

Reliance Communication (RELCOM)

₹ 170

Rating matrix

Rating	: REDUCE
Target	: ₹ 162
Target Period	: 12 months
Potential Upside	: -5%

Key Financials

₹ Crore	FY09	FY10E	FY11E	FY12E
Net Sales	22,242	21,613.6	20,662.1	22,488.6
EBITDA	8,598.5	7,250.2	6,416.2	6,965.0
Net Profit	6,044.9	4,703.4	1,242.1	1,893.1
EPS (Rs)	29.3	22.8	6.0	9.2

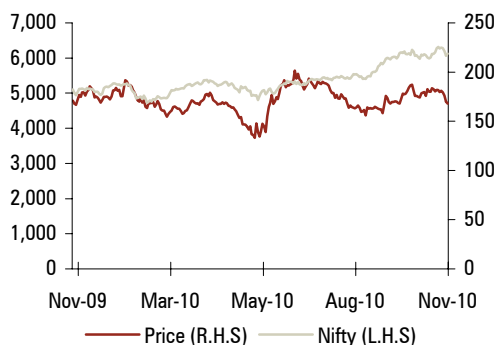
Valuation summary

	FY09	FY10E	FY11E	FY12E
P/E	6.1	7.9	29.4	19.5
Target P/E	5.5	7.1	26.5	17.6
EV / EBITDA	8.7	7.9	10.8	9.4
Price /BV	0.9	0.8	0.8	0.7
RoNW (%)	14.3	10.0	2.6	3.8
RoCE (%)	4.8	4.8	2.9	3.1

Stock data

Market Capitalization	35,088.3
Total Debt (FY10E)	24,747.3
Cash and Investments (FY10E)	4,354.0
EV	55,481.6
52 week H/L	202 / 133
Equity capital	1,032.0
Face value	Rs 5
MF Holding (%)	9.2
FII Holding (%)	8.4

Price movement (Stock vs. Nifty)



Analyst's name

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WHAT'S CHANGED...

PRICE TARGET	Unchanged
EPS (FY11E)	Changed from ₹ 5.7 to ₹ 6.1
EPS (FY12E)	Unchanged
RATING.....	Unchanged

Freeing 'free minutes' to stabilise business...

Reliance Communication (Rcom) reported its Q2FY11 results that were slightly below expectations. The company reported a topline of ₹ 5023.0 crore against our expectation of ₹ 6123.0 crore, declining 8.6% YoY. However, it remained flat sequentially. The decline in revenue was led by an 18.8% and 14.1% YoY decline in global and broadband revenue. EBITDA for the quarter declined 13.8% YoY and 1.7% QoQ to ₹ 1564.2 crore. EBITDA margin at 31.1% declined 186 bps YoY and marginally declined by 26 bps QoQ. PAT margin was at 8.9%. Margin improvement was led by lower interest cost due to lower MTM losses. PAT stood at ₹ 445.9 crore, improving 77.7% QoQ and declining 39.8% YoY.

Highlights for the quarter

RCom has been focusing on the paid minutes and it is reducing free minutes on the network in the last couple of quarters to arrest the declining ARPM. Due to seasonality, the MoU has fallen by 6.4% QoQ to 276. This has resulted in a mere 0.1% increase in traffic on network at 94.6 billion minutes on the network. ARPM stood at ₹ 0.44, steady QoQ. ARPU for RCom fell by 6.2% to ₹ 122. Wireless revenues have improved by 3.8% YoY and a mere 0.2% QoQ. Revenues from the global segment fell 18.8% YoY and improved 1.4% QoQ. Lower MTM loss of ₹ 50 crore as compared to ₹ 200 crore in the last quarter aided the PAT in Q2FY11.

Valuation

At the CMP of ₹ 170, the stock is trading at 28.2x FY11E EPS of ₹ 5.1 and 18.5x FY12E EPS of ₹ 9.2. We have valued the stock using DCF methodology and arrived at a target price of ₹ 162/ share, assuming 7.3% CAGR in revenue over FY11E–FY20E and terminal growth rate of 3%. Our target price discounts the FY11E and FY12E EPS by 26.9x and 17.6x, respectively. We reiterate our rating on the stock as **REDUCE**.

