

# Reliance Communications

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## Tower, FLAG on top

We maintain BUY rating on Reliance Communications (RCOM) with a revised target price of Rs610 (vs. Rs630 earlier) despite ~3-5% revenue and EBITDA downgrade post lower-than-expected operating performance in Q4FY07. The company expects to unlock value by listing/stake sale in FLAG and Tower Co. within the next six months. This announcement takes away the timing uncertainty and hence we no longer incorporate any discount in incremental valuation of Tower co. (we add Rs71/sh in SOTP based on DCF vs. Rs59/sh earlier). We continue to incorporate Rs22/sh (EV of ~US\$1bn) for value unlocking from FLAG. DCF value of core business now stands at Rs516/sh (vs. Rs547 earlier) post our ~3-5% downgrade. Stock performance will be likely driven by expectations/extent of value unlocking in FLAG and Tower Co. as they remain "top-of-the-mind" issues.

**Operating performance below expectations:** QoQ revenue growth of 5% and EBITDA growth of 7% was ~4% below our estimates. Net profit grew at 10% QoQ (above estimates) mainly due to higher finance income & lower tax rate and depreciation.

**Capex of US\$2.5bn except Tower Co., US\$1bn likely for GSM overlay:** RCOM has maintained the capex guidance of US\$2.5bn for FY08E but this excludes the capex that would be incurred on ~20,000 towers to be added this year. Tower Co. is expected to leverage its own balance sheet for this capex. ~US\$1bn could be spent on the GSM network in balance 15 circles. The GSM network will have ~60% population coverage (Same as Bharti's current coverage). Overall (GSM+CDMA) population coverage targeted at ~85%.

**Cutting estimates but maintain buy on 28% upside:** Despite a ~3-5% cut in our revenue and EBITDA estimates, RCOM remains our top sector pick based on attractive valuations and value-unlocking potential. Maintain Buy with a one-yr price target of Rs610.

Maintain BUY / Rs 477  
Target Rs 610 (+28%)

### Sector (Relative to market)

OW	N	UW

### Stock (Relative to market)

B	OP	N	UP	S
> 10%	5% to 10%	5% to -5%	-5% to -10%	< -10%

*This note should be read for*

- Q4 Results analysis
- Target price and estimates change

Bloomberg code : RCOM IN  
Reuters code : RLCM.BO  
[www.rcovl.com](http://www.rcovl.com)

BSE Sensex : 13872  
NSE Nifty : 4088

### Company data

O/S shares :	2045mn
Market cap (Rs) :	975bn
Market cap (USD) :	23.7bn
52 - wk Hi/Lo (Rs) :	518 / 186
Avg. daily vol. (3mth) :	8.5mn
Face Value (Rs) :	

### Share holding pattern, %

Promoters :	66.8
FII / NRI :	14.6
FI / MF :	6.4
Non Pro. Corp. Holdings :	2.2
Public & Others :	10.0

### Price performance, %

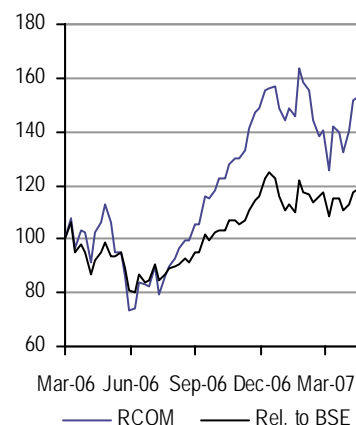
	1mth	3mth	1yr
Abs	13.6	3.5	49.1
Rel to BSE	7.5	5.0	33.9

