

November 16, 2010

HOLD

Reliance Communications

Target Price (INR)

159

ARPMs stable but growth remains a concern

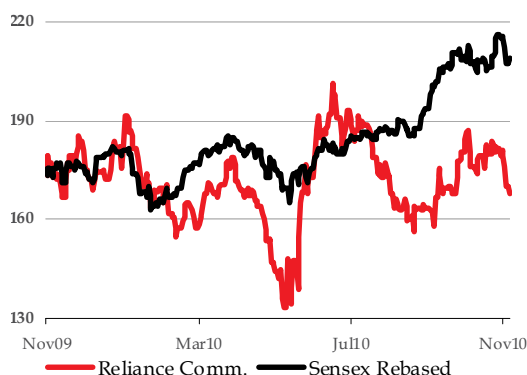
MAINTAIN RATING

Last Price (INR) **168**

Bloomberg code	RCOM IN
Reuters code	RLCM.BO
Avg. Vol. (3m)(mn)	5.03
Avg. Val.(3m)(INRmn)	868
52-wk H/L (INR)	208 / 132
Sensex	20,310
MCAP (INRbn/USDbn)	346.9 / 7.7

Shareholding (%)	06/10	09/10
Promoters	67.7	67.7
MFs, Fls, Banks	9.4	9.3
FIIIs	8.0	8.4
Public	11.7	11.8
Others	2.6	2.2

Stock Chart (Relative to Sensex)



Stock Perf. (%)	1m	6m	1yr
Absolute	-4.5	16.4	-3.2
Rel. to Sensex	-5.4	-3.1	-23.7

Financials (INRmn)	03/10	03/11f	03/12f
Sales	222,504	213,417	253,676
y-o-y (%)	0	-4	19
EBITDA (%)	35	32	33
A.PAT	48,437	12,765	23,273
Sh o/s (diluted)	2,064	2,064	2,064
A.EPS (INR)	22.8	5.3	10.4
y-o-y (%)	23	-77	96
D/E (x)	0.4	0.5	0.6
P/E (x)	7.6	32.6	16.7
EV/E (x)	6.4	8.3	7.1
RoCE (%)	5	3	4
RoE (%)	12	3	5

Quarterly Trends	12/09	03/10	06/10	09/10
Sales (INRmn)	53,098	50,928	51,092	51,183
PAT (INRmn)	11,077	12,195	2,509	4,459

Wireless revenue for the Sep10 quarter grew by only 0.2% q-o-q. The negative variance from forecasts was the result of weak volume growth, partly driven by seasonality. EBITDA margins improved by 48-bp q-o-q leading to consolidated EBITDA growth of 2% q-o-q. Reduction in losses in Others despite 19% q-o-q growth in revenues led to improvement in EBITDA margins. PAT grew by 78% q-o-q on reduction in mark-to-market forex losses by cINR1.5bn. We lower our net profit forecasts for FY11-FY13 by up to 12% due to muted growth in the wireless segment. We lower the Sep11 target price to INR159 and maintain the Hold rating on the stock.

Lower than expected wireless revenue growth

Wireless revenue for the Sep10 quarter grew by only 0.2% q-o-q. The negative variance from forecasts was the result of weak volume growth, partly driven by seasonality. Minutes growth in the wireless segment is likely to resume from 3QFY11. Launch of Mobile Number Portability (MNP) in Nov10 may further enhance minutes growth. However, minutes growth is likely to be partially offset by a drop in ARPMs. We forecast wireless revenue to grow at a sequential run-rate of 6% in 2HFY11.

EBITDA margin expansion may be short-lived

EBITDA margins improved by 48-bp q-o-q leading to consolidated EBITDA growth of 2% q-o-q. As a percent of sales, SG&A costs and access and interconnect charges declined by 173-bp q-o-q and 24-bp q-o-q, respectively. The sequential decline in SG&A costs was due to absence of one-off expenses pertaining to brand promotion and sponsorship fee of the T20 World Cup in 1QFY11. While Wireless, Global and Broadband reported stable EBITDA margins, losses reduced in Others despite 19% q-o-q growth in revenues. EBITDA margins may remain under pressure due to MNP and launch of 3G services in 2HFY11f.

