

HOLD

Reliance Communications

Target Price (INR)

59

Concerns on growth remain

RATING

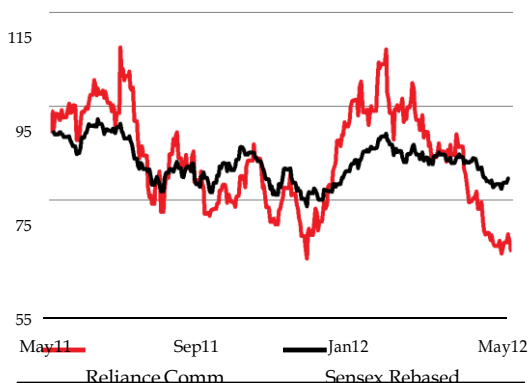
↑

Last Price (INR) **63.8**

Bloomberg code	RCOM IN
Reuters code	RLCM.BO
Avg. Vol. (3m)(mn)	11.4
Avg. Val.(3m)(INRmn)	957
52-wk H/L (INR)	110 / 60.8
Sensex	16,312
MCAP (INRbn/USDbn)	131.58 / 2.35

Shareholding (%)	12/11	03/12
Promoters	67.9	67.9
MFs, Fls, Banks	9.2	9.3
FIIs	8.1	7.4
Public	11.8	11.6
Others	3.1	3.8

Stock Chart (Relative to)



Absolute	-15.1	-32.5	-27.2
Rel. to Sensex	-9.2	-24.4	-16.7

	203,424	218,976	241,244
Sales			
YoY (%)	-12	8	10
EBITDA (%)	31.7	32.1	33.5
A.PAT	9,273	9,111	18,206
Sh o/s (diluted)	2,064	2,064	2,064
A.EPS (INR)	4.5	4.4	8.8
YoY (%)	-30	-2	100
D/E (x)	0.9	0.8	0.7
P/E (x)	14.2	14.4	7.2
EV/E (x)	6.5	5.8	4.7
RoCE (%)	4	3	5
RoE (%)	3	3	5

	49,401	50,402	50,521	53,100
Sales (INRmn)				
PAT (INRmn)	1,574	2,521	1,862	3,316

Wireless revenues were below our estimates, led by a sequential fall in the ARPU. However, overall revenues grew 5% owing to healthy growth in the Global Enterprise and Others segments. Higher network operating costs drove a 67% q-o-q fall in the PBT. Negative tax provisioning and minority interest, however, saved the day, helping the PAT rise 78% q-o-q to INR3.3bn. On the other hand, write-offs due to bad debts and forex variations led to an INR32bn decline in the net worth. We lower our earnings forecasts up to 12% over FY13f–FY14f. Reduce TP to INR59, including the impact of likely refarming, license & spectrum renewal fees and free roaming. Upgrade the stock to Hold due to a c24% underperformance in the last three months.

Wireless segment disappoints; consolidated revenues up 5% q-o-q

The 1.3% sequential growth in wireless revenues was below expectations due to a q-o-q fall in the average revenue per minute (ARPM). The significant q-o-q drop in the ARPM after seven quarters has not led to strong growth in total minutes. Consolidated revenue grew by 5% q-o-q led by 4% revenue growth in Global Enterprise and 18% in Others. We expect a slower revenue growth of 9% during FY13f–FY15f.

Margins decline due to higher network operating costs

As a percentage of sales, the network operating costs rose 500-bp q-o-q. This was partially offset by a 180-bp q-o-q decline in SG&A costs, as a percentage of sales. Though the management attributed this increase to be a seasonal phenomenon, the network operating costs, as a percentage of sales, rose 600-bp y-o-y in FY12. We expect a 307-bp improvement in the EBITDA margin over FY13f–FY15f.