## Valuation summary

Y/E Mar, Rs mn	FY06	FY07	FY08E	FY09E
Net Sales	107,665	144,684	198,578	264,205
Growth, %	0.0	34.4	37.2	33.0
Core EBITDA	25,352	57,205	85,293	117,994
EBIDTA margin, %	23.5	39.5	43.0	44.7
Net profit	4813	31937	44077	62628
Net Profit margin, %	4.5	22.1	22.2	23.7
EPS, Rs	2.4	15.6	21.6	30.6
EPS Growth, %	na	563.6	38.0	42.1
PER, x	202.7	30.5	22.1	15.6
EV/EBIDTA, x	39.8	17.4	12.2	8.6
EV/Net Sales, x	9.4	6.9	5.2	3.8
Price/Book Value, x	8.3	4.8	3.9	3.3
ROIC, %	6.9	17.7	17.8	20.5
ROE, %	8.2	19.9	19.5	22.9
Dividend Yield, %	0.0	0.0	0.0	1.3

Source: Company, Man Financial Research Estimates

## Price vs Sensex



Source: Bloomberg, Man Financial Research

### Q4FY07 results: Soft revenue growth, but significant margin expansion

(Rs mn)	Q4FY07	Q4FY06	FY2007A	FY2006A
Net sales	39369	29704	144684	107665
<i>Growth Yoy, %</i>	32.5		34.4	
Operating expenses	23017	19207	87479	82313
<b>EBITDA</b>	<b>16352</b>	<b>10498</b>	<b>57205</b>	<b>25352</b>
<i>Growth Yoy, %</i>	55.8		125.6	
<i>Margin, %</i>	41.5	35.3	39.5	23.5
Depreciation	6378	5457	24653	16987
<b>EBIT</b>	<b>9974</b>	<b>5041</b>	<b>32552</b>	<b>8365</b>
<i>Growth Yoy, %</i>	97.9		289.2	
<i>Margin, %</i>	25.3	17.0	22.5	7.8
Net Finance Cost	-391	479	4	3215
Pre-tax profit	10365	4563	32548	5150
Tax provided	148	137	611	337
<b>MAN Net profit</b>	<b>10217</b>	<b>4426</b>	<b>31937</b>	<b>4813</b>
<i>Growth Yoy, %</i>	130.9		563.6	
Extraordinary Gains/(Losses)	27	-374	-303	-374
<b>Reported PAT</b>	<b>10244</b>	<b>4051</b>	<b>31634</b>	<b>4439</b>
Diluted EPS, Rs	5.00	2.16	15.62	2.35
<b>Annualised EPS, Rs</b>	<b>20.0</b>	<b>8.7</b>	<b>15.62</b>	<b>2.35</b>
Basic shares (mn)	2045	2045	2045	2045
Diluted shares (mn)	2045	2045	2045	2045

Source: Company, Man Financial Research

RCOM's Q4FY07 operating performance was below our expectations. QoQ revenue and EBITDA growth remained soft at 5% and 7% respectively.

### Sum-Of-The Parts Valuation for RCOM

#### Reliance Communications: SOTP Valuation

Core Business	DCF	516
Tower Company	DCF	71
FLAG	EV of US\$1bn	22
<b>Total Value</b>		<b>610</b>
CMP		477
<b>% Upside</b>		<b>28%</b>

Source: Man Financial Research Estimates

## Summary of estimates change

	FY07	FY08E	FY09E
<b>Revenue</b>			
Old	145758	209811	272793
New/Actual	144684	198578	264205
% Chng	-1%	-5%	-3%
<b>EBITDA</b>			
Old	57969	90025	121356
New/Actual	57205	85293	117994
% Chng	-1%	-5%	-3%
<b>Net Profit</b>			
Old	30724	44992	65855
New/Actual	31937	44077	62628
% Chng	4%	-2%	-5%
<b>EPS</b>			
Old	15.0	22.0	32.2
New/Actual	15.6	21.6	30.6
% Chng	4%	-2%	-5%

