

July 11, 2012

Rating	Previous Reco
Reduce	Reduce
CMP	Target Price
Rs71	Rs67
EPS Chg FY13E/FY14E (%)	NA
Target Price change (%)	NA
Nifty	5,345
Sensex	17,618

Price Performance

(%)	1M	3M	6M	12M
Absolute	8	-17	-12	-27
Rel. to Nifty	2	-19	-19	-22

Source: Bloomberg

Relative price chart



Source: Bloomberg

Stock Details

Sector	Telecommunications
Bloomberg	RCOM IB
Equity Capital (Rs mn)	10,320
Face Value(Rs)	5
No of shares o/s (mn)	2,064
52 Week H/L	110/ 59
Market Cap (Rs bn/USD mn)	147/ 2,645
Daily Avg Volume (No of sh)	10,601,590
Daily Avg Turnover (US\$m)	13.4

Shareholding Pattern (%)

	Mar12	Dec11	Sep11
Promoters	67.9	67.9	67.9
FII/NRI	7.8	8.5	8.5
Institutions	9.3	9.2	9.0
Private Corp	2.7	2.0	2.1
Public	12.3	12.6	12.6

Source: Bloomberg

Naval Seth

naval.seth@emkayglobal.com
+91-22-66242414

- Global Telecommunications Infrastructure Trust, a wholly owned Trust of Rcom is looking to raise \$700mn-\$1bn via IPO in Singapore, implying total EV of \$1.5bn
- Proceeds of \$1bn would de-leverage Rcom's balance sheet. Consolidated debt of Rs370bn at the end of FY12 would decline by Rs54bn (15%) post this transaction
- Post this transaction, Consolidated EBITDA of Rcom would contract by 10% (Rs6.9bn), which would get partly nullified with the reduction in finance cost
- IPO price band at \$1.02-\$1.39 per unit translates into healthy dividend yield of 9.5%-11.5%. Implied valuations of GTI Trust stand at 6.6x/7.9x FY13E EV/EBITDA on lower/upper band

Implied valuations of GTI Trust - premium to peer valuation

With this IPO the company is expected to raise \$1bn on the higher price band of IPO, which would reduce the consolidated debt of Rs370 (at the end of FY12) by ~Rs54bn. Implied equity value for the trust stands at \$1.5bn and EV of \$1.5bn (due to insignificant debt) on the higher price band. The implied EV/EBITDA stand at 6.6x on lower price band and 7.9x on upper band, which is premium to its comparable peers (Tata communication & CWW). Tata communication and Cable and Wireless Worldwide (CWW) trade at ~6.5x FY13E and 3.3x CY2012E, resp. Rcom currently trades at 6.4x FY13E, which is at par with Bharti and Idea (despite weak financials). This indicates that most of the potential upside from the stake sale is already factored in the stock price.

GTI Trust listing to help de-leverage RCOM balance sheet, but not in a big way

At the higher price band Rcom would be able to raise \$1bn (~Rs54bn), which would not reduce the current debt of 370bn (at the end of FY12) in a big way. Net-Debt to EBITDA post this transaction would still remain stretched at 4.1x for FY13E.

Only debt reduction but no value creation for Rcom

We assume debt reduction of Rs54bn and EBITDA reduction Rs6.9bn for Rcom, post this transaction. We have assigned the EV/EBITDA multiple of 6.4x (Rcom's current multiple) on revised EV and EBITDA and arrive at fair value of Rs73.

Valuations

This transaction is the first step towards reducing debt via divestment of stake in subsidiary. While the net debt would be reduced but concerns over weakness in core business still remain. The wireless (core) revenue of RCom has been stagnant from last 12 quarters which is in complete contrast with Bharti and Idea. EBITDA has also fallen at a CQGR of 3.3%. RCom has guided Rs15bn capex for FY13 while that of Bharti and Idea stand at Rs120bn and Rs40bn, respectively. We believe this may impact network quality and lead to loss of market share. We maintain our cautious view on the stock with REDUCE rating. We would revise our financials and target price post this transaction.