PAT higher on one-offs; net worth fell by INR32bn

PAT was up 78% q-o-q to INR3.3bn led by one-offs. This includes a negative tax provision of INR1.2bn on the reversal of provisions, which are no longer required. Also, the provision for losses worth INR1.3bn towards minority interest on restructuring of a foreign subsidiary boosted the PAT. However, the consolidated net worth declined INR32bn during the quarter (INR16/share) owing to various write-offs, including INR11bn worth of debts due from cancelled licensees. Other write-offs are mainly due to forex variations.

Downgrade earnings; include regulatory impact; upgrade to Hold

We reduce our PAT estimates up to 12% over FY13f–FY14f to reflect a moderation in our growth assumptions for the wireless segment. Furthermore, we include a regulatory impact of INR7/share for refarming, INR2/share for license renewals and INR3/share for free roaming in the new proposed telecom policy. Thus, we arrive at a Jun13 TP of INR59. Due to a c24% underperformance over the last three months, we upgrade the stock to Hold. At our TP, the stock is likely to trade at one-year forward EV/EBITDA and P/E multiples of 4.3x and 6.0x, respectively. The success of the planned IPO of the subsea telecommunications infrastructure business is a key upward risk to our call.

Exhibit 1: Result snapshot for Mar12 quarter

(INRmn)	Mar11*	Dec11	Q-o-q (%)	Mar12	Y-o-y (%)
Total operating income	53,310	50,521	5.1	53,100	-0.4
Total operating expenses	37,540	34,410	6.9	36,778	-2.0
EBITDA	15,770	16,111	1.3	16,322	3.5
Other income	0	0		0	
Depreciation	10,050	9,780	-0.8	9,703	-3.5
EBIT	5,720	6,331	4.5	6,619	15.7
Interest	2,234	3,782	53.2	5,795	
Recurring PBT	3,486	2,549	-67.7	824	-76.4
Net extraordinary items	-123	0		-12	
PBT (reported)	3,609	2,549	-67.2	836	-76.8
Total taxes	1,711	141		-1,193	-169.7
PAT (reported)	1,898	2,408	-15.7	2,029	6.9
(+) Share in assoc. earnings					
Less: Minority interest	212	546		-1,287	
Prior period items					
Net income (reported)	1,686	1,862	78.1	3,316	96.7
Shares outstanding (mn)	2,064	2,064		2,064	
EPS (INR)	0.8	0.9	78.1	1.6	96.7
Operating ratios (%)					
EBITDA margin	29.6	31.9	-115-bp	30.7	116-bp
EBIT margin	10.7	12.5	-7-bp	12.5	174-bp
Net profit margin	3.2	3.7	256-bp	6.2	308-bp

Source: Company, Avendus Research

*adjusted for one-time IRU income of INR25bn

Exhibit 2: Segmental information for Mar12 quarter

(INRmn)	Mar11*	Dec11	Q-o-q (%)	Mar12	Y-o-y (%)
Wireless					
Gross revenue	41,978	44,471	1.3	45,055	7.3
EBITDA	11,490	11,823	1.7	12,022	4.6
EBITDA margin (%)	27.4	26.6	10-bp	26.7	-69-bp
EBIT	6,710	7,195	-27.2	5,238	-21.9
EBIT margin (%)	16.0	16.2	-455-bp	11.6	-436-bp
Global					
Gross revenue	26,214	23,516	3.7	24,395	-6.9
EBITDA	6,083	5,694	3.5	5,893	-3.1
EBITDA margin (%)	23.2	24.2	-6-bp	24.2	95-bp
EBIT	2,315	1,957	103.4	3,980	71.9
EBIT margin (%)	8.8	8.3	799-bp	16.3	748-bp
Others					
Gross revenue	3,643	2,292	17.8	2,700	-25.9
EBITDA	-949	-1,378		-1,562	
EBITDA margin (%)	-26.0	-60.1		-57.9	
EBIT	-2,600	-2,792		-2,563	
EBIT margin (%)	-71.4	-121.8		-94.9	

