

## Company Flash

1 February 2008 | 6 pages

# Reliance Communications (RLCM.BO)

## Hold: 3QFY08 Slightly Below, GSM Launch Some Time Away

- EBITDA slightly below expectations** — RCOM's 3QFY08 EBITDA at Rs21.0bn was slightly below expectations as wireless revenue growth was affected by lower-than-expected ARPUs. PAT was lower despite higher other income, partially due to higher tax rates (9%).
- Wireless KPIs still getting rebalanced, ARPU decline not as bad as it seems** — MOU decline was a sharp 8%qoq unlike peers but was a result of reduced free promotional minutes. As a result, rev/min inched up resulting in only 6%qoq decline in ARPUs. In fact, ARPU decline would have been only 2%qoq (in-line with peers) after adjusting for the Rs1.67bn refund booked in 2Q. Reduced losses in "Others" segment indicate possible lowering of subsidies as well.
- GSM launch in 4QFY09, capex significantly higher** — Management indicated target GSM launch date of 4QFY09 (slightly later than we expected), which will coincide with targeted 60k towers by Mar-09 (36k in Mar-08) in the towerco. FY08E capex guidance was US\$5.2bn (US\$2.0bn for towerco + US\$2.5bn RCOM + US\$0.7bn for Yipes and GSM entry fee). FY09E capex target of US\$6.0bn seems high notwithstanding towerco capex (US\$2.0bn) and GSM active (US\$1.3bn), and implies parallel capex on CDMA during FY09E.
- Reality check on GSM option value?** — Our target price includes GSM option value of Rs115/share factoring in cum. market share gains of 3-5% over FY09-10E, which now seems very optimistic in the context of the 4QFY09 GSM launch. Maintain Hold (2L).

<b>Hold/Low Risk</b>	<b>2L</b>
Price (31 Jan 08)	Rs601.95
Target price	Rs835.00
Expected share price return	38.7%
Expected dividend yield	0.2%
<b>Expected total return</b>	<b>38.9%</b>
Market Cap	Rs1,242,424M
	US\$31,614M

### Price Performance (RIC: RLCM.BO, BB: RCOM IN)



Figure 1. Statistical abstract

Rs m	Sep-06	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07	Q/Q%	Y/Y%
Net Revenues	35,260	37,553	39,369	43,037	45,785	48,742	6.5	29.8
Access & IUC	(6,087)	(6,356)	(6,696)	(6,076)	(5,837)	(7,060)	21.0	11.1
Other opex	(12,666)	(12,791)	(13,040)	(15,208)	(16,421)	(16,489)	0.4	28.9
License Fees	(2,981)	(3,135)	(3,281)	(3,611)	(3,909)	(4,128)	5.6	31.7
EBITDA	13,526	15,272	16,352	18,142	19,618	21,065	7.4	37.9
PBT	7,233	9,404	10,366	13,224	13,989	15,331	9.6	63.0
PAT	7,169	9,274	10,217	12,193	13,291	13,952	5.0	50.4

Source: Citi Investment Research

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Figure 2. Wireless Summary

Rs m	Sep-06	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07	Remarks
Wireless Revenue	25,744	27,520	29,692	33,730	37,230	39,567	11% qoq growth adjusted for Rs1.67 refund in 2Q
Net revenue	17,998	19,308	20,673	24,244	27,722	28,892	
Wireless EBITDA	9,294	10,293	11,511	13,392	14,873	15,819	
Wireless EBITDA margin (%)	36.1	37.4	38.8	39.7	39.9	40.0	Scale economies help in margin expansion
ARPU	354	328	377	375	361	339	Adjusted decline of only 2% qoq
MoU	461	454	541	510	490	449	Impacted by reduced free minutes
Pre-paid as % of net adds	94.6	92.3	96.3	97.0	99.2	98.1	Ongoing trend
Non-voice revenue %	6.3	6.3	6.3	5.7	6.2	6.4	
Minutes of usage (bn min)	33.5	38.1	42.5	45.8	50.7	52.5	Robust increase in network usage
Revenue per min (Rs)	0.77	0.72	0.70	0.74	0.73	0.75	Inched up due to lower free mins
EBITDA per min (Rs)	0.28	0.27	0.27	0.29	0.29	0.30	
Capex per min	7.2	2.6	2.2	4.5	10.1	33.7	Upfronting of capex on towers which will be fully used post-GSM launch

Source: Citi Investment Research

Figure 3. Global Business Summary

Rs m	Sep-06	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07	Remarks
NLD mins (m)	4,339	4,715	4,873	5,639	5,853	5,795	Possibly on account of lower free mins
ILD mins (m)	1,361	1,472	1,503	1,590	1,688	1,747	
Global Business Revenue	13,158	13,335	12,938	13,033	13,161	13,299	
Global Business EBITDA	3,199	3,552	3,121	3,239	3,276	3,428	
Global Business EBITDA margin (%)	24.3	26.6	24.1	24.9	24.9	25.8	
Net retention per LD min (Rs)	0.60	0.55	0.55	0.50	0.45	0.40	