Exhibit 1: Performance Highlights

(₹ Crore)	Q2FY11	Q2FY11E	Q2FY10	Q1FY11	QoQ (Chg %)	YoY (Chg %)
Net Sales	5023.0	5163.0	5496.3	5068.5	-0.9	-8.6
EBITDA	1564.2	1572.9	1813.6	1591.3	-1.7	-13.8
EBITDA Margin (%)	31.1	30.5	33.0	31.4	-26 bps	-186 bps
Depreciation	955.3	1005.7	714.4	964.8	-1.0	33.7
Interest	279.7	282.6	655.3	439.7	-36.4	-57.3
Other Income	0.0	0.0	0.0	0.0	NA	NA
Reported PAT	445.9	274.4	740.2	250.9	77.7	-39.8
EPS (₹)	2.2	1.3	3.6	1.2	77.7	-39.8

Source: Company, ICICIdirect.com Research

Result Analysis

▪ **Stable EBITDA margins, forex gain aid PAT**

The EBITDA margin declined 186 bps YoY and 26 bps QoQ, primarily due to lower revenue realisation as compared to the same period last year. EBITDA margins for the mobility business improved slightly by 20 bps to 29.1% QoQ.

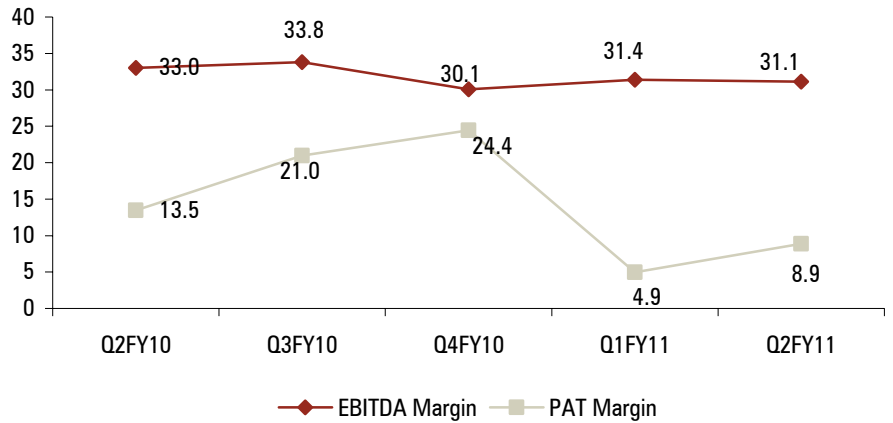
EBITDA margin declined by 186 bps YoY and 26 bps QoQ primarily due to lower revenue realisation as compared to the same period last year. EBITDA margins for the mobility business improved slightly by 20 bps to 29.1% QoQ.

The consolidated EBITDA margins were supported by lower SG&A expenses, which declined as one-time expenses charged in Q1FY11, got adjusted in Q2FY11.

However, the company reported an improvement in PAT margin of 8.9% after its worst ever PAT margin at 4.9% in Q1FY11. The net profit improved by 77.7% QoQ to ₹ 445.9 crore led by lower MTM losses. Finance cost for the quarter stood at ₹ 279.7 crore as compared to ₹ 439.7 crore in the last quarter.

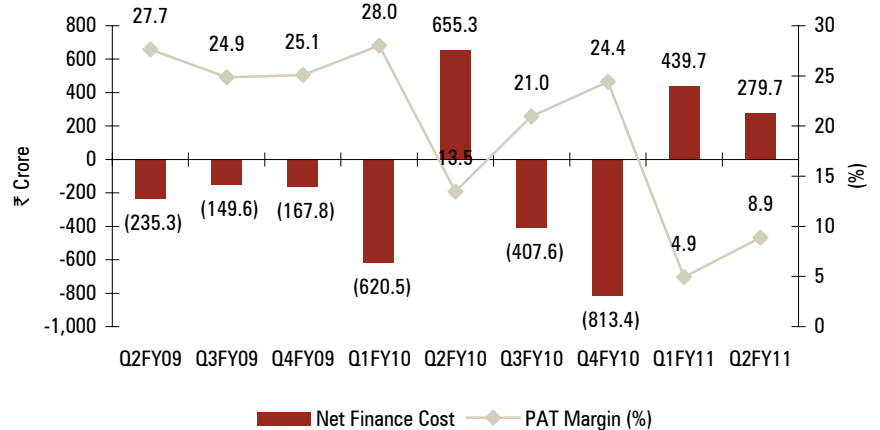
However, the company reported an improvement in PAT margin of 8.9% after its worst ever PAT margin of 4.9% in Q1FY11. The net profit improved by 77.7% QoQ to ₹ 445.9 crore led by lower forex losses