Lower forex losses boost PAT

RCOM's net finance expense of INR2.8bn in the Sep10 quarter was lower by INR1.6bn q-o-q due to reduction in forex losses. This led to PAT growth of 78% q-o-q versus EBITDA growth of 2% q-o-q.

Lower forecasts and target price; maintain Hold

We have lowered our net profit forecasts for FY11-FY13 by up to 12% due to muted growth in the wireless segment. Consequently, our target price for Sep11 has been lowered to INR159. Our target price is based on the sum-of-parts of the non-tower business (INR73) and the tower business (INR86). We continue to value the non-tower business at one-year forward EV/EBITDA of 5.8x. Our tower business valuations imply an EV/tower of INR6mn. We maintain the Hold rating on the stock.

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Exhibit 1: Earnings revision summary

(INRmn)	FY11f			FY12f			FY13f		
	Old	New	Var (%)	Old	New	Var (%)	Old	New	Var (%)
Revenue	220,888	213,417	-3	261,591	253,676	-3	290,710	282,416	-3
EBITDA	69,461	67,961	-2	86,396	83,423	-3	95,690	94,044	-2
PAT	14,148	12,765	-10	26,538	23,273	-12	32,095	28,544	-11
EPS (INR)	6	5	-10	12	10	-13	15	13	-11

Source: Company, Avendus Research

Exhibit 2: Segmental information

(INRmn)	Sep10 (3m)	Jun10 (3m)	q-o-q chg (%)	Sep09 (3m)	y-o-y chg (%)
Wireless					
Gross Revenue	41,613	41,528	0	40,100	4
EBITDA	12,101	11,989	1	13,132	-8
EBITDA Margin (%)	29	29		33	
EBIT	7,135	6,817	5	10,240	-30
EBIT Margin (%)	17	16		26	
Global					
Gross Revenue	18,391	18,137	1	22,643	-19
EBITDA	3,393	3,317	2	5,227	-35
EBITDA Margin (%)	18	18		23	
EBIT	1,030	1,035	0	2,797	-63
EBIT Margin (%)	6	6		12	
Broadband					
Gross Revenue	6,617	6,763	-2	7,700	-14
EBITDA	2,481	2,477	0	3,199	-22
EBITDA Margin (%)	37	37		42	
EBIT	1,263	1,304	-3	2,039	-38
EBIT Margin (%)	19	19		26	
Others					
Gross Revenue	3,984	3,348	19	2,760	44
EBITDA	-1,343	-1,350		-1,245	
EBITDA Margin (%)	-34	-40		-45	
EBIT	-2,348	-2,370		-2,022	
EBIT Margin (%)	-59	-71		-73	

Source: Company, Avendus Research

Exhibit 3: Mar10 quarter results snapshot

(INRmn)	Sep10 (3m)	Jun10 (3m)	q-o-q chg (%)	Sep09 (3m)	y-o-y chg (%)
Wireless					
Subscribers (mn)	117	111	6	86	36
ARPU (INR/subscriber)	122	130	-6	161	-24
MoU (min/subscriber)	276	295	-6	340	-19
ARPM (INR/min)	0.44	0.44	0.3	0.47	-7
Total Minutes (mn min)	94,600	94,400	0.2	84,500	12
Consolidated					
Revenue	51,183	51,092	0.2	57,026	-10
EBITDA	16,595	16,320	2	20,199	-18
EBITDA Margin (%)	32.4	31.9		35.4	
PAT	4,459	2,509	78	7,403	-40
PAT Margin (%)	8.7	4.9		13.0	