Source: Man Financial Research Estimates

## DCF – Core business

(Rs mn)	FY08E	FY09E	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E	FY16E	FY17E	FY18E	FY19E	FY20E
Revenue	198578	264205	320420	361972	393097	422134	448835	472532	494946	518606	542734	567689	593533
Revenue Growth, %	37	33	21	13	9	7	6	5	5	5	5	5	5
EBITDA	85293	117994	143979	162801	176205	188354	199067	208028	217428	227412	237526	247833	258339
EBITDA Growth, %	49	38	22	13	8	7	6	5	5	5	4	4	4
EBITDA, %	43	45	45	45	45	45	44	44	44	44	44	44	44
Capex	147248	98005	80381	59771	68848	70264	70361	69513	74673	76450	81100	83193	86506
Capex/Sales, %	74	37	25	17	18	17	16	15	15	15	15	15	15
Change in Working Capital	-20407	-24825	-11889	-4887	-14181	-14003	-13965	-16545	-14387	-15153	-15878	-16671	-16252
Tax Outflow	5064	8796	11419	13454	28691	31380	33888	36160	37462	55750	57739	59733	61747
Tax Rate, %	10%	12%	12%	12%	23%	23%	23%	23%	23%	33%	33%	33%	33%
FCF	-46613	36017	64067	94463	92847	100713	108783	118900	119680	110365	114566	121578	126338
FCF Growth, %		na	78	47	-2	8	8	9	1	-8	4	6	4
<b>Terminal Value</b>													<b>2012973</b>
WACC	11.6%												
<b>Mar' 08E</b>													
PV Of FCF		32276	51450	67981	59878	58205	56339	55183	49776	41134	38265	36390	33887
Net Debt	64,851												
PV-Explicit Period	580763												
PV-Terminal Value	539926												
<b>Equity Value</b>	<b>1055839</b>												
<b>Equity Value per Share</b>	<b>516</b>												
<b>Terminal Value Assumptions</b>													
EBITDA Margin, %	42%												
Capex/Sales, %	15%												
Cash Tax Rate, %	33%												
FCF Margin, %	18%												
FCF Growth, %	5%												
FCF Multiple, x	15												
EBITDA Multiple, x	6.5												

Source: Man Financial Research Estimates

## Incremental DCF – Tower Company

	FY08E	FY09E	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E	FY16E	FY17E	FY18E	FY19E	FY20E
Total Towers	32,000	45,179	55,995	62,514	68,256	73,686	78,582	82,795	86,306	89,388	92,549	95,793	99,120
Additional Towers	20,000	13,179	10,816	6,519	5,742	5,430	4,896	4,212	3,511	3,082	3,162	3,244	3,327
Tenants/tower	0.4	0.6	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Total Tenants	12,800	27,108	44,796	50,011	54,605	58,949	62,866	66,236	69,045	71,510	74,040	76,634	79,296
Annual Rental/tower (Rs mn)	0.30	0.31	0.32	0.33	0.34	0.35	0.36	0.37	0.38	0.39	0.40	0.42	0.43
Incr. Revenue (Rs mn)	3,840	8,376	14,257	16,395	18,438	20,501	22,520	24,438	26,239	27,991	29,851	31,824	33,917
Incr. EBITDA Margin, %	70%	75%	80%	85%	85%	85%	85%	85%	85%	85%	85%	85%	85%
Incr. EBITDA (Rs mn)	2,688	6,282	11,406	13,935	15,672	17,426	19,142	20,773	22,303	23,793	25,373	27,050	28,830
Incr. FCF	2,001	4,677	8,492	10,375	11,668	12,974	14,251	15,465	16,605	17,714	18,890	20,139	21,464
Incr. FCF/tower (Rs mn)	0.06	0.10	0.15	0.17	0.17	0.18	0.18	0.19	0.19	0.20	0.20	0.21	0.22
FCF Margin, %	52%	56%	60%	63%	63%	63%	63%	63%	63%	63%	63%	63%	63%
Net Debt (3x EBITDA)	8,064	18,847	34,217	41,806	47,016	52,278	57,425	62,318	66,910	71,378	76,120	81,151	86,489
Interest (@9%)	726	1,696	3,080	3,763	4,231	4,705	5,168	5,609	6,022	6,424	6,851	7,304	7,784
<b>Terminal Value (Rs mn)</b>													<b>274,629</b>
<b>PV Of FCF (Rs mn)</b>	<b>1,802</b>	<b>3,793</b>	<b>6,201</b>	<b>6,822</b>	<b>6,909</b>	<b>6,918</b>	<b>6,842</b>	<b>6,687</b>	<b>6,465</b>	<b>6,210</b>	<b>5,964</b>	<b>5,726</b>	<b>5,495</b>
Current Net Debt (Rs mn)	0												
PV-Explicit Period (Rs mn)	75,832												
PV-Terminal Value (Rs mn)	70,308												
Equity Value (Rs mn)	146,140												
Equity Value (US\$ bn)	3.3												
Equity Value per Share (Rs)	71												
<b>Terminal Value Assumptions</b>													
EBITDA Margin, %	85%												
Cash Tax Rate, %	35%												
FCF Margin, %	63%												
FCF Growth, %	3%												
FCF Multiple, x	13												
EBITDA Multiple, x	10												

