

June 20, 2014

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Incorporated in 2004, Reliance Communications Ltd (RCOM) is the flagship company of Reliance Group. With a customer base of ~120 mn (including over 2.5 mn individual overseas retail customers), RCOM ranks among the Top 7 Telecom companies in the world by number of customers in a single country. The company's corporate clientele includes over 39,000 Indian and multinational corporations, including small and medium enterprises, and over 830 global, regional and domestic carriers. Internationally, RCOM has over 2,100 enterprise customers globally in developed markets of the US, UK, France, Germany, Benelux, Singapore and Australia.

Investor's Rationale

Revenue to grow by ~13.1% YoY in FY15E: Despite of posting weak numbers in FY14, we are hopeful that the company will achieve a growth of ~13.1% YoY in its revenue in FY15E driven by ~11.2% YoY growth in Indian operations along with ~6.1% growth in global operations. Within Indian operations, we expect the voice and non-voice business to grow by 10% and 15%, respectively. Further, data and voice business (global operations) are expected to grow merely by 8% and 2%, respectively.

Deal with Reliance Jio to aid profitability in the upcoming quarters: RCOM partnership with Mukesh Ambani led Reliance Jio Infocomm is yet to yield fruitful results as over 2/3rd of RCOM's sites are capable of high speed/broadband services including handling 4G services and Reliance Jio already owns a nationwide licence for high-speed 4G mobile phone networks, which it won by outbidding rivals three years ago. While RCOM's fiber network will help Jio roll-out 4G services across the country, RCOM will benefit from the cash generated from the deal.

Tariff hike by 20%, a significant move to strengthen ARPM: RCOM's move to strengthen average revenue per minute (ARPM) by continual reduction in free and promotional minutes is most likely to work in the company's favor. Voice realisation has increased from 30.9 paise in Q4FY13 to 33 paise in Q4FY14. The management's move to hike tariffs by 20% for all of its pre-paid customers will bring a significant improvement in ARPM in the next 2-3 quarters.

All set to reap benefits from initiatives undertaken: RCOM has several path-breaking, industry-defining initiatives to its name, among them the revolutionary Zero Plan and the recently-introduced One India, One Rate Plan, have created new benchmarks in the Indian telecommunications industry. Combined with the launch of 3G services in 5 new Circles, these initiatives together make up a powerful proposition for the high-value Corporate and SME customer, offering them seamless, affordable and high-speed connectivity, backed by a best-in-class network.

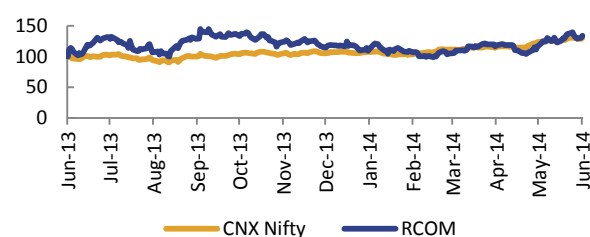
Market Data

Rating	BUY
CMP (₹)	149.1
Target (₹)	175
Potential Upside	~17.4%
Duration	Long Term
Face Value (₹)	5.0
52 week H/L (₹)	164.7/104.8
Adj. all time High (₹)	800.1
Decline from 52WH (%)	9.4
Rise from 52WL (%)	42.3
Beta	1.4
Mkt. Cap (₹bn)	304.5
Enterprise Value (₹bn)	668.5

Fiscal Year Ended

Y/E	FY13A	FY14A	FY15E	FY16E
Revenue (₹bn)	205.6	212.4	233.6	254.9
EBITDA (₹bn)	59.4	66.4	74.8	81.6
Net Profit (₹bn)	6.7	10.5	11.3	12.5
Adj EPS (₹)	3.3	5.1	5.5	6.1
P/E (x)	45.8	29.1	26.9	24.3
P/BV (x)	0.9	0.9	0.9	0.9
EV/EBITDA (x)	11.3	10.1	9.1	8.5
ROCE (%)	5.0	4.9	5.9	6.1
ROE (%)	2.0	3.1	3.4	3.6

One year Price Chart



Shareholding Pattern	Mar'14	Dec'13	Diff.
Promoters	67.8	67.8	-
FII	11.9	11.0	0.9
DII	8.9	9.7	(0.8)
Others	11.4	11.5	(0.1)

RCOM operates a complete range of telecom services, including broadband, national and international long distance services and data services along with an exhaustive range of value-added services and applications.

