

February 10, 2012

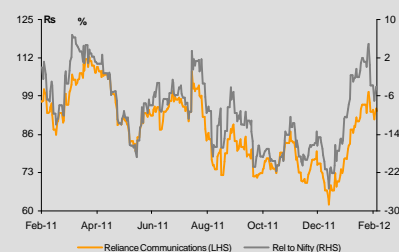
| Reco | Previous Reco |
|--------------------------|---------------|
| Hold | Hold |
| CMP | Target Price |
| Rs94 | Rs82 |
| EPS change FY12E/13E (%) | -29.9/-29.4 |
| Target Price change (%) | - |
| Sensex | 5,382 |
| Nifty | 17,749 |

Price Performance

| (%) | 1M | 3M | 6M | 12M |
|---------------|----|----|----|-----|
| Absolute | 15 | 12 | 11 | (3) |
| Rel. to Nifty | 3 | 9 | 5 | (6) |

Source: Bloomberg

Relative Price Chart



Source: Bloomberg

Stock Details

| | |
|-----------------------------|--------------------|
| Sector | Telecommunications |
| Bloomberg | RCOM@IN |
| Equity Capital (Rs mn) | 10320 |
| Face Value(Rs) | 5 |
| No of shares o/s (mn) | 2064 |
| 52 Week H/L | 114/61 |
| Market Cap (Rs bn/USD mn) | 194/3,904 |
| Daily Avg Volume (No of sh) | 11880212 |
| Daily Avg Turnover (US\$m) | 19.8 |

Shareholding Pattern (%)

| | Dec-11 | Sep-11 | Jun-11 |
|--------------|--------|--------|--------|
| Promoters | 67.9 | 67.9 | 67.9 |
| FII/NRI | 9.2 | 9.2 | 9.7 |
| Institutions | 9.1 | 9.0 | 8.9 |
| Private Corp | 2.0 | 2.1 | 1.7 |
| Public | 11.9 | 11.9 | 11.8 |

Source: Capitaline

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- Q3FY12 results were below estimates. Cons. revenue at Rs50.5bn flat qoq. EBITDA at Rs16.1bn flat QoQ with EBITDA margin at 319%. PAT stood at Rs1.9bn down 26.0% QoQ
- Wireless rev. grew 0.7% QoQ, despite of seasonally strong quarter. ARPU decline of 1.0% qoq to Rs100. MOU declined 1.3% qoq to 224, RPM stood at Rs0.45. Traffic was up 1.0% qoq to 99.8bn mins
- Tariff hike and seasonally strong was unable to aid ARPU decline. We expect wireless revenue growth to remain under leading to operationally weak performance going forward
- Cut EPS estimate by 29.9/29.4 for FY12E/13E, on account of cut in revenue est. and significantly high interest cost. Maintain HOLD with TP of Rs82

Results below estimates, bottom-line aided by lower depreciation

RCOM reported cons. revenue of Rs50.5bn which remained flat sequentially. Wireless revenue remained flat qoq, despite seasonally strong quarter. Global and enterprise segment reported revenue growth of 0.7% qoq to Rs23.5bn. EBITDA was flat at Rs16.1bn, led by higher network operating cost (which included one-time expense of Rs900mn). However, employee cost and access charge declined sequentially by 10.9% and 7.2% qoq. EBITDA margin stood at 31.9%, flat sequentially. PAT of Rs1.9bn was below our estimate of Rs2.2bn, primarily due significantly higher interest cost at Rs3.8bn v/s Rs2.3bn in Q2FY12. However, bottom-line was aided by lower depreciation due to change in depreciation policy (to SLM) in its subsidiary, Reliance Telecom.

Wireless KPI's

ARPU for the quarter stood at Rs100 (our estimate of Rs101.4), declining 1.0% qoq. MoU decline of 1.3% which was in line, ARPM remained flat at Rs0.45. Traffic on network improved 1.0% to 99.8bn minutes. Management indicated VAS share of >20%, improved qoq. Net active 3G subscribers for the company stood at 2.8mn v/s 2.5mn total subscribers in Q2FY12. Management has indicated that its 'Mera Pack Mera Plan' has been going strong and it would see improvement in traffic going forward.

Downward revision in estimates

Led by lower than expected results for Q3FY12, we have revised our estimates downwards. Tariff hike has not shown any signs of improvement in ARPU for RCOM, unlike its peers. After showing some signs of revival in wireless revenue in Q2FY12, Q3FY12 again witnessed submissive performance. We have cut our EBITDA estimate for FY12E/13E by 4.4%/4.0%. Significant increase in finance charges has led to revision in EPS estimates. Cut in revenue, EBITDA estimate and adjusting for higher interest cost led to our EPS downgrade of 29.9%/29.4 for FY12E/13E.