Exhibit 2: EBITDA and PAT margin



Source: Company, ICICIdirect.com Research

Exhibit 3: Net finance cost impacts PAT

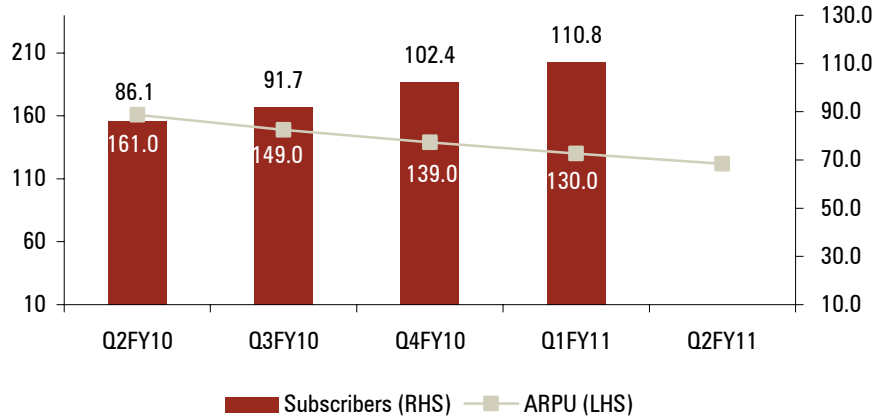


Source: Company, ICICIdirect.com Research

Wireless business

Revenues from this segment stood at ₹ 4161.3 crore remaining flat as compared to last quarter’s revenue of ₹ 4152.8 crore. The company added 6.5 million subscribers in the quarter. The ARPU for the quarter for RCom fell by 6.9% to ₹ 122, in line with other players (Bharti and Idea).

Exhibit 4: Wireless – Subscribers and ARPU

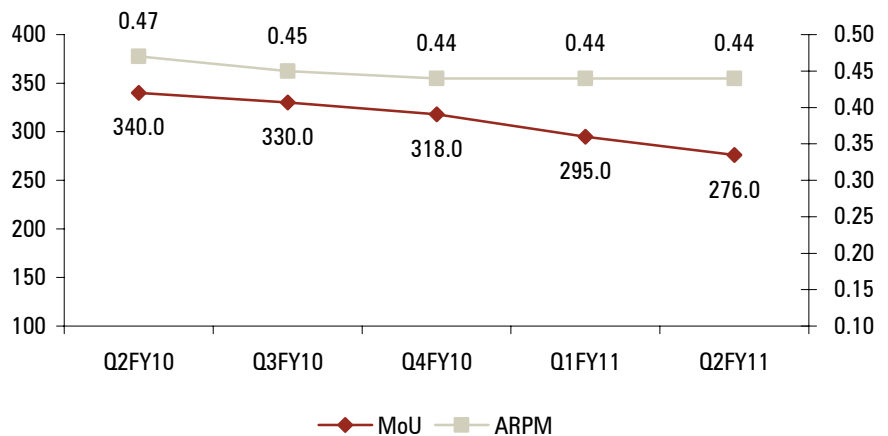


Source: Company, ICICIdirect.com Research

The company added 7.6 million subscribers in the quarter. The ARPU for the quarter for RCom fell by 6.5% to ₹ 130 while the same has fallen by 2.4% for Bharti Airtel and 1.6% for Idea Cellular

Reliance Communication has been focusing on the paid minute strategy from the last couple of quarters and is reducing the free minutes on the network to arrest the ARPM decline. Due to seasonality impact, the MoU has fallen by 6.4% QoQ to 276. However, the minutes on the network remained flat at 94.6 billion minutes. ARPM for the quarter stood at ₹ 0.44 in line with its competitors. A stable ARPM has led to stabilisation in wireless revenues, which improved by a mere 0.2% QoQ.

