rs49bn, instead of Rs54bn for FY08.

Net Interest Calculation	(Rs m)	
	FY07*	FY08
Interest & other charges on term loans	5,477	5,538
Interest on other loans	2,392	4,790
Other financial cost	776	354
Income from investments & interest income	(7,158)	(10,455)
Foreign currency exchange fluctuation loss/(gain)-net	(840)	(4,223)
Net interest (income)/expense	647	(3,997)

Source: Annual Report

*For 15 month period

Issue of shares upon FCCB/GDR conversion

RCom had raised funds in the form of FCCB/GDR's in FY06 and FY07, respectively (details attached). During the year, it has received conversion notice for 19.4m equity shares of Rs5 each, due to which the equity capital of the company increased by Rs97m and share premium account increased by Rs9.3bn. The fully paid-up equity shares now stand at Rs2,064m.

GDR details

Amount Raised	US\$1bn
Issue Date	02-06-07
No. of shares to be issued	63.7m
Conversion price	Rs661.23
Converted in this year	0.67m shares
Maturity	May-11
Rs/\$	44.48

Source: Company Data, PL Research

FCCB details

Amount Raised	US\$500m
Issue Date	22/3/06
No. of shares to be issued	46.2m
Conversion Price	Rs 480.68
Converted in this year	18.74m shares
Maturity	5 yrs
Redemption premium	24.86%

Source: Company Data, PL Research

Scheme of arrangement for transfer of passive infrastructure

RCom has transferred its passive infrastructure portfolio to Reliance Infratel Limited (about 79% subsidiary), which had a book value of Rs32bn. The company had re-valued its investments in passive infrastructure and recorded them at fair value of Rs~45bn. The reserve of business restructuring arising thereof stood at Rs~13bn.

Fair value of assets and liabilities

	(in m)
Amount transferred to general reserve	44,878
Less: book value of tower assets	32,007
Revaluation reserve	12,871

Source: Company Data, PL Research

Segmentwise capex for FY08 (in bn)

	Capex
Wireless Services	171.7
Global Segment	25.7
Broadband	14.4
Others/unallocated	0.2
Total	212

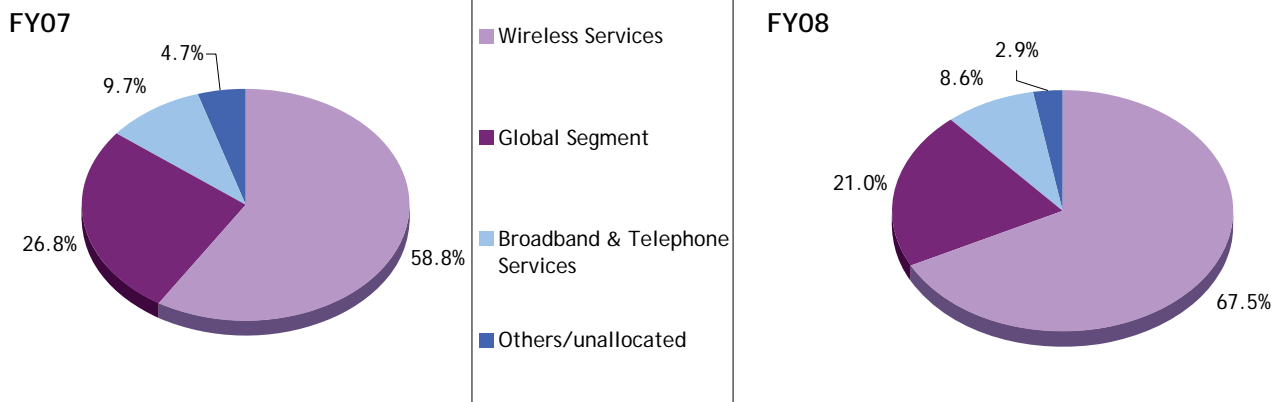
Source: Company Data, PL Research

Capital employed in various businesses

Thrust on expanding wireless coverage was clearly seen for yet another year with capex of around Rs171bn committed in FY08 in the wireless segment.