Financial Snapshot (Consolidated)

(Rsmn)

YE-	Net Sales	EBITDA (Core)	EBITDA (%)	APAT	EPS (Rs)	EPS % chg	RoE (%)	P/E	EV/ EBITDA	P/BV
Mar										
FY10A	214,964	71,846	33.4	46,925	22.7	-6.7	11.0	3.1	5.5	0.3
FY11A	224,304	84,044	37.5	13,336	6.5	-71.6	3.2	11.0	5.7	0.4
FY12E	203,418	64,503	31.7	9,276	4.5	-30.4	2.4	15.8	7.6	0.4
FY13E	219,553	72,000	32.8	7,910	3.8	-14.7	2.2	18.6	6.4	0.4

Exhibit 1: IPO valuations and post transaction fair value

	Lower price band	Higher Price band
Units to be sold (mn)	642	758
Price band (\$)	1.09	1.32
Amount to be raised (US\$ mn)	700	1,000
Equity value of the Global Telecom (US\$ mn)	1,268	1,536
EV of Global Telecom (US\$ mn)	1,287	1,555
EV/EBITDA (x) at the on the price bands	6.6	7.9
100% of GTI Trust EBITDA (US\$ mn)	196	196
EBITDA loss (US\$ mn)	108.2	127.6
EBITDA loss (Rs mn)	5,815	6,858
Pre transaction FY2013E EBITDA (Rs mn)	72,000	72,000
Post transaction FY2013E EBITDA (Rs mn)	66,185	65,142
Pre transaction FY13E Net debt (Rs mn)	319,355	319,355
Pre transaction Net-debt/EBITDA (x)	4.4	4.4
Post transaction FY2013E Net debt (Rs mn)	281,730	265,603
Post transaction Net-debt/EBITDA (x)	4.3	4.1
Pre- transaction fair value (Rs/share)*	76	76
Pre- transaction EV (Rs bn)	461	461
Pre- transaction EV/EBITDA multiple (x)	6.40	6.40
Post- transaction EV/EBITDA multiple (x)	6.40	6.40
Post- transaction EV (Rs bn)	423	417
Post- transaction fair value (Rs/share)*	69	73

Source: Company, Emkay Research. *Note: per share value does not include negative impact regulatory recommendations

Some details about the sub sea business

- The sub-sea cable business has over 68,000 km of cable assets, landing at 46 locations in 26 countries. It currently serves 403 customers.
- It operates in six out of eight global data-traffic routes. The design capacity of the cable network is 48,520 Gbps, with installed capacity of 19,440 Gbps. Total utilized lit capacity of the sub-sea cable business is 4,835 Gbps, implying utilization of 24.9% of the installed capacity.
- Currently the business has a market share of 18.8% of total utilized lit capacity on the six routes in which it is present.
- In FY2012, billed EBITDA was US\$177.5mn on billed revenue of US\$330.3mn. RCOM expects FY2013 and FY2014 billed revenue to be US\$352.7mn and US\$370mn respectively. It expects billed EBITDA to be US\$196.1mn (EBITDA margin of 55.6%) and US\$205mn (EBITDA margin of 55.4%) over the next two years.

Exhibit 2: Financial snapshot

Financials	2010	2011	2012	2013E
Billed revenue (US\$ mn)	320	252	330	353
Billed EBITDA (US\$ mn)	155	99	178	196
EBITDA Margin (%)	48.3	39.2	53.7	55.6
Distributable FCF (US\$ mn)	126	-93	116	153
Capex (US\$ mn)	105	191	70	82

Source: Company, Emkay Research

Exhibit 3: Projected dividend payouts and yield details

	Based on the Minimum offer price		Based on the Maximum offer price	
	FY13E	FY14E	FY13E	FY14E
Issue Price (US\$)	1.09	1.09	1.32	1.32
Distribution to Unit-holders (US\$ mn)	145.4	154.7	145.4	154.7
Weighted average number of Units (mn)	1163.1	1163.1	1163.1	1163.1
DPU (US cents)	12.5	13.3	12.5	13.3
DPU yield (%)	11.47	12.20	9.47	10.08

Source: Company, Emkay Research

Exhibit 4: Capacity details

Capacity details of the sub-sea cable business	Design capacity (Gbps)	Installed capacity (Gbps)	Utilized capacity (Gbps)	Utilization (%)
Trans Atlantic	18,720	4,750	2,759	58.1
Intra Asia	10,120	6,670	1,659	24.9
Middle East - West	9,800	5,100	212	4.2
Middle East - East	160	80	55	68.8
India - West	9,560	2,700	150	5.6
India - East	160	140	55	39.3
Total	48,520	19,440	4,835	24.9

