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Meeting Update

Reliance Communication

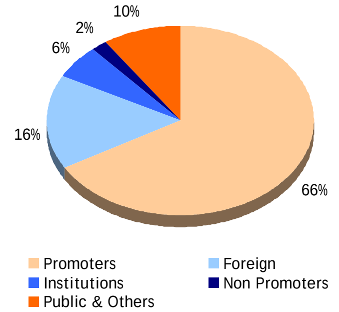
Outperformer | **Rs 420** | **March 30, 2007**

Poised for growth

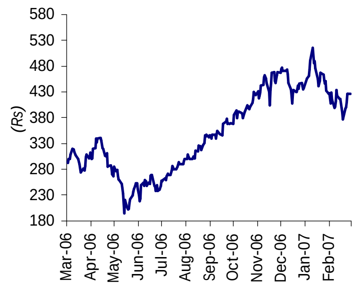
Company Details

Market Cap:	Rs 856,696m
52-Week High/Low:	Rs 518/186
Bloomberg Code:	RCOM@IN
Reuters Code:	RLCM.BO / NS
Shares O/s:	2,045m
Average Volume (3 months):	9.0m

Share-Holding Pattern



Price Chart



Price Performance

(%)	1m	3m	12m
Absolute	(1.4)	(10.2)	44.5
Relative to Sensex	2.3	(4.9)	26.0

(Stock price as on March 30, 2007)

We recently met the senior management of Reliance Communications. With accelerated capex plans for its CDMA and GSM networks (the present circles) and wider geographical coverage, it was confident of reviving the growth rate in net additions. The company is striving to maintain a 21-22% market share of incremental net additions in the next 12 months.

With aggressive capex plans for passive infrastructure ($1bn-1.2bn) in the next 12 months, the company is preparing to shift to the GSM platform, depending upon spectrum availability, while simultaneously trying to enhance stakeholder value through third-party leasing of towers from its newly hived-off Tower division of the business.

Value would further be unlocked through the overseas listing of FLAG Telecom, although the timing would hinge upon key outcomes of pre-sale agreements regarding N-G-N (next-generation network) capacity.

Going forward, we expect a 33% CAGR in revenue, following a 45% rise in the number of subscribers, and 34% and 40% CAGRs in EBITDA and PAT respectively. At the CMP of Rs 420, the stock trades at a P/E of 21x FY08E earnings and at an EV/EBIDTA of 12.4x, based on the fully diluted equity. The stock appears more attractive on a sum-of-parts valuation, as 13-15% of the present valuation is embedded in the Tower and Global parts of the business (listing of FLAG Telecom).

Key Figures

Y/e March	FY06	FY07	FY08E	FY09E
Revenue (Rs m)	107,664	145,259	196,558	256,924
EBITDA (Rs m)	25,353	56,895	78,842	102,416
Margins (%)	*23.5*	*39.2*	*40.8*	*39.9*
PAT (Rs m)	5,831	30,321	43,167	59,235
EPS (Rs)	2.9	14.1	20.0	27.4
PER (x)	147.3	29.9	21.0	15.3
EV / E (x)	36.4	16.3	12.4	9.7
EV / Sales (x)	8.6	6.4	5.0	3.9
RoCE (%)	*4.4*	*13.6*	*16.6*	*21.8*
RoE (%)	*5.0*	*18.5*	*18.6*	*21.1*

Business Overview

Subscriber growth to pick up momentum

- Aggressive subscriber acquisition by major operators has led to the explosive growth in wireless subscribers in India. The company is in sync with the growth targets of the Telecom Ministry/ TRAI of 500m subscribers by 2010 (from the present 159m). It aims to maintain its 20% market share.
- Although the company plans to adopt the GSM platform as a long-term growth driver for its business depending on available spectrum, yet, not to miss any market opportunity, RComm has again begun investing in expanding the CDMA network and in widening population coverage. Against H1 FY07 investment of $500m, it will invest almost $900m in the wireless network in H2 FY07, primarily in CDMA and GSM in its present eight circles.
- The bad patch of February 2007 (1m subscribers added, compared to an average 1.35m per month in the past three months) could continue in March and maybe in April (partly because of the re-verification exercise). From May, though, the company expects to pick up momentum and maintain it at 1.3m to 1.4m net monthly subscribers added.