The company's operations can be broadly divided into Indian and global operations.

Indian operations has been further categorised into voice, non-voice and others segments, while global operations are categorised into data and voice operations.

RCOM – one of the leading CDMA & GSM Service providers in India

RCOM, the flagship company of Reliance group was incorporated in 2004. With around 120mn costumers, RCOM is the country's leading integrated telecommunication company. The company operates a complete range of telecom services, including broadband, national and international long distance services and data services along with an exhaustive range of value-added services and applications.

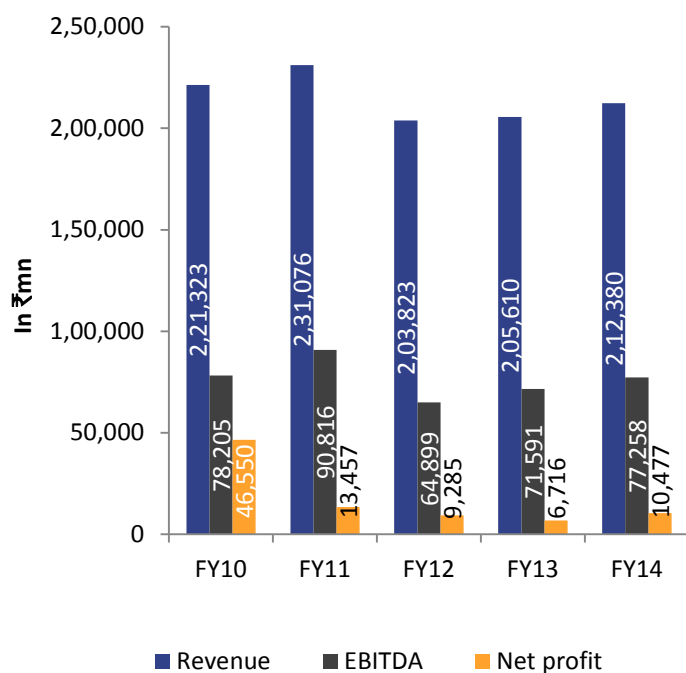
The company operates pan-India across the full spectrum of wireless, wireline, and long distance, voice, data, video and internet communication services. Indian operations are further categorised into voice, non-voice and other segments. Voice segment constitutes business generated mainly from the wireless customers and 1.2 mn wireline customers (~1% of total customers). The Others segment constitute activities such as managed internet data centres and direct-to-home (DTH) business etc.

The voice and non-voice business is driven by CDMA and GSM based wireless services to customers on a nationwide basis. Following the roll-out of GSM network, RCOM is now the only player in the country offering both GSM and CDMA services on a nationwide basis. As on date, the company has rolled-out 3G services in all the 13 circles where it won 3G spectrum, covering over 333 towns. On CDMA platform, High Speed Data service is available in over 1,000 cities with seamless handover to 1x service across 20,000 towns.

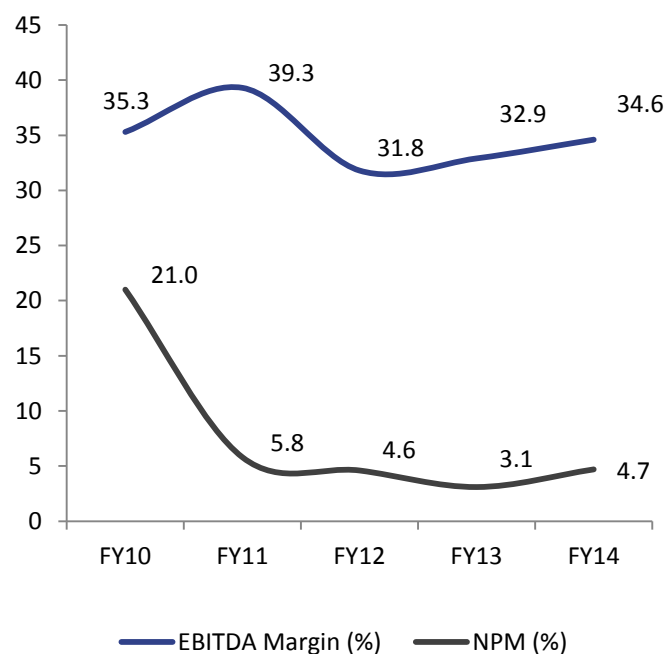
With nine operational data centers in Navi Mumbai, Bengaluru, Chennai & Hyderabad, and a total capacity of 11,00,000 sq ft, RCOM's IDC footprint is the largest in India. Further, it offers nationwide DTH satellite TV services, employing state-of-the-art MPEG4 technology.