Source: Company, Emkay Research

Exhibit 5: Market share data based on utilized capacity

Route	Utilized capacity of the market (Gbps)	Utilized capacity of the subsea cable business (Gbps)	Market share (%)
Trans Atlantic	13,036	2,531	19.4
Intra Asia	9,493	1,730	18.2
Middle East - West	601	211	35.1
Middle East - East	218	31	14.2
India - West	700	134	19.1
India - East	567	31	5.5
Total	24,615	4,637	18.8

Source: Company, Emkay Research

Financial projections look aggressive, strong yield could attract investor

The company has provided financial projections for FY13E and FY14E. Billed revenue growth of 7%/5% for FY13E/14E is reasonable but EBITDA margin at 55.6% and 55.4% for the same period seems to be aggressive. The company has reported 53.7% EBITDA margin for FY12 which improved from 39.2% in FY11, consistency in delivering such high margin is yet to be seen over the longer period. Rcom's peers, Tata communication and Cable and Wireless Worldwide generate ~15% lower EBITDA margins. The company has indicated strong dividend pay out of \$12.5c/\$13.3c for FY13E/14E which translates to 9.5% /11.5% dividend yield on upper/lower price band of the IPO. Healthy dividend yield could attract investors.

Exhibit 6: Income statement of the trust (US\$ mn)

Particulars	2010	2011	2012	2013E	2014E
Service Income	357.0	315.6	322.2	287.6	308.8
Other income	0.2	1.6	2.9		
Total Income	357.2	317.2	325.10	287.6	308.8
EXPENSES					
Network Operation Expenses	122.8	116.3	115.6	116.8	123.3
Employee cost	30.1	25.9	26.0	27.5	28.9
Trustee-Manager fee				2.0	2.0
Selling, Administration and Other Expenses	11.0	10.1	10.7	10.4	10.8
Total Expenditure	163.9	152.3	152.3	156.7	165.0
Operating profit	193.3	164.2	172.8	130.9	143.8
Finance income	0.0	0.0	0.0	3.6	3.8
Finance costs	-4.9	-10.4	-12.9		
(Loss) on Foreign Currency exchange differences (net)	-1.6	-0.7	-0.5	3.6	3.8
Depreciation and amortization	72.8	83.4	76.4	133.1	139.4
Profit before income tax	114.1	70.4	83.0	-5.8	0.6
Income tax (charge)/credit	0.1	-6.7	-5.0	8.6	8.0
Net profit for the year	114.2	63.7	78.0	-14.4	-7.4
Other comprehensive income					
Total other comprehensive income for the year, net of tax					
Total comprehensive income for the year	114.2	63.7	78.0	-14.9	-7.9
Net profit attributable to: Owners of the Subsea Telecommunications Network Business	114.5	63.6	78.2		
Non-controlling interests	-0.2	0.1	-0.2	0.5	0.5
Net Profit/Loss	114.2	63.7	78.0	-14.4	-7.4

Source: Company, Emkay Research

Note: Projected figures for FY13E and FY14E are provided by the company in its prospectus

Exhibit 7: Balance sheet (US\$ mn)