Source: Man Financial Research Estimates

### Q4FY07 Results: Muted revenue growth, margins surprise positively

Rs mn	Q4FY06	Q3FY07	Q4FY07	YoY%	QoQ%
<b>Revenue</b>					
Wireless	21200	27520	29692	40	8
Global	14158	13335	12938	-9	-3
Broadband	1948	3161	3299	69	4
Others	440	769	947	115	23
Total Revenue	37746	44785	46876	24	5
Eliminations	-8042	-7232	-7507	-7	4
Consolidated Revenue	29704	37554	39369	33	5
<b>EBITDA</b>					
Wireless	7571	10293	11511	52	12
<i>EBITDA, %</i>	<i>35.7</i>	<i>37.4</i>	<i>38.8</i>	<i>305bps</i>	<i>137bps</i>
Global	2632	3552	3121	19	-12
<i>EBITDA, %</i>	<i>18.6</i>	<i>26.6</i>	<i>24.1</i>	<i>554bps</i>	<i>-251bps</i>
Broadband	606	1486	1611	166	8
<i>EBITDA, %</i>	<i>31.1</i>	<i>47.0</i>	<i>48.8</i>	<i>1772bps</i>	<i>184bps</i>
Total EBITDA	10810	15331	16244	50	6
Eliminations	-313	-61	107	-134	-275
Consolidated EBITDA	10498	15271	16352	56	7
<i>Consolidated EBITDA, %</i>	<i>35.3</i>	<i>40.7</i>	<i>40.7</i>	<i>532bps</i>	<i>0bps</i>
Depreciation	5457	6524	6378	17	-2
Net Interest	479	-657	-391	-182	-40
Profit Before Taxes	4563	9404	10365	127	10
Tax	137	130	148	8	14
<i>Tax Rate</i>	<i>3.0</i>	<i>1.4</i>	<i>1.4</i>	<i>-157bps</i>	<i>4bps</i>
Recurring PAT	4426	9274	10217	131	10
Extraordinary Expenses	374	30	-27	na	-190
Reported PAT	4051	9244	10244	153	11
Recurring EPS	2.16	4.53	5.00	131	10

Source: Company, Man Financial Research

### Revenue Drivers

(Rs mn)	Q4FY06	Q3FY07	Q4FY07	YoY%	QoQ%
<b>Mobile</b>					
Wireless Subs (000s)	20212	29980	28007	39	-7
Wireless ARPU (Rs/month)	379	328	377	-1	15
Total Minutes of Use (bn)	30	38	43	43	12
Minutes of Use/Sub/Month	532	454	541	2	19
Effective Mobile Rev. per Min.(Rs)	0.71	0.72	0.70	-2	-4
<b>Global</b>					
NLD Minutes (mn)	2755	4715	4873	77	3
ILD Minutes (mn)	1188	1472	1503	27	2

