INITIATING COVERAGE

Reliance Communications Limited **Buy**

Share Data

Market Cap	Rs. 1052.87 bn
Price	Rs. 514.95
BSE Sensex	14431.06
Reuters	RLCM.BO
Bloomberg	RCOM IN
Avg. Volume (52 Week)	1.88 mn
52-Week High/Low	Rs. 525.75/218.05
Shares Outstanding	2044.61 mn

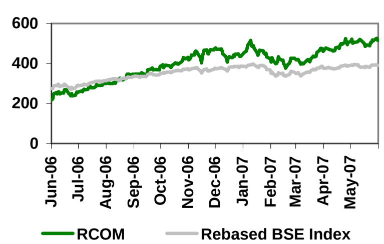
Valuation Ratios

Year to 31 March	2008E	2009E
EPS (Rs.)	21.6	31.1
+/- (%)	38.5%	43.7%
PER (x)	23.8x	16.6x
EV/ Subscribers	27144.0	19849.6
EV/ Sales (x)	5.8x	4.3x
EV/ EBITDA (x)	14.0x	10.1x

Shareholding Pattern (%)

Promoters	67
FIIs	13
Institutions	6
Public & Others	14

Relative Performance



Reliable Reliance

Reliance Communications Limited (RCOM) is India's largest integrated communications service provider, with subscriber's base exceeding 30 mn. The company is one of the largest wealth creator with market capitalisation of over Rs. 1,000 bn. The company is poised for stronger participation in the rapidly growing Indian telecom market. Currently, RCOM enjoys a pan-India presence with CDMA network across India and is in the process of shifting to GSM network to more effectively capture the Indian market. The company is also planning to unlock value by demerging its tower business and listing of FLAG telecom.

Key Figures

Year to March	FY06	FY07	FY08E	FY09E	CAGR (%)
(Figures in Rs mn, except per share data)					(FY07-09E)
Net Sales	106,273	142,625	200,146	267,720	37.0%
EBITDA	23,961	55,148	82,432	114,279	44.0%
EBITDA Margin	22.5%	38.7%	41.2%	42.7%	
Wireless Subscribers	20	28	43	58	44.2%
% increase in subscribers	NA	38.6%	52.0%	36.7%	
Wireless ARPU	379	377	345	337	
Wireless minutes of use per customer	532	541	555	577	
Average realised rate	0.71	0.70	0.62	0.58	
Blended churn	2.1%	2.6%	2.0%	1.8%	
Per Share Data (Rs.)					
Normalized EPS	2.3	15.6	21.6	31.1	41.0%
PER (x)	219.9x	33.0x	23.8x	16.6x	

- We expect RCOM to report EBITDA CAGR of 44% for FY07-09E driven by an increased subscriber base and higher minutes of use. Moreover, the growth in broadband services will also add to the increase in EBITDA.
- At the current price of Rs. 514.95, the stock is trading at a forward PE of 23.8x FY08E and 16.6x FY09E.
- Our target price of Rs. 605 is based on a forward PE of 28x and future EPS of Rs.21.6 per share, and represents an upside of 17.6% from current levels. We initiate coverage of RCOM with a BUY rating with a one year perspective.

Rationale

Pan India presence

Pan India presence across 10,000 towns and 300,000 villages

The company is among the few players in India with a pan-India network. The company's area of operations covers about 54% of the Indian population, in approximately 10,000 towns and 300,000 villages. RCOM's pan-India optic fiber network totals 100,000 km and the company is planning to expand the same to 130,000 km by the end of FY08. Pan-India coverage enables the company to provide seamless roaming services and innovative plans like the One India tariff. It also helps in connecting the offices of corporate customers across the country for enterprise solutions.

Increasing global presence

Global presence across 40 countries

The company enjoys international presence in countries like the United States, Canada, the United Kingdom, and Australia. RCOM has become the largest carrier of international voice minutes (6 bn minutes) and enjoys a leadership position in international long distance voice segment with 40% market share for inbound international voice traffic to India. The company operates through FLAG, the largest private submarine cable system in the World, connecting all the countries from the East coast of the United States, to Europe, the Middle East, India, South and East Asia, through to Japan. In September 2006, the company laid down 11,500 km of fibre optic under the FALCON project. The FALCON cable thus connects all countries in the Middle East and seamlessly integrates with the FLAG global network, taking the total number of countries connected on the FLAG global network to 40 countries, which were 28 at the end of March 2006. The success of the FALCON project and continued growth in demand led to the launch of FLAG Next Generation Network project in December 2006. On completion, the FLAG's global Network will connect over 60 countries and address 90% plus of world GDP, which is $ 35 tn.

