

8th February 2008**BUY**

Price	Target Price
Rs646	Rs847

Sensex	17,465
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Price Performance

(%)	1M	3M	6M	12M
Absolute	(21)	(8)	24	32
Rel. to Sensex	(6)	0	6	11

Source: Bloomberg

Stock Details

Sector	Telecom
Reuters	RLCM.BO
Bloomberg	RCOM@IN
Equity Capital (Rs mn)	10320
Face Value (Rs)	5
52 Week H/L (Rs)	844/371
Market Cap (Rs bn)	1333.5
Daily Avg Vol (No of shares)	7140409
Daily Avg Turnover (US\$ mn)	127.4

Shareholding Pattern (%)

(31 st Dec.'07)	
Promoters	66.2
FII/NRI	13.4
Institutions	8.5
Private Corp.	2.3
Public	9.6

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Reliance CommunicationsResult
Update**On an aggressive capex mode**

RCOM reported Q3FY08 results in line with expectations. The net sales for the quarter grew by 6.5% qoq to Rs48.7bn as against our expectation of Rs49.5bn. The EBIDTA grew by 7.4% qoq to Rs21.1bn and the EBIDTA margins expanded by 37bps qoq to 43.2%. The expansion in the EBIDTA margins was primarily on account of decline in the network operating expenses, which declined by 120bps qoq. The PAT grew by 5.2% qoq to Rs13.7bn, higher than our estimate of Rs13.4bn. The PAT growth was higher than our estimate on account of net interest income of Rs1.5bn arising out of forex gains (Rs1.4bn) and income from investments in FMP (Rs2.3bn). During the quarter the company has made an aggressive capex investment of Rs88bn, which includes Rs16.5bn paid for GSM license fees and Rs12bn for the acquisition of Yipes. We have revised our estimates for RCOM factoring the upsides from rollout of GSM services, the equity dilution from FCCB of US\$500mn made in May 2006 and the aggressive capex plans of the company. We continue to maintain BUY recommendation on the stock with a revised price target of Rs847. Our target price is based on DCF value of core telecom services business at Rs776 per share (WACC 12.1%) and DCF value of tower business at Rs71 per share (WACC 10%). At CMP of Rs646 the stock trades at an EV/EBIDTA of 12.4x for FY09E and 9.6x for FY10E.

Key highlights

- The revenues from wireless business grew by 6.3% QoQ to Rs39.6bn. The ARPU and MOU for the quarter declined significantly by 6% and 8% qoq respectively. The RPM for the quarter improved to 0.76, a growth of 2.5% qoq. The company added 4.6mn subscribers during the quarter, a growth of 13% qoq.
- The revenues from the global business once again remained flat at Rs13.6bn as also the volume at 7.5bn minutes, remained flat on qoq basis. The EBIDTA margins from the business improved by 90bps to 25.8%.
- The revenues from broadband business showed a muted growth of 4.4% qoq to Rs4.9bn mainly due to fall in the realization. The ARPL declined by 8% QoQ to Rs1797. However the EBIDTA margins at 48.7% continued to remain strong.
- RCOM has got an approval by the DoT for allotment of start-up spectrum of 4.4MHz in the 14 circles, where the company plans to begin offering the services over the next 12 months.
- Last week the company has received the approval to launch the CDMA services in the two circles of Assam and North East, which would complete the nation wide presence of the company in CDMA services.
- The company management has revised its capex guidance for FY08 to US\$5.2bn. The upward revision is mainly on account of the Rs16.5bn license fee paid for pan India GSM services and Rs12bn paid for acquisition of Yipes.
- The company has announced an aggressive capex plan of US\$6bn for FY09, in which US\$2bn would be spent on rollout of passive infrastructure through Reliance Infratel, US\$1.3bn for GSM active infrastructure rollout and remaining US\$2.7bn on Global, broadband, IPTV and DTH businesses.
- RCOM has formed a new subsidiary Tech Reliance, which would provide IT and technology support services like OSS and BSS. We sense that this subsidiary could be an addition in the list of subsidiaries to be hived-off to create shareholder value, going forward.
- The tower subsidiary Reliance Infratel plans to deploy 36,000 towers by FY08 and 60,000 towers by FY09.

