

# Visit eases some concerns


**Merrill Lynch**

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## Unambiguous capex focus on GSM

We met with Reliance Communications (RCom) & understand that their capex strategy is now unambiguously focused on GSM. RCom indicated that only a small minority of their wireless capex will be towards CDMA, going forward. At this point RCom expects to keep its CDMA network, and will build further on CDMA only where it is most cost effective. The company expects its capex on GSM to be similar versus what it might have otherwise been on CDMA for supporting growth.

## Execution visibility is still some quarters away

RCom expects to receive requisite GSM spectrum by early 2007. While GSM operations will require more cell-sites/base stations, the capex and opex impact is expected to be mitigated by the growing trend of co-location in the industry. Given that both BSNL and RCom currently have no tenants on their sites, there could be significant opportunity for infrastructure sharing between them. Overall, we think the execution of RCom's GSM expansion will become visible 4-5 quarters hence.

## FALCON impact to kick in from 3Q FY07 onwards

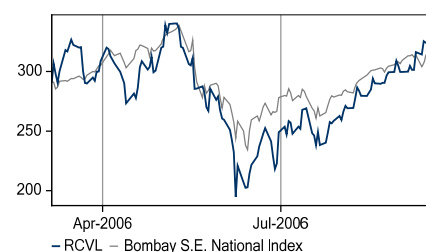
In the non-wireless segment, RCom commissioned its FALCON subsea cable in Sep '06 & positive contribution from the same should fully kick-in from 3Q FY07 onwards. In the broadband biz, RCom continues to focus on enterprise services. While development work on IPTV is underway, the company is not looking to launch IPTV as a mere substitute for cable.

## Raising price target to Rs385

We are raising our price target on RCom to Rs385 (vs Rs345 earlier). While execution risks still remain, visibility on the company's capex strategy is relatively better (unambiguously focused on GSM). Hence, we have narrowed our DCF discount to ~5% vs ~10% earlier. Bharti remains our top pick in the sector.

## Stock Data

Price	Rs331.00
Price Objective	Rs385.00
Date Established	20-Sep-2006
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs186.40-Rs347.70
Mrkt Val / Shares Out (mn)	US\$14,687 / 2,044.6
Average Daily Volume	1,825,620
ML Symbol / Exchange	RLCMF / BSE
Bloomberg / Reuters	RCOM IN / RLCM.BO
ROE (2007E)	20.1%
Net Dbt to Eqty (Mar-2006A)	28.0%
Est. 5-Yr EPS / DPS Growth	50.0% / 20.0%
Free Float	33.4%



## Estimates (Mar)

(Rs)	2005	2006A	2007E	2008E	2009E
Net Income (Adjusted - mn)	NA	5,123	25,985	39,867	51,026
EPS	NA	2.51	12.43	19.07	24.40
EPS Change (YoY)	NA	NA	396.0%	53.4%	28.0%
Dividend / Share	NA	0	1.27	1.95	2.50
Free Cash Flow / Share	NA	0.316	(5.96)	1.94	8.10

## Valuation (Mar)

	2005	2006A	2007E	2008E	2009E
P/E	NA	132.10x	26.63x	17.36x	13.56x
Dividend Yield	NA	0%	0.384%	0.589%	0.754%
EV / EBITDA*	NA	28.97x	12.89x	9.27x	7.63x
Free Cash Flow Yield*	NA	0.096%	-1.80%	0.586%	2.44%

\* For full definitions of *iQmethod*<sup>SM</sup> measures, see page 4.

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Refer to important disclosures on page 5 to 6. Analyst Certification on page 3. Price Objective Basis/Risk on page 3.

# *iQprofile*<sup>SM</sup> Reliance Communication Ltd.

## Key Income Statement Data (Mar)

(Rs Millions)	2005	2006A	2007E	2008E	2009E
Sales	NA	109,094	147,873	197,790	235,489
Gross Profit	NA	23,499	52,342	75,151	91,800
Sell General & Admin Expense	NA	NA	NA	NA	NA
Operating Profit	NA	6,512	28,818	45,652	57,759
Net Interest & Other Income	NA	(2,595)	(4,206)	(4,003)	(3,753)
Associates	NA	NA	NA	NA	NA
Pretax Income	NA	5,460	28,555	44,794	57,332
Tax (expense) / Benefit	NA	(337)	(2,571)	(4,927)	(6,307)
Net Income (Adjusted)	NA	5,123	25,985	39,867	51,026
Average Fully Diluted Shares Outstanding	NA	2,045	2,091	2,091	2,091

