

May 14, 2008

Rating	BUY
Price	Rs559
Target Price	Rs706
Implied Upside	26.2%
Sensex	16,978

(Prices as on May 14, 2008)

#### Trading Data

Market Cap. (Rs bn)	1,206.7
Shares o/s (m)	2,157.5
Free Float	33.9%
Avg. Daily Vol ('000)	6,331.4
Avg. Daily Value (Rs m)	3,439.4

#### Major Shareholders

Promoters	66.1%
Foreign	9.6%
Domestic Inst.	12.0%
Public & Others	12.3%

#### Stock Performance

(%)	1M	6M	12M
Absolute	13.2	(23.0)	15.8
Relative	5.8	(8.2)	(5.8)

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



Source: Bloomberg

## Reliance Communications

### In a sweet spot

- **Reliance Globalcom - addressable market at US\$275bn:** Rcom has guided for a potential market size of US\$275bn for its global assets, which will be offering a diverse portfolio of global communication business services, including global voice, managed network, carrier ethernet and fibre capacity businesses. Total investments in Reliance Globalcom stands at US\$2.75bn at the end of FY08.
- **Reliance Infra looking to expand to 70,000 towers by FY10:** Reliance Infratel aims to increase its tower portfolio to 70,000, thus enabling it to have 280,000 slots by FY10. The company has hinted at using around 110,000-120,000 slots for captive use. Further, the company is in active talks with two new entrants for pan-India tower portfolio.
- **Full fledged GSM rollout to cover 90% population by CY09:** Rcom has outlined to spread its GSM network to cover 90% of the population by CY09. This will be the fastest rollout of GSM network in India. It has already signed conclusive arrangements of US\$1.3bn for electronic equipment with vendors, including Huawei, ZTE and Alcatel Lucent. The company management has hinted at net additions to pick-up in subsequent months due to increase in its coverage of existing eight GSM circles.
- **Valuation:** With favourable regulatory developments in the last couple of quarters, we believe Rcom is in a sweet spot. At the CMP of Rs559, the stock trades at a PER of 14.2x and at an EV/EBITDA of 9.8x FY10E earnings. Unlocking value in Reliance Globalcom and Reliance Infratel could be key catalysts in the next 6-12 months. Maintain BUY.

Key financials (Y/e March)	FY07	FY08	FY09E	FY10E
Revenue (Rs m)	144,683	190,678	257,682	336,518
Growth (%)	34.4	31.8	35.1	30.6
EBITDA (Rs m)	57,210	81,989	110,008	143,020
PAT (Rs m)	31,639	54,015	65,171	84,991
EPS (Rs)	15.5	25.0	30.2	39.4
Growth (%)	442.6	61.8	20.7	30.4
Net DPS (Rs)	0.5	0.8	1.5	2.0

Source: Company Data; PL Research

Profitability & valuation	FY07	FY08	FY09E	FY10E
EBITDA margin (%)	39.5	43.0	42.7	42.5
RoE (%)	18.3	21.3	20.0	20.6
RoCE (%)	10.4	12.4	13.5	15.0
EV / sales (x)	8.1	6.8	5.3	4.2
EV / EBITDA (x)	20.4	15.7	12.5	9.8
PE (x)	36.1	22.3	18.5	14.2
P / BV (x)	5.0	4.2	3.2	2.7
Net dividend yield (%)	0.1	0.1	0.3	0.4

Source: Company Data; PL Research

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## Highlights

### Wireless segment - GSM launch by Dec '08

Rcom will be launching its GSM network starting December 2008 in a phased manner and would expand to 90% of population coverage with about 65,000 GSM systems (BTS) by end CY09. It has already signed conclusive arrangements of US\$1.3bn for electronic equipment with vendors, including Huawei, ZTE and Alcatel Lucent.

Rcom currently operates dual networks, i.e. GSM and CDMA, in six circles, where it enjoys around 30% market share of incremental net additions. It expects net additions to pick-up similarly in the remaining circles post the GSM rollout.

Further, it expects substantial capex and opex synergies from existing network infrastructure (rolled out for their CDMA operations), while expanding its GSM footprint. These include passive telecom infrastructure (37,000 odd towers), nationwide sales and distribution network (about 500,000 retail outlets), and customer support infrastructure, including all back-end IT and billing systems.