Exhibit 5: Wireless – MoU and ARPM



Source: Company, ICICIdirect.com Research

Reliance Communication has been focusing on the paid minute strategy from the last couple of quarters and is reducing the free minutes on network to arrest ARPM decline. Due to the seasonality impact, the MoU has fallen by 6.4% QoQ to 276. ARPM for the quarter stood at ₹ 0.44 in line with its competitors

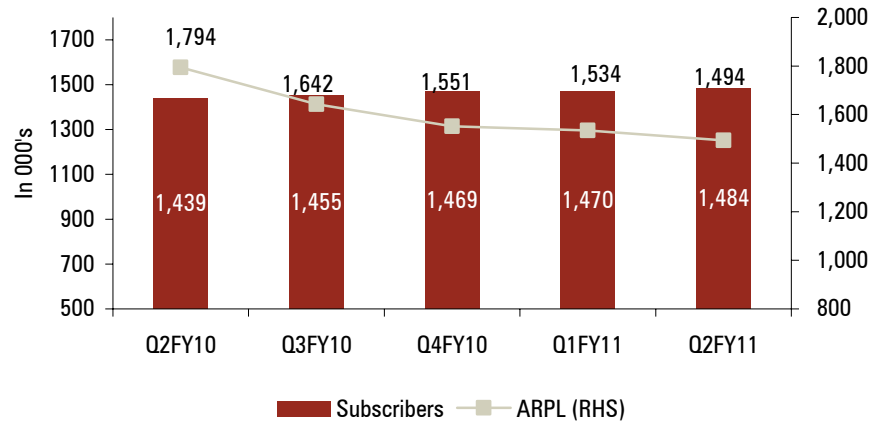
Broadband and global segment

The broadband subscriber base increased by 14,000 subscribers against the last four quarter’s average of 12,000 subscribers. The revenue per subscriber declined to ₹ 1494 from ₹ 1534 in the last quarter. Consequently, the revenue from the broadband segment de-grew by 2.2% QoQ and 14.1% YoY to ₹ 661.7 crore in Q2FY11. Margins improved from 36.6% in Q1FY11 to 37.5% in Q2FY11.

The global segment reported gross revenues of ₹ 1839.1 crore for Q2FY11, which de-grew by 18.8% YoY.

Exhibit 6: Broadband – Subscribers and ARPM

The broadband subscriber base increased by 14,000 subscribers against last four quarter's average of 12,000 subscribers. The revenue per subscriber declined to ₹ 1494 from ₹ 1439 in the last quarter



Source: Company, ICICIdirect.com Research

Exhibit 7: Key performance indicators

	Units	FY07	FY08	FY09	FY10	FY11E	FY12E	CAGR% (09-12E)
Mobility								
Wireless Subs	Million	28.6	45.4	72.7	102.4	128.0	148.4	26.9
Blended ARPU	Rs.	375	327	226	142	106	95	(25.0)
Total Minutes	Bn Min	45.9	205.5	275.1	350.6	386.5	434.5	16.5
MOU per sub	Minutes	540	462	388	334	280	262	(12.3)
ARPM	Rs.	0.73	0.74	0.63	0.48	0.45	0.42	(12.9)

Source: Company, ICICIdirect.com Research

Exhibit 8: Segmental revenue

₹ Crore	FY07	FY08	FY09	FY10	FY11E	FY12E	CAGR % (09 - 12E)
Mobile	12,847.6	15,213.5	17,367.7	16,915.6	17,227.7	18,149.4	1.5
Global	6,592.9	5,475.0	6,776.1	8,158.3	7,498.2	7,835.2	5.0
Broadband	1,338.9	1,786.8	2,524.3	2,838.5	2,676.0	2,773.8	3.2
Others	181.3	190.0	303.3	543.7	1,327.5	1,531.5	71.6
Gross revenue	20,960.7	22,665.3	26,971.4	28,456.1	28,729.4	30,290.0	3.9
Elimination	3,771.9	3,838.1	4,736.8	6,842.5	8,067.3	7,801.4	
Net Revenue	17,188.8	18,827.3	22,234.6	21,613.6	20,662.1	22,488.6	0.4

