

November 19, 2010

Reco	Previous Reco
Reduce	Hold
CMP	Target Price
Rs154	Rs135

EPS change FY11E/12E (%)	-14/-16.3
Target Price change (%)	-25
Sensex	19,931
Nifty	5,999

Price Performance

(%)	1M	3M	6M	12M
Absolute	(12)	(6)	13	(13)
Rel. to Nifty	(11)	(14)	(7)	(27)

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	205/132
Market Cap (Rs bn/USD mn)	318/7,021
Daily Avg Volume (No of sh)	5069550
Daily Avg Turnover (US\$mn)	19.3

Shareholding Pattern (%)

	Sep-10	Jun-10	Mar-10
Promoters	67.7	67.7	67.6
FII/NRI	9.7	9.3	9.0
Institutions	9.2	9.3	9.7
Private Corp	2.2	2.6	2.4
Public	11.2	11.0	11.3

Source: Capitaline

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- **Q2FY11 EBIDTA grew by 1.7% QoQ to Rs16.6bn (below est of Rs17.6bn), PAT of Rs4.45bn led by lower interest expense**
- **ARPU falls 6.2% QoQ to Rs122 purely on MOU decline as RPM remains stable. Wireless traffic growth absent**
- **Cut EBIDTA and EPS estimates by 1.8% /3.5% and 14% /16.3% for FY11E /12E respectively**
- **Cut target price to Rs135 (from Rs180) and rating to REDUCE from HOLD earlier. Valuations expensive at 9.2x and 8.8x EV/EBIDTA for FY11E and FY12E respectively**

Revenue & EBIDTA stable, interest on increased net-debt hit profitability

RCOM's Q2FY11 revenues were flat at Rs51.2bn, in-line with industry trend affected by seasonally weak quarter. We highlight RCOM's revenues have remained flat for last 3 quarters with decline in MOU and stable realization (RPM). EBIDTA grew by 1.7% QoQ to Rs16.6bn (below our estimate of Rs17.6bn). S, G & A expense fell 10% QoQ, which helped improve margins by 50bps. Although PAT of Rs4.45bn was above our estimate of Rs2.2bn, the same was entirely driven by lower interest expenses. Interest expense decreased by 36.4% QoQ to Rs2.8bn, v/s our estimate of Rs5.1bn. Lower than expected interest expenses during the quarter

Wireless ARPU falls by sharp 6.2% to Rs122

In line with industry trend owing to seasonality, the wireless revenues remained stable during Q2FY11. However, the RPM also was stable v/s slight declines witnessed in case of peers Bhart & Idea. ARPU fell by 6.2% to Rs122, entirely impacted by MOU drop. Wireless traffic remained stable yet again at 94.5bn.

EBIDTA & EPS estimates cut by 1.8%/3.5% and 14%/16.3% for FY11E/12E

With continued disappointment on operating performance front, we have cut our revenue and EBIDTA estimates by 2.3% /3.9% and 1.8% /3.5% for FY11E /12E. Factoring higher interest expenses on the large debt of Rs292bn as of Q2FY11 (which we estimate would increase to Rs316bn by FY11) we have cut our EPS estimate by 14% /16.3% for FY11E /12E to Rs9.7 /9.1.

Downgrade to REDUCE with target price of Rs135 (from Rs180)

Considering below estimated operating performance and continued deteriorating trend in wireless business, we have cut our earnings estimate by 14-16%. Although capex for the company has reduced sharply (Rs30bn for FY11E), lack of profitability improvement given the industry headwinds, and cost of servicing large debt (Rs292bn in Q2FY11) would continue to let RCOM remain FCF -ve.

We cut our rating on RCOM from HOLD to REDUCE with reduced target price of Rs135 (from Rs180 earlier). At CMP of Rs154, the stock trades at 9.2x and 8.8x EV/EBIDTA and 15.9x and 17x our revised EPS for FY11E and FY12E respectively. High debt on books (net-debt/ EBIDTA at 4.6x FY11E) remains prime risk especially given the recovery in revenue and profitability of the company.