Source: Company, Avendus Research

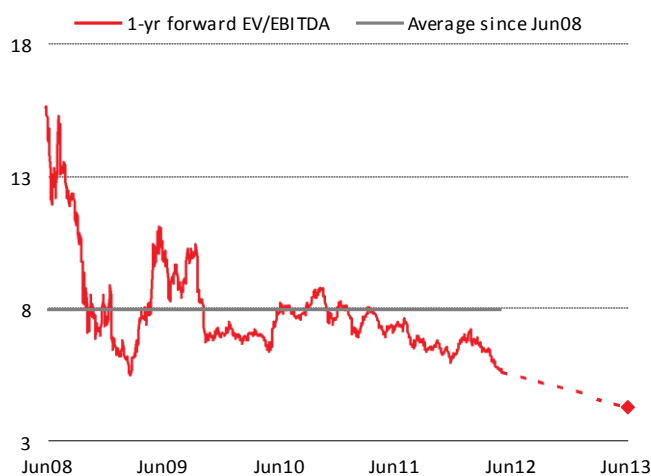
*adjusted for one-time IRU income of INR25bn

Exhibit 3: Earnings revision summary

(INRmn)	-----FY13f-----			-----FY14f-----			----- FY15f -----
	Old	New	Var (%)	Old	New	Var (%)	Introduced
Revenue	225,708	218,976	-3.0	250,771	241,244	-3.8	262,673
EBITDA	73,714	70,250	-4.7	84,212	80,817	-4.0	91,374
PAT	9,141	9,111	-0.3	20,585	18,206	-11.6	27,119
EPS (INR)	4.4	4.4	-0.3	10.0	8.8	-11.6	13.1

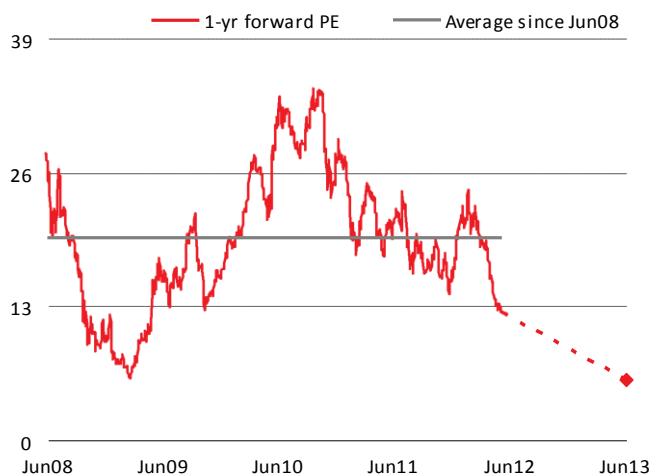
Source: Company, Avendus Research

Exhibit 4: One-year forward EV/EBITDA



Source: Company, Bloomberg, Avendus Research

Exhibit 5: One-year forward P/E



Source: Company, Bloomberg, Avendus Research

Rollover TP to Jun13 and cut by 23% to INR59

We continue to value the non-tower business at a 40% discount to BHARTI's target one-year forward EV/EBITDA for the Indian non-tower business. Following the downgrade in forecasts and rollover of TP to Jun13, we estimate the per share value at INR71. Furthermore, we include a regulatory impact of INR7/share for refarming, INR2/share for license renewals and INR3/share for free roaming, as per the proposed recommendations in the new telecom policy. Thus, we arrive at a Jun13 TP of INR59.

Exhibit 6: Impact of TRAI recommendations on Jun13 TP

	INR/share
Jun13 TP excluding regulatory impact	71
Impact of TRAI recommendations on TP	
- Spectrum refarming	-7
- License renewal	-2
- free roaming	-3
Subtotal	-12
Jun13 TP including regulatory impact	59

Source: Company, TRAI, Avendus Research

Risk factors

Upside risks

- ▶ Better-than-expected EBITDA margins are likely to lead to stronger EBITDA growth in FY13f and FY14f.
- ▶ If the planned listing of the subsea telecommunications infrastructure network business in Singapore is successful, it may reduce net debt and improve valuations.