Estimates revised

Post the higher than expected fall in ARPU, lower depreciation and net interest income as against interest expenses projected, we are revising our estimates for the company. In our revised estimates, we have factored the aggressive capex guidance given by the company, the equity dilution on account of FCCB conversion of US\$500mn issued on 9 May 2006 at price of Rs480.68 leading to an increase of 46.2mn shares and the upsides from the GSM rollout from end FY09. We have factored a capex of US\$4bn in FY09 as compared to a guidance of US\$6bn given by the management. The difference of US\$2bn capex on Reliance Infratel has separately been factored in valuing the tower business.

	Old estimates			New estimates			% Change		
	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E
Mobile business									
Subscribers	44,950	60,885	75,795	45,670	64,005	86,115	1.6%	5.1%	13.6%
Market share	18.0	18.4	18.9	18.3	19.3	21.5	30bps	90bps	160bps
ARPU	356	335	318	347	319	306	-2.6%	-4.7%	-3.7%
Broadband business									
Subscribers	1,070	1,550	2,090	1,004	1,484	2,024	-6.2%	-4.3%	-3.2%
ARPU	1,915	1,762	1,639	1,828	1,682	1,564	-4.5%	-4.5%	-4.5%
Global business									
NLD traffic	27,328	39,361	51,679	23,296	32,941	44,522	-14.8%	-16.3%	-13.8%
ILD traffic	8,390	11,843	15,550	6,948	9,911	13,396	-17.2%	-16.3%	-13.8%
Total LD traffic	35,719	51,204	67,229	30,243	42,852	57,918	-15.3%	-16.3%	-13.8%
Consolidated									
Net revenues	201,876	269,455	328,841	190,052	254,248	328,075	-5.9%	-5.6%	-0.2%
EBIDTA	84,384	114,249	140,744	80,677	109,327	141,728	-4.4%	-4.3%	0.7%
EBIDTA %	41.8%	42.4%	42.8%	42.5%	43.0%	43.2%	70bps	60bps	40bps
PAT	43,321	60,273	78,819	50,837	60,939	79,437	17.3%	1.1%	0.8%
EPS	21.2	29.5	38.6	24.9	29.1	38.0	17.3%	-1.1%	-1.4%

DCF valuation of Reliance Communications

	FY07	FY08E	FY09E	FY10E	FY11E	FY12E
EBITDA	57,211	80,677	109,327	141,728	174,321	199,643
Tax	(611)	(4,735)	(7,578)	(13,023)	(17,697)	(20,879)
Inc/(dec) in working capital	56,192	15,256	21,349	32,027	35,218	34,160
Cash flow from operations	112,792	91,199	123,098	160,732	191,842	212,924
Capex	(124,527)	(180,000)	(160,000)	(102,500)	(83,000)	(63,000)
FCF	(11,736)	(88,801)	(36,902)	58,232	108,842	149,924
					87%	38%
WACC	12.1%					
PV of cash flows till 2012 (a)	91,997					
Interim growth rate FY13-FY20	9.0%					
PV of FCF from FY13-FY20 (b)	637,671					
Terminal gr rate beyond FY20	3.0%					
FCF in FY20	298,734					
Terminal Value	3,399,951					
PV of terminal value (c)	821,683					
EV (a+b+c)	1,551,351					
Net debt	104,050					
Value to equity shareholders	1,447,301					
				Now 12 month		
Value per share	692	776				

Sensitivity WACC v/s terminal growth

	2.0%	2.5%	3.0%	3.5%	4.0%
11.1%	847	878	912	951	996
11.6%	784	810	840	873	910
12.1%	728	751	776	804	835
12.6%	677	697	718	742	769
13.1%	632	649	667	688	711