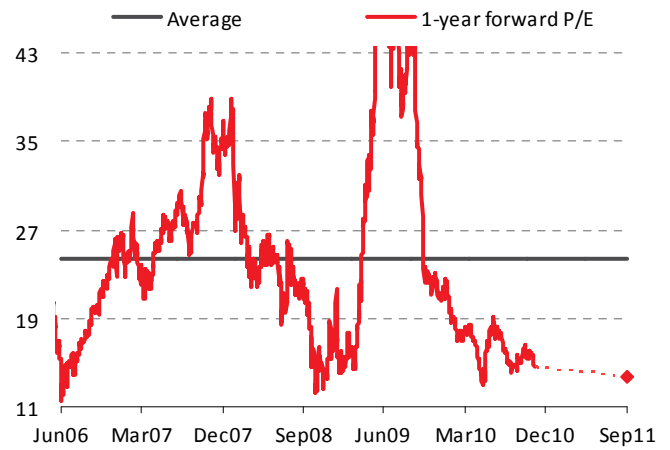
Source: Company, Avendus Research

Exhibit 4: 1-year forward EV/EBITDA



Source: Company, Avendus Research

Exhibit 5: 1-year forward P/E



Source: Company, Avendus Research

Income statement (INRmn)

Fiscal year ending	03/10	03/11f	03/12f	03/13f
Total operating income	222,504	213,417	253,676	282,416
Total operating expenses	143,634	145,456	170,252	188,372
EBITDA	78,870	67,961	83,423	94,044
Other income	0	0	0	0
Depreciation	37,731	40,585	45,992	48,932
EBIT	41,139	27,375	37,431	45,112
Interest	-11,863	12,532	10,370	11,921
Recurring PBT	53,002	14,844	27,062	33,190
Net extra ordinary items	(111)	-	-	-
PBT (reported)	52,891	14,844	27,062	33,190
Total taxes	4,454	2,078	3,789	4,647
PAT (reported)	48,437	12,765	23,273	28,544
(+) Share in assoc. earnings	-	-	-	-
Less: Minority interest	1,396	1,827	1,864	1,901
Prior period items	0	-	-	-
Net income (reported)	47,041	10,938	21,410	26,643
Avendus net income	47,152	10,938	21,410	26,643
Shares outstanding (mn)	2,064	2,064	2,064	2,064
Avendus dil. shares (mn)	2,064	2,064	2,064	2,064
Avendus EPS (INR)	22.8	5.3	10.4	12.9

Growth ratios (%)

Total operating income	0.0	-4.1	18.9	11.3
EBITDA	-8.4	-13.8	22.8	12.7
EBIT	-17.7	-33.5	36.7	20.5
Recurring PBT	33.2	-72.0	82.3	22.6
Avendus net income	23.2	-76.8	95.7	24.4
Avendus EPS	23.2	-76.8	95.7	24.4

Operating ratios (%)

EBITDA margin	35.4	31.8	32.9	33.3
EBIT margin	18.5	12.8	14.8	16.0
Net profit margin	21.2	5.1	8.4	9.4
Other income/PBT	0.0	0.0	0.0	0.0
Effective Tax rate	8.4	14.0	14.0	14.0

Balance sheet (INRmn)

Fiscal year ending	03/10	03/11f	03/12f	03/13f
Equity capital	10,320	10,320	10,320	10,320
Preference capital	0	0	0	0
Reserves and surplus	377,505	379,653	401,062	427,705
Net worth	387,825	389,973	411,382	438,025
Minority interest	7,472	8,472	10,336	12,236
Total debt	247,473	325,066	351,549	316,238
Deferred tax liability	0	0	0	0
Total liabilities	642,770	723,511	773,266	766,499
Gross block	786,643	910,998	996,371	1,054,753
less: Acc. depreciation	190,765	244,165	300,784	360,967
Net block	595,878	666,834	695,587	693,786
CWIP	119,517	124,227	110,708	117,195
Goodwill	-	-	-	-
Investments	1,199	1,190	1,190	1,190
Cash	48,585	65,119	70,365	73,973
Inventories	5,446	5,530	6,092	6,760
Debtors	33,380	32,821	35,289	38,990
Loans and advances	76,741	80,905	81,448	93,650
less: Current liabilities	198,855	208,554	175,254	201,336
less: Provisions	39,121	44,561	52,157	57,708
Net working capital	-73,824	-68,740	-34,218	-45,671
Total assets	642,770	723,511	773,266	766,499