Retain HOLD with target price of Rs82

We maintain our cautious view on the stock due to highly leveraged balance sheet and operationally weak performance. At CMP of Rs94, the stock trades at 7.7x & 5.8x EV/EBITDA and 27.8x & 17.4x per on our revised EPS for FY12E and FY13E, respectively.

Financial Snapshot

Rs Mn

| Y/E | Net Sales | EBITDA (Core) | EBITDA (%) | PAT (Rs) | EPS (Rs) | EPS %chg | ROE (%) | P/E | EV/EBITDA | P/BV |
|-------|-----------|---------------|------------|----------|----------|----------|---------|------|-----------|------|
| March | | | | | | | | | | |
| FY10 | 214964 | 71846 | 33.4 | 46550 | 22.6 | -23.0 | 10.4 | 4.2 | 6.1 | 0.4 |
| FY11 | 224304 | 84044 | 37.5 | 13457 | 6.5 | -71.1 | 2.8 | 14.4 | 6.3 | 0.5 |
| FY12E | 201665 | 65006 | 32.2 | 6965 | 3.4 | -48.2 | 2.3 | 27.8 | 7.7 | 0.5 |
| FY13E | 231351 | 76931 | 33.3 | 11153 | 5.4 | 60.1 | 2.9 | 17.4 | 5.8 | 0.4 |

Quarterly financials

| Rs mn | Q3FY11 | Q4FY11 | Q1FY12 | Q2FY12 | Q3FY12 | YoY (%) | QoQ (%) | YTD'12 | YTD'11 | YoY (%) |
|-----------------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|----------------|----------------|---------------|
| Wireless | 40,644 | 41,978 | 43,267 | 44,170 | 44,470 | 9.4 | 0.7 | 131,907 | 123,785 | 6.6 |
| Global Enterprise | 25,417 | 26,214 | 22,916 | 23,353 | 23,520 | (7.5) | 0.7 | 69,789 | 75,325 | (7.3) |
| Others | 3,107 | 3,643 | 2,780 | 2,827 | 2,292 | (26.2) | (18.9) | 7,899 | 10,439 | |
| Total gross Sales | 69,168 | 71,835 | 68,963 | 70,350 | 70,282 | 1.6 | (0.1) | 209,595 | 209,549 | 0.0 |
| Inter-segmental elimination | 19126.7 | 18524.0 | 19562.0 | 19948.0 | 19760.0 | 3.3 | (0.9) | 59270.0 | 57232.7 | 3.6 |
| Net Sales | 50,041 | 53,311 | 49,401 | 50,402 | 50,522 | 1.0 | 0.2 | 150,325 | 152,316 | (1.3) |
| Network Operating | 12493.0 | 15331.0 | 13335.0 | 13744.0 | 14957.0 | 19.7 | 8.8 | 42,036 | 39,385 | 6.7 |
| as % of sales | 25.0 | 28.8 | 27.0 | 27.3 | 29.6 | | | 28.0 | 25.9 | |
| Employee Expenses | 3558.4 | 4067.0 | 3511.0 | 3300.0 | 2940.0 | (17.4) | (10.9) | 9,751 | 10,690 | (8.8) |
| as % of sales | 7.1 | 7.6 | 7.1 | 6.5 | 5.8 | | | 6.5 | 7.0 | |
| Access Charge | 6639.6 | 6654.6 | 6676.0 | 6510.0 | 6040.0 | (9.0) | (7.2) | 19,226 | 19,822 | (3.0) |
| as % of sales | 13.3 | 12.5 | 13.5 | 12.9 | 12.0 | | | 12.8 | 13.0 | |
| License Fee | 2829.9 | 2606.7 | 2666.0 | 2780.0 | 3010.0 | 6.4 | 8.3 | 8,456 | 8,965 | (5.7) |
| as % of sales | 5.7 | 4.9 | 5.4 | 5.5 | 6.0 | | | 5.6 | 5.9 | |
| Administrative expenses | 7840.0 | 8881.0 | 7192.0 | 8016.0 | 7458.0 | (4.9) | (7.0) | 22,666 | 23,860 | (5.0) |
| as % of sales | 15.7 | 16.7 | 14.6 | 15.9 | 14.8 | | | 15.1 | 15.7 | |
| Total operating expenditure | 33361 | 37540 | 33380 | 34350 | 34405 | 3.1 | 0.2 | 102135 | 102721 | (0.6) |
| EBITDA | 16680 | 15771 | 16021 | 16052 | 16117 | (3.4) | 0.4 | 48,190 | 49,595 | (2.8) |
| Depreciation | 10337.7 | 10050.0 | 9760.0 | 10540.0 | 9780.0 | (5.4) | (7.2) | 30080.0 | 29538.4 | 1.8 |
| EBIT | 6342 | 5721 | 6261 | 5512 | 6337 | (0.1) | 15.0 | 18110 | 20057 | (9.7) |
| Other Income | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | | 0.0 | 0.0 | |
| Interest | 1296.3 | 2234.0 | 4050.0 | 2280.0 | 3780.0 | 191.6 | 65.8 | 10110.0 | 8490.0 | 19.1 |
| Exceptional Item | 0.0 | -123.0 | 10.0 | 0.0 | 0.0 | | | 10.0 | 0.0 | |
| PBT | 5046.1 | 3609.7 | 2201.0 | 3232.0 | 2557.0 | (49.3) | (20.9) | 7990.0 | 11566.7 | (30.9) |
| Tax | -213.7 | 1711.0 | -24.0 | 10.0 | 140.0 | (165.5) | 1,300.0 | 126.0 | -1593.2 | (107.9) |
| PAT before MI | 5260 | 1899 | 2225 | 3222 | 2417 | (54.0) | (25.0) | 7864.0 | 13159.9 | (40.2) |
| MI | 454.2 | 112.4 | 651.0 | 710.0 | 560.0 | | | 1921.0 | 1390.3 | 38.2 |
| Profit from Associates | -3.0 | -99.8 | 0.0 | 10.0 | 10.0 | | | 20.0 | 1.2 | 1,512.9 |
| PAT | 4803 | 1687 | 1574 | 2522 | 1867 | (61.1) | (26.0) | 5963.0 | 11770.8 | (49.3) |