RCOM has an extensive international presence through the provision of long distance voice, data and internet services and submarine cable network infrastructure globally.

Revenue growth remained consistent YoY



Margins Trend



RCOM's key parameters such as data traffic, subscriber base, ARPU and MoU improved sequentially, indicating easing competition in the sector.

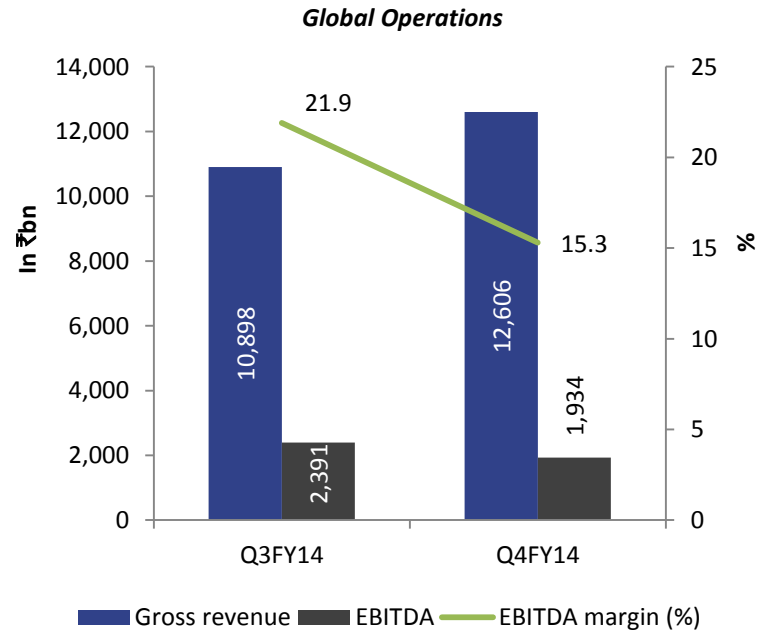
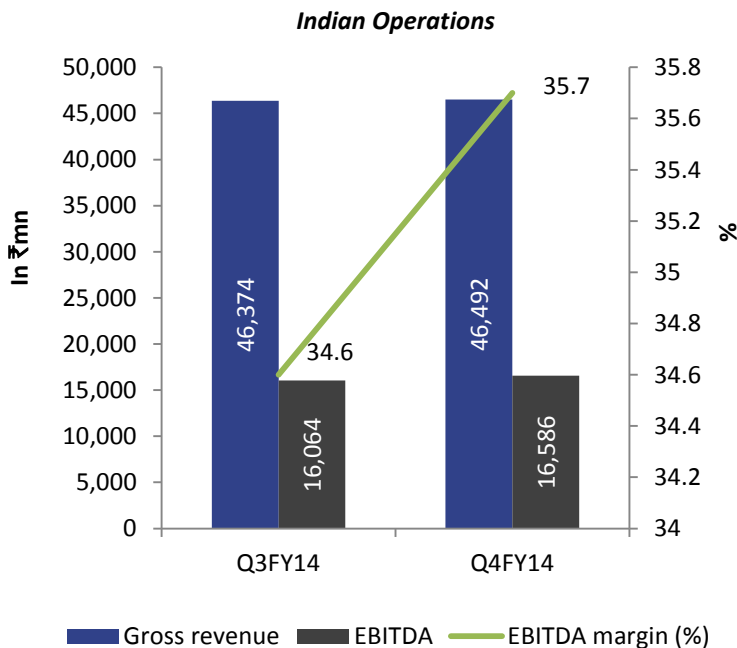
During Q4F14, PAT declined substantially by 48.5% YoY, while growing by 44.4% QoQ.

Showcased weak numbers in Q4FY14

ROCM showcased a weak performance in Q4FY14, the performance, however, was better on quarterly basis. While PAT declined substantially by 48.5% YoY, it grew by 44.4% on sequential basis. Total revenue remained marginally higher by 5.4% YoY and 4.8% QoQ. RCOM's key parameters such as data traffic, subscriber base, average revenue per user (ARPU) and minutes of usage (MoU) also improved sequentially, indicating easing competition in the sector, which allowed the company to raise telephone call prices.