Sensitivity WACC v/s interim growth

	8.0%	8.5%	9.0%	9.5%	10.0%
11.1%	859	885	912	940	969
11.6%	791	815	840	865	892
12.1%	731	753	776	799	823
12.6%	677	698	718	740	762
13.1%	629	648	667	687	707

Valuation & Recommendation

With strong subscriber growth in the industry and likely acceleration in the growth and market share from GSM rollout, we continue to remain bullish on the stock. We have revised our price target for the stock from Rs878 to Rs847 after factoring the high capex, equity dilution from FCCB conversion, and upsides from the GSM rollout. Our target price for the stock is based on the DCF value of core telecom services business at Rs776 (WACC 12.1%) and the value of Reliance Infratel (tower business) at Rs71 per share (WACC 10%). While we have factored the full capex, which includes capex attributable to DTH and IPTV businesses, we have not factored the upside from the same due to lack of visibility.

The company has recently announced the IPO of Reliance Infratel, which according to media reports is valued at Rs500-600bn or ~Rs250 per share. However, we have valued Reliance Infratel at Rs71 per share based on DCF.

At current levels the stock trades at an EV/EBIDTA 12.4x for FY09E and 9.6x for FY10E. We maintain our BUY recommendation with revised price target of Rs847.

Quarterly result update

	3Q07	4Q07	1Q08	2Q08	3Q08	QOQ %
Wireless	27,520	29,692	33,730	37,231	39,567	6.3%
Global	13,335	12,938	13,033	13,161	13,299	1.0%
Broadband	3,161	3,299	3,833	4,372	4,564	4.4%
Others	769	947	990	1,087	1,544	42.1%
Gross Revenues	44,785	46,876	51,586	55,850	58,974	5.6%
Inter segment	(7,232)	(7,507)	(8,549)	(10,065)	(10,232)	
Net revenues	37,553	39,369	43,037	45,785	48,742	6.5%
License fees & access chg	9,491	9,978	9,687	9,746	11,188	14.8%
Network operating exp	4,165	4,424	4,338	5,662	5,446	-3.8%
Employee cost	2,200	2,452	2,464	3,056	3,087	1.0%
S, G & A	6,426	6,164	8,406	7,703	7,956	3.3%
Operating expenses	22,281	23,018	24,895	26,166	27,677	5.8%
EBIDTA	15,272	16,352	18,142	19,619	21,065	7.4%
Depreciation	6,524	6,378	6,192	6,754	7,252	7.4%
EBIT	8,747	9,974	11,950	12,865	13,813	7.4%
Extra ordinary	30	(27)	(15)	(12,203)	-	
Interest charges	(657)	(391)	(1,274)	(1,125)	(1,518)	35.0%
PBT	9,374	10,392	13,239	26,192	15,331	-41.5%
Minority interest				12,448	223	
Tax	130	148	1,031	698	1,379	97.5%
PAT	9,244	10,244	12,208	13,046	13,729	5.2%

	% of sales					Chg bps
License fees & access chg	25.3	25.3	22.5	21.3	23.0	167
Network operating exp	11.1	11.2	10.1	12.4	11.2	(119)
Employee cost	5.9	6.2	5.7	6.7	6.3	(34)
S, G & A	17.1	15.7	19.5	16.8	16.3	(50)
EBIDTA	40.7	41.5	42.2	42.8	43.2	37
PAT	24.6	26.0	28.4	28.5	28.2	(33)

