

**Reliance Communication Ltd ----- Maintain UNDERPERFORM**
**Minority stake sale in tower subsidiary valued at Rs135/share of RCOM**
**EPS: ◀▶ TP: ▶▶**

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- RCOM announced the sale of a minority stake in its tower subsidiary to a group of financial investors for an equity valuation of US\$6.8 bn. This compares with consensus valuation of this business of around US\$4 bn.
- RTIL has 14,000 towers currently and should reach 40,000 towers by Mar-08 and 50,000 by Mar-10. 100% of these towers should be capable of handling 4 tenants by FY3/10, which could be further enhanced to 7 tenants.
- RCOM believes that RTIL could charge each tenant a capex recovery rate of around 11-13%. This would be significantly higher than our expectations of cost of equity returns of this business
- RCOM indicated that it intends to divest stakes in its long distance, BPO, and SEZ subsidiaries in FY3/08. This could make RCOM an asset valuation play from current focus on cash flows.
- The news on core business is also turning positive with strong capex spend and improving CDMA economics. This should keep the share strong in near term.

should expand to 25,000 towns and 600,000 villages in FY08. In particular, RTIL would have comprehensive coverage along railway tracks and road network. This would be supported by RCOM's national fiber network for the backhaul (current ~100,000 Kms with further 30,000Kms of fiber to be laid in FY3/08).

By Mar-08, around 80% of RCOM's towers would be capable of handling 4+ tenants and this number should rise to 100% by FY3/10. This capacity could be further enhanced to 7 tenants by marginal capex.

RCOM would be the anchor tenant for RTIL and would have a 10-year master service agreement with RTIL. Both its CDMA and GSM business would be separate tenants for the tower business. The rental charges would be decided on arms-length basis between the two companies. RCOM believes that it could charge each tenant a capex recovery rate of 11-13% per annum.

RTIL currently has net worth of Rs47 bn and should do a capex of Rs80 bn in FY3/08. The company would raise debt for this capex.

Bbg/RIC	RCOM IN / RLCM.BO	Price (19 Jul 07, Rs)	567.20			
Rating (prev. rating)	U (U)	TP (Rs) (prev. TP)	385 (385)			
Shares outstanding (mn)	2,044.62	Est. pot. % chg. to TP	(32)			
Daily trad vol-6m avg (mn)	2.2	52-wk range (Rs)	574.05 - 238.15			
Daily trad val-6m avg (US\$ mn)	0.3	Mkt cap (Rs/US\$ bn)	1,159.7/ 26.9			
Free float (%)		Performance	1M	3M	12M	
Major shareholders	Reliance ADAG group 66.6%	Absolute	16.1	30.4	130.3	
		Relative	6.8	16.5	53.9	
Year		3/05A	3/06A	3/07E	3/08E	3/09E
Revenues (Rs mn)	0	107,663	147,398	215,554	287,286	
EBITDA (Rs mn)		24,732	58,168	87,346	119,200	
Net profit (Rs mn)		4,813	30,384	43,871	61,918	
EPS (Rs)		2.2	14.9	21.5	30.3	
- Change from prev. EPS (%)		n.a.	0	0	0	
- Consensus EPS (Rs)		n.a.	14.8	22.1	30.0	
EPS growth (%)		n.a.	584.5	44.4	41.1	
P/E (x)		261.3	38.2	26.4	18.7	
Dividend yield (%)		0.0	0.0	0.0	0.0	
EV/EBITDA (x)		49.5	21.7	14.6	10.8	
P/B (x)		9.9	7.8	6.1	4.6	
ROE (%)		4.1	20.6	22.9	24.4	
Net debt/equity (%)						

Note 1: Reliance Communications Ltd. offers integrated telephone services. The Company offers fixed line and wireless voice, data and video transmission services, and Internet access.

**Announces the sale of a minority stake in tower subsidiary**

RCOM today announced that it has sold a 5% share in its tower subsidiary RTIL to a group of global investors. The stake sale is done at an equity valuation of US\$6.8 bn (or Rs135/share of RCOM). By comparison, consensus was estimating around US\$4 bn valuation for this company.

The deal has resulted in a cash inflow of US\$337.5 mn (Rs1.4 bn) and a US\$280 mn capital gains for RCOM

**Details of RTIL**

Reliance indicated that RTIL currently has 14,000 towers and should reach 40,000 towers by Mar-08 and 50,000 by Mar-10. From the current coverage of 10,000 towns and 300,000 villages, coverage

**More divestments ahead**

RCOM indicated that along with its tower company, it also plans to divest stakes in Flag Telecom (long distance subsidiary), BPO business, and SEZ business. We believe that this could make RCOM an asset valuation play instead of our current focus on cash flows.

**A string of positive steps**

Management has taken a number of decisive steps over the past few months and could have emerged stronger in the Indian wireless space. Clearly by announcing divestment of stake in its subsidiaries it has got the first-mover advantage.

Also, strong capex plans of US\$5 bn in FY3/08 puts it significantly ahead of the Bharti at US\$3.5 bn. This should help it regain lost market share.

Finally, CDMA economics could be improving with lower handset prices, increasing handset choices and improving economics of handset subsidy. (For more details, please read our note titled *India wireless update: CDMA outlook improving*, published on 3<sup>rd</sup> July 07.) These steps should keep the share strong in the near term.