Source: Company, Man Financial Research

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**Capex**

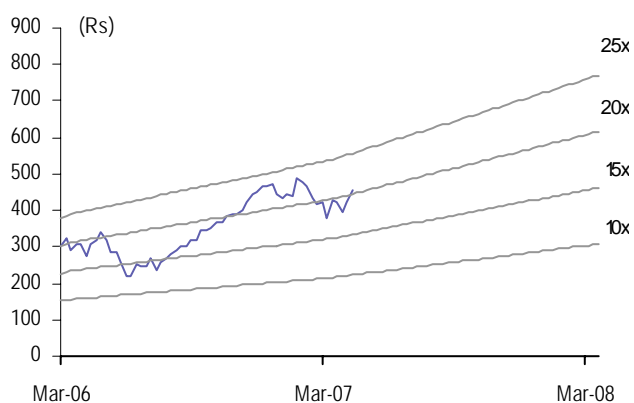

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(Rs mn)	Q3FY07	Q4FY07	QoQ%
Wireless	12090	9860	-18
<i>Capex/Sales, %</i>	<i>43.9</i>	<i>33.2</i>	
Global	490	3330	580
<i>Capex/Sales, %</i>	<i>3.7</i>	<i>25.7</i>	
Broadband	3230	2240	-31
<i>Capex/Sales, %</i>	<i>102.2</i>	<i>67.9</i>	
Other	30	510	
Consolidated Capex	15840	15940	1
<i>Consolidated Capex/Sales, %</i>	<i>42.2</i>	<i>40.5</i>	