Revenue grew marginally backed by better revenue from international operations: RCOM reported a growth of 4.8% QoQ in consolidated revenue to ₹54,050 mn in Q4FY14 as against ₹51,570 mn in the previous quarter, primarily on account of 15.7% QoQ jump in revenue from global operations (contributed ~21.3% to total revenue) while Indian operations (contributed ~78.7% to total revenue) showed a muted growth of 0.3% QoQ. The increase in revenue from global operation (broadly enterprise, data network offerings, ILD etc) was contributed by ~27% rise in revenue from data business while revenue from voice business declined 9.4% QoQ. The flat growth in Indian revenues was due to 2% QoQ growth in Non-Voice business to ₹10,393 mn with a decline in Voice business by 1.1% QoQ to ₹33,787 mn.

Marginal growth in revenue driven by global operations; Indian operations disappointed in Q4FY14



EBITDA margin declined by 166bps QoQ to 29.3% in Q4FY14, led by higher other expenses and employee cost.

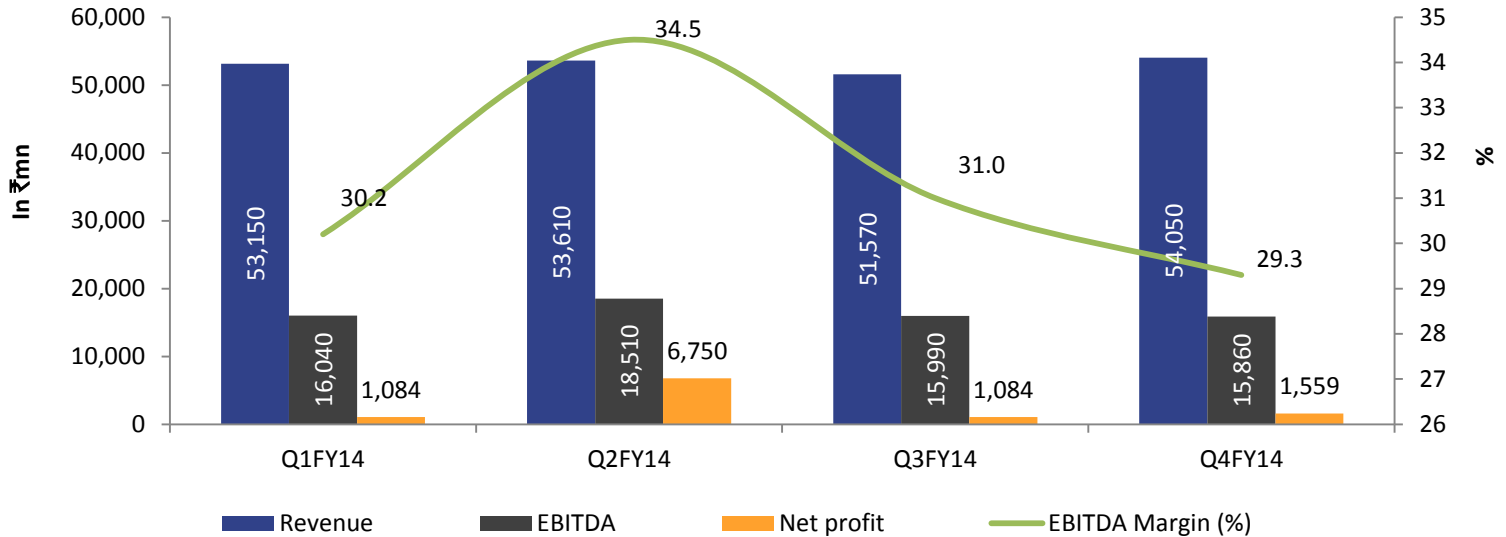
RCOM's net profit grew significantly by 44.4% led by a net tax credit of ₹10,260 mn during the quarter.

Margins dipped led by higher operating cost: The consolidated EBITDA margin declined 166 bps QoQ to 29.3% from the previous quarter's 31.0% on the back of increase in other expenses and employee cost by 155bps and 83bps QoQ (as a percentage of net sales) to 45.6% and 5.7% from 44.1% and 4.9%, respectively. License fee and Access fee, on the other hand, fell by 48bps and 24bps QoQ (as a percentage of net sales) to 5.6% and 13.8% from 6.0% and 14.0%, respectively. The consolidated EBITDA declined by 0.8% QoQ to ₹15,860 mn from ₹15,990 mn in Q3FY'14.