Source: Citi Investment Research

Figure 4. Broadband Business Summary

Rs m	Sep-06	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07	Remarks
Broadband revenues	2,710	3,161	3,299	3,833	4,371	4,564	Robust growth continues
Broadband EBITDA	1,215	1,486	1,611	1,836	2,102	2,222	
Broadband EBITDA margin (%)	44.8	47.0	48.8	47.9	48.1	48.7	
ARPL (Rs)	2420	2206	1932	1929	1948	1797	Focusing on quality of subscribers
Towns active (wireline only)	30	30	40	42	42	42	
Buildings directly connected	269,676	379,000	488,661	593,805	666,368	727,229	Sustained pace of rollout

Source: Citi Investment Research

## Reliance Communications

### Company description

RCOM is an integrated player in the Indian telecoms sector. It was listed on the Indian stock exchanges following the de-merger of Reliance Industries. RCOM is the second-largest player in the mobile segment, has an 80,000km-long India-wide optic-fiber network and owns the FLAG submarine cable network. RCOM has three business units: 1) Wireless, which includes a nationwide wireless network on CDMA and GSM; 2) Global Business comprising wholesale voice and data; and 3) Broadband for both retail and enterprise.

## Investment strategy

We rate RCOM Hold/Low Risk. Continued expansion of the wireless market and RCOM's ability to capture its due market share profitably will, in our view, be a recurring theme. The wireless business has maintained return parameters despite lower revenue yields. Competitive pressures, though intense, should continue to be rational. RCOM's GSM foray has gained visibility with TRAI's and TEC proposals. RCOM has higher market shares in dual technology circles as compared to single technology circles. Yet there are inherent risks in the execution of the dual network strategy (i.e. cost duplication, low market share gains) that cannot be wished away. Spectrum allocation could get delayed if legal wrangles prolong and/or Defence delays release of 20 Mhz.

## Valuation

Our 12-month forward target price of Rs835 is based on a core business fair value of Rs650, a GSM option value of Rs115, a net towerco value of Rs50 and Flag's potential value unlocking at Rs20. We usually value Indian wireless plays on DCF given the back-ended nature of profits and cash flow. For RCOM, however, we use EV/EBITDA. Our 12-month core business value of Rs650 is based on 11.9x FY09E EV/EBITDA, a 5% discount to Bharti's implied target multiple (ex- towerco). Higher-than-average earnings growth (CAGR of 37% over FY07-10E) and the low sensitivity of wireless demand to interest rates should continue to support premium valuations for the sector, in our view.

## Risks

Our risk-rating system, which tracks 260-day share price volatility, assigns a High Risk rating to RCOM, but we believe Low Risk is more appropriate. RCOM has been de-merged from Reliance Industries, and its shareholding at the time of listing mirrored the holding of RIL. The stock is therefore unlikely to have risks that are typical of newly listed companies. Besides, growth in the telecoms sector gives visibility to RCOM's prospects. Downside risks to our target price include smaller-than-expected market share, lower-than-anticipated operating leverage (especially in FY07) due to handset subsidies, cost-overruns in GSM overlay, regulatory and competition risks, unremunerative capex and delays in the ongoing re-organization and more telecom-related paper.

# Appendix A-1

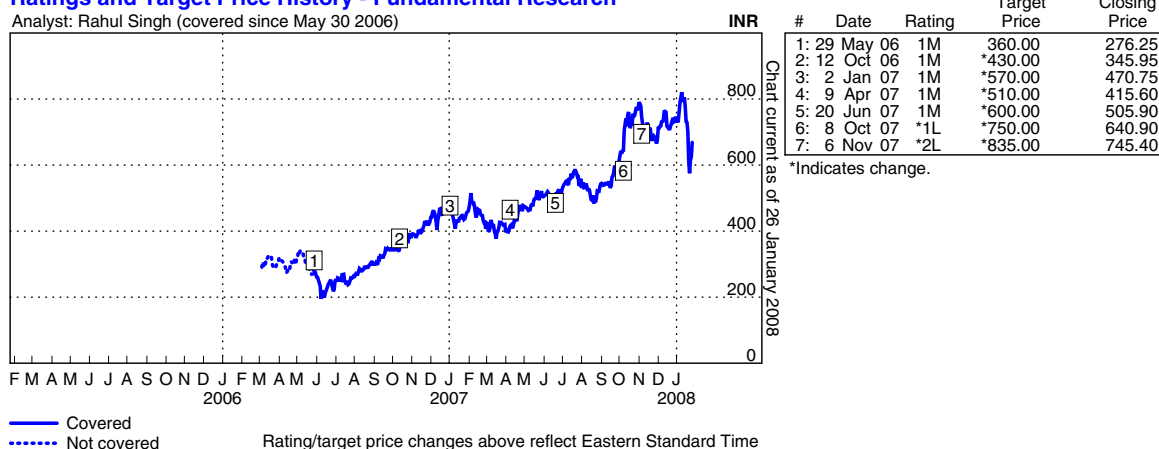
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