

Research

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Svyazinvest's IRCs

It is time to increase tariffs

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Bullet moments

☎ Mass media reported this week that a range of Svyazinvest's IRCs plans to increase (or have already increased) the tariffs for unlimited local communications usage to the highest level, confirmed by FTS. Among these companies are: Centertelecom, STC, Uralsvyzinvest and NWTelecom. As other IRCs reported the given issue under a discussion now. We think that the other IRCs have all opportunities to increase the tariffs – the elections for State Duma and presidential elections were ended and there were other constraining factors, influencing on the companies.

☎ We see the news as positive for IRCs and their stocks as well, i.e. increased tariffs will lead to a growth of revenue and efficiency of the companies. It should be mentioned that we have not reflected a growth of tariffs in our previous model.

☎ We have reviewed the models of NWTelecom, Centertelecom and STC and we will renew them, taking into account received data. Regarding the other companies: we plan to publish their researches, including a possible growth of tariffs in the nearest future. In accordance with received information, we increase the estimations of NWTelecom's, Centertelecom's and STC's securities.

☎ It should be mentioned that the stocks of all IRCs have a high growth potential. Over the year, a fall of IRCs' stocks formed about 50%, due to a negative market situation. However, our forecasts are based on the "normal" market conditions, excluding political and war risks, providing a negative influence on companies' stocks.

☎ We have reviewed the fair prices of NWTelecom, Centertelecom and STC (Page 2). We confirm our "BUY" recommendation on Centertelecom's and STC's securities. Increase NWTelecom's estimation from "ACCUMULATE" to "BUY" recommendation on company's stocks.

Principal estimates

Information about NWTelecom

Ticker RTS	SPTL / SPTLP
Market price (cs), USD	0.8300
Market price (ps), USD	0.5650
Min / max price during last year (cs), USD	0.8000 / 1.9200
Min / max price during last year (ps), USD	0.5650 / 1.2700
Fair price at year end (cs), USD	1.3503
Fair price at year end (ps), USD	1.0127
Upside (downside) (cs), %	62.7
Upside (downside) (ps), %	79.2
MC, mn USD	866
EV, mn USD	1,289

Information about Centertelecom

Ticker RTS	ESMO / ESMOP
Market price (cs), USD	0.4250
Market price (ps), USD	0.3075
Min / max price during last year (cs), USD	0.4050 / 0.9600
Min / max price during last year (ps), USD	0.2800 / 0.6375
Fair price at year end (cs), USD	1.0463
Fair price at year end (ps), USD	0.7847
Upside (downside) (cs), %	146.2
Upside (downside) (ps), %	155.2
MC, mn USD	2,064
EV, mn USD	2,915

Information about STC