Net profit grew 44.4% QoQ led by rise in other income: The company posted a 44.4% QoQ increase in net profit at ₹1,559 mn in Q4FY14 as a net tax credit of ₹10,260 mn during the quarter negated the impact of massive rise in depreciation cost which grew by 86.4% QoQ to

₹17,670 mn in Q4FY14. On yearly basis, RCOM posted a significant decline in net profit by 48.5% stung by higher depreciation cost and interest.

Squeezing margins and flat growth in revenue reflected weak performance in Q4FY14



We expect RCOM to do well in the near term, as the company is well focussed on withdrawing promotional offers and raising the price of voice calls.

RCOM has raised headline tariffs from 1.5 paise to 1.6 paise per second, while tariffs on discounted and promotional plans will increase by upto 20%, with effect from 25 April 2014.

RPM is believed to be positively impacted by this move.

With its continuous focus on withdrawing promotional offers and raising the price of voice calls (which accounts for about 85% of revenues), we believe the company will do well in the near term.

Tariff hike by 20%, RPM to be impacted positively

Addition in overall customer base: RCOM witnessed an addition of 2 mn in its overall subscriber base, which grew to 120 mn in Q4FY14. On a sequential basis, total customer base has grown by 3.3% QoQ to 37.4 mn including 12.9 mn 3G customer base, up by 16.2% QoQ.

Total data usage remained higher in the industry: Led by an increase in data subscribers and higher data usage per customer which stood at 455 MB in Q4FY14, total data traffic grew by 20.5% QoQ to 50,251 mn MB.

RPM remained stable in Q4FY14: During the quarter, the company observed a 2.4% increase in ARPU at ₹128 with 0.4% QoQ increase in total minutes of usage at 102.3 bn. As per the management, the revenue per minute (RPM) was stable at 43.2 paise. Voice RPM stood at 33.0 paise, on account of tariff hikes and strong focus on paid and profitable minutes.

We believe the company will see an improvement in RPM over the next few quarters, following RCOM's move to reduce free and discounted minutes by increasing tariffs by upto 20% for all of its pre-paid customers. This is to ensure that the company maintains profitability under the current high spectrum cost framework and also to offset other inflationary costs pressures. Thus, RPMs will improve over the next few quarters and this will positively impact RCOM's performance.

***With effect from 25 April 2014, RCOM has raised headline tariffs from 1.5 paise to 1.6 paise per second, while tariffs on discounted and promotional plans will increase by upto 20%.**

Key Performance Indicators (KPIs)

Metric	Unit	Q3FY14	Q4FY14
Service areas operational *	Nos.	22	22
Total sites on network	Nos.	86,792	86,792
Total 3G sites	Nos.	11,659	11,659
Subscriber base	In mn	118.5	112.1
Pre-paid % of customer base	%	95.4	95.3
Total Minutes of Usage	Bn mins	101.9	102.3
ARPU	₹/subscriber	125	128
RPM	₹/minute	0.435	0.432
Voice ARPU	₹/subscriber	96	98
Voice Usage per customer/ month	Minute/subscriber	288	296
Voice revenue per minute	₹/minute	0.335	0.330
Non-voice & data business			
Total data customers	Mn	36.2	37.4
3G customers	Mn	11.1	12.9
Total data traffic	Mn MBs	41,702	50,251
Data usage per customer	MBs	396	455
Non-Voice as % of Telecom revenue	%	23.0	23.5

Voice market still has room to grow...

Overall subscribers for the telecom sector have grown from 812 mn in FY11 to about 903.3 mn in the period ending FY14. However, in the same period RCOM registered de-growth in the subscriber number from the peak of 153 mn in FY12 to 112.1 mn in the current quarter. This was primarily on account of weeding out of inactive users as well as some churn seen by the company. Consequently, voice volume has grown marginally at a CAGR of 3.2% from 374 bn in FY11 to 412 bn minutes in FY14. However, the company has managed to stem the declining ARPM trend by curbing discounts to bring an expansion in realisations, which have grown from 40.3 paisa in Q4FY13 to 43.2 paisa in Q4FY14.

Going forward, we expect the voice market for RCOM to further grow as the company would strike a balance between voice and pricing growth. Also, since the industry can still add ~200 mn new subscriber with VLR penetration of 86.4% and rural India penetration at 40%, RCOM is likely to grab a significant share in the segment.

