

**June 16, 2010**

<b>Recommendation</b>	<b>Not rated</b>
<b>CMP</b>	<b>187</b>
<b>Target</b>	<b>Not rated</b>
<b>Stock Return</b>	<b>NA</b>

Nifty	5,222
Sensex	17,413

**Key Stock Data**

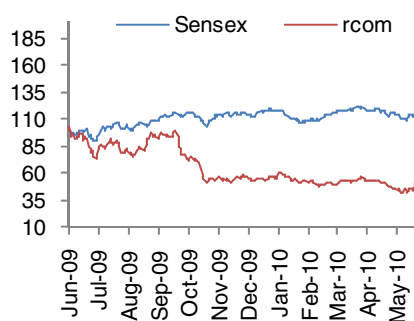
Sector	Telecom
Reuters Code	RLCM.BO
BLOOMBERG Code	RCOM IN
No. of Shares (mn)	2,064
Market Cap (Rs bn)	386
Market Cap (\$ mn)	8,280
Avg 6month vol. ('000)	6,325

**Stock Performance (%)**

52 - Week high / low	Rs 335 /132		
	<b>3M</b>	<b>6M</b>	<b>12M</b>
Absolute (%)	16.4	6.7	(43.1)
Relative (%)	16.2	3.8	(59.5)

**Shareholding Pattern (%)**

Promoters	67.6
FIs & Local MFs	9.8
FIIIs	7.7
Public & Others	14.9
Source : Company, BSE	100.0

**Sensex and Stock Movement**

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Rcom is in the process of restructuring its subsidiary Reliance Infratel as an independent tower company by inducting strategic and financial partners. Media reports say GTL Infrastructure (GTL) is a frontrunner. Deal with GTL could be similar to WTTIL –Quippo tower merger. This merger of the tower portfolio with GTL into a new independent tower company could reduce Rcom's debt burden by Rs100-150bn, pull down net debt/Equity and net debt/EBITDA to 0.8x and 2.9x respectively from 1.6x and 3.4x currently. While the stock price has appreciated by 42% in the past month, de-leveraging of balance sheet on restructuring of tower portfolio and potential equity infusion by dilution of stake in the parent company could keep the stock price moving upwards in the near to medium term. Positive trigger on fundamental issues like financial transparency, execution risk, poor capital productivity and return ratios will remain key long-term drivers for stock price appreciation, in our view.

**GTL Infra – potential candidate for independent tower company**

Rcom's proposed restructuring of Reliance Infratel to create the world's largest independent infrastructure company with the induction of domestic and international strategic and financial partners could include GTL Infra, WTTIL-Quippo, Indus towers, American tower, Reliance Industries, Etisalat DB etc and other financial investors. Media reports say GTL is at the forefront of the potential restructuring to create the new tower company along-with Reliance Infratel. In our view, merger of Rcom's tower portfolio with GTL along-with induction of financial/strategic partners look more probable due to its size (33k towers) and assured tenancy from Aircel. The deal with GTL could be similar to that of WTTIL – Quippo tower merger in Jan'09. Here GTL and Rcom each could hold between 26-49% in GTL Infra or create a newly independent tower company with the other financial/strategic partner holding between 15-30%.

**Restructuring of Infratel – positive on balance sheet, neutral on P&L**

The independent tower company with a portfolio of 80-85k towers of Reliance Infratel and GTL could command enterprise value of Rs500-550bn, in our view. Rcom's 26-49% stake in the independent tower company could be valued at Rs130-250bn against estimated enterprise value of Reliance Infratel at Rs350bn. The restructuring / merger of towers with the independent company, depending upon its holding, would enable Rcom to raise cash / reduce debt between Rs100-150bn. We thus find the deal positive for Rcom helping it to de-leverage its balance sheet. In our view the impact on P&L (excluding proportionate consolidation of independent tower company) would be insignificant, but EBITDA and EBITDA margin could witness a decline. Incremental network operating expenses on payout on tower rentals (Rs16bn) and the opportunity lost on getting revenue from external tenants (Rs6bn) would be offset by a decline in depreciation charge (Rs12bn) and reduced interest outgo (Rs9bn) for Rcom.

**Independent tower company to enhance value for Rcom**

Following the auction of 3G and BWA and consequent entry of new players like Reliance etc the demand for tenancy slots and passive infrastructure will remain robust, pushing up the valuations of all tower companies (Indus towers, WTTIL-Quippo etc). Reliance Infratel could not attract external tenants and failed in raising funds twice through IPOs. An independent tower company would help Rcom to monetize the tower portfolio, de-leverage its debts and focus on the wireless business. A separate management (outside Rcom) will foster independence and neutrality to attract external tenants. Rcom will benefit from the predicted high growth of passive infrastructure industry due to its strategic stake in it.