Downside risks

- ▶ Slower-than-expected minutes growth is likely to increase muted earnings.

Financials and Valuations

Income statement (INRmn)

Fiscal year ending	03/12	03/13f	03/14f	03/15f
Total operating income	203,424	218,976	241,244	262,673
Total operating expenses	138,919	148,725	160,426	171,299
EBITDA	64,505	70,250	80,817	91,374
Other income	0	0	0	0
Depreciation	39,783	43,035	43,841	44,688
EBIT	24,722	27,215	36,976	46,686
Interest	15,901	15,875	14,316	12,934
Recurring PBT	8,821	11,340	22,660	33,752
Net extra ordinary items	(1)	-	-	-
PBT (reported)	8,820	11,340	22,660	33,752
Total taxes	-1,062	1,134	2,266	3,375
PAT (reported)	9,882	10,206	20,394	30,377
(+) Share in assoc. earnings	-	-	-	-
Less: Minority interest	609	1,095	2,187	3,258
Prior period items	-	-	-	-
Net income (reported)	9,273	9,111	18,206	27,119
Aventus net income	9,273	9,111	18,206	27,119
Shares outstanding (mn)	2,064	2,064	2,064	2,064
Aventus dil. shares (mn)	2,064	2,064	2,064	2,064
Aventus EPS (INR)	4.5	4.4	8.8	13.1

Growth ratios (%)

Total operating income	-12.0	7.6	10.2	8.9
EBITDA	-29.0	8.9	15.0	13.1
EBIT	-4.1	10.1	35.9	26.3
Recurring PBT	-41.4	28.6	99.8	49.0
Aventus net income	-30.4	-1.8	99.8	49.0
Aventus EPS	-30.4	-1.8	99.8	49.0

Operating ratios (%)

EBITDA margin	31.7	32.1	33.5	34.8
EBIT margin	12.2	12.4	15.3	17.8
Net profit margin	4.6	4.2	7.5	10.3
Other income/PBT	0.0	0.0	0.0	0.0
Effective Tax rate	-12.0	10.0	10.0	10.0

Balance sheet (INRmn)

Fiscal year ending	03/12	03/13f	03/14f	03/15f
Equity capital	10,320	10,320	10,320	10,320
Preference capital	0	0	0	0
Reserves and surplus	306,803	315,914	334,121	361,239
Net worth	317,123	326,234	344,441	371,559
Minority interest	8,602	9,697	11,884	15,142
Total debt	369,178	332,936	300,786	251,076
Deferred tax liability	0	0	0	0
Total liabilities	694,903	668,867	657,111	637,777
Gross block	995,639	1,009,050	1,025,844	1,043,721
less: Acc. depreciation	331,091	370,675	411,007	452,124
Net block	664,548	638,375	614,838	591,597
CWIP	50,230	53,108	53,992	54,933
Goodwill	-	-	-	-
Investments	1,230	1,230	1,230	1,230
Cash	10,785	11,166	12,051	12,864
Inventories	5,663	6,031	6,634	6,890
Debtors	35,839	42,152	43,770	49,785
Loans and advances	108,519	84,180	79,866	72,485
less: Current liabilities	147,004	138,853	131,096	126,194
less: Provisions	34,907	28,523	24,174	25,812
Net working capital	-21,105	-23,846	-12,949	-9,982
Total assets	694,903	668,867	657,111	637,777

Cash flow statement (INRmn)

Fiscal year ending	03/12	03/13f	03/14f	03/15f
Net profit	9,273	9,111	18,206	27,119
Depreciation	39,783	43,035	43,841	44,688
Deferred tax	0	-	0	0
Working capital changes	15,728	-19,012	-12,671	-5,398
Less: Other income	0	0	0	0
Cash flow from operations	64,784	33,135	49,377	66,409
Capital expenditure	-43,055	-16,289	-17,678	-18,817
Strategic investments	0	-	0	0
Marketable investments	-141	0	0	0
Change in other loans & adv.	-28,087	22,135	2,658	3,245
Goodwill paid	-	-	-	-
Other income	0	0	0	0
Cash flow from investing	-71,283	5,846	-15,020	-15,573
Equity raised	-	-	-	-
Change in borrowings	-4,579	-36,242	-32,150	-49,711
Dividends paid (incl. tax)	0	0	0	0
Others	-31,409	-2,357	-1,322	-312
Cash flow from financing	-35,988	-38,600	-33,472	-50,023
Net change in cash	-42,487	381	885	813