| Margins (%) | | | | | | (bps) | (bps) | | | (bps) |
|-------------|------|------|------|------|------|-------|-------|------|------|-------|
| EBIDTA | 33.3 | 29.6 | 32.4 | 31.8 | 31.9 | (143) | 5 | 32.1 | 32.6 | (50) |
| EBIT | 12.7 | 10.7 | 12.7 | 10.9 | 12.5 | (13) | 161 | 12.0 | 13.2 | (112) |
| EBT | 10.1 | 6.8 | 4.5 | 6.4 | 5.1 | (502) | (135) | 5.3 | 7.6 | (228) |
| PAT | 10.5 | 3.6 | 4.5 | 6.4 | 4.8 | (573) | (161) | 5.2 | 8.6 | (341) |

Wireless business performance

| | 2Q11 | 3Q11 | 4Q11 | 1Q12 | 2Q12 | 3Q12 | QoQ % |
|--------------|---------|---------|---------|---------|---------|---------|-------|
| Revenues | 41,613 | 40,644 | 41,978 | 43,267 | 44,170 | 44,470 | 0.7% |
| EBIDTA | 12,101 | 11,792 | 11,490 | 11,727 | 11,756 | 11,823 | 0.6% |
| EBIDTA % | 29.1 | 29.0 | 27.4 | 27.1 | 26.6 | 26.6 | |
| Subs ('000) | 117,337 | 125,652 | 135,718 | 143,265 | 147,087 | 150,078 | 2.7% |
| ARPU (Rs) | 122 | 111 | 107 | 103 | 101 | 100 | -1.0% |
| MOU (mins) | 276 | 251 | 241 | 233 | 227 | 224 | -1.3% |
| RPM (Re) | 0.44 | 0.44 | 0.44 | 0.44 | 0.45 | 0.45 | 0.0% |
| Minutes (bn) | 94.5 | 91.5 | 94.5 | 97.3 | 98.9 | 99.8 | 1.0% |

EPS estimate revised downward by 29.9%/29.4 for FY12E/13E

Led by lower than expected results for Q3FY12, we have revised our estimates downwards. Tariff hike has not shown any signs of improvement in ARPU for RCOM, unlike its peers. After showing some signs of revival in wireless revenue in Q2FY12, Q3FY12 again witnessed submissive performance. We have cut our EBITDA estimate for FY12E/13E by 4.4%/4.0%. Significant increase in finance charges has led to revision in EPS estimates. Cut in revenue, EBITDA estimate and adjusting for higher interest cost led to our EPS downgrade of 29.9%/29.4 for FY12E/13E.