Unlocking Initiatives

Demerger of tower business and listing of FLAG

RCOM is currently examining a number of opportunities to unlock value, in the next 6 months. To achieve this, the company is pursuing a two point agenda. Firstly, it is in the process of demerging its tower business i.e. Reliance Telecom and secondly the company is planning for the listing of Flag Telecom.

Both these will be high value creators for all the stakeholders of Reliance Communications.

Tower business: a catalyst to unlocking of value

Reduction in set-up and operating costs and unlocking of value

In a recent development, TRAI recommended for active infrastructure sharing between operators. To counter this opportunity, the company has planned the spin off of Reliance Telecom's tower business to its subsidiary Reliance Telecom Infrastructure Ltd. (RTIL) in the next 6 months. The move is expected to reduce set-up and operating costs, resulting in cost efficiencies, and thus converting cost-centric assets to revenue-centric ones by sharing of the infrastructure of the resulting company with other wireless operators. The company has transferred 12,000 towers to RTIL at a Rs. 30 bn valuation and plans to roll out 20,000 towers during the next year.

Shifting focus to GSM network

Shift to GSM will lead to greater market expansion

Indian telecom market is GSM centric. Presently, RCOM operates GSM network in 8 circles, where the company follows dual network approach i.e. both CDMA and GSM network. RCOM's GSM and CDMA subscribers account for 88% and 12% of wireless subscriber base respectively. The company has applied for licenses in other circles and plans to follow the dual network approach. One of the key advantages in GSM is the low handset cost which in turn lowers the subscriber acquisition cost. CDMA handsets are expensive primarily due to the licensing fee that Qualcomm charges the operators. Further, the absence of a second-hand market for CDMA handsets also hurts CDMA operators. Presently, RCOM buys CDMA handsets, carries the inventory, and sells the handsets directly to customers at subsidized rates which in turn results in margin reduction.

The company thus plans to roll-out a nationwide GSM network by 2010, channel all new subs into GSM, and gradually migrate the existing CDMA subscribers to GSM.

Growth in telecom sector

Low teledensity provides huge opportunity

The Indian telecom market is among the fastest growing and one of the least penetrated telecom markets in the world. India's telecom spending as a percentage of GDP is currently only 1.7% and the telecom industry has a teledensity of just 20%. The total number of wireless subscribers in India are expected to increase from mere 161 mn in 2007 to 291 mn by the end of 2009 and telecom spending as a percentage of GDP is believed to rise to 3.2% by 2012. The Indian telecom market is expected to take advantage of rising income levels and strong GDP growth. This provides a huge opportunity for RCOM to capture the market, as the company is on a progressive path with the wireless market share of 17.4% and wireless subscribers of 28 mn.

Entry into rural market

Government support to start network in rural areas

According to TRAI estimates, the rural teledensity stood at 2% in 2005. Hence there is a vast scope for rural expansion. RCOM is on a massive drive to increase rural telephony services through fixed wireless phones (FWP) and public call offices (PCO). In January 2007, Universal Services Obligation Fund (USOF) conducted a tender to extend financial support for setting up the infrastructure for mobile services in rural and remote areas of the country. This is expected to lower capital cost, incurred for setting up infrastructure in rural areas. RCOM won more than 9,000 towers in the bidding process for active infrastructure, i.e. BTS, backhaul, battery and power plant. This would allow RCOM to enter rural markets with reduced capital expenditure as the company will have access to towers for 5 years without incurring any pay out on rentals.

Increase in broadband services

70% market share in wireless data cards

RCOM's broadband business is rapidly expanding with the company adding more than 386,000 buildings during the year, taking the total to 488,000 buildings in the top 40 cities of operations. The company has over 70% market share in wireless data cards which provides customers with the highest data speed of 144 kbps anywhere in the country, as against its peers who are able to offer this service in just a few towns where they have launched the Edge service. The company is also in the advanced stages of developing capabilities in digital TV, video on demand, interactive TV through IPTV and DTH product platforms. Entry in these areas will provide the company with a good market share.

Extensive distribution network

RCOM has one of the most extensive distribution and service networks among all telecom players in India. The company has 1,650 Web World outlets throughout India, over 6,000 service centres with multilingual capabilities, *1,650 Web World outlets throughout India*

2,365 distributors linked to 250,000 retail outlets and approximately 3,000 sales agents. RIC also has seven electronic recharge voucher distributors, 105,000 outlets and 3,000 ATMs for electronic recharge of vouchers. All this helps the company to provide a wide range of services to its customers.