Key Ratios

Fiscal year ending	03/12	03/13f	03/14f	03/15f
Valuation ratios (x)				
P/E (on Aventus EPS)	14.2	14.4	7.2	4.9
P/E (on basic, reported EPS)	14.2	14.4	7.2	4.9
P/CEPS	2.7	2.5	2.1	1.8
P/BV	0.4	0.4	0.4	0.4
Dividend yield (%)	0.0	0.0	0.0	0.0
Market cap. / Sales	0.6	0.6	0.5	0.5
E V/Sales	2.1	1.8	1.6	1.3
E V/EBITDA	6.5	5.8	4.7	3.6
Net Cash / Market cap.	69.1	52.6	51.3	49.4
Per share ratios (INR)				
Aventus EPS	4.5	4.4	8.8	13.1
EPS (Basic, reported)	4.5	4.4	8.8	13.1
Cash EPS	23.8	25.3	30.1	34.8
Book Value	153.6	158.1	166.9	180.0
Dividend per share	0.0	0.0	0.0	0.0
Total assets / equity (x)	2.1	2.1	2.0	1.8
Return ratios (%)				
ROCE	3.8	3.4	4.7	6.0
ROIC	4.8	3.8	5.2	6.7
ROE	2.7	2.8	5.4	7.6
ROA	1.3	1.3	2.7	4.2
OCF/Sales	31.8	15.1	20.5	25.3
FCF/Sales	10.7	7.7	13.1	18.1
Turnover ratios (x)				
Asset turnover (x)	0.3	0.3	0.4	0.4
Gross asset turnover	0.2	0.2	0.2	0.3
Inventory / Sales (days)	9.7	9.7	9.6	9.4
Receivables (days)	68.1	65.0	65.0	65.0
Payables (days)	517.9	498.3	431.9	381.4
Working capital cycle (days)	-184.8	-168.9	-129.3	-106.2
Solvency ratios (x)				
Gross debt to equity	1.2	1.1	0.9	0.7
Net debt to equity	0.9	0.8	0.7	0.5
Net debt to EBITDA	5.7	4.7	3.7	2.7
Interest Coverage (on EBIT)	1.6	1.7	2.6	3.6

Analyst Certification

The following analyst(s) is(are) primarily responsible for this report and, certifies(y) that the opinion(s) on the subject company(ies) and its security(ies) and any other views or forecasts expressed herein accurately reflect their personal view(s). They further certify that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Abhay Moghe.

Disclosures

Meaning of Avendus Securities Private Limited’s equity research ratings

The rating represents the expected change in the price of the stock over a horizon of 12 months.

Buy: more than +20%	Add: 10% to +20%	Hold: -10% to +10%	Reduce: -10% to -20%	Sell: less than -20%
----------------------------	-------------------------	---------------------------	-----------------------------	-----------------------------

Proportion of ratings in each category and investment banking relationships

At the end of March 2012	Buy	Add	Hold	Reduce	Sell	NR	Total
Proportion of ratings in each category	29.1	33.3	17.4	11.6	1.4	7.2	100.0
Proportion of companies to whom material investment banking services were offered during the previous 12 months	0.0	8.7	8.3	0.0	0.0	20.0	5.8

