

# Reliance Communications

Relative to sector: **Outperformer**

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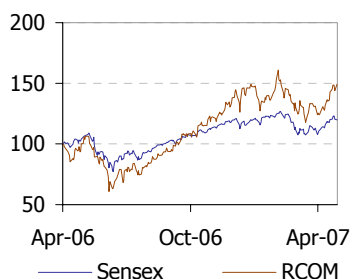
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## Relative Performance



Source: Bloomberg, ENAM Research

## Stock data

No. of shares	: 2,045mn
Market cap	: Rs 976bn
52 week high/low	: Rs 518/ Rs 186
Avg. daily vol. (6mth)	: 8.0mn shares
Bloomberg code	: RCOM IN
Reuters code	: RLCM.BO

## Shareholding (%) Mar-07 QoQ chg

Promoters	: 66.8	0.0
FII's	: 13.0	(0.0)
MFs / UTI	: 2.3	0.2
Banks / FIs	: 4.2	0.4
Others	: 13.7	(0.5)

## STRATEGIC MOVES

Reliance Communications (RCOM's) topline and PAT for Q4FY07 has been lower than our expectations although margins have staged an uptrend (OPM – 41.5%, QoQ ↑ of 87bps). The wireless business with ~8% QoQ revenue growth was impacted because of deactivation of ~5.9mn subscribers and a decline in roaming tariffs. The performance of the global business segment would have been better but for lower QoQ growth in long distance traffic (~3% QoQ). Key to the result announcement was the continued thrust on unlocking value in crucial business segments (FLAG, Tower business expected within 6 months) and the direction of its GSM strategy.

**Value Unlocking:** Value unlocking in FLAG and the Tower Business (through Reliance Telecom Infrastructure Ltd, RTIL) is expected over the next 2-3 quarters (~6 months). The tower business currently has ~13000 towers with approximate gross block of Rs 30bn. FY08 is likely to see an additional 20000 towers being developed.

**FY08, the year in perspective:** FY08 remains an instrumental year for RCOM. Apart from the expected unlocking of value in FLAG and the Tower business, the GSM strategy will be implemented through a USD 1bn capex, out of total capex of USD 2.5bn planned for its existing businesses (this excludes the USD 1.5bn proposed for FLAG's NGN network over the next 3 years). FY08 would result in RCOM covering ~85% of India's population from this outlay. Spectrum availability is critical to RCOM's GSM roll-out plans. The management has indicated a 1-year timeframe for the national roll-out of its GSM strategy post spectrum availability. Thus in the interim phase, GSM subscriber additions are likely to be impacted.

**Valuations:** At CMP (Rs 477), the stock trades at 23.1x FY08E EPS and 13.3x FY08E EV/EBITDA. Our target price based on EV/EBITDA multiples for various business units (with wireless business at 20% discount to Bharti's target EV/EBITDA target for wireless business). With 13% price upside, we are retaining our sector **Outperformer** rating on the stock. A key risk to our price target would be a faster roll-out of its GSM operations.

## Financial summary

Y/E Mar	Sales (Rs mn)	PAT (Rs mn)	Cons. EPS* (Rs.)	EPS (Rs.)	Change YoY (%)	P/E (x)	RoE (%)	RoCE (%)	EV/EBIDTA (x)
2006	106,273	4,439	-	2.4	-	-	8.2	7.9	-
2007	142,625	31,632	-	15.6	563.4	26.9	19.9	11.4	15.9
2008E	197,479	42,171	21.8	20.6	32.1	23.1	18.7	12.7	13.3
2009E	253,212	55,851	29.2	27.3	32.4	17.5	20.4	15.7	10.4