### Continues to run parallel, low cost CDMA network

Rcom will continue to provide CDMA product services even after the launch of its GSM service. The management is looking at leveraging advantages of both networks as per the customers' requirements. In the last couple of years, the company has been selling CDMA handsets, which can be used for dual network; thus enabling easy switch for its subscribers to the GSM network, if desired.

### To leverage advantages of both networks

CDMA	GSM
Spectrum efficiency	Handsets
Unlimited talk plans	Tariffs
PCO/FWP	To tap international roaming market of Rs15bn
Wireless data connectivity	Dual SIM strategy to further strengthen subscriber base
Multimedia/video capability	On net calling

Source: Company Presentation, PL Research

**Expects to increase market share post the GSM rollout**

Rcom is looking at increased subscriber market share post its GSM rollout. It currently has a total market share of 18%, and around 20% of incremental net additions. The company has highlighted the following points for gain in market share:

- GSM rollout to increase target market, which includes high-end customers and international roamers.
- Churn rate in GSM is at 5%, which gives the opportunity to address these subscribers. Rcom’s CDMA network doesn’t cater to this segment at present.
- MNP implementation (coinciding with Rcom’s GSM rollout) to help garner existing high ARPU GSM subscribers.

**Favourable regulatory development**

Rcom feels the regulatory developments in the last couple of months were quite favourable. Introduction of MNP will help it garner incremental market share due to very little churn possible from its network subscribers.

**Impact of regulatory development**

Technology neutrality	Crossover spectrum allocation
Stricter criteria for spectrum	Only player with nationwide GSM spectrum - No real negative impact
No cap on no. of players	More tower sharing potential
MNP implementation	Opportunity to churn GSM subscribers from other networks
Implementation of 3G	3G ready networks. Only 3G cards to be installed in BTS
MVNO	Low cost network enabling to share capacity with MVNOs
Carriers access code	Private operators to gain from new entrants due to widest fibre reach

*Source: Company Presentation, PL Research*



## Reliance Globalcom potential market at US\$275bn

Rcom is looking at the global opportunity for telecommunication and managed services quite actively. It has presence in about 50 countries (>90% of world population) and has more than 1.5 million customers. The company caters to 200 large carriers and about 1,000 enterprises. The overall market potential, as guided by the company, stands at US\$275bn. We can expect a positive surprise from this segment, but the management is still not forthcoming with the actual break-up of revenue in this segment.

### Market potential for Reliance Globalcom

Service	Global demand (\$ bn)	Margins (%)
Managed services	85	45-65
Consumer	95	15-30
Enterprise	90	30-55
Wholesale	5	15-35
<b>Total</b>	<b>275</b>	<b>15-65</b>

Source: Company Presentation, PL Research

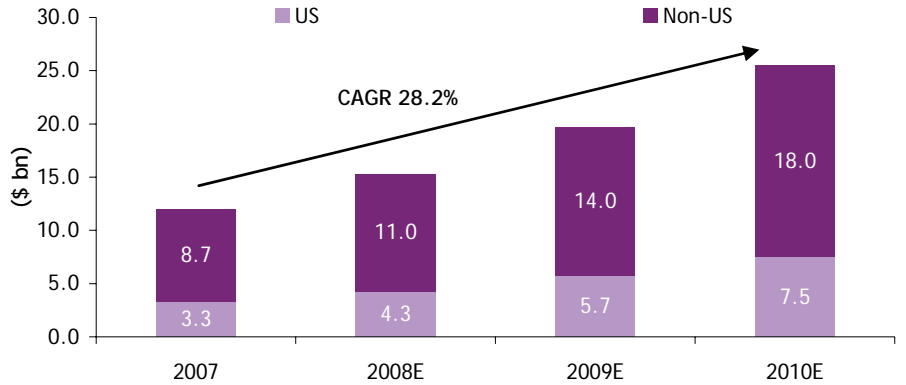
Rcom has invested about US\$2.75bn in its global assets, including Flag, Yipes, eWave and Falcon submarine cable. eWave, the recently acquired European player, is looking to launch Wi-Max based services in 22 countries and scale them up to 50 countries by 2012. The company has hinted at further investment to the tune of US\$500m in Wi-Max. eWave has around 36,000km of optic fibre in China (which connects 31 of china's most important metros) that will enable it to provide broadband services in that country. The estimated addressable market is US\$10bn.