| | FY12E | | | FY13E | | |
|----------|--------|--------|---------|--------|--------|--------|
| | Old | New | Chg % | Old | New | Chg % |
| Revenues | 208543 | 201665 | -3.3% | 240887 | 231351 | -4.0% |
| EBIDTA | 67974 | 65006 | -4.4% | 80107 | 76931 | -4.0% |
| EBIDTA % | 32.6 | 32.2 | -36 bps | 33.3 | 33.3 | 0 bps |
| PAT | 9940 | 6965 | -29.9% | 15792 | 11153 | -29.4% |
| EPS | 4.8 | 3.4 | -29.9% | 7.7 | 5.4 | -29.4% |

Financials

Income Statement

| Y/E, Mar (Rs. mn) | FY10 | FY11 | FY12E | FY13E |
|------------------------------------|----------------|----------------|----------------|----------------|
| Net Sales | 214,964 | 224,304 | 201,665 | 231,351 |
| <i>Growth (%)</i> | -3.4 | 4.3 | -10.1 | 14.7 |
| Employee cost | 15,001 | 14,757 | 12,711 | 13,067 |
| Marketing expenses | 35,334 | 32,740 | 30,227 | 35,059 |
| Access charge | 21,377 | 26,476 | 25,360 | 29,322 |
| Network operating charge | 59,955 | 54,716 | 56,837 | 64,541 |
| License fee | 11,451 | 11,572 | 11,523 | 12,430 |
| Total operating expenditure | 143,118 | 140,261 | 136,659 | 154,419 |
| EBITDA | 71,846 | 84,044 | 65,006 | 76,931 |
| <i>Growth (%)</i> | -16.5 | 17.0 | -22.7 | 18.3 |
| Depreciation | 37,465 | 65,038 | 41,976 | 51,025 |
| Other non-operating expenses | 375 | -121 | 10 | 0 |
| EBIT | 34,006 | 19,126 | 23,020 | 25,906 |
| <i>EBIT margin (%)</i> | 15.8 | 8.5 | 11.4 | 11.2 |
| Other Income | 6,359 | 6,773 | 500 | 2,000 |
| Interest expenses | -11,863 | 10,722 | 13,879 | 14,137 |
| PBT | 52,228 | 15,177 | 9,642 | 13,770 |
| Tax | 4,454 | 118 | 225 | 1,377 |
| <i>Effective tax rate (%)</i> | 8.5 | 0.8 | 2.3 | 10.0 |
| PAT before MI | 47,774 | 15,059 | 9,416 | 12,393 |
| Share of MI and Associates | 1,224 | 1,602 | 2,451 | 1,239 |
| Adjusted PAT | 46,550 | 13,457 | 6,965 | 11,153 |

Cash Flow

| Y/E, Mar (Rs. mn) | FY10 | FY11 | FY12E | FY13E |
|---------------------------|----------------|----------------|----------------|----------------|
| PBT | 45,837 | 8,305 | 9,172 | 11,770 |
| Depreciation | 37,465 | 65,038 | 41,976 | 51,025 |
| Interest | -11,863 | 10,722 | 13,879 | 14,137 |
| Other Non-Cash items | -34,117 | -38,091 | -30 | 0 |
| Chg in working cap | 3,465 | -50,340 | -2,753 | 7,218 |
| Tax paid | -4,454 | -118 | -225 | -1,377 |
| Operating Cashflow | 36,333 | -4,483 | 62,019 | 82,772 |
| Capital expenditure | -22,951 | -81,911 | -15,000 | -18,200 |
| Free Cash Flow | 13,382 | -86,394 | 47,019 | 64,572 |
| Other income | 6,359 | 6,773 | 500 | 2,000 |
| Investments | 56,266 | 38,305 | 30 | 0 |
| Investing Cashflow | 39,674 | -36,833 | -14,470 | -16,200 |
| Equity Capital Raised | 0 | 158 | -30 | 0 |
| Loans Taken / (Repaid) | -94,468 | 93,560 | -45,000 | -25,000 |
| Interest Paid | 11,863 | -10,722 | -13,879 | -14,137 |
| Dividend paid (incl tax) | -2,046 | -1,203 | -1,203 | -1,203 |
| Financing Cashflow | -84,651 | 81,792 | -60,112 | -40,340 |
| Net chg in cash | -8,644 | 40,476 | -12,563 | 26,232 |
| Opening cash position | 16,829 | 8,185 | 48,661 | 36,098 |
| Closing cash position | 8,185 | 48,661 | 36,098 | 62,330 |