Source: \*Consensus broker estimates, Company, ENAM estimates

## Results update

(Rs mn)	Quarter ended					12 months ended*		
	Mar-07	Mar-06	% Chg	Dec-06	% Chg	Mar-08E	Mar-07	% Chg
<b>Net Sales</b>	<b>39,369</b>	<b>29,910</b>	<b>31.6</b>	<b>37,553</b>	<b>4.8</b>	<b>197,479</b>	<b>142,625</b>	<b>38.5</b>
<b>EBIDTA</b>	<b>16,352</b>	<b>10,476</b>	<b>56.1</b>	<b>15,272</b>	<b>7.1</b>	<b>80,868</b>	<b>55,147</b>	<b>46.6</b>
PBIDT	16,352	10,476	56.1	15,272	7.1	83,857	57,205	46.6
Depreciation	6,378	5,457	16.9	6,524	(2.3)	35,884	24,653	45.6
Interest	(392)	479	(181.7)	(657)	(40.4)	413	3	-
<b>PBT</b>	<b>10,366</b>	<b>4,540</b>	<b>128.3</b>	<b>9,404</b>	<b>10.2</b>	<b>47,560</b>	<b>32,549</b>	<b>46.1</b>
Tax	149	137	9.1	130	14.8	5,389	615	775.8
<b>Adjusted PAT</b>	<b>10,217</b>	<b>4,403</b>	<b>132.0</b>	<b>9,274</b>	<b>10.2</b>	<b>42,171</b>	<b>31,934</b>	<b>32.1</b>
Extra ordinary income/ (exp.)	29	(374)	-	(30)	-	-	(302)	-
<b>Reported PAT</b>	<b>10,245</b>	<b>4,029</b>	<b>154.3</b>	<b>9,244</b>	<b>10.8</b>	<b>42,171</b>	<b>31,632</b>	<b>33.3</b>
No. of shares (mn)	2,045	2,045	-	2,045	-	2,045	2,045	-
EBIDTA margins (%)	41.5	35.0	-	40.7	-	41.0	38.7	-
PBIDT margins (%)	41.5	35.0	-	40.7	-	42.5	40.1	-
<b>EPS - annualized (Rs.)</b>	<b>20.0</b>	<b>8.6</b>	<b>-</b>	<b>18.1</b>	<b>-</b>	<b>20.6</b>	<b>15.6</b>	<b>-</b>

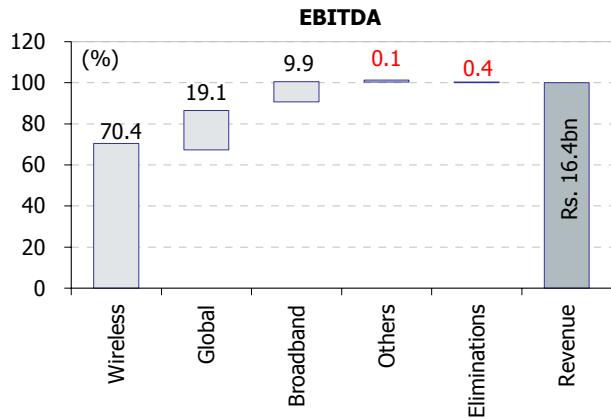
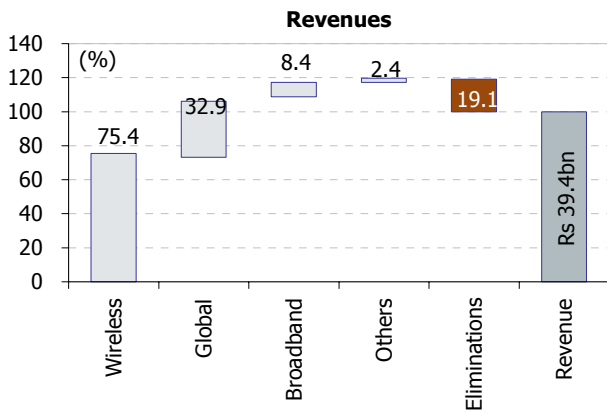
Source: Company, ENAM Research;

## RCOM: Trend in costs

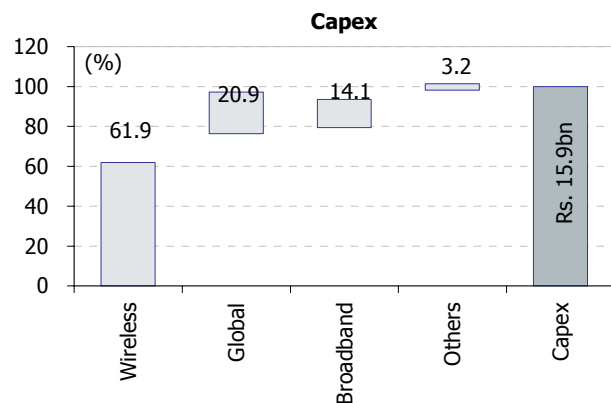
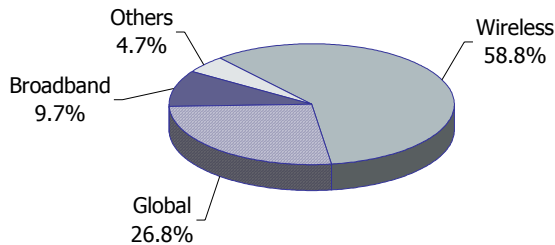
(Rs mn)	Mar-06	Jun-06	Sep-06	Dec-06	Mar-07
<b>Revenue from Operations</b>	<b>29,704</b>	<b>32,501</b>	<b>35,260</b>	<b>37,553</b>	<b>39,369</b>
License, Access and IUC	10,291	9,286	9,068	9,491	9,978
<i>% of sales</i>	<i>34.6%</i>	<i>28.6%</i>	<i>25.7%</i>	<i>25.3%</i>	<i>25.2%</i>
Network Operations Cost	3,349	3,816	4,332	4,165	4,423
<i>% of sales</i>	<i>11.3%</i>	<i>11.7%</i>	<i>12.3%</i>	<i>11.1%</i>	<i>11.2%</i>
Employee Cost	1,824	2,157	2,271	2,200	2,451
<i>% of sales</i>	<i>6.1%</i>	<i>6.6%</i>	<i>6.4%</i>	<i>5.9%</i>	<i>6.2%</i>
Selling and General Cost	3,764	5,180	6,063	6,426	6,166
<i>% of sales</i>	<i>12.7%</i>	<i>15.9%</i>	<i>17.2%</i>	<i>17.1%</i>	<i>15.7%</i>
Total Cost	19,228	20,439	21,734	22,281	23,017
<i>% of sales</i>	<i>64.7%</i>	<i>62.9%</i>	<i>61.6%</i>	<i>59.3%</i>	<i>58.5%</i>
EBIDTA	10,476	12,062	13,525	15,272	16,352
<b>OPM</b>	<b>35.3%</b>	<b>37.1%</b>	<b>38.4%</b>	<b>40.7%</b>	<b>41.5%</b>