RCOM rolls out 3G footprints in five more circles; a move that would grab 80% of India's 3G data market revenue

With its present footprint over 13 circles (Delhi, Mumbai, Kolkata, Punjab, Rajasthan, Madhya Pradesh, West Bengal, Himachal Pradesh, Bihar, Orissa, Assam, North East and Jammu & Kashmir), RCOM has now expanded its footprints over a total of 18 service zones. The company has aimed to capture a major pie of the data market with the addition of new circles, namely, Karnataka, Andhra Pradesh, Tamil Nadu, Kerala and Uttar Pradesh (East). With this move, RCOM will now offer best-in-class, high-speed 3G services in the entire southern part of India and UP-East as well. Services in new circles will be commenced from June 20, 2014. The move would help RCOM cover 80% of country's 3G data revenue market. RCOM is well positioned to target a disproportionate share of the Corporate, SME and high-

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The company has aimed to capture a major pie of the data market with the addition of new 3G circles, namely, Karnataka, Andhra Pradesh, Tamil Nadu, Kerala and Uttar Pradesh (East).

RCOM has planned a capex of ₹20 bn in FY15 with main focus on CDMA business, as the company sees a potential opportunity in CDMA business on the back of improved universal chipset and handset ecosystem.

RCOM's gross debt stood at ₹413,227 mn (including foreign currency loan of ₹265,072 mn and Rupee loan of ₹148, 155 mn) in Q4FY14.

RCOM has entered into a master service agreement with Reliance Jio Infocomm Ltd for sharing its extensive intra-city optic fiber infrastructure.

We believe that the agreement will not only help Reliance Jio speed up the launch of its 4G services, but will also help RCOM create cash to ease debt pressure in long term.

value customer market. This expansion will help Reliance Communications further consolidate its data leadership position in the Indian market.

Plan a capex of ₹20 bn in FY15 with more focus on CDMA business

RCOM is planning a capex of ₹20 bn in FY15 with hopes of rejuvenating its code division multiple access (CDMA) telephony business. Being a pioneer in CDMA technology, RCOM has started operations in 2002 and has revolutionised the Indian telecom industry by offering voice calls at cheapest possible rates. However, due to poor device eco-system and inadequate back-end support, the company was unable to do well with this technology. It eventually rolled out GSM (Global System for Mobile Communications) services as well in 2009 and that eventually overtook the CDMA business in terms of number of subscribers for voice services.

Now, RCOM sees a potential opportunity in CDMA business on the back of improved universal chipset and handset ecosystem. Also, with plans of introduction of handsets which will offer both DCMA as well as GSM capabilities, RCOM is confident of rejuvenating the CDMA business.

Debt Overhang: A Key Concern

Despite management's guidance of several steps to reduce debt, RCOM's gross debt stood at ₹413,227 mn (including foreign currency loan of ₹265,072 mn and Rupee loan of ₹148, 155 mn) in Q4FY14. On QoQ basis, the company has been able to bring a marginal reduction in gross debt by ~1.7%, as gross debt at the end of Q3FY14 stood at ₹420,650 mn. The company has cash and cash equivalents of ₹11,451 mn as in Q4FY14, which is not sufficient to pay the huge amount of debt. However, the company's move to lease its optical fibre to Reliance Jio Infocomm may ease the debt pressure on the company to an extent.

Master Services Agreement with Reliance Jio may reduce the debt burden

Mukesh Ambani led Reliance Jio Infocomm Ltd has entered into a Master Services Agreement with RCOM for sharing its extensive intra-city optic fiber infrastructure. Under the terms of the agreement, Reliance Jio will utilize RCOM's nationwide intra-city fiber network for accelerated roll-out of its state-of-the-art 4G services across the country. Reliance Jio owns is the first company which owns a nationwide license for high speed 4G mobile phone networks. RCOM's optic fibre network is running across 500,000 km in around 300 cities and towns which will provide Jio a good opportunity to usher a new age of technology in the country.

As per the agreement, pricing of the leases will depend upon the prevailing price in the market. The third such infrastructure sharing pact between the two will strengthen the comprehensive framework of business co-operation following the inter-city optic fiber sharing agreement signed in April 2013, and the nationwide telecom towers infrastructure sharing agreement signed in August 2013.