Balance Sheet

| Y/E, Mar (Rs. mn) | FY10 | FY11 | FY12E | FY13E |
|--------------------------------|----------------|----------------|----------------|----------------|
| Equity share capital | 10,320 | 10,320 | 10,320 | 10,320 |
| Reserves & surplus | 423,286 | 394,673 | 400,435 | 410,385 |
| Net worth | 433,606 | 404,993 | 410,755 | 420,705 |
| Minority Interest | 6,584 | 8,245 | 10,696 | 11,935 |
| Loan Funds | 297,154 | 390,714 | 345,714 | 320,714 |
| Net deferred tax liability | 991 | 3,668 | 3,668 | 3,668 |
| Total Liabilities | 738,335 | 807,619 | 770,832 | 757,022 |
| Gross Block | 786,653 | 820,906 | 864,106 | 892,306 |
| Less: Depreciation | 190,671 | 273,407 | 315,383 | 366,408 |
| Net block | 595,982 | 547,500 | 548,723 | 525,898 |
| Capital work in progress | 116,557 | 181,912 | 153,712 | 143,712 |
| Investment | 41,599 | 5,698 | 5,698 | 5,698 |
| Goodwill | 49,976 | 47,473 | 47,473 | 47,473 |
| Current Assets | 121,573 | 164,645 | 150,403 | 189,316 |
| Inventories | 5,446 | 5,172 | 5,680 | 6,444 |
| Sundry debtors | 33,117 | 39,840 | 38,676 | 44,369 |
| Cash & bank balance | 8,185 | 48,661 | 36,098 | 62,330 |
| Loans & advances | 54,098 | 50,863 | 50,133 | 53,691 |
| Other current assets | 20,726 | 20,110 | 19,816 | 22,482 |
| Current liab & Prov | 187,351 | 139,608 | 135,177 | 155,075 |
| Current liabilities | 147,085 | 106,018 | 104,976 | 120,429 |
| Provisions | 40,267 | 33,591 | 30,200 | 34,646 |
| Net current assets | -65,778 | 25,037 | 15,226 | 34,240 |
| Total Assets | 738,335 | 807,619 | 770,832 | 757,022 |

Key Ratios

| Y/E, Mar | FY10 | FY11 | FY12E | FY13E |
|----------------------------|-------|-------|-------|-------|
| Profitability (%) | | | | |
| Core EBITDA Margin | 33.4 | 37.5 | 32.2 | 33.3 |
| Net Margin | 14.6 | 8.4 | 11.2 | 10.1 |
| ROCE | 8.8 | 4.7 | 3.8 | 4.7 |
| ROE | 10.4 | 2.8 | 2.3 | 2.9 |
| Per Share Data (Rs) | | | | |
| EPS (adjusted) | 22.6 | 6.5 | 3.4 | 5.4 |
| CEPS | 40.1 | 37.3 | 24.9 | 30.7 |
| BVPS | 213.3 | 200.2 | 204.2 | 209.6 |
| DPS | 0.8 | 0.5 | 0.5 | 0.5 |
| Valuations (x) | | | | |
| PER | 4.2 | 14.4 | 27.8 | 17.4 |
| P/CEPS | 2.3 | 2.5 | 3.8 | 3.1 |
| P/BV | 0.4 | 0.5 | 0.5 | 0.4 |
| EV / Sales | 1.1 | 2.0 | 2.0 | 1.7 |
| EV / EBITDA | 6.1 | 6.3 | 7.7 | 5.8 |
| Dividend Yield (%) | 0.9 | 0.5 | 0.5 | 0.5 |
| Gearing Ratio (x) | | | | |
| Net Debt/ Equity | 0.1 | 0.4 | 0.3 | 0.2 |
| Net Debt/EBITDA | 3.2 | 3.7 | 4.6 | 3.2 |

Recommendation History: Reliance Communications – RCOM IN

| Date | Reports | Reco | CMP | Target |
|------------|---|--------|-----|--------|
| 14/11/2011 | Reliance Communication Q2FY12 Result Update | Hold | 82 | 82 |
| 17/08/2011 | Reliance Communication Q1FY12 Result Update | Hold | 77 | 82 |
| 31/05/2011 | Reliance Communication Q4FY11 Result Update | Reduce | 88 | 85 |
| 15/02/2011 | Reliance Communication Q3FY11 Result Update | Reduce | 97 | 85 |

Recent Research Reports

| Date | Reports | Reco | CMP | Target |
|------------|---|------------|-----|--------|
| 02/02/2012 | Telecom Sector Update | | | |
| 09/02/2012 | Tulip Telecom Q3FY12 Result Update | Hold | 115 | 124 |
| 08/02/2012 | Bharti Airtel Q3FY12 Result Update | Accumulate | 354 | 412 |
| 01/02/2012 | Jagran Prakashan Q3FY12 Result Update | Accumulate | 97 | 116 |

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