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										
FY09	229,411	92,875	40.5	59,077	28.6	9.4	19.7	5.4	5.8	0.9
FY10	222,502	78,869	35.4	47,044	22.8	-20.4	12.9	6.8	6.5	0.8
FY11E	211,490	68,509	32.4	19,949	9.7	-57.6	5.2	15.9	9.2	0.8
FY12E	221,762	71,809	32.4	18,722	9.1	-6.2	4.7	17.0	8.8	0.8

EBIDTA cut by 1.8% /3.5% and EPS by 14% /16.3% for FY11E /12E

	FY10	FY11E			FY12E		
		Old	New	Chg %	Old	New	Chg %
Revenues	222,502	216,388	211,490	-2.3%	230,771	221,762	-3.9%
EBIDTA	78,869	69,789	68,509	-1.8%	74,383	71,809	-3.5%
EBIDTA %	35.4	32.3	32.4	14	32.2	32.4	15
PAT	48,813	23,197	19,949	-14.0%	22,374	18,722	-16.3%
EPS	22.8	11.2	9.7	-14.0%	10.8	9.1	-16.3%

Wireless business performance

	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	QoQ %	Remarks
Revenues	47,931	40,100	40,225	40,900	41,528	41,613	0.2%	Wireless revenues have remained stable for last 5 quarters
EBIDTA	18,489	13,132	12,550	11,815	11,989	12,101	0.9%	
EBIDTA %	38.6	32.7	31.2	28.9	28.9	29.1	21 bps	
Subs ('000)	79,616	86,118	93,796	102,422	110,806	117,337	5.9%	
ARPU (Rs)	210	161	149	139	130	122	-6.2%	
MOU (mins)	365	340	330	318	295	276	-6.4%	MOU continues declining trend
RPM (Re)	0.58	0.47	0.45	0.44	0.44	0.44	0.3%	RPM has remained stable for last 3 quarters at the cost of MOU fall
Minutes (bn)	83.4	84.5	89.1	93.6	94.4	94.5	0.1%	

Quarterly financials

Particulars	2Q10	3Q10	4Q10	1Q11	2Q11	QoQ %	YoY %	YTD '10	YTD '11	YoY %
Wireless	40,100	40,225	40,900	41,528	41,613	0.2%	3.8%	88,031	83,141	-5.6%
Global	22,643	19,818	20,278	18,137	18,391	1.4%	-18.8%	41,487	36,528	-12.0%
Broadband	7,700	7,045	6,798	6,763	6,617	-2.2%	-14.1%	14,542	13,380	-8.0%
Others	2,760	3,160	2,845	3,348	3,984	19.0%	44.3%	5,791	7,332	26.6%
Gross Revenues	73,203	70,248	70,821	69,776	70,605	1.2%	-3.5%	149,851	140,381	-6.3%
Inter segment	(16,178)	(17,150)	(19,894)	(18,684)	(19,422)			(31,374)	(38,106)	
Net revenues	57,026	53,098	50,927	51,092	51,183	0.2%	-10.2%	118,478	102,275	-13.7%
Access charges	4,772	5,501	6,294	6,610	6,572	-0.6%	37.7%	9,583	13,182	37.6%
<i>% of sales</i>	8.4	10.4	12.4	12.9	12.8			8.1	12.9	
License fees	2,913	2,836	2,668	3,102	3,033	-2.2%	4.1%	5,947	6,135	3.2%
<i>% of sales</i>	5.1	5.3	5.2	6.1	5.9			5.0	6.0	
Network optg exp	15,919	16,708	15,251	13,079	13,813	5.6%	-13.2%	29,775	26,892	-9.7%
<i>% of sales</i>	27.9	31.5	29.9	25.6	27.0			25.1	26.3	
Employee cost	3,816	3,677	3,396	3,535	3,596	1.7%	-5.8%	7,928	7,131	-10.1%
<i>% of sales</i>	6.7	6.9	6.7	6.9	7.0			6.7	7.0	
S,G & A	9,407	6,250	7,300	8,446	7,574	-10.3%	-19.5%	20,521	16,020	-21.9%
<i>% of sales</i>	16.5	11.8	14.3	16.5	14.8			17.3	15.7	
Operating expenses	36,827	34,971	34,909	34,772	34,588	-0.5%	-6.1%	73,754	69,360	-6.0%
EBIDTA	20,198	18,127	16,018	16,320	16,595	1.7%	-17.8%	44,723	32,915	-26.4%
Depreciation	7,144	8,331	10,847	9,648	9,553	-1.0%	33.7%	18,288	19,201	5.0%
EBIT	13,055	9,796	5,171	6,672	7,042	5.5%	-46.1%	26,436	13,714	-48.1%
Extra ordinary	29	221	15	-	-			140	-	
Interest charges	6,551	(4,076)	(8,134)	4,396	2,797	-36.4%	-57.3%	346	7,193	1977.1%
PBT	6,475	13,651	13,290	2,276	4,245	86.5%	-34.4%	25,950	6,521	-74.9%
Tax	(1,739)	2,003	1,923	(719)	(661)	-8.1%	-62.0%	528	(1,380)	-361.5%
PAT before minority	8,214	11,648	11,367	2,995	4,906	63.8%	-40.3%	25,422	7,901	-68.9%
Minority interest	811	568	(826)	486	447	-8.0%	-44.9%	1,653	933	-43.6%
Net profit	7,403	11,080	12,193	2,509	4,459	77.7%	-39.8%	23,769	6,968	-70.7%