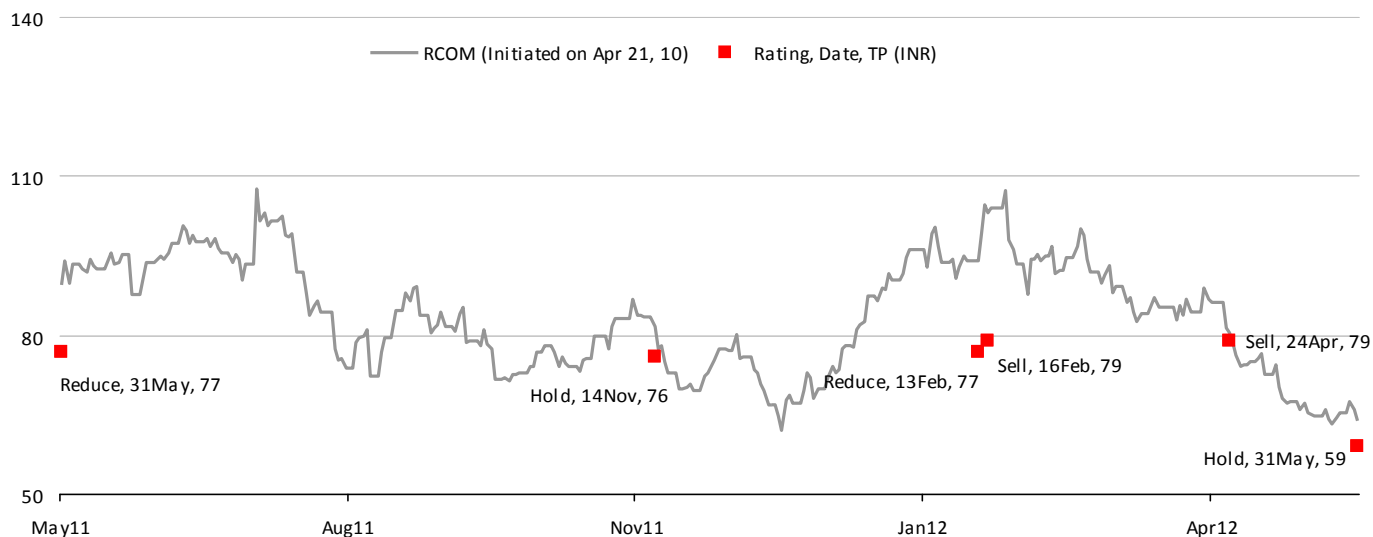
Analyst disclosures

None of the analysts involved in the preparation of this research report or a member of his/her household is an officer, director or supervisory board member of any of the company(ies) that is/are the subject of this research report. None of the analysts involved in the preparation of this research report or members of his/her household hold any financial interest in the securities of the company(ies) that is/are the subject of this research report. None of the analysts involved in the preparation of this research report have received or purchased shares of the subject company prior to the public offering of those shares.

Disclosures on potential conflicts of interest for Avendus Securities Private Limited and/or its associate companies (Avendus) as on May 31, 2012

As on the above-mentioned date, the shareholdings of Avendus does not exceed 5% of the total issued share capital of Reliance Communications Limited (RCOM). Avendus does not hold any other financial interest in RCOM that is significant with regard to the research recommendation. As on the above-mentioned date, the shareholdings of RCOM does not exceed 5% of the total issued share capital of Avendus. Avendus is not a market maker or liquidity provider in the securities of the relevant issuer or in any related derivatives. Avendus has not been a lead manager or co-lead manager of a publicly-disclosed offer of securities of RCOM or in any related derivatives over the past 12 months. Over the past 12 months, Avendus has not been party to an agreement with RCOM with regard to the provision of other investment banking services that do not entail the disclosure of any confidential commercial information. Avendus is not party to an agreement with the subject company(ies) of this research report with regard to the production of this research report.