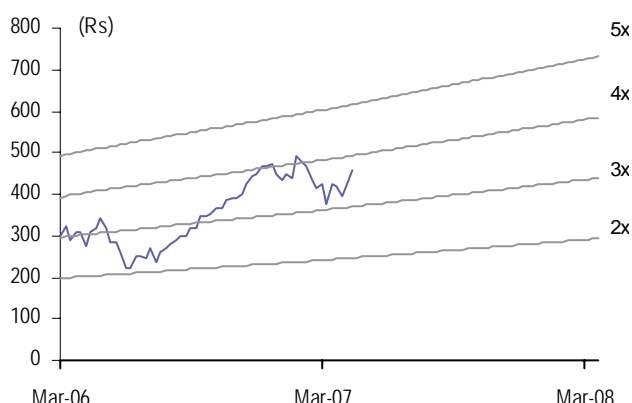
Source: Company, Man Financial Research

# ABSOLUTE ROLLING VALUATION BAND CHARTS

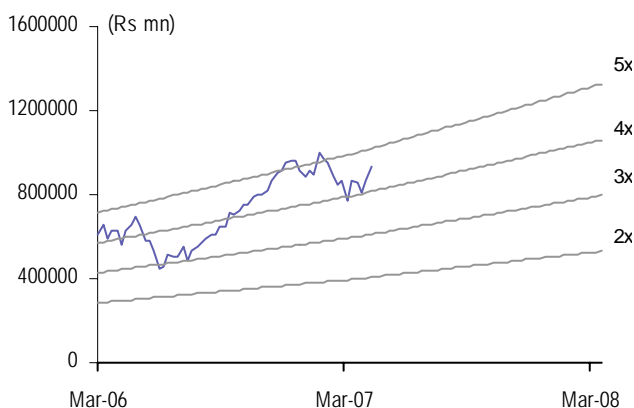
**PE band**



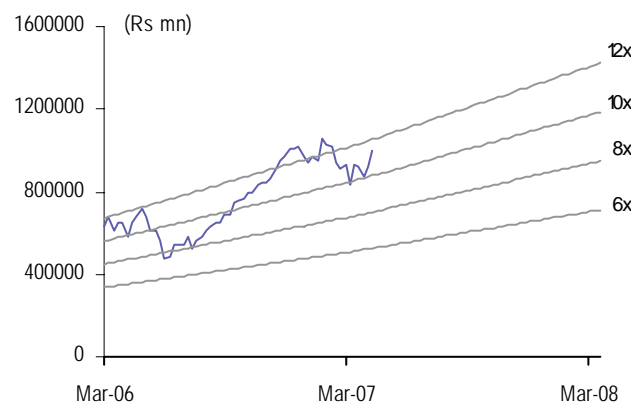
**PBV band**



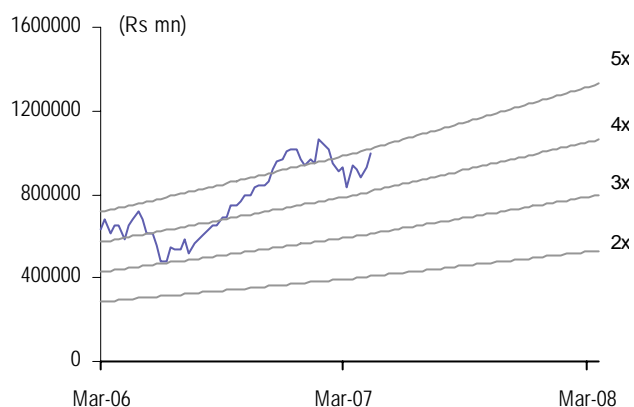
**MCap/Sales band**



**EV/EBIDTA band**



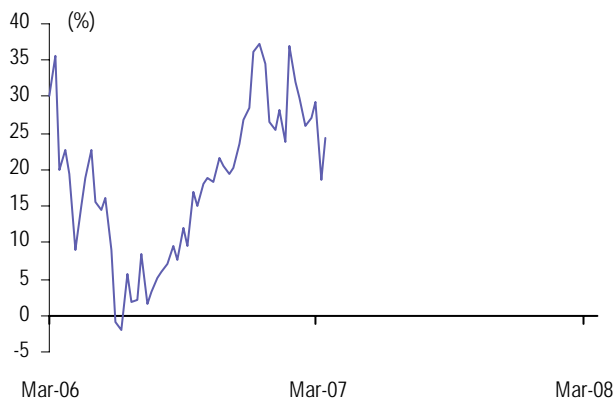
**EV/Sales band**



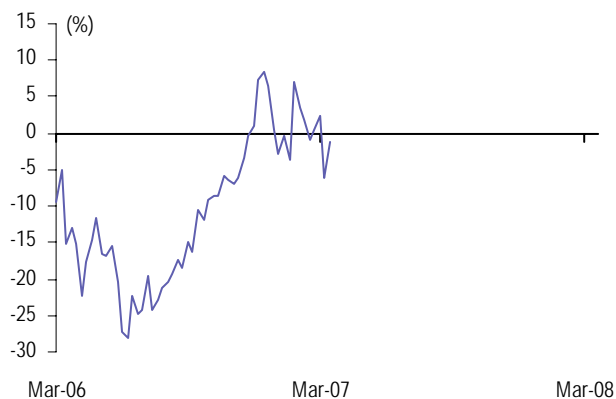
Source: Man Financial Research

# PREMIUM / DISCOUNT TO SENSEX

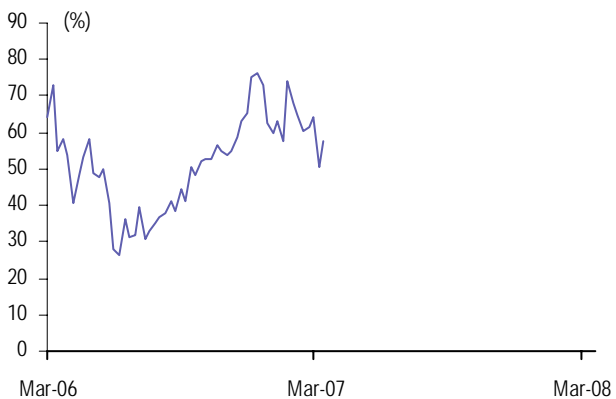
## PE



## PBV

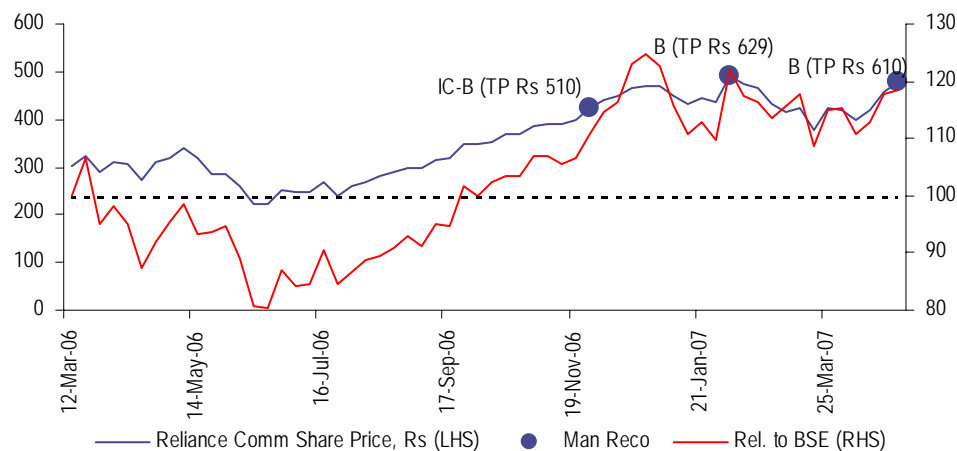


## MCap/Sales



Source: Man Financial Research

## Recommendation performance



IC = Initiating Coverage; DG = Downgrade; UG = Upgrade; TP = Target Price;  
 OP = Outperformer; UP = Underperformer; N = Neutral; S = Sell, B = Buy  
 Source: Bloomberg, Man Financial Research



## FINANCIALS

### Income Statement

Y/E Mar, Rs mn	FY06	FY07	FY08E	FY09E
Net sales	107,665	144,684	198,578	264,205
<i>Growth, %</i>		34.4	37.2	33.0
Operating expenses	-82,313	-87,479	-113,286	-146,211
<b>EBITDA</b>	<b>25,352</b>	<b>57,205</b>	<b>85,293</b>	<b>117,994</b>
<i>Growth, %</i>		125.6	49.1	38.3
<i>Margin, %</i>	23.5	39.5	43.0	44.7
Depreciation	-16,987	-24,653	-34,648	-44,691
<b>EBIT</b>	<b>8,365</b>	<b>32,552</b>	<b>50,645</b>	<b>73,303</b>
<i>Growth, %</i>		289.2	55.6	44.7
<i>Margin, %</i>	8	22.5	25.5	27.7