	2009	2010	2011	2012
Non-current assets				
Property, plant and equipment	631.7	674.3	767.1	752.3
Capital Work-in-Progress	38.4	32.5	42.1	59.6
Intangible assets	176.1	172.1	177.4	168.3
Other assets	3.4	3.1	2.6	2.7
Deferred income tax assets	28.4	28.7	22.8	20.5
Total Non-current assets	877.9	910.7	1,012.2	1,003.3
Current assets				
Trade and other receivables	225.9	155.2	207.8	190.1
Cash and bank deposits	17.3	15.4	11.9	9.1
Other assets	12.6	8.3	12.6	5.3
Total Current assets.	255.8	178.9	232.3	204.5
Total Assets	1,133.8	1,089.6	1,244.5	1,207.8
Combined Capital	271.6	271.6	109.2	391.3
Distribution to parent	-299.1	-390.9	-439.4	-521.9
Retained earnings	-55.3	59.2	122.8	201.1
Networth	-82.8	-60.0	-207.3	70.5
Non-controlling interests	-6.2	-6.5	-6.4	-6.6
Total Equity	-89.0	-66.5	-213.7	63.9
Liabilities				
Non-current liabilities				
Deferred Income Tax Liabilities	0.1	0.0	0.0	0.0
Deferred Revenue	832.2	804.2	745.6	732.8
Trade and other payables	5.8	5.3	3.8	3.3
Retirement benefit obligation	0.5	0.5	0.6	0.7
Asset retirement obligation	64.3	69.0	73.9	72.1
Total Non-current liabilities	902.9	879.0	823.9	808.8
Current liabilities				
Borrowings	57.7	19.5	333.8	19.1
Trade and other payables	143.3	136.4	182.8	193.8
Deferred Revenue	111.6	115.3	110.8	115.0
Current income tax liabilities	5.2	4.6	5.5	6.2
Other liabilities	2.2	1.4	1.3	1.0
Total Current liabilities	319.9	277.2	634.3	335.0
Total Liabilities	1,222.8	1,156.1	1,458.2	1,143.8
Net assets/(liabilities)	-89.0	-66.5	-213.7	63.9
Total Equity and Liabilities	1,133.8	1,089.6	1,244.5	1,207.8

Source: Source: Company, Emkay Research

Key Financials (Consolidated)

Income statement

Y/E Mar (Rsmn)	FY10A	FY11A	FY12E	FY13E
Net Sales	214,964	224,304	203,418	219,553
<i>Growth (%)</i>	-3.4	4.3	-9.3	7.9
Expenditure	143,118	140,261	138,915	147,553
Other Expenditure	92,789	92,764	96,508	104,572
Employee Cost	15,001	14,757	12,831	12,731
Selling & Admin	35,328	32,740	29,576	30,250
EBITDA	71,846	84,044	64,503	72,000
<i>Growth (%)</i>	-16.5	17.0	-23.3	11.6
EBITDA margin (%)	33.4	37.5	31.7	32.8
Depreciation	37,465	65,038	39,780	42,167
EBIT	34,381	19,005	24,723	29,832
EBIT margin (%)	16.0	8.5	12.2	13.6
Other Income	6,359	6,773	0	0
Interest expenses	-11,863	10,722	15,900	20,581
PBT	52,603	15,056	8,823	9,251
Tax	4,454	118	-1,064	463
<i>Effective tax rate (%)</i>	8.5	0.8	-12.1	5.0
Adjusted PAT	48,149	14,938	9,887	8,789
<i>Growth (%)</i>	-8.0	-69.0	-33.8	-11.1
Net Margin (%)	22.4	6.7	4.9	4.0
(Profit)/loss from JVs/Ass/MI	-1,193	-1,503	-621	-879
Adj. PAT After JVs/Ass/MI	46,925	13,336	9,276	7,910
E/O items	-375	121	0	0
Reported PAT	46,550	13,457	9,276	7,910
PAT after MI	46,925	13,336	9,276	7,910
<i>Growth (%)</i>	-6.7	-71.6	-30.4	-14.7

Cash Flow

Y/E Mar (Rsmn)	FY10A	FY11A	FY12E	FY13E
PBT (Ex-Other income)	46,244	8,283	8,823	9,251
Depreciation	37,465	65,038	39,780	42,167
Interest Provided	-11,863	10,722	15,900	20,581
Other Non-Cash items	0	0	0	0
Chg in working cap	4,175	-47,662	14,587	-5,705
Tax paid	0	0	0	0
Operating Cashflow	76,021	36,382	79,090	66,295
Capital expenditure	-20,711	-79,409	-12,982	-15,200
Free Cash Flow	55,309	-43,027	66,108	51,095
Other income	6,359	6,773	0	0
Investments	54,058	35,901	0	0
Investing Cashflow	39,706	-36,735	-12,982	-15,200
Equity Capital Raised	0	0	0	0
Loans Taken / (Repaid)	-94,468	93,560	-30,000	-25,000
Interest Paid	11,863	-10,722	-15,900	-20,581
Dividend paid (incl tax)	-2,046	-1,203	-602	-602
Income from investments	0	0	0	0
Others	-22,890	-32,620	-7,697	11,447
Financing Cashflow	-107,541	49,014	-54,199	-34,736
Net chg in cash	8,185	48,661	11,910	16,359
Opening cash position	16,829	8,185	48,661	11,910
Closing cash position	8,185	48,661	11,910	16,359