RCom also acquired "Yipes Holdings", a US-based ethernet service provider for a consideration of US\$300m. Yipes Communications has fibre ducted across 14 key US metros and has 1000 enterprise customers.

Investments across business segments increased from 326bn in FY07 to Rs 538bn in FY08



Source: Company Data, PL Research

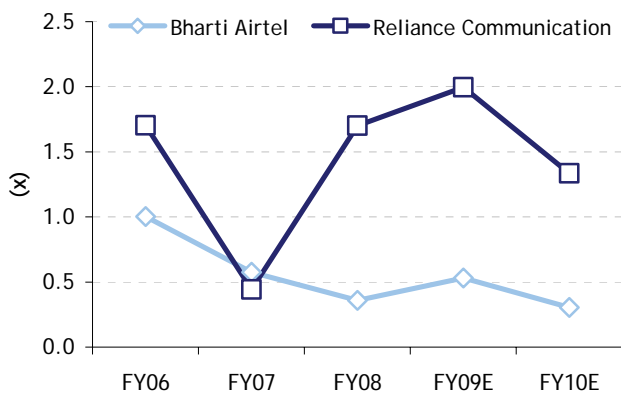
Comparison of costs of services between Rcom & Bharti (FY08) (Rs m)

	Rcom	Bharti	Rcom vis-à-vis Bharti
Net Revenues	190,678	270,122	
Expenditure			
Access charges & License fee	41,855	68,011	
<i>% of Net Revenues</i>	<i>22.0</i>	<i>25.2</i>	↑
Network Opns cost	20,736	32,430	
<i>% of Net Revenues</i>	<i>10.9</i>	<i>12.0</i>	↑
Employee cost	12,037	14,392	
<i>% of Net Revenues</i>	<i>6.3</i>	<i>5.3</i>	↓
SG&A expenses	34,059	40,083	
<i>% of Net Revenues</i>	<i>17.9</i>	<i>14.8</i>	↓
EBITDA	81,992	145,502	
<i>EBIDTA Margin (%)</i>	<i>43.0</i>	<i>40.8</i>	↑

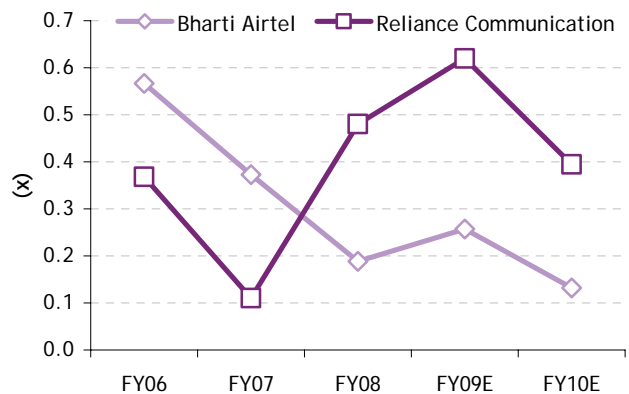
Source: Company Data, PL Research

Low Net debt/Equity & Net Debt/EBIDTA provides ample scope for future fund raising

Net debt/EBIDTA



Net debt/Equity



Source: Company Data, PL Research

RoE shall continue to slide on back of robust capex

RCom's RoCE has been stable in FY07-08 at around ~10% (even on margin expansion), primarily led by low asset turnover. The asset turnover over the next two years shall further keep RoCE under pressure due to high capital deployment (-US\$8bn over the next two years), to facilitate increased coverage and pan- India GSM rollout.

RoE in FY08 improved to ~21% due to positive impact of interest income of Rs~400m for the year. However, we expect the return ratios to be under pressure for the next two years, as the company launches its GSM operations in 14 circles, where the average return on incremental capital deployed would be initially low.

