

Reliance Communications – REDUCE



RCOM IN

Rs144

Telecom

17 May 2010

Result preview

Wireless revenues flat while margins contract

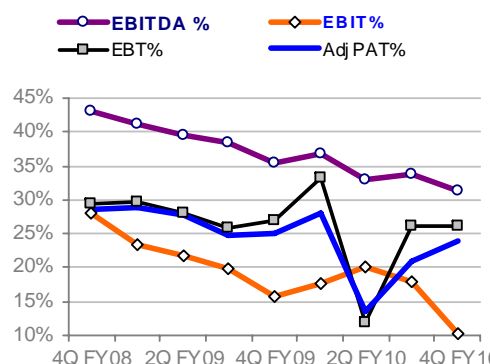
RCOM's 4QFY10 results were characterised by: 1) overall revenue decline of 3.6% QoQ, with flat wireless revenues; 2) muted traffic growth of 5%, lower than the growth reported by industry peers; 3) RPM flat at Rs0.44 (but Bharti is still higher at Rs0.47); and 4) EBITDA margin down 236bps QoQ. Reported revenues came in at Rs51bn, with EBITDA of Rs16bn at 31.5%. Excess financing gains (FX gains) contributed to PAT, which came in at Rs12bn. Capex in the quarter was materially lower at Rs8.8bn, as against Rs13.3bn in 3Q. We retain REDUCE with 12m TP of Rs140.

Traffic growth disappoints, RPMs surprise on the upside: Wireless segment revenues grew 1.6% QoQ on account of moderate traffic growth of 5%, and RPM drop of only 2.2%. EBITDA margin for the wireless segment contracted 230bps to 28.9%, driven by higher licence and access charges and network opex, which is due to traffic growth. RCOM has seen deteriorating margins in the segment for the last 8-9 quarters, with peak EBITDA margin of ~40% achieved in 1QFY09. ARPUs fell to Rs139, down 6.7%

Global net revenues grow, while Broadband/other business (DTH) decline: RCOM's global business saw a net revenue growth of 24%, mainly on account of abnormally low licence and access charges and 18% growth in NLD minutes. Broadband revenues declined 3.5%, as ARPUs fell 6%, with flat subscriber additions (14,000). The other business declined sharply by 10%, contributing negative EBITDA of Rs 1.76bn.

Recent TRAI recommendations to be +ve for RCOM: Recent recommendations released by TRAI will have a disproportionately favourable impact on RCOM, with: 1) highest priority in gaining incremental spectrum; 2) lower spectrum fee; and 3) little impact from the one-time charge imposed on incumbents with spectrum beyond 6.2Mhz (GSM). If the recommendations were to be accepted, RCOM would be positively affected relative to the other telcos. We believe that the recommendations in the current form may not go through.

RCOM's EBITDA% falling for 8-9 quarters



Source: IIFL Research

Quarterly Result Summary

Rs. mn	4Q FY09	3Q FY10	4Q FY10	% YoY	% QoQ
Total Revenues	57,978	52,836	50,928	-12.2%	-3.6%
Access & Licence charges	9,506	8,337	8,992	-5%	8%
Network Opex	13,582	13,915	15,251	12.3%	9.6%
Personnel Expenditure	4,213	3,677	3,396	-19.4%	-7.6%
SG&A	10,104	9,043	7,300	-27.8%	-19.3%
EBIDTA	20,573	17,864	16,019	-22.1%	-10.3%
EBIDTA %	35.5%	33.8%	31.5%	-403bps	-236bps
Depreciation and Amortization	11,426	8,331	10,847	-5.1%	30.2%
Interest Expenses (Income)	-1,678	-4,075	-8,134	384.7%	99.6%
Other Income	4829	262	15	-99.1%	-94.3%
Tax	485	2,003	1,923	296.5%	-4.0%
Adjusted PAT	14,544	11,301	12,224	-15.9%	10.3%
Adj. PAT Margin	19.7%	21.4%	24.0%	433bps	262bps
Extra ordinary expense/(income)		-221			
Reported PAT	11,404	11,080	12,224	7.2%	10.3%

12-mth TP (Rs) 140 (-3%)

Market cap (US\$ m) 6,593

52Wk High/Low (Rs) 362/142

Diluted o/s shares (m) 2064

Daily volume (US\$ m) 13

Dividend yield FY10ii (%) 0.6

Free float (%) 32.7

Shareholding pattern (%)

Promoters 67.3

FII's 9.4

DII's 9.8

American Depository Receipts 0.0

Price performance (%)