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**Companies Mentioned** (Price as of 19 Jul 07)

Reliance Communication Ltd (RLCM.BO, Rs567.20, UNDERPERFORM, TP Rs385.00, MARKET WEIGHT)

Bharti Airtel Ltd (BRTI.BO, Rs883.10, UNDERPERFORM, TP Rs630.00, MARKET WEIGHT)

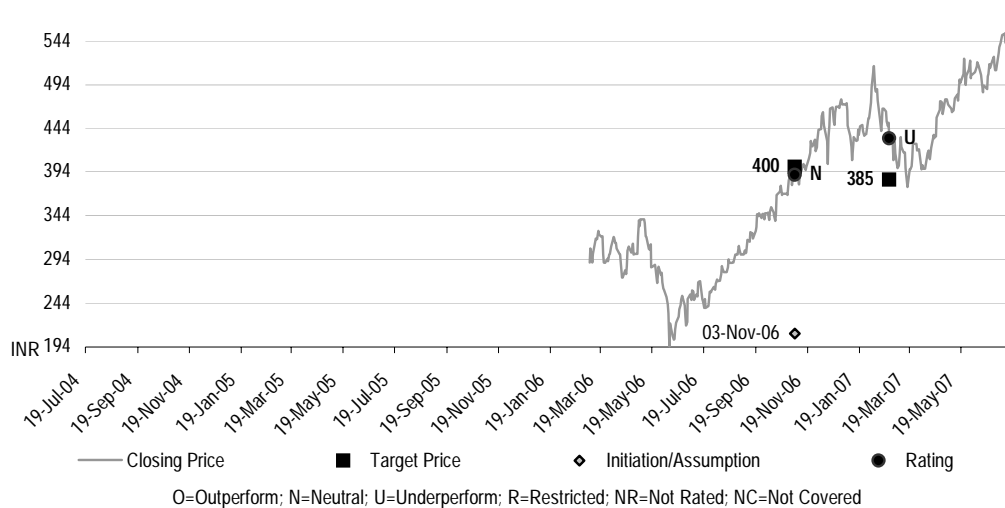
**Disclosure Appendix**

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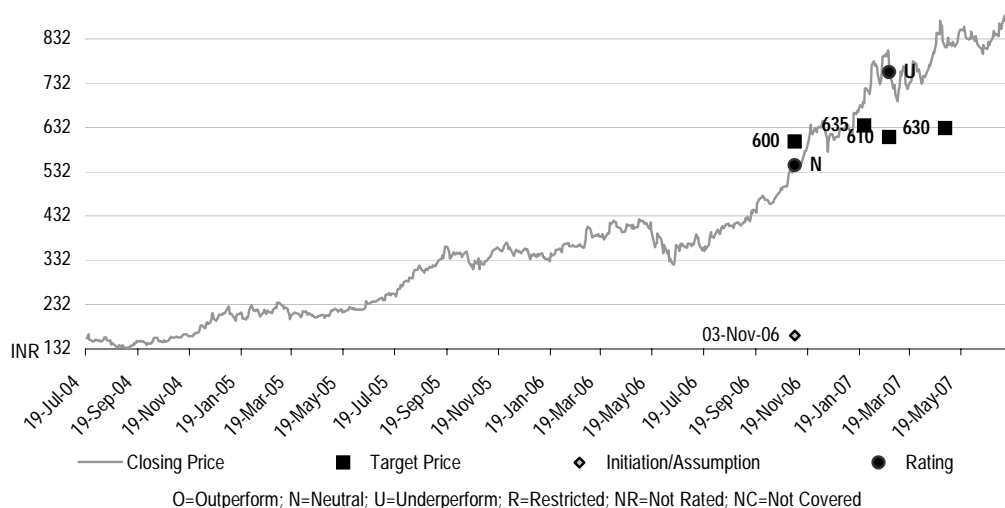
See the *Companies Mentioned* section for full company names.

**3-Year Price, Target Price and Rating Change History Chart for RLCM.BO**



RLCM.BO Date	Closing Price Price (INR)	Target Price Price (INR)	Rating	Initiation/ Assumption
3-Nov-06	391	400	NEUTRAL	X
23-Feb-07	432.35	385	UNDERPERFORM	

**3-Year Price, Target Price and Rating Change History Chart for BRTI.BO**



BRTI.BO Date	Closing Price Price (INR)	Target Price Price (INR)	Rating	Initiation/ Assumption
3-Nov-06	546.65	600	NEUTRAL	X
24-Jan-07	686.9	635		
23-Feb-07	756.1	610	UNDERPERFORM	
30-Apr-07	812.05	630		

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**Price Target:** (12 months) for (RLCM.BO)

**Method:** Our 12-month target price of Rs385 for Reliance is based on discounted cash flow (DCF) analysis. We assume a weighted average cost of capital (WACC) of 11.6 and beta of 1.2. Our DCF model builds in strong cashflow growth till FY3/15, a 5% medium term growth (FY3/15 - FY3/30) and 3% terminal growth

**Risks:** Key risk to our target price of Rs385 for Reliance includes 1) execution risk of the shift to GSM network from CDMA network, 2) stronger than expected margin performance and 3) continuous uptrend in overall market

**Price Target:** (12 months) for (BRTI.BO)

**Method:** Our 12-month target price of Rs630 for Bharti Airtel Ltd is based on discounted cash flow (DCF) analysis. We assume a weighted average cost of capital (WACC) of 11.6 and beta of 1.2. Our DCF model builds in strong cashflow growth till FY3/15, a 5% medium term growth (FY3/15 - FY3/30) and 3% terminal growth

**Risks:** Risks to our 12-month target price of Rs630 for Bharti include stronger than expected margin improvement and continuous uptrend in Indian market

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