**Institutional Research**
**Table 1: Potential deal structure with GTL Infra**

Parties	Towers	Enterprise Value/tower	Enterprise Value	% holding in independent tower company
Rcom/R Infratel	48,139	7.0	336,973	
GTL Infra	32,500	5.0	162,500	
<b>Combined</b>	<b>80,639</b>	<b>6.2</b>	<b>499,473</b>	
Rcom's share in tower co @ 40%			199,789	40%
<b>Balance to be receivable by Rcom as cash or transfer of debt from Rcom to tower co</b>			<b>137,184</b>	
GTL Infra's stake (in proportion to assets transferred)			162,500	33%
Financial partner's stake / cash infusion			137,184	27%

Source: Company data, HDFC Securities Institutional Research

**Note:** Tower valuation assumed higher for Rcom due to higher incumbent tenancy. Tower valuation for Rcom could also vary depending upon whether OFC (Optical Fibre Cable) network of 190,000 KMs forms part of the transaction or not

Reduction in EBITDA from rental payouts and revenue foregone on external tenancy to be offset by reduced depreciation and interest charge

**Table 2: FY11 P&L impact on Rcom of stake sale in Reliance Infratel**

EBITDA current	80,315
Revenue/EBITDA from external tenant	6,055
<b>Total EBITDA (Current)</b>	<b>86,370</b>
Loss of revenue/EBITDA from external tenant on sale of towers	6,055
Increase in operating exps	
- Rcom's payout of rental to tower co	27,648
- Savings in monthly operating cost on towers	(11,520)
<b>Decline in EBITDA</b>	<b>(22,183)</b>
<b>Revised EBITDA</b>	<b>64,187</b>
Savings depreciation (Rs150bn@8%)	12,000
Savings in interest on debt (Rs135bn*8%)	10,800
<b>P&amp;L impact</b>	<b>617</b>

Source: HDFC Securities Institutional Research

Balance sheet impact to be positive, P&L impact to be neutral from Infratel restructuring

**Table 3: Balance sheet impact of Rcom**

Rcom 's net debt as of FY10	198,888
Debt for 3G	85,850
Rcom 's net debt post 3G	284,738
Funding from tower co	137,184
Net debt post stake sale in tower co	147,554
Equity (ex revaluation)	189,000
<b>Net debt/Equity (current)</b>	<b>1.51</b>
<b>Net debt/Equity (post transaction)</b>	<b>0.78</b>
EBITDA current	86,370
<b>Net debt/EBITDA (current)</b>	<b>3.3</b>
EBITDA revised	64,187
<b>Net debt/EBITDA (post transaction)</b>	<b>2.9</b>

Source: Company data, HDFC Securities Institutional Research

**Table 4 - Rcom's payout of rental to independent tower co**

No of towers	48,000
Tenancy (GSM + CDMA)	1.60
Tenancy slots (GSM + CDMA)	76,800
Rentals/tenant/month	30,000
<b>- Rcom's payout of rental to tower co</b>	<b>27,648</b>

Source: Company data, HDFC Securities Institutional Research

**Table 5 - Savings in monthly operating cost on transfer of towers**

No of towers	48,000
Operating cost/tower/month	20,000
<b>- Savings in monthly operating cost on towers</b>	<b>11,520</b>

Source: Company data, HDFC Securities Institutional Research

**Table 6: Valuation of Rcom post transfer of towers to independent company**

	Current	Revised1	Revised2
Outstanding shares (mn)	2,064	2,064	2,064
CMP (in Rs)	178	178	178
Market Cap (in Rs mn)	367,392	367,392	367,392
Net debt	284,738	147,554	147,554
<b>Enterprise Value (Enterprise Value)</b>	<b>652,130</b>	<b>514,946</b>	<b>514,946</b>
(-) EV of 40% stake in independent tower co.	-	199,789	
(-) Equity Value of 40% stake in independent tower co. (assuming 50% debt)			99,895
<b>Rcom's standalone business value</b>	<b>652,130</b>	<b>315,157</b>	<b>415,052</b>
Rcom's standalone EBITDA	86,370	64,187	64,187
<b>EV/EBITDA</b>	<b>7.6</b>	<b>4.9</b>	<b>6.5</b>

Source: Company data, HDFC Securities Institutional Research

GBT/RBT mix of towers similar for Rcom and GTL Infra.

However in our view tower portfolio for GTL infra more concentrated in some circles

**Table 7: Tower mix**

	GBT	RTT	Total	GBT/RTT	Tenancy	Tenants
Rcom / Reliance Infratel	36,586	11,553	48,139	76:24	1.60	77,022
GTL Infra	24,050	8,450	32,500	74:26	1.17	38,025

Source: Company data, HDFC Securities Institutional Research

Assets portfolio of Reliance Infratel in addition to passive infrastructure / towers also include OFC (optical fiber cable) of 190,000 KMs

**Table 8: Reliance Infratel - BS summary**

(Rs mn)	FY08	FY09
<b>ASSETS</b>		
Fixed Assets		
Gross Block	88,887	185,607
(-) Acc Depreciation	10,249	38,093
Net Block	78,638	147,514
CWIP	28,165	38,065
Investments	13,517	0
CA, Loans & advances (ex C&CE)	9,777	20,497
C&CE	491	1,538
<b>Total</b>	<b>130,588</b>	<b>207,614</b>
<b>LIABILITIES</b>		
Current Liabilities	19,836	15,633
Unsecured Loans	65,091	151,613
Equity	45,661	40,368
<b>Total</b>	<b>130,588</b>	<b>207,614</b>

Source: Company data, HDFC Securities Institutional Research

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