Net Interest and others	-3,215	-4	-1,670	-2,135
<b>Pre-tax profit</b>	<b>5,150</b>	<b>32,548</b>	<b>48,974</b>	<b>71,168</b>
Tax provided	-337	-611	-4,897	-8,540
Profit after tax	4,813	31,937	44,077	62,628
Minority Interest	0	0	0	0
<b>MAN Net profit</b>	<b>4,813</b>	<b>31,937</b>	<b>44,077</b>	<b>62,628</b>
<i>Growth, %</i>		563.6	38.0	42.1
Extraordinary items: Gains/(Losses)	-374	-303	0	0
Unadj. shares (m)	2,045	2,045	2,045	2,045
Wtd avg shares (m)	2,045	2,045	2,045	2,045

### Cash Flow

Y/E Mar, Rs mn	FY06	FY07	FY08E	FY09E
Pre-tax profit	4,776	32,245	48,974	71,168
Depreciation	16,987	24,653	34,648	44,691
Chg in working capital	63,930	56,193	21,910	26,703
Total tax paid	-337	-611	-4,897	-8,540
Other operating activities	0	-384	0	0
<b>Cash flow from operating activities</b>	<b>85,356</b>	<b>112,096</b>	<b>100,635</b>	<b>134,022</b>
Capital expenditure	-231,249	-77,720	-147,248	-98,005
Chg in investments	-121	-11,804	0	0
<b>Cash flow from investing activities</b>	<b>-231,370</b>	<b>-89,524</b>	<b>-147,248</b>	<b>-98,005</b>
Free cash flow	-146,015	22,571	-46,613	36,017
Equity raised/(repaid)	10,223	-3	0	0
Debt raised/(repaid)	92,976	62,462	23,306	-11,746
Dividend (incl. tax)	0	0	0	-12,526
Other financing activities	0	59	0	0
<b>Cash flow from financing activities</b>	<b>103,199</b>	<b>62,518</b>	<b>23,306</b>	<b>-24,271</b>
Net chg in cash	-42,816	85,089	-23,306	11,746