GSM -future plans

- The company plans to incur a capex of $450m in GSM, increasing coverage and capacity three-fold. This would result in an additional 6m subscribers in the eight circles of the North-Eastern states and Central India. By March 2008, in terms of net additions the company expects to be on par with BSNL and Bharti in its present GSM circles.
- The other GSM expansion plans hinge on spectrum availability and allocation, which has been undecided for the past year. Rcomm has applied for spectrum in Feb.'06 and Jun.'06. Due to limited spectrum available, allocation (whenever it happens) might be decided on a "first-come first-served basis" but even that criterion has not been substantiated by anyone. The company expects a release of 20 MHz of spectrum by July 2007 in some parts of some circles.
- Overall, depending on spectrum allocation, in the next three or four years, it expects GSM to be the main driver of subscriber growth and dominate the field, with 60% of its overall subscriber base in 2010.

GSM expansion; no impact on margins or competitiveness

- The company claims to have the lowest operating-expense (opex) per subscriber, opex per minute and expects to maintain competitiveness regardless of investing in two technology platforms. It claims that the incremental opex in running both the platforms would not be substantial ($12m-15m pa) as it would primarily entail higher fuel and power cost. Moreover, it has received attractive terms from equipment suppliers for its large GSM tender for its present expansion.

Passive Infrastructure, unlocking value

The hiving off of its towers business to Reliance Telecom Infrastructure has been approved by the High Court. Now with an arms-length relationship with the parent, the company plans to unlock value for all its stakeholders through third-party rentals. With 20,000 new towers planned (capex $1bn-1.2bn) as part of its widening coverage for its CDMA and expanding its GSM network, it would turn into a formidable player with 32,000 towers by end-FY08, next only to Bharti. As a first step RTIL is expected to raise the resources based on its own balance sheet strength. The parent plans to raise the money for expansion by divesting some (20-24%) of its holdings in the next two or three months.

The new towers will be specifically designed for the electronics of three or four operators and, as a head-start over other players, it would have two anchor tenants in the form of GSM and CDMA services of Rcomm. All in all, it would have roughly 100,000 slots for operators (32,000 towers with three or four slots each) of which Rcom is expected to use 45,000 slots for self-use. The others are geared towards operators such as Idea, Tata Teleservices, Spice & Aircel, which have announced expansion plans. The tenant charges are expected to be 10% of capex per site for the anchor tenant, while the subsequent tenant would come at a discounted rate. ***Based on the discounted cash flow assuming increased utilisation, we arrive at an equity value of around $1bn or Rs 18-19/share for RComm.***

FLAG, unlocking value through overseas listing

After acquiring FLAG Telecom in 2003, the company has rapidly expanded with the help of the Falcon network, which connects 12 countries in the Middle East, East Africa and the Mediterranean to the rest of the world through the FLAG Global Network. Now it plans further capex of $1.5bn for the N-G-N (next generation network) over the next three years covering Asia, Africa, the Mediterranean and the Trans-Pacific markets. This project would make the company the largest fully undersea cable-system operator, reaching 80% of the world's population and would cater to the 50 largest telecom markets (from 30 at present).

The funding of the project is expected to be done by FLAG itself through the pre-sale agreements of capacity, through IPO and debt. The company expects data and storage needs would be growth drivers. With tonnes of data transfer expected in entertainment content such as Music and Movies, the company expects a booming opportunity. It ***plans to list in overseas markets diluting roughly a 24% stake. While it is very early to arrive at valuations, we expect it to report $110m-120m EBITDA in CY07. Further surprises could come in the form of some aggressive pre-sale agreements of NGN capacity.***

Broadband

- The Enterprise market is $1bn and the Wireless market is $15bn, both growing at roughly 30%.
- RComm has a 50% market share in Internet Data Centre, 56% in Virtual Private Networks and 57% in Centrex Solutions.
- Broadband would help improve margins.

Dish TV and IPTV

IPTV depends on two factors, network rollout and the software to support that service. RComm has the network in place but locking onto the software is taking some time. It is in the process of test trials and not expecting the IPTV roll-out by this calendar year.