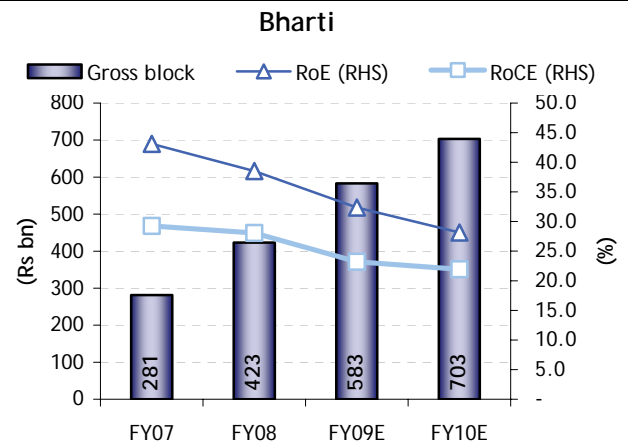
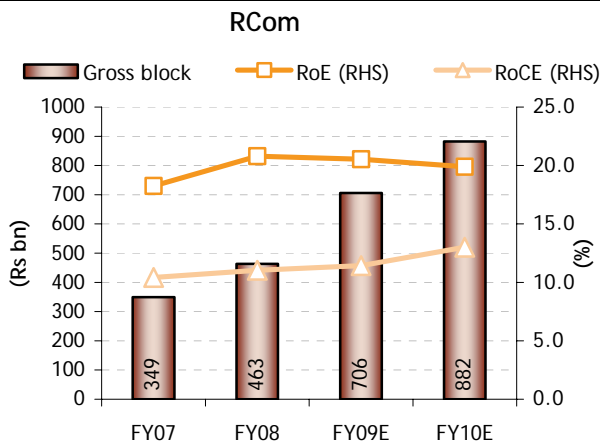
RoE decomposition

Y/e March	FY07	FY08	FY09E	FY10E
EBIT margin	22.5%	28.3%	28.0%	27.4%
Asset turnover	46.3%	39.0%	40.7%	46.6%
Tax impact	97.2%	93.2%	94.4%	90.5%
RoCE*	10.1%	10.3%	10.7%	11.5%
Leverage impact	180.2%	188.2%	177.6%	162.6%
Interest impact	100.0%	107.4%	100.0%	100.0%
RoE	18.2%	20.8%	19.1%	18.8%

Source: PL Research

*RoCE calculated by taking effective tax rate

Return ratios to remain subdued - Gross Block almost doubling in next 2 years



Source: Company Data, PL Research



Financials

Income statement

(Rs m)