Financials

Profit & Loss

	FY07	FY08E	FY09E	FY10E
Net Sales	144,683	190,052	254,248	328,075
<i>Growth (%)</i>	34.4	31.4	33.8	29.0
License fees & Access chg	37,822	42,762	58,223	75,457
<i>% to sales</i>	26.1	22.5	22.9	23.0
Network operating exp	16,737	22,141	30,255	39,369
<i>% to sales</i>	11.6	11.7	11.9	12.0
Personnel exp	9,080	11,783	15,763	19,356
<i>% to sales</i>	6.3	6.2	6.2	5.9
S, G & A	23,833	32,689	40,680	52,164
<i>% to sales</i>	16.5	17.2	16.0	15.9
EBITDA	57,211	80,677	109,327	141,728
<i>EBITDA %</i>	39.5	42.5	43.0	43.2
Depreciation	24,653	28,125	39,005	49,627
EBIT	32,557	52,552	70,321	92,101
<i>EBIT %</i>	22.5	27.7	27.7	28.1
Interest	4	(3,152)	1,435	(921)
Extra ordinary items	(303)	0	0	0
PBT	32,250	55,704	68,886	93,022
Taxes	611	4,735	7,578	13,023
<i>ETR</i>	1.9	8.5	11.0	14.0
PAT	31,639	50,969	61,309	79,999
<i>Growth (%)</i>	467.1	61.1	20.3	30.5

Balance Sheet

	FY07	FY08E	FY09E	FY10E
Equity Capital	10,223	10,223	10,454	10,454
Reserves & surplus	193,708	243,511	323,807	397,690
Net worth	203,931	253,734	334,261	408,144
Minority interest	59	59	59	59
Total Debt	155,438	154,438	152,231	122,231
Capital Employed	359,428	408,231	486,550	530,434
Gross Block	349,456	529,456	689,456	791,956
Less Depreciation	55,940	84,065	123,070	172,698
Net Fixed Assets	293,516	445,391	566,386	619,258
CWMP	36,907	45,907	50,707	53,782
Investments	11,925	1,925	1,925	1,925
Other non current assets				
Current assets				
Inventory	4,821	6,248	8,359	10,786
Debtors	18,316	24,993	31,346	40,448
Cash and Bank	137,203	50,388	24,261	44,224
Other CA	35,926	46,862	57,815	74,603
Total Curr. Assets	196,266	128,491	121,780	170,061
Current Liabilities & prov	179,186	213,483	254,248	314,592
Net Current Assets	17,080	(84,991)	(132,467)	(144,531)
Capital Deployed	359,428	408,231	486,550	530,434

Cash Flow Statement

	FY07	FY08E	FY09E	FY10E
EBIT	32,557	52,552	70,321	92,101
Depreciation	24,653	28,125	39,005	49,627
Interest (Net)	(4)	3,152	(1,435)	921
Tax Paid	(611)	(4,735)	(7,578)	(13,023)
Change in WC	56,192	15,256	21,349	32,027
Others	(303)	0	0	0
CFO	112,485	94,351	121,663	161,653
Net Capex	(124,527)	(189,000)	(164,800)	(105,575)
Others	(28,031)	10,000	0	0
CFI	(152,558)	(179,000)	(164,800)	(105,575)
Equity Issue	0	0	22,207	0
Net Borrowings	62,462	(1,000)	(2,207)	(30,000)
Others	54,777	0	0	0
CFF	117,239	(1,000)	20,000	(30,000)
Inc/(dec) in cash	77,165	(85,649)	(23,137)	26,078
Opening Cash	60,038	137,203	51,554	28,416
Closing Cash	137,203	51,554	28,416	54,495

Ratios

	FY07	FY08E	FY09E	FY10E
EBITDA %	39.5	42.5	43.0	43.2
EBIT %	22.5	27.7	27.7	28.1
NPM %	21.9	26.8	24.1	24.4
ROCE %	11.4	13.7	15.7	18.1
ROE %	19.7	22.3	20.9	21.6
ROIC %	18.1	18.6	17.2	19.5
EPS	15.5	24.9	29.3	38.3
Cash EPS	26.9	37.8	48.0	62.0
Book Value	98	121	160	195
Div per share	1.0	2.5	5.0	7.5
Net Debt: Equity	0.0	0.4	0.4	0.2
Asset Turnover (adj)	0.4	0.5	0.5	0.6
PE (x)	41.7	25.9	22.0	16.9
Cash PE (x)	24.0	17.1	13.5	10.4
P/BV (x)	7	5	4	3
EV/Sales (x)	9.6	7.3	5.4	4.2
EV/EBITDA	23.7	16.8	12.4	9.6

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