Margins (%)	bps chg		bps chg		bps chg		bps chg		bps chg	
EBIDTA	35.4	34.1	31.5	31.9	32.4	48	(300)	37.7	32.2	(557)
EBIT	22.9	18.4	10.2	13.1	13.8	70	(913)	22.3	13.4	(890)
EBT	11.4	25.7	26.1	4.5	8.3	384	(306)	21.9	6.4	(1,553)
PAT	13.0	20.9	23.9	4.9	8.7	380	(427)	20.1	6.8	(1,325)
ETR	(26.9)	14.7	14.5	(31.6)	(15.6)	1,602	1,129	2.0	(21.2)	(2,320)

Financials**Profit & Loss**

Y/E, Mar (Rs. mn)	FY09	FY10	FY11E	FY12E
Net Sales	229,411	222,502	211,490	221,762
License & Access chg	35,682	32,828	39,267	36,591
Network optng exp	43,642	61,734	56,768	64,463
Personnel exp	16,702	15,001	15,751	16,145
S, G & A	40,510	34,071	31,195	32,755
EBITDA	92,875	78,869	68,509	71,809
EBIDTA %	40.5	35.4	32.4	32.4
Depreciation	39,314	37,465	37,086	39,989
EBIT	53,561	41,404	31,423	31,820
Interest	(7,867)	(11,863)	7,500	8,500
PBT	61,429	53,267	23,923	23,320
Taxes	(123)	4,453	3,142	3,818
<i>Effective Tax Rate</i>	-0.20	8.36	13.14	16.37
PAT	61,551	48,813	20,781	19,502
Extra ordinary	75	375	0	0
APAT before MI	61,476	48,438	20,781	19,502
Net Margin	26.8	21.8	9.8	8.8
Minority interest	(2,399)	(1,395)	(831)	(780)
APAT after MI	59,077	47,044	19,949	18,722
<i>Growth (%)</i>	9.4	-20.4	-57.6	-6.2