## Key Cash Flow Statement Data

Net Income (Reported)	NA	5,123	25,985	39,867	51,026
Depreciation & Amortization	NA	16,987	23,524	29,498	34,041
Change in Working Capital	NA	17,304	6,742	9,399	6,953
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	NA	0	0	0	0
Cash Flow from Operations	NA	39,414	56,250	78,764	92,019
Capital Expenditure	NA	(38,767)	(68,435)	(74,796)	(75,457)
(Acquisition) / Disposal of Investments	NA	0	0	0	0
Other Cash Inflow / (Outflow)	NA	0	0	0	0
Cash Flow from Investing	NA	(38,767)	(68,435)	(74,796)	(75,457)
Shares Issue / (Repurchase)	NA	0	0	0	0
Cost of Dividends Paid	NA	0	(2,858)	(4,385)	(5,613)
Cash Flow from Financing	NA	0	(2,858)	(4,385)	(5,613)
Free Cash Flow	NA	647	(12,185)	3,967	16,562
Net Debt	NA	32,938	48,132	48,550	37,601
Change in Net Debt	NA	(274)	15,194	418	(10,949)

## Key Balance Sheet Data

Property, Plant & Equipment	NA	214,263	259,175	304,472	345,889
Other Non-Current Assets	NA	121	121	121	121
Trade Receivables	NA	16,808	22,493	30,419	36,282
Cash & Equivalents	NA	60,038	51,992	38,635	49,584
Other Current Assets	NA	28,508	38,151	51,594	61,538
Total Assets	NA	319,738	371,931	425,241	493,414
Long-Term Debt	NA	92,976	100,124	87,185	87,185
Other Non-Current Liabilities	NA	0	0	0	0
Short-Term Debt	NA	0	0	0	0
Other Current Liabilities	NA	109,247	131,316	162,084	184,844
Total Liabilities	NA	202,223	231,440	249,269	272,029
Total Equity	NA	117,515	140,491	175,973	221,385
Total Equity & Liabilities	NA	319,738	371,932	425,242	493,415

## *iQmethod*<sup>SM</sup> - Bus Performance\*

Return On Capital Employed	NA	NA	13.1%	17.2%	19.0%
Return On Equity	NA	8.7%	20.1%	25.2%	25.7%
Operating Margin	NA	6.1%	20.0%	23.5%	24.9%
EBITDA Margin	NA	23.0%	38.1%	39.6%	40.4%

## *iQmethod*<sup>SM</sup> - Quality of Earnings\*

Cash Realization Ratio	NA	7.7x	2.2x	2.0x	1.8x
Asset Replacement Ratio	NA	2.3x	2.9x	2.5x	2.2x
Tax Rate (Reported)	NA	6.2%	9.0%	11.0%	11.0%
Net Debt-to-Equity Ratio	NA	28.0%	34.3%	27.6%	17.0%
Interest Cover	NA	3.1x	7.8x	12.2x	16.3x

## Key Metrics

\* For full definitions of *iQmethod*<sup>SM</sup> measures, see page 4.

## Company Description

Reliance Communication Ventures (RCVL) ranks among the largest private telecom operators in India. It has dominant wireless and long-distance businesses and is present in the fixed-line and broadband segments. RCVL also owns 100% of the global undersea cable – FLAG. RCVL was listed in Mar '06 as a result of the de-merger of Reliance Industries. The Anil D. Ambani group is the promoter-shareholder of RCVL.

## Stock Data

Price to Book Value 4.8x

## Price Objective Basis & Risk

Our price target of Rs385/sh is based on DCF and places Reliance at ~5-10% long-term discount versus Bharti on PE & EV/EBITDA. The effective discount is higher at ~15-20% factoring the foreign premium for Bharti.

Risks to our price objective are 1) unexpected slowdown in market growth and 2) higher-than-anticipated capex towards technology migration.

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20 September 2006

**iQmethod<sup>SM</sup> Measures Definitions**

<b>Business Performance</b>	<b>Numerator</b>	<b>Denominator</b>
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill Amortization}$
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
<b>Quality of Earnings</b>		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
<b>Valuation Toolkit</b>		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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B : Buy, N : Neutral, S : Sell, PO : Price objective, NA : No longer valid

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Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	72	48.65%	Buy	31	43.06%
Neutral	64	43.24%	Neutral	18	28.13%
Sell	12	8.11%	Sell	4	33.33%

### Investment Rating Distribution: Global Group (as of 30 Jun 2006)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1264	44.12%	Buy	430	34.02%
Neutral	1398	48.80%	Neutral	404	28.90%
Sell	203	7.09%	Sell	45	22.17%

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