### Next generation network under implementation

Particulars	FY03	Current Falcon + Yipes	Post NGN under execution
International submarine & terrestrial (rkms)	55,000	82,000	137,000
Landing sites	26	43	64
Countries connected	28	40	60

Source: Company Presentation, PL Research

**Managed ethernet market**

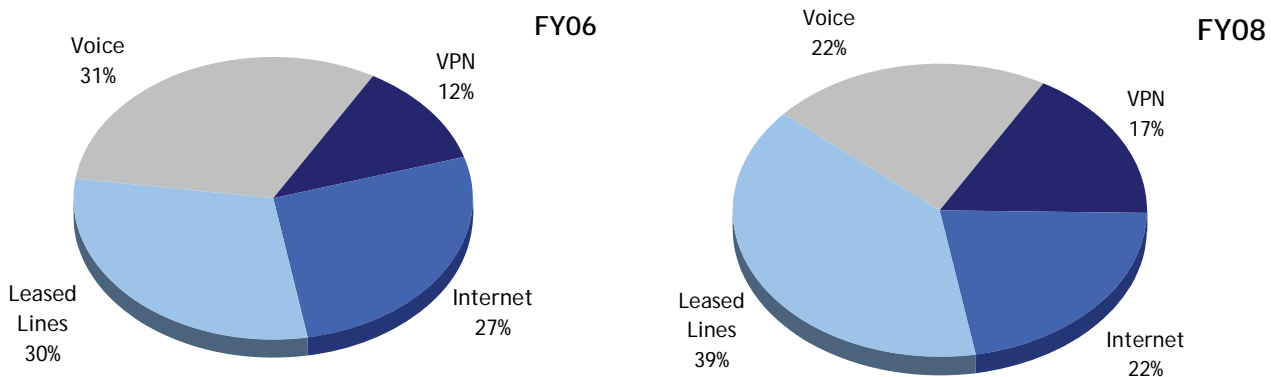


Source: Company Presentation, PL Research

**Enterprise segment**

The management remains upbeat on high margins and growth in its enterprise business, which primarily has broadband and voice revenues. Revenue split for this segment is as highlighted below:

**Enterprise segment revenue split**



Source: Company Presentation, PL Research

Rcom is expecting the potential market to grow at a CAGR of 33% from US\$5.5bn to US\$13bn by 2010.

**Enterprise segment bandwidth**

Intercity fibre (Rkms)	130,000
Intracity fibre (Rkms)	30,000
Points of presence (POPs)	650
Point of interconnection (POIs)	1,300
Cities present	44
Buildings connected	850,000
Transport capacity (Tbps)	2

Source: Company Presentation, PL Research

### Expanding into data centre business

Rcom currently has six level 3+ data centres in Mumbai and Bangalore, aggregating to over 260,000 sq.ft. of facility space. These facilities host 20,000+ system platforms and hold 1,400+ terabytes of storage capacity. It is aggressively building data centres in Delhi, Chennai and Hyderabad, which will result in an aggregate of 1.24 million sq.ft. space. The company management has hinted at a surge in third-party data centres; it expects a market opportunity of US\$1.5bn by 2012 in this segment. This segment had revenues of Rs2.8bn (up 48%YoY) for FY08.

#### Facility wise IDC break-up

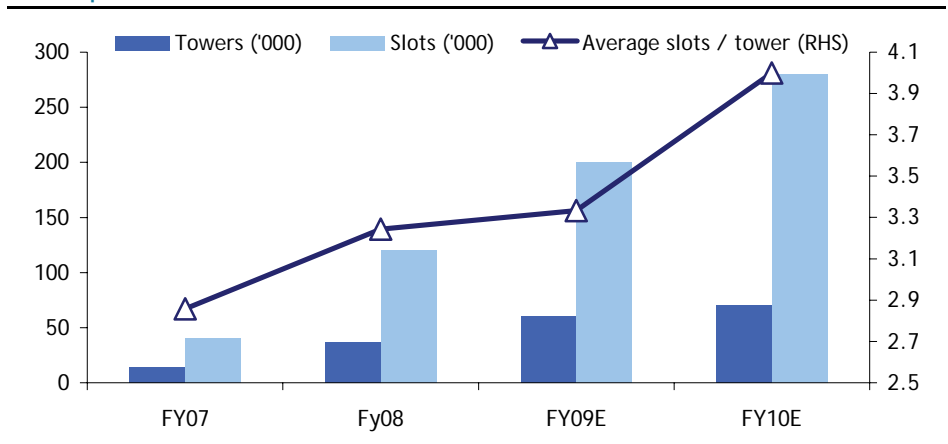
City	IDC level	Built out (sq.ft.)
Mumbai	IDC 4	400,000
Bangalore	IDC 4	300,000
Delhi	IDC 1	180,000
Chennai	IDC 1 & 2	260,000
Hyderabad	IDC 1	100,000
<b>Total</b>		<b>1.24m</b>