Y/e March	FY06	FY07	FY08	FY09E	FY10E
Wireless revenue	73,640	107,276	152,135	208,525	275,696
Global revenue	51,860	51,771	54,750	63,322	72,820
Broadband revenue	5,130	11,442	17,868	26,068	34,482
Less: inter-segmental eliminations	(26,167)	(29,677)	(38,379)	(47,613)	(61,043)
Net Revenues	107,664	144,683	190,678	246,865	326,719
Expenditure					
Access charges & License fee	40,404	37,823	41,855	45,951	62,077
<i>% of Net Revenues</i>	<i>37.5</i>	<i>26.1</i>	<i>22.0</i>	<i>18.6</i>	<i>19.0</i>
Network Opns cost	15,346	16,738	20,736	32,604	40,840
<i>% of Net Revenues</i>	<i>14.3</i>	<i>11.6</i>	<i>10.9</i>	<i>13.2</i>	<i>12.5</i>
Employee cost	8,394	9,080	12,037	15,615	21,563
<i>% of Net Revenues</i>	<i>7.8</i>	<i>6.3</i>	<i>6.3</i>	<i>6.3</i>	<i>6.6</i>
SG&A expenses	18,167	23,833	34,059	45,740	63,384
<i>% of Net Revenues</i>	<i>16.9</i>	<i>16.5</i>	<i>17.9</i>	<i>18.5</i>	<i>19.4</i>
Total Operational Expenses	82,311	87,473	108,686	139,910	187,864
EBITDA	25,353	57,210	81,992	106,955	138,856
<i>EBIDTA Margin (%)</i>	<i>23.5</i>	<i>39.5</i>	<i>43.0</i>	<i>43.3</i>	<i>42.5</i>
Net interest	3,215	7	(3,997)	660	3,250
Dep & amortisation	16,987	24,654	28,053	37,231	46,166
EBIT	9,757	32,557	53,939	69,724	92,689
<i>EBIT Margin (%)</i>	<i>9.1</i>	<i>22.5</i>	<i>28.3</i>	<i>28.2</i>	<i>28.4</i>
PBT	6,542	32,549	57,936	69,064	89,439
Exceptional & non recurring items	374	303	12,827		
Total Tax Provision	337	609	2,836	3,864	8,497
<i>Effective Tax Rate (%)</i>	<i>5.2</i>	<i>1.9</i>	<i>4.9</i>	<i>5.6</i>	<i>9.5</i>
PAT	5,831	31,638	54,012	65,200	80,943
<i>Net Profit Margin (%)</i>	<i>5.4</i>	<i>21.9</i>	<i>28.3</i>	<i>26.4</i>	<i>24.8</i>
EPS (Rs)	2.9	15.5	24.8	30.0	37.2
CEPS (Rs)	11.2	27.5	37.7	47.1	58.4
No fo shares (Mn)	2,045	2,045	2,175	2,175	2,175
Dividend Per Share (Rs)	-	0.5	0.75	1.5	2.0



Balance Sheet

(Rs m)

Y/e March	FY06	FY07	FY08	FY09E	FY10E
Sources of Fund					
Share Capital	10,223	10,223	10,320	10,542	10,875
Reserves and Surplus	107,196	219,083	279,943	333,675	458,758
Total Shareholder's fund	117,419	229,306	290,263	344,217	469,633
Total Loan funds	103,332	174,383	258,217	260,717	240,717
Deferred tax liability	16	26	1028	1254	1468
Total Liabilities	220,863	403,772	573,817	633,497	742,327
Application of Funds					
Fixed Assets					
Gross Block	228,295	349,442	463,387	706,037	882,037
Less: Depreciation & Impairment	47,573	55,926	89,561	126,792	172,958
Net Block	180,722	293,516	373,826	579,245	709,079
Capital work in progress	31,305	36,907	149,299	100,000	60,000
Goodwill	2,237	26,588	35,654	35,654	35,654
Total Fixed Assets	214,263	357,010	558,780	714,899	804,733
Investments	22,163	77,114	109,996	32,500	42,560
Current Assets					
Inventories	4,075	4,821	4,059	5,479	5,753
Debtors	16,808	18,316	27,224	27,155	39,206
Other current assets	765	13,884	23,058	36,201	53,216
Cash & Cash equivalents	37,995	72,006	8,782	14,370	12,989
Loans & Advances	23,668	22,103	42,695	61,907	71,194
Total Current assets	83,310	131,130	105,817	145,113	182,358
Current liabilities & provisions					
Current liabilities	79,584	114,334	156,213	210,887	231,976
Provisions	19,291	47,149	44,564	48,129	55,348
Total current liabilities & provision	98,874	161,482	200,776	259,016	287,324
Net current assets	(15,564)	(30,352)	(94,959)	(113,902)	(104,968)
Total Assets	220,862	403,772	573,817	633,497	742,327