The two companies are also exploring avenues for future cooperation in the areas of retail outlets, distribution network, data centres and customer care. We believe that the agreement will not only help Reliance Jio speed up the launch of its 4G services, but will also help RCOM create cash to ease debt pressure (which stood at ₹413,227 mn in Q4FY14) in long term.

Balance Sheet (Consolidated)

Y/E (₹mn)	FY13A	FY14A	FY15E	FY16E
Share Capital	10,320.0	10,210.0	10,210.0	10,210.0
Reserves&Surplus	328,180.0	313,880.0	324,606.9	336,558.2
Minority Interest	7,250.0	7,430.0	7,430.0	7,430.0
Total debt	374,780.0	368,220.0	381,167.0	393,144.8
Other long term liabilities	12,330.0	9,150.0	10,339.5	11,063.3
Deferred tax	13,720.0	18,030.0	18,030.0	14,510.0
Provisions	27,590.0	22,880.0	25,879.5	27,737.7
Current Liabilities	127,650.0	153,720.0	164,218.8	173,303.8
Total Equity & Liabilities	901,820.0	903,520.0	941,881.7	973,957.8
Fixed Assets	692,520.0	664,430.0	684,430.0	704,962.9
Goodwill	51,250.0	53,000.0	53,000.0	53,000.0
Long term loans & advances	32,100.0	35,420.0	36,503.0	37,441.6
Deferred tax assets	-	14,880.0	14,880.0	14,880.0
Non Current Investments	1,110.0	1,180.0	1,180.0	1,180.0
Current Assets	122,610.0	133,770.0	151,048.7	161,653.3
Other Non Current Assets	2,230.0	840.0	840.0	840.0
Total Assets	901,820.0	903,520.0	941,881.7	973,957.7

Key Ratios (Consolidated)

Y/E	FY13A	FY14A	FY15E	FY16E
EBITDA Margin (%)	28.9	31.3	32.0	32.0
EBIT Margin (%)	16.1	15.0	17.1	16.5
NPM (%)	3.3	4.7	4.8	4.9
ROCE (%)	5.0	4.9	5.9	6.1
ROE (%)	2.0	3.1	3.4	3.6
EPS (₹)	3.3	5.1	5.5	6.1
P/E (x)	45.8	29.1	26.9	24.3
BVPS (₹)	164.0	158.7	164.0	169.8
P/BVPS (x)	0.9	0.9	0.9	0.9
EV/Operating Income (x)	9.4	8.7	7.9	7.3
EV/EBITDA (x)	11.3	10.1	9.1	8.5

Profit & Loss Account (Consolidated)

Y/E (₹mn)	FY13A	FY14A	FY15E	FY16E
Revenue	205,610.0	212,380.0	233,624.5	254,864.1
Operating Expense	146,190.0	145,950.0	158,864.6	173,307.6
EBITDA	59,420.0	66,430.0	74,759.8	81,556.5
Other Income	12,170.0	10,830.0	11,914.8	12,998.1
Depreciation	38,450.0	45,350.0	46,801.2	52,417.3
EBIT	33,140.0	31,910.0	39,873.5	42,137.3
Interest	24,990.0	30,190.0	31,095.7	32,028.6
PBT	8,150.0	1,720.0	8,777.8	10,108.7
Exceptional Item	-	560.0	-	-
PBT (after exceptional items)	8,150.0	1,160.0	8,777.8	10,108.7
Tax	710.0	(10,210.0)	(3,520.0)	(3,520.0)
PAT	7,440.0	11,370.0	12,297.8	13,628.7
Minority Interest	730.0	920.0	993.8	1,100.3
Share in Profit/(loss) of associates	10.0	20.0	10.0	10.0
Net Profit	6,720.0	10,470.0	11,314.0	12,538.4

Valuation and view

For the last few quarters, almost all the major telecom players are struggling to capture users by luring them with heavy discounts. But now all the companies come together and hike tariffs and lower down their discounts, which end the price war on the domestic front. Also, the company's plan to spend around ₹20 bn on bringing a renewal in CDMA telephony business would also have a positive impact on the company. Further, deal with Reliance Jio Infocomm will also strengthen future prospects of the company as the partnership will help company reduce the debt burden.

At a current CMP of ₹149.1, RCOM is attractively placed at EV/EBITDA of ~9.1x FY15E. Considering the above aspects, we rate the stock as 'BUY' with a target price of ₹175, a potential upside of ~17.4% for the coming 12 months.



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