Source: Company Presentation, PL Research

### Reliance Infra to have 70K towers by FY10; IPO plans still on

The company management has hinted that it is aggressively going to expand its tower assets to 70,000 by FY10, on the back of strong demand anticipated from new entrants. It hinted that cash break-even for new operators (which will have around US\$10bn capex for its rollout operations) would be faster by 2-3 years if they go in for infrastructure sharing. The company is also in active negotiations with a couple of new entrants for their pan-India rollout. The company management has indicated that its IPO plan is still on and is awaiting the capital markets to stabilise.

#### Tower portfolio



Source: Company Presentation, PL Research

## DTH & IPTV rollout soon; price points still awaited

Rcom is looking to launch its DTH operations soon, with a start-up bouquet of over 200 channels on high digital platform. Trials are being carried out in around 45,000 households, whose initial response has been positive. The company has invested around Rs4bn in this venture and is looking at it as a medium to cross-sell its various entertainment businesses. Following is a list of potential revenue generators in this segment-

- Broadcasting TV & radio
- Information & entertainment
- Advertisement
- Messaging
- Public service

IPTV services will be offered to select class of consumers due to high investment needed for rolling out fibre. The company is looking to address top metros initially.

### Comparative analysis of various DTH operators

Particulars	Big TV	Dish TV	Tata Sky	DD Direct
Channels	240+	140+	120+	40+
Technology	MPEG 4	MPEG 2	MPEG 2	MPEG 2
Towns	4,000	2,200	1,700	NA
Distributors	689	550	350	NA
Retailers	103,000	40,000	40,000	NA

*Source: Company Presentation, PL Research*

## Reliance Tech Services

Reliance Tech Services, 89% subsidiary of Rcom, was formed primarily to cater to IT requirements of Rcom and ADAG Group companies. It is also eyeing external clients and has formed a JV with Alcatel Lucent, which will offer managed network services to telcos across the globe. Product offering will include consulting services, ERP, GIS and network warehousing. It has acquired ISO 20001 certificate and would have a employee base of 3,000 post acquiring the IT team of group companies like Reliance Infrastructure and Reliance Capital.



## Capex outlook

Rcom reiterated its capex guidance of US\$6bn and hinted that FY09 would be the peak year for capex. It has already signed conclusive arrangements of US\$1.3bn for electronic equipment with vendors, including Huawei, ZTE and Alcatel Lucent.

Capex split for FY09E	(US\$ bn)
Passive infrastructure (towers)	2.0
Active infrastructure	1.3
Global business	0.7
DTH/IPTV, data centres & enterprise	2.0
<b>Total</b>	<b>6.0</b>

Source: Company Data, PL Research

## Valuation

With favourable regulatory developments in the last couple of quarters, we believe Rcom is in a sweet spot. At the CMP of Rs559, the stock trades at a PER of 14.2x and at an EV/EBITDA of 9.8x FY10E earnings. Unlocking value in Reliance Globalcom and Reliance Infratel could be key catalysts in the next 6-12 months. Maintain BUY.





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#### PL's Recommendation Nomenclature

<b>BUY</b>	: > 15% Outperformance to BSE Sensex	<b>Outperformer (OP)</b>	: 5 to 15% Outperformance to Sensex
<b>Market Performer (MP)</b>	: -5 to 5% of Sensex Movement	<b>Underperformer (UP)</b>	: -5 to -15% of Underperformance to Sensex
<b>Sell</b>	: <-15% Relative to Sensex		
<b>Not Rated (NR)</b>	: No specific call on the stock	<b>Under Review (UR)</b>	: Rating likely to change shortly

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