Key Ratios

Y/e March	FY06	FY07	FY08	FY09E	FY10E
Return Ratios (%)					
ROCE	—	10.4	11.0	11.4	13.0
ROE	—	18.2	20.8	20.5	19.9
Growth (%)					
Sales	—	34.4	31.8	29.5	32.3
EBITDA	—	125.7	43.3	30.4	29.8
PAT	—	442.6	70.7	20.7	24.1
EPS	—	442.6	60.5	20.7	24.1
Liquidity					
Current Ratio	1.10	0.81	0.53	0.56	0.63
Acid Test Ratio	1.07	0.78	0.51	0.54	0.61
Per Share Ratios (Rs)					
EPS	2.9	15.5	24.8	30.0	37.2
BV	57.4	112.2	133.5	158.4	215.9
CEPS	11.2	27.5	37.7	47.1	58.4
DPS	—	0.5	0.75	1.5	2.0
FCPS	—	(5.3)	(66.3)	(41.8)	(4.1)
Margins (%)					
EBITDA	23.5	39.5	43.0	43.3	42.5
PAT	5.4	21.9	28.3	26.4	24.8
Tax Rate	5.2	1.9	4.9	5.6	9.5
Valuations (x)					
PER	139.4	25.7	16.0	13.3	10.7
P/CEPS	—	14.4	10.5	8.4	6.8
P/BV	6.9	3.5	3.0	2.5	1.8
EV/EBITDA	33.8	14.6	12.2	10.1	7.6
EV/Sales	7.9	5.8	5.3	4.4	3.2
Market Cap/Sales	7.5	5.6	4.5	3.5	2.6



Annexure

Subsidiary Accounts

(Rs m)

Particulars	Country	Extent of Holding interest (%)	Capital	Reserves	Total Assets	Total Liabilities	Investment	Total Income	Profit / (Loss) before taxation	Provision for taxation	Profit / (Loss) after taxation
Reliance Communications Infrastructure Limited	India	100	2,000.2	20,453.6	148,128.4	148,128.4	67,072.4	36,227.0	7,444.9	1,232.2	6,212.7
Reliance Infratel Limited	India	79.7	3,990.2	47,116.7	137,040.7	137,040.7	13,516.8	14,576.1	4,212.6	1,006.8	3,205.8
Reliance Webstore Limited	India	100	0.5	5.9	12,499.8	12,499.8	7,060.4	4,694.9	10.4	8.6	1.8
Reliance Infocomm Infrastructure Private Limited	India	100	50.0	8,162.0	21,336.5	21,336.5	6,431.4	1,067.0	3.7	1.0	2.7
Reliance Telecom Limited	India	100	800.0	3,189.9	32,334.7	32,334.7	-	13,619.5	438.4	(29.8)	468.2
Reliance Big TV Limited	India	100	100.0	10.9	1,268.8	1,268.8	-	-	(18.2)	(5.3)	(12.9)
Reliance FLAG Telecom Ireland Limited	Ireland	80	-	(3,994.4)	6,053.2	6,053.2	-	3,581.6	309.4	2.0	307.5
Reliance FLAG Atlantic France SAS	France	80	1.5	(5,950.5)	3,033.3	3,033.3	-	1,509.9	257.6	26.9	230.7
FLAG Telecom Group Services Limited	Bermuda	80	0.5	(1,258.7)	12,970.6	12,970.6	1,654.4	82.0	41.6	-	41.6
Yipes Holdings Inc.	USA	80	11,211.8	5,632.6	5,573.3	5,573.3	-	0.9	0.9	-	0.9
Reliance Globalcom Services Inc (formerly known as Yipes Enterprise Services Inc)	USA	80	173.9	(5,801.6)	7,937.6	7,937.6	71.5	864.7	(169.6)	0.3	(169.9)

Source: Annual Report, PI Research



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PL's Recommendation Nomenclature

BUY	: > 15% Outperformance to BSE Sensex	Outperformer (OP)	: 5 to 15% Outperformance to Sensex
Market Performer (MP)	: -5 to 5% of Sensex Movement	Underperformer (UP)	: -5 to -15% of Underperformance to Sensex
Sell	: <-15% Relative to Sensex		
Not Rated (NR)	: No specific call on the stock	Under Review (UR)	: Rating likely to change shortly

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