1M 3M 1Y

RCOM -15.8 -14.8 -35.7

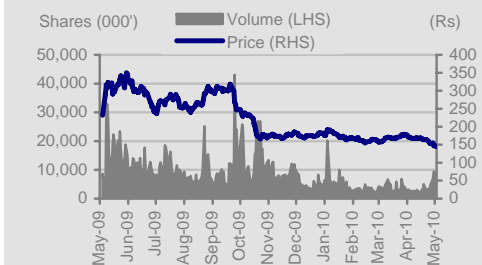
Rel. to Sensex -11.2 -20.0 -78.9

Bharti Airtel -13.8 -15.9 -30.8

Idea -15.7 -2.2 -5.4

MTNL -12.6 -12.1 -15.5

Stock movement



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Figure 1: Quarterly result summary

(Rs. mn)	4Q FY09	3Q FY10	4Q FY10	% YoY	% QoQ
Total Revenues	57,978	52,836	50,928	-12.2%	-3.6%
Expenditure:					
Access	6,528	5,501	6,294	-3.6%	14.4%
Licence	2,978	2,836	2,668	-10.4%	-5.9%
Network Opex	13,582	13,915	15,251	12.3%	9.6%
Personnel Expenditure	4,213	3,677	3,396	-19.4%	-7.6%
SG&A	10,104	9,043	7,300	-27.8%	-19.3%
Total Cost	37,405	34,971	34,909	-6.7%	-0.2%
EBIDTA	20,573	17,864	16,019	-22.1%	-10.3%
EBIDTA Margin	35.5%	33.8%	31.5%	-403bps	-236bps
Depreciation and Amortization	11,426	8,331	10,847	-5.1%	30.2%
EBIT	9,147	9,534	5,172	-43.5%	-45.7%
EBIT%	15.8%	18.0%	10.2%	-562bps	-789bps
Interest Expenses	-1,678	-4,075	-8,134	384.7%	99.6%
Other Income	4,829	262	15	-99.7%	-94.3%
Profit before Tax	15,654	13,871	13,321	-14.9%	-4.0%
Tax	485	2,003	1,923	296.5%	-4.0%
Other provisions / minority etc	625	568	-826	-232.2%	-245.4%
Adjusted PAT	14,544	11,301	12,224	-15.9%	8.2%
Adj. PAT Margin	25.1%	21.4%	24.0%	-108bps	262bps
Extra ordinary expense/(income)		-221			
Reported PAT	14,544	11,080	12,224	-15.9%	10.3%

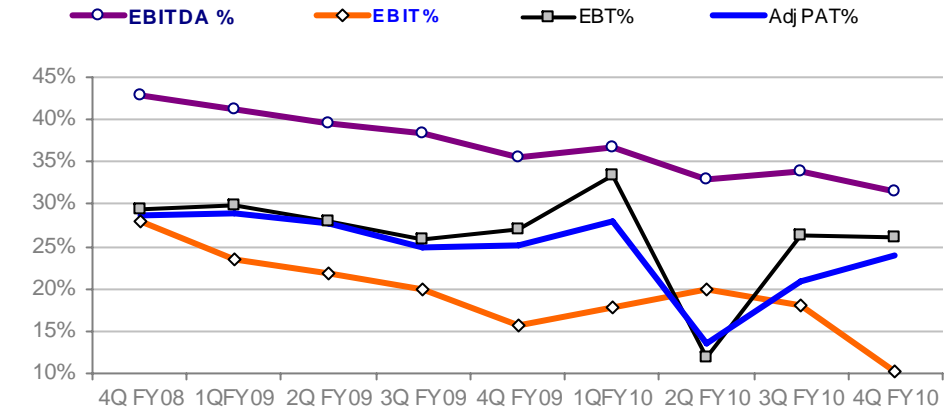
Source: IIFL Research

Figure 2: RCOM's KPIs have been under pressure over the last few quarters

	1QFY10	2Q FY10	3Q FY10	4Q FY10
Wireless net adds (mn)	80	86	94	102
Gross ARPU (Rs)	210	161	149	139
Traffic (bn mins)	83.3	84.5	89.0	93.5
MoUs (per sub)	365	340	330	318
RPM (Rs)	0.58	0.47	0.45	0.44