Balance Sheet

Y/E Mar (Rsmn)	FY10A	FY11A	FY12E	FY13E
Equity share capital	10,320	10,320	10,320	10,320
Reserves & surplus	423,286	394,673	347,147	354,455
Net worth	433,606	404,993	357,467	364,775
Minority Interest	6,584	8,245	7,634	8,513
Secured Loans	30,000	216,928	186,928	161,928
Unsecured Loans	267,154	173,785	173,785	173,785
Loan Funds	297,154	390,714	360,714	335,714
Net deferred tax liability	991	3,668	3,668	3,668
Total Liabilities	738,335	807,619	729,483	712,670
Gross Block	836,629	868,379	911,579	936,779
Less: Depreciation	190,671	273,407	315,205	357,373
Net block	645,958	594,973	596,374	579,407
Capital work in progress	116,557	181,912	153,712	143,712
Investment	41,599	5,698	5,698	5,698
Current Assets	121,573	164,645	126,770	137,036
Inventories	5,446	5,172	5,697	6,129
Sundry debtors	33,117	39,840	39,012	42,106
Cash & bank balance	8,185	48,661	11,910	16,359
Loans & advances	54,098	50,863	50,278	51,061
Other current assets	20,726	20,110	19,874	21,381
Current lia & Prov	187,351	139,608	153,071	153,182
Current liabilities	147,085	106,018	122,608	120,303
Provisions	40,267	33,591	30,463	32,879
Net current assets	-65,778	25,037	-26,301	-16,147
Misc. exp	0	0	0	0
Total Assets	738,335	807,619	729,483	712,670

Key Ratios

Y/E Mar	FY10A	FY11A	FY12E	FY13E
Profitability (%)				
EBITDA Margin	33.4	37.5	31.7	32.8
Net Margin	22.4	6.7	4.9	4.0
ROCE	5.2	3.3	3.2	4.1
ROE	11.0	3.2	2.4	2.2
RoIC	5.9	3.3	4.4	5.4
Per Share Data (Rs)				
EPS	22.7	6.5	4.5	3.8
CEPS	40.9	38.0	23.8	24.3
BVPS	210.1	196.2	173.2	176.7
DPS	0.8	0.5	0.3	0.3
Valuations (x)				
PER	3.1	11.0	15.8	18.6
P/CEPS	1.7	1.9	3.0	2.9
P/BV	0.3	0.4	0.4	0.4
EV / Sales	1.8	2.2	2.4	2.1
EV / EBITDA	5.5	5.7	7.6	6.4
Dividend Yield (%)	1.2	0.7	0.4	0.4
Gearing Ratio (x)				
Net Debt/ Equity	0.6	0.8	1.0	0.9
Net Debt/EBITDA	4.0	5.3	4.4	3.7
Working Cap Cycle (days)	-38.4	-68.6	-54.0	-47.7

Recommendation History: Reliance Communications – RCOM IN

Date	Reports	Reco	CMP	Target
29/05/2012	Reliance Communication Q4FY12 Result Update	Reduce	67	67
10/02/2012	Reliance Communication Q3FY12 Result Update	Hold	94	82
14/11/2011	Reliance Communication Q2FY12 Result Update	Hold	82	82
17/08/2011	Reliance Communication Q1FY12 Result Update	Hold	77	82

Recent Research Reports

Date	Reports	Reco	CMP	Target
28/05/2012	Jagran Prakashan Q4FY12 Result Update	Hold	86	94
24/05/2012	Bharti Airtel Event Update	Accumulate	298	375
21/05/2012	HT Media Q4FY12 Result Update	Hold	113	121
16/05/2012	Dish TV Q4FY12 Result Update	Accumulate	55	66

Emkay Global Financial Services Ltd.

7th Floor, The Ruby, Senapati Bapat Marg, Dadar - West, Mumbai - 400028. India

Tel: +91 22 66121212 Fax: +91 22 66121299 Web: www.emkayglobal.com

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