Key Risks

Intense competition

Increasing competition to put greater pressure on service charges

The Indian telecommunications industry is highly competitive with most circles having 6 or 7 wireless operators using GSM and CDMA technology and it is expected to further intensify. Increasing competition is likely to put greater pressure on handset prices and service charges. For national long distance (NLD) and international long distance (ILD) segment, licenses to provide these services have been allotted to a number of new players which are likely to penetrate into the market using aggressive pricing as an entry strategy. Thus revenues from these services may come under pressure.

Late entry in new circles

Stiff competition from already existing companies in the GSM market

RCOM is a late entrant in the GSM circles and the launch of its operations is contingent on availability of spectrum. Delay in allotment of spectrum could adversely affect the operations and future growth of the company. RCOM has a challenging job and will have to face stiff competition from the already existing companies which may affect the company's subscriber growth and profitability. Also, quality of subscribers is also likely to be relatively inferior as the creamy layer of subscribers will already have been bagged by the incumbent operators.

Mobile Number Portability

MNP increases the subscriber churn

With the advent of Mobile Number Portability ("MNP"), which allows subscribers to switch their wireless service provider while retaining their number, competition in Indian telecom is expected to increase and thereby increase the subscriber churn across the industry. MNP increases churn and RCOM can expect to lose some its high-value customers to more mature GSM operators like Bharti and Hutchison- Essar.

Choice to the subscribers to choose their long distance service provider

Carrier Access Code

Carrier Access Code ("CAC") enables subscribers to choose their long distance service provider as against the current scenario where they have to route their long distance calls through the NLD and ILD network with whom the service provider has an interconnect agreement. With the implementation of CAC, the competition in NLD and ILD segments is expected to increase as even long distance operators, with no last mile access, will be able to offer their carrier network to the end users. This posse a threat to RCOM in its global business segment.

Delay in the release of spectrum will lead to losing out on additional subscriber growth

Spectrum: the key risk

The Indian telecom space is spectrum-starved and the present spectrum allocation in the 2G space is below international standards. Delay in the release of additional 2G spectrum will not only see operators facing a congested network, but perhaps losing out on additional subscriber growth as well. Though RCOM presently has CDMA operations which are spectrally efficient, yet with the company entering the GSM market, delay in the release of spectrum would have a bearing on our rating.

Outlook

Consolidating its position and shifting towards GSM-centric growth strategy

RCOM is the number 2 player in the rapidly growing fragmented Telecom space. The company plans to spend over $2.5 billion to support its growth strategy. To grow aggressively the company is also targeting a long term transition from CDMA technology to GSM technology mainly to reduce acquisition cost per customer. Although the cost associated with this transition is difficult to ascertain. Driven by regulatory reforms, infrastructure sharing opportunities, low priced handsets, falling infrastructure costs and strong execution skills, RCOM is in a commending position in the Indian telecom space.

The company is also in the advanced stages of developing capabilities in digital TV, video on demand, interactive TV through IPTV and DTH product platforms. Entry in these areas will provide the company with future growth potential.

At the current price of Rs. 514.95, the stock trades at a forward PE of 23.8x estimated FY08 earnings and 16.6x estimated FY09 earnings. We recommend

RCOM to be a buy with a one year price target of Rs. 605. Our target price has been arrived using a forward PE of 28x and future EPS of Rs. 21.6 per share.

Company Background

India's largest integrated communications service provider

Reliance Communications Limited (RCOM) is India's largest integrated communications service provider in the private sector with over 30 mn individual, enterprise, and carrier customers. RCOM's wireless ARPU is Rs. 377 and pre-paid subscribers accounted for 84.7% of the subscriber base.

The Company operates pan-India across the full spectrum of wireless, wireline, NLD, ILD, voice, data, video and internet based communications services organised into three strategic business units; Wireless, Global and Broadband.

Wireless: the company offers CDMA and GSM based wireless services, including mobile and fixed wireless voice, data, and value added services for individual consumers and enterprises.

Global: RCOM offers NLD and ILD services. In the overseas markets, the company offers a retail virtual calling card service for calls to India (Reliance India Call) and to 200 other international destinations (Reliance Global Call).

Broadband: the company offers the complete portfolio of enterprise voice, data, video, internet and IT infrastructure services like national and international private leased circuits, broadband internet access, audio and video conferencing, MPLS-VPN, Centrex, and managed internet data centre ("IDC") services.

RCOM was incorporated on 15th July, 2004, as a private limited company in the name of Reliance Infrastructure Developers Private Limited. In 2005, the company changed its status to a public limited and changed its name to Reliance Communication Ventures Limited. The equity shares of the company were listed on the BSE and the NSE with effect from 6th March, 2006. The name of the Company was again changed to Reliance Communications Limited in June 2006, as a result of break-up of Indian conglomerate Reliance Industries.

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