## Balance Sheet

As at 31st Mar, Rs mn	FY06	FY07E	FY08E	FY09E
Cash & bank	60,038	137,200	113,894	125,639
Marketable securities at cost	0	0	0	0
Debtors	16,808	18,316	25,139	33,446
Inventory	4,076	4,821	6,617	8,804
Loans & advances	23,668	32,662	44,828	59,643
Other current assets	765	3,264	4,480	5,960
Total current assets	105,355	196,263	194,957	233,493
Investments	121	11,925	11,925	11,925
Gross fixed assets	230,531	349,456	496,704	594,709
Less: Depreciation	-47,573	-55,940	-90,588	-135,279
Add: Capital WIP	31,305	36,907	36,907	36,907
Net fixed assets	214,262	330,423	443,023	496,337
Other non-current assets	0	0	0	0
Total assets	319,738	538,611	649,905	741,755
Current liabilities				
Provisions				
Total current liabilities	109,247	179,186	223,097	276,590
Non-current liabilities	92,976	155,497	178,803	167,058
Total liabilities	202,223	334,683	401,900	443,648
Paid-up capital	10,223	10,220	10,220	10,220
Reserves & surplus	107,292	193,708	237,785	287,887
Shareholders' equity	117,515	203,928	248,005	298,107
Total equity & liabilities	319,738	538,611	649,905	741,755

## Per-share data

	FY06	FY07E	FY08E	FY09E
MAN EPS (INR)	2.4	15.6	21.6	30.6
Growth, %	na	563.6	38.0	42.1
Book NAV/share (INR)	57.5	99.7	121.3	145.8
FDEPS (INR)	2.2	15.5	21.6	30.6
CEPS (INR)	10.7	27.7	38.5	52.5
CFPS (INR)	41.7	55.0	49.2	65.5
DPS (INR)	0.0	0.0	0.0	6.1

## Financial structure

	FY06	FY07E	FY08E	FY09E
Total debt/Equity (%)	79.1	76.2	72.1	56.0
Net debt/Equity (%)	28.0	8.9	26.1	13.9

**Profitability, Productivity, Liquidity and Valuation Ratios**

	FY06	FY07E	FY08E	FY09E
Return on assets (%)	4.1	7.4	7.6	9.2
Return on equity (%)	8.2	19.9	19.5	22.9
Return on Invested capital (%)	6.9	17.7	17.8	20.5
RoIC/Cost of capital (x)	0.5	1.4	1.4	1.6
RoIC - Cost of capital (%)	-5.9	4.8	4.9	7.3
Return on capital employed (%)	6.2	11.1	11.5	14.3
Cost of capital (%)	12.8	12.9	12.9	13.2
RoCE - Cost of capital (%)	-6.7	-1.8	-1.5	1.2
Asset turnover (x)	1.0	0.8	0.8	0.8
Sales/Total assets (x)	0.7	0.3	0.3	0.4
Sales/Net FA (x)	1.0	0.5	0.5	0.6
Working capital/Sales (x)	-0.6	-0.8	-0.7	-0.6
Fixed capital/Sales (x)	0.0	0.0	0.0	0.0
Receivable days	57.0	46.2	46.2	46.2
Inventory days	13.8	12.2	12.2	12.2
Payable days	0.0	0.0	0.0	0.0
Current ratio (x)	1.0	1.1	0.9	0.8
Quick ratio (x)	0.9	1.1	0.8	0.8
Interest cover (x)	2.6	7398.2	30.3	34.3
Dividend cover (x)				
PER (x)	202.7	30.5	22.1	15.6
PEG (x) - y-o-y growth	n/a	0.1	0.6	0.4
Price/Book (x)	8.3	4.8	3.9	3.3
Yield (%)	0.0	0.0	0.0	1.3
EV/Net sales (x)	9.4	6.9	5.2	3.8
EV/EBITDA (x)	39.8	17.4	12.2	8.6
EV/EBIT (x)	120.6	30.5	20.5	13.9
EV/NOPLAT (x)	129.7	31.1	22.8	15.8
EV/CE	4.8	2.8	2.4	2.2
EV/IC (x)	8.9	5.5	4.1	3.2

Source: Company, Man Financial Research Estimates

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