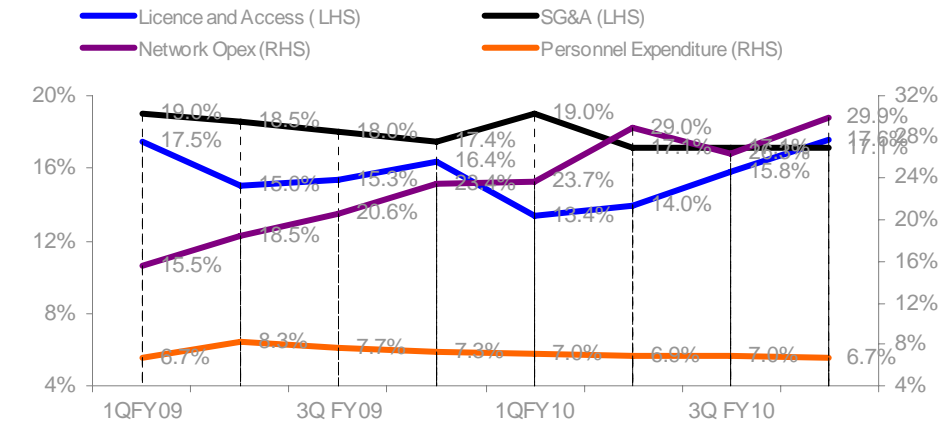
Source: IIFL Research

Figure 3: EBITDA margins have declined in the last 8-9 quarters



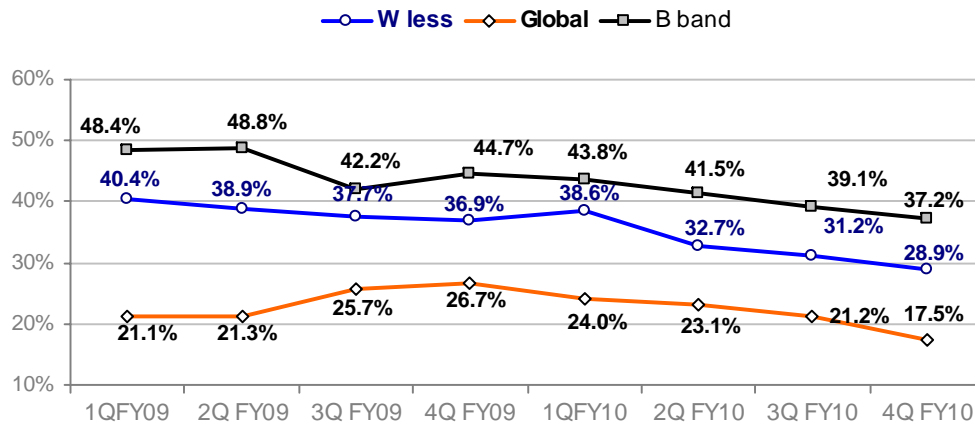
Source: IIFL Research

Figure 4: Licence and access charges and network opex have steadily increased as proportion of revenues



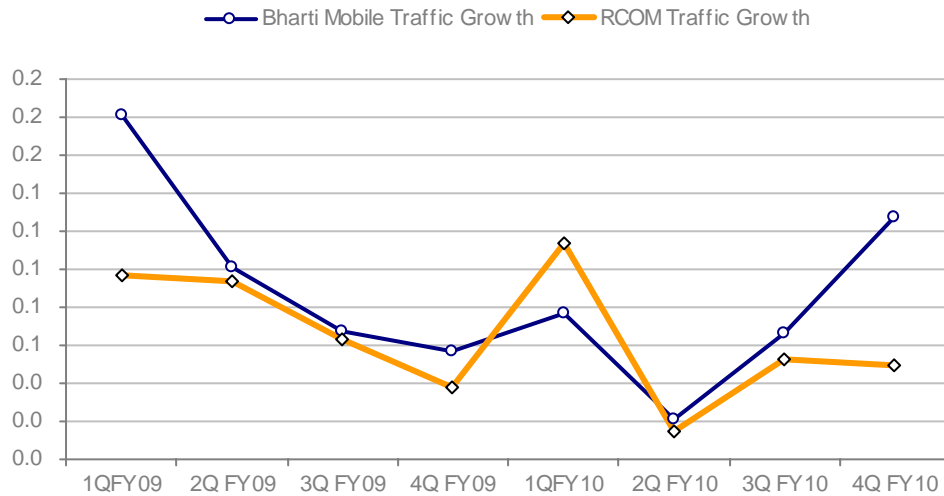
Source: IIFL Research

Figure 5: All business verticals including Wireless, Global and Broadband have registered EBITDA margin decline



Source: Company, IIFL Research

Figure 6: RCOM has been consistently lagging behind Bharti in terms of traffic growth



Source: Company, IIFL Research



Key to our recommendation structure

BUY - Absolute - Stock expected to give a positive return of over 20% over a 1-year horizon.

SELL - Absolute - Stock expected to fall by more than 10% over a 1-year horizon.

In addition, **Add** and **Reduce** recommendations are based on expected returns relative to a hurdle rate. Investment horizon for **Add** and **Reduce** recommendations is up to a year. We assume the current hurdle rate at 10%, this being the average return on a debt instrument available for investment.

Add - Stock expected to give a return of 0-10% over the hurdle rate, ie a positive return of 10%+.

Reduce - Stock expected to return less than the hurdle rate, ie return of less than 10%.

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