Balance Sheet

Y/E, Mar (Rs. mn)	FY09	FY10E	FY11E	FY12E
Equity Capital	10,320	10,320	10,320	10,320
Reserves & surplus	359,683	377,505	396,233	413,320
Networth	370,003	387,825	406,553	423,640
Minority interest	8,228	7,472	7,472	7,472
Total Debt	335,520	247,473	347,473	347,473
Capital Employed	713,751	642,770	761,498	778,585
Gross Block	756,489	786,643	861,643	915,643
Less Depreciation	141,069	190,765	227,851	267,840
Net Fixed Assets	615,420	595,878	633,792	647,803
CWIP	114,056	119,517	180,367	181,987
Investments	2,857	1,199	1,199	1,199
Current assets				
Inventory	5,427	5,446	4,925	4,861
Debtors	54,785	33,920	31,868	33,416
Cash and Bank	109,577	48,585	31,026	35,086
Other CA	76,771	76,201	72,428	72,908
Total Cur. assets	246,560	164,152	140,248	146,271
Cur Liab & prov	265,142	237,976	194,107	198,674
Net Cur assets	(18,582)	(73,824)	(53,859)	(52,403)
Capital Deployed	713,751	642,770	761,498	778,585

Cash Flow Statement

Y/E, Mar (Rs. mn)	FY09	FY10E	FY11E	FY12E
EBT	61,429	53,267	23,923	23,320
Depreciation	39,314	37,465	37,086	39,989
Interest (Net)	7,867	11,863	(7,500)	(8,500)
Tax Paid	123	(4,453)	(3,142)	(3,818)
Change in WC	(16,353)	(5,750)	(37,523)	2,604
Others	(75)	(375)	0	0
Operating cash Flow	84,437	80,154	20,344	62,095
Net Capex	(258,578)	(35,615)	(135,850)	(55,620)
Free Cash Flow	(174,141)	44,539	(115,506)	6,475
Others	20,109	21,361	0	0
Investing cash flow	20,109	21,361	0	0
Equity Issue	0	0	0	0
Net Borrowings	119,839	(88,047)	100,000	0
Dividend paid	(1,811)	(1,932)	(2,052)	(2,415)
Others	29,600	(36,913)	0	0
Financing cash flow	147,628	(126,891)	97,948	(2,415)
Inc/(dec) in cash	(6,404)	(60,992)	(17,559)	4,060
Opening Cash	115,981	109,577	48,585	31,026
Closing Cash	109,577	48,585	31,026	35,086

Ratios

Y/E, Mar	FY09	FY10E	FY11E	FY12E
Profitability (%)				
EBITDA %	40.5%	35.4%	32.4%	32.4%
EBIT %	23.3%	18.6%	14.9%	14.3%
NPM %	26.8	21.9	9.8	8.8
ROCE %	8.9	6.1	4.5	4.1
ROE %	19.7	12.9	5.2	4.7
Per Share Data (Rs)				
AEPS	28.6	22.8	9.7	9.1
Cash EPS	48.9	41.8	28.0	28.8
Book Value	179	188	197	205
Div per share	1.6	1.7	2.0	2.0
Valuations (x)				
PE (x)	5.4	6.8	15.9	17.0
Cash PE (x)	3.2	3.7	5.5	5.3
P/BV (x)	0.9	0.8	0.8	0.8
EV/Sales (x)	2.4	2.3	2.4	2.3
EV/EBITDA	5.8	6.5	9.2	8.8
Gearing Ratio (x)				
Net Debt/ Equity	0.6	0.5	0.8	0.7
Net Debt/ EBIDTA	2.4	2.5	4.6	4.3

Recommendation History: Reliance Communications – RCOM IN

Date	Reports	Reco	CMP	Target
16/08/2010	Reliance Communication Q1FY11 Result Update	Hold	168	180
28/06/2010	Reliance Communication Event Update	Accumulate	201	228
03/02/2010	RCOM 3QFY10 Result Update	Reduce	170	152
03/09/2009	RCOM Company Update	Hold	276	303

Recent Research Reports

Date	Reports	Reco	CMP	Target
16/11/2010	Tulip Telecom Q2FY11 Result Update	Buy	178	240
16/11/2010	Deccan Chronicle Q2FY11 Result Update	Buy	129	175
11/11/2010	Bharti Airtel Q2FY11 Result Update	Hold	238	345
01/11/2010	Jagran Prakashan Q2FY11 Result Update	Buy	129	155

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