In the meanwhile, the company has received a license for its DTH operations and has hired the CEO of Dish TV to roll out operations (in FY08). The wiring cost of buildings for DTH is quite low. The company has 500,000 buildings already wired and expects at least three subscribers per building, with an ARPU of roughly $7 to $10 for its DTH services.

Capex Plans

RComm plans to invest $2.5bn in FY08; of this, $400m would be in GSM networks, $1.2bn in infrastructure and the rest in CDMA. The Q4 FY07 capex has picked up to almost $600m (compared to the $400m in the previous quarter) due to the step-up in CDMA investments. Current D/E is only 0.2x

Financial Overview and Valuation

For 9M FY07, the company reported revenue of Rs 105bn and EBIDTA of Rs 40.9bn, yoy growths of 35% and 179% respectively, primarily due to the 2,000-bp improved operating margin at 38.8%.

Ahead, we expect a 33% CAGR in revenue, following a 45% rise in number of subscribers, and 34% and 40% CAGRs in EBITDA and PAT respectively.

At the CMP of Rs 420, the stock trades at a P/E of 21x FY08E earnings and at an EV/EBIDTA of 12.4x, based on fully diluted equity. The stock appears less expensive on a sum-of-parts valuation, with almost 13-15% of the present valuation embedded in its Towers and Global aspects (listing of FLAG Telecom).

Peer Comparison *(Rs m)*

9M FY07	Bharti	RComm
Revenue		
Wireless	99,011	77,584
YoY Growth (%)	*69.9*	*47.9*
Others	47,680	49,900
YoY Growth (%)	*43.7*	*14.3*
EBIDTA Margin (%)		
Wireless	*37.0*	*36.5*
Others	*35.5*	*26.9*
Number of Subscribers *(m)*	31,9	29,9
Incremental Market Share (%)	*23.6*	*20.8*
FY08E		
PER (x)	25.2	21.0
EV / EBIDTA (x)	14.4	12.4
RoE (%)	*40.3*	*18.6*
RoCE (%)	*26.1*	*16.6*

Income Statement

(Rs m)

Y/e March	FY06	FY07E	FY08E	FY09E
Net Revenue	**107,664**	**145,259**	**196,558**	**256,924**
Expenditure				
Access Charges & License Fees	40,404	37,871	51,245	66,983
Network Operations Cost	15,346	17,107	21,384	26,730
Employee Cost	8,394	9,025	10,378	11,935
SG&A Expenses	18,167	24,361	34,708	48,860
Total Operational Expenses	82,311	88,364	117,715	154,508
EBITDA	**25,353**	**56,895**	**78,842**	**102,416**
EBITDA Margin (%)	*23.5*	*39.2*	*40.1*	*39.9*
Other Income	1,391	1,400	2,100	2,415
Net Interest	3,215	1,498	1,750	1,925
Depreciation & Amortisation	16,987	25,452	30,327	35,852
EBIT	**9,757**	**32,843**	**50,615**	**68,978**
PBT	**6,542**	**31,345**	**48,865**	**67,053**
Exceptional & Non-Recurring Items	374	380	-	-
Tax	337	644	5,698	7,818
Effective Tax Rate (%)	*5.2*	*2.1*	*11.7*	*11.7*
PAT	**5,831**	**30,321**	**43,167**	**59,235**

Balance Sheet

(Rs m)

Y/e March	FY06	FY07E	FY08E	FY09E
Liabilities				
Share Capital	10,223	10,223	10,223	10,223
Reserves and Surplus	107,196	200,140	242,875	296,187
Total Shareholder's fund	117,419	210,363	253,098	306,410
Minority Interest	96	124	159	194
Total Loan funds	103,332	158,283	193,283	203,283
Total Liabilities	**220,863**	**368,770**	**446,540**	**509,887**
Assets				
Fixed Assets				
Total Fixed Assets	214,263	357,785	437,458	503,105
Investments	22,163	125	125	125
Cash & Cash equivalents	37,995	136,545	124,224	118,488
Net current assets	(15,564)	10,860	8,958	6,656
Total Assets	**220,862**	**368,770**	**446,540**	**509,887**