Source: ENAM Research

**R-COM Consolidated: Financials & Capex**



**Investments to Date: Rs. 327 bn**

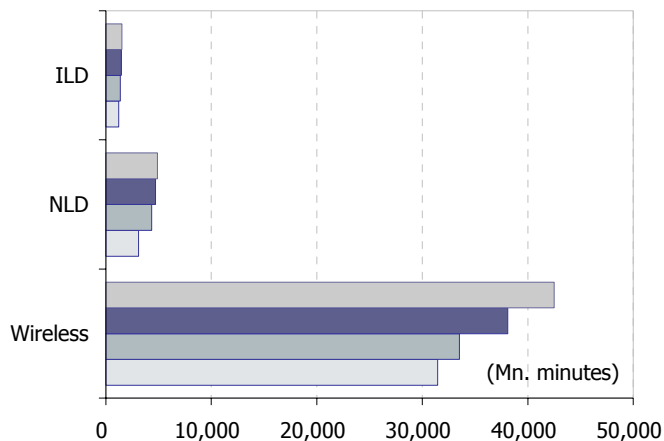


Source: Company, ENAM Research; Note: All percentages adjusted for eliminations

**Financials**

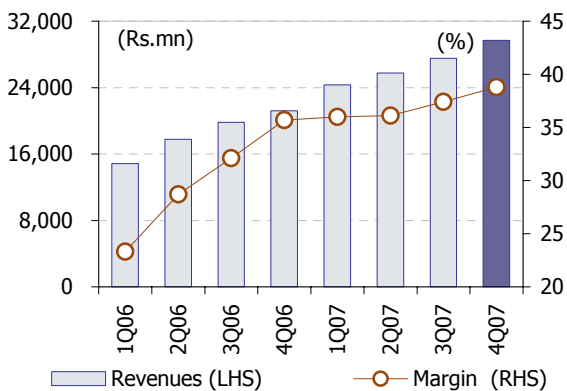
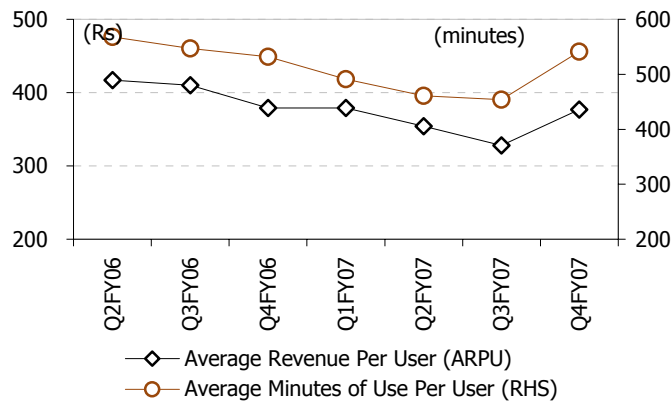
- Revenues (Rs 39.4bn) with 4.8% QoQ, lower than our expectations. QoQ Topline growth impacted by de-activation of 5.58mn wireless subscriber base (for adherence to pre-paid verification norms) and lower traffic growth (just 3% QoQ) in the long distance segment.
- Lower SG&A and better ARPUs in the wireless segment improved EBITDA by 7.1% QoQ to Rs 16.4bn.
- Lower depreciation also aided PAT growth. PAT (before extraordinary items) grew at 10.9% QoQ, nonetheless lower than our expectations.