Share price history and rating changes



Disclaimer

This document has been prepared by Avendus Securities Private Limited (ASPL). This document is meant for the use of the intended recipient only. Though dissemination to all intended recipients is simultaneous, not all intended recipients may receive this document at the same time. This document is neither an offer nor solicitation for an offer to buy and/or sell any securities mentioned herein and/or official confirmation of any transaction. This document is provided for assistance only and is not intended to be, and must not be taken as, the sole basis for an investment decision. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigation as he deems necessary to arrive at an independent evaluation, including the merits and risks involved, for investment in the securities referred to in this document and should consult his own advisors to determine the merits and risks of such investment. The investment discussed or views expressed may not be suitable for all investors. This document has been prepared on the basis of information obtained from publicly available, accessible resources. ASPL has not independently verified all the information given in this document. Accordingly, no representation or warranty, express or implied, is made as to accuracy, completeness or fairness of the information and opinion contained in this document. The information given in this document is as of the date of this document and there can be no assurance that future results or events will be consistent with this information. Though ASPL endeavors to update the information contained herein on reasonable basis, ASPL, its associate companies, their directors, employees, agents or representatives (ASPL and its affiliates) are under no obligation to update or keep the information current. Also, there may be regulatory, compliance or other reasons that may prevent us from doing so. ASPL and its affiliates expressly disclaim any and all liabilities that may arise from information, error or omission in this connection. ASPL and its affiliates shall not be liable for any damages whether direct, indirect, special or consequential, including lost revenue or lost profits, which may arise from or in connection with the use of this document. This document is strictly confidential and is being furnished to you solely for your information. This document and/or any portion thereof may not be duplicated in any form and/or reproduced or redistributed without the prior written consent of ASPL. This document is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of the United States or Canada or is located in any other locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law or regulation or which would subject ASPL and its affiliates to any registration or licensing requirements within such jurisdiction. Persons in whose possession this document comes should inform themselves about and observe any such restrictions. ASPL and its affiliates may be performing or seeking to perform investment banking and other services for any company referred to in this document. Affiliates of ASPL may have issued other reports that are inconsistent with and reach a different conclusion from the information presented in this document.

This communication is exempt from the financial promotion restriction (in Section 21 of the Financial Services And Markets Act, 2000 (FSMA)) relating to the communication of an invitation or inducement to engage in investment activity on the grounds that it is made to an investment professional. Any investment to which this communication relates is only available to investment professionals. Any persons who do not have professional experience in such investments should not rely on this communication.

ASPL and its affiliates may have interest/positions, financial or otherwise, in the companies mentioned in this document. In order to provide complete transparency to our clients, we have incorporated disclosures about interests of analysts and about potential conflicts of interest of ASPL and its associate companies in this document. This should, however, not be treated as an endorsement of the view expressed in the document. ASPL is committed to providing high-quality, objective and unbiased research to our investors. To this end, we have policies in place to identify, consider and manage potential conflicts of interest and protect the integrity of our relationships with investing and corporate clients. Employee compliance with these policies is mandatory. Any comment or statement made herein are solely those of the analyst and do not necessarily reflect those of ASPL.

OUR OFFICES

Avendus Securities Private Limited

Mumbai: 6th Floor, B Quadrant, IL&FS Financial Centre, Bandra Kurla Complex, Bandra (E), Mumbai - 400 051 **T:** +91 22 6648 0050 **F:** +91 22 6684 2870

Avendus Capital Private Limited

Mumbai: 5th Floor, B Quadrant, IL&FS Financial Centre, Bandra Kurla Complex, Bandra (E), Mumbai - 400 051 **T:** +91 22 6648 0050 **F:** +91 22 66480040

Bangalore: The Millenia Tower, A - 10th Floor, No 1 & 2 Murphy Road, Ulsoor, Bangalore - 560 008, India **T:** +91 80 6648 3600 **F:** +91 80 6648 3636

New Delhi: Suite 22A/B, The Aman Resort, Lodhi Road, New Delhi - 110 003, India **T:** +91 11 4535 7500 **F:** +91 11 4535 7540

London: Avendus Capital (U.K.) Private Limited, 33, St James's Square, London, SW1Y 4JS **T:** +44 203 159 4353 **F:** +44 207 661 9400