Cash flow statement (INRmn)

Fiscal year ending	03/10	03/11f	03/12f	03/13f
Net profit	47,041	10,938	21,410	26,643
Depreciation	37,731	40,585	45,992	48,932
Deferred tax	0	0	0	-
Working capital changes	39,180	15,508	-35,427	28,209
Less: Other income	0	0	0	0
Cash flow from operations	123,952	67,032	31,974	103,784
Capital expenditure	-37,963	-129,065	-71,853	-64,869
Strategic investments	0	0	0	-
Marketable investments	94,458	9	0	0
Change in other loans & adv.	12,731	-4,058	6,150	-13,148
Goodwill paid	52,215	-	-	-
Other income	0	0	0	0
Cash flow from investing	121,441	-133,114	-65,703	-78,016
Equity raised	-	-	-	-
Change in borrowings	-144,150	77,593	26,483	-35,311
Dividends paid (incl. tax)	-2,052	0	0	0
Others	-67,435	5,023	12,491	13,152
Cash flow from financing	-213,637	82,616	38,974	-22,159
Net change in cash	31,756	16,534	5,245	3,609

Key Ratios

Fiscal year ending	03/10	03/11f	03/12f	03/13f
Valuation ratios (x)				
P/E (on Avendus EPS)	7.6	32.6	16.7	13.4
P/E (on basic, reported EPS)	7.6	32.6	16.7	13.4
P/CEPS	4.2	6.9	5.3	4.7
P/BV	0.9	0.9	0.9	0.8
Dividend yield (%)	0.5	0.0	0.0	0.0
Market cap. / Sales	1.6	1.7	1.4	1.3
EV/Sales	2.3	2.6	2.3	1.9
EV/EBITDA	6.4	8.3	7.1	5.8
Net Cash / Market cap.	29.3	35.1	34.8	39.5
Per share ratios (INR)				
Avendus EPS	22.8	5.3	10.4	12.9
EPS (Basic, reported)	22.8	5.3	10.4	12.9
Cash EPS	41.1	25.0	32.7	36.6
Book Value	187.9	188.9	199.3	212.2
Dividend per share	0.9	0.0	0.0	0.0
Total assets / equity (x)	1.8	1.8	1.9	1.8
Return ratios (%)				
ROCE	5.0	3.2	4.1	4.8
ROIC	6.8	4.3	5.4	6.3
ROE	11.6	2.8	5.3	6.3
ROA	6.4	1.6	2.9	3.5
OCF/Sales	55.8	31.4	12.6	36.7
FCF/Sales	38.7	-29.1	-15.7	13.8
Turnover ratios (x)				
Asset turnover (x)	0.3	0.3	0.3	0.4
Gross asset turnover	0.3	0.2	0.3	0.3
Inventory / Sales (days)	8.9	9.4	8.4	8.3
Receivables (days)	59.9	56.6	49.0	48.0
Payables (days)	692.0	764.6	601.8	527.1
Working capital cycle (days)	-258.6	-316.4	-251.8	-221.5
Solvency ratios (x)				
Gross debt to equity	0.7	0.9	0.9	0.7
Net debt to equity	0.4	0.5	0.6	0.4
Net debt to EBITDA	3.1	4.8	4.2	3.4
Interest Coverage (on EBIT)	-3.5	2.2	3.6	3.8

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