**RCOM Consolidated: Usage Trends**



Source: Company, ENAM Research

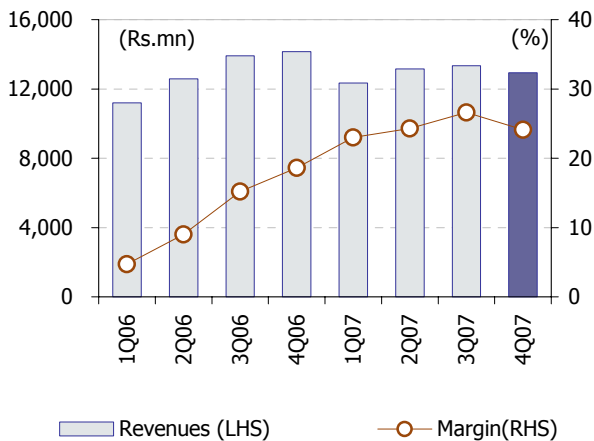
**Wireless Business**



- Revenues at Rs. 29.7bn, QoQ growth of 7.9%
- Net additions were a negative 1.97mn excluding the 5.58mn subscribers deactivated due to the re-verification.
- Wireless EBITDA margin expanded 140bps QoQ, led by growth in total traffic and increase in ARPU.
- 11.6% QoQ growth in traffic minutes and increase in net ARPU (~14.9% QoQ, due to deactivation of low-ARPU subscribers) led to a higher QoQ growth of 11.8% in operating profit.

Source: Company, Industry, ENAM Research

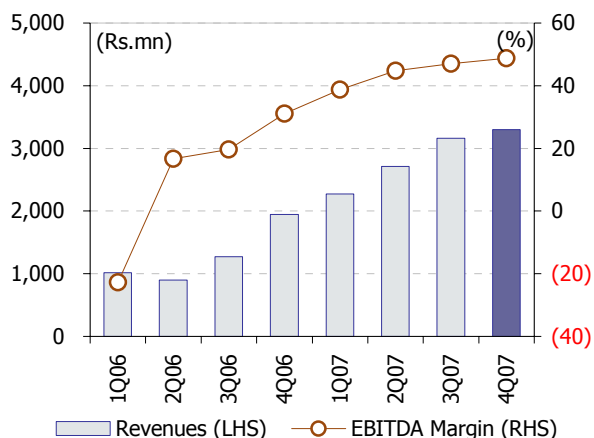
**Global**



- Price declines combined with slower growth in traffic minutes led to a de-growth in revenues:
  - Topline declined by 3% QoQ (v/s a subdued 1.4% growth in Q307)
  - NLD traffic grew 3.4% QoQ to 4.87bn mins
  - ILD traffic recorded 2.1% QoQ to 1.503bn mins
- FLAG's global reach increased by 12 countries to cover a total of 40 countries on the network.
- EBITDA margin dipped by 250bps QoQ to 24.1%.

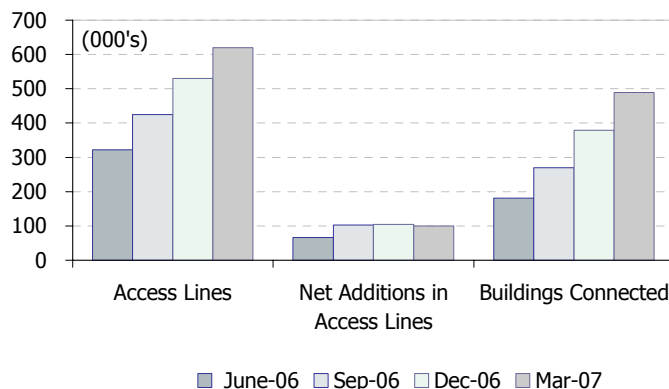
Source: Company, ENAM Research

**Broadband**



- Revenues (Rs 3.3bn) grew by only 4.4% QoQ, despite a 17.8% increase in access lines due to the continued reduction in tariffs.
- QoQ decline in ARPUs for Q407 was 12.4% on a already 8.8% QoQ decline recorded in Q3FY07
- A 180 bps improvement in EBITDA margin to 48.8% marginally offset the effect of lower ARPUs.
- The growth in the number of buildings connected on the broadband network was slower at ~29% vs. ~41 in Q307. The total number of buildings connected stood at 488661.

**Broadband: Operational Parameters**



Source: Company, Industry, ENAM Research

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