As debt piles up, Anil Ambani's Reliance Comm faces key test

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MUMBAI (Reuters) - The clock is ticking and costs are seen rising for Reliance Communications Ltd as it struggles to reduce a $7 billion mountain of debt ahead of a major bond redemption next year.

Shares in India's No. 2 mobile carrier, controlled by Anil Ambani, who ranked 36th on last year's Forbes global rich list, dropped to a record low this week leaving the company valued at $4.3 billion.

Six straight quarters of falling profits as a tough telecoms market squeezes margins and failed attempts to raise cash are eroding investor confidence in the company, which faces tests with $1.2 billion in convertible debt falling due.

"The competitive landscape for telecoms firms in India is very tough and that's a problem for Reliance as well," said Lars Hemmingsen, a Copenhagen-based portfolio manager at Nordea Intia, which manages $260 million worth of Indian shares.

"What makes the matter worse for them is huge debt on the balance sheet and weak cash flow. You also have these negative news headlines hitting investor confidence in the firm," said Hemmingsen, who does not hold Reliance Communications shares.

In February, Ambani became the highest-profile executive to be questioned by CBI investigating a telecoms fraud that state auditors say cost the government $39 billion in lost revenues.

No executives from Reliance Communications have been charged and the company has denied any wrongdoing.

Last year, Reliance Communications attempted to sell a 26 percent stake in itself to pare debt. But it found no takers.

A plan to float its tower unit in an initial public offering also failed to take off and a deal to merge its tower arm with a rival collapsed.

Reliance Communications is battling a fast-growing but ferociously competitive cellular market in which call charges have fallen and operational costs have risen, triggering declines in margins, while regulatory worries have also increased.

The shares have fallen about 35 percent this year, making them the eighth worst performer globally among large capitalised firms.

On Feb 9 alone, shares in six companies of Reliance ADA, Ambani's conglomerate, dropped suddenly to wipe $2.5 billion off its market value. The billionaire blamed "baseless and motivated rumours" for the drop.

DEBT TEST

The cost of insuring against debt default in Reliance Communications through credit default swaps (CDS) has risen 90 basis points this year to 525 basis points.

That's an insurance premium of $525,000 for every $10 million of debt and has risen as markets focused on about $1.2 billion of convertible bonds in Reliance Communications that will mature by March 2012.

"If you look globally, the appetite for new issues is pretty low and this company has so many problems. I think the terms of refinancing would be stiff because the company's cash flow continues to be very weak," said Thorsten Vetter, a portfolio manager at Flossbach & Von Storch in Cologne, Germany, who last year sold Reliance Communications bonds maturing in 2012.

Two convertible bonds are due over the next 12 months but investors are unlikely to convert their holdings into equity following the fall in the share price to 93 rupees.

A $297 million bond due in May has a conversion price of 475 rupees. A $925 million bond maturing in March 2012 has a conversion price of 654 rupees.

Since the bonds are out of the money at current prices, the firm is likely to have to shell out about $374 million for the 2011 bond and $1.2 billion for the 2012 debt.

The 2011 convertible bonds are bid at 122-123 in secondary markets versus the redemption price of 125.84, while investors are more cautious about the 2012s, which are bid at 114.25-114.75 versus their 127.69 redemption price.

A Reliance Communications spokesman declined to comment on the company's plan to reduce its debt burden.

During an analysts call in February, Satish Seth, group managing director of Reliance ADA Group, said the company was evaluating several options.

WEAKENING CASH FLOWS, HIGH DEBT

Reliance Communication's net debt to EBITDA (earnings before interest, tax, depreciation and amortisation) is seen at 4.8 times in the year ending March 31, Thomson Reuters data show.

This compares to just under 3 times at bigger rival Bharti Airtel and 2.8 times at Idea Cellular.

"It doesn't make sense to lend to this company any more. It needs a serious equity injection," said a senior Singapore-based loans banker who covers Indian deals, who was not authorised to speak to the media on the record.

An equity issue, however, would be painfully dilutive, given that Reliance Communications shares have tumbled nearly 90 percent from their 2008 peak .

JPMorgan recently slashed the company's share price target for December by 49 percent to 82 rupees, citing concern about high leverage and the cost of a possible refinancing of $1.2 billion of bonds maturing by March 2012.

"First they will have to set their house in order before they start looking for strategic investors," Hemmingsen of Nordea Intia said. "There is always a buyer for a right price and transactions do happen despite a lot of headwinds."

Despite the troubles, some banks are not shying away from lending to the company, Reliance Communications signed a deal with China Development Bank in December for a $1.93 billion 10-year, syndicated loan.

(Additional reporting by Shankar Ramakrishnan in SINGAPORE, Umesh Desai and Maggie Chen in HONG KONG, Devidutta Tripathy and Neha D'silva in MUMBAI; Editing by Tony Munroe and Anshuman Daga)