Source: Company, ICICIdirect.com Research

Outlook & Valuation

Outlook

The company reported Q2FY11 results more or less in line with expectations. RCom has changed its strategy from free minutes to the paid minutes. This strategy has been fruitful for the company to arrest the decline in ARPM and it remained stable in Q2FY11 at ₹ 0.44, in line with competitors. However, the seasonality impact in Q2FY11 has led to a decline in MoU, in turn, leading to flattish traffic on the network. We expect the MoU to improve in the coming quarters and the intense price war to soften, going forward.

The management is very bullish about the launch of 3G services in the country. The company is expected to launch its services in the next couple of months and expects the pricing to not be irrational like 2G services. We have not incorporated any estimates from 3G services in our financials.

The company has obtained an in-principle approval from the board of directors for induction of strategic/private equity investors for a 26% equity stake in the company.

Cash infusion and debt reduction through tower sale and stake sale to a strategic investor would be a positive trigger for the company. Also, the company may stand to gain with the introduction of MNP in the short-term.

Valuation

At the CMP of ₹ 170, the stock is trading at 28.2x FY11E EPS of ₹ 5.1 and 18.5x FY12E EPS of ₹ 9.2. We have valued the stock using DCF methodology and arrived at a target price of ₹ 162/ share, assuming 7.3% CAGR in revenue over FY11E–FY20E and terminal growth rate of 3%. Our target price discounts FY11E and FY12E EPS by 26.9x and 17.6x, respectively. We reiterate our rating on the stock as **REDUCE**.

Exhibit 9: Valuation table

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY09	22242.0		29.3		5.8	8.4	14.3	4.8
FY10E	21613.6	-2.8	22.8	-22.2	7.5	7.7	10.0	4.8
FY11E	20662.1	-4.4	6.0	-73.6	28.2	10.5	2.6	2.9
FY12E	22488.6	8.8	9.2	52.4	18.5	9.2	3.8	3.1

Source: Company, ICICIdirect.com Research

ICICIdirect.com coverage universe (Telecom Service Providers)

Bharti Airtel				Sales (₹ Cr)	EPS (₹)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
Idirect Code	BHATE		FY09	36961.5	22.3	13.9	8.2	27.9	24.0
		CMP	309.5	FY10	39615.0	24.0	12.9	7.3	19.7
		Target	368.0	FY11E	59397.1	17.3	17.9	8.5	9.5
MCap (₹ Cr)	117,501	% Upside	18.9%	FY12E	71567.5	23.8	13.0	6.7	12.1
RCOM				Sales (₹ Cr)	EPS (₹)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
Idirect Code	RELCOM		FY09	22242.0	29.3	5.8	8.4	14.3	4.8
		CMP	170.0	FY10E	21613.6	22.8	7.5	10.0	4.8
		Target	161.6	FY11E	20662.1	6.0	28.2	2.6	2.9
MCap (₹ Cr)	35,088	% Upside	-5.0%	FY12E	22488.6	9.2	18.5	9.2	3.1
Idea				Sales (₹ Cr)	EPS (₹)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
Idirect Code	IDECEL		FY09	10131.3	2.8	24.3	10.2	6.6	6.4
		CMP	69.2	FY10	12447.1	2.9	23.9	8.7	6.2
		Target	70.0	FY11E	14864.6	1.7	41.6	3.7	3.6
MCap (₹ Cr)	22,818	% Upside	1.2%	FY12E	17367.5	1.3	54.0	8.6	4.5

Source: Company, ICICIdirect.com Research

RATING RATIONALE

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 Buy: Between 10% and 20%;
 Add: Up to 10%;
 Reduce: Up to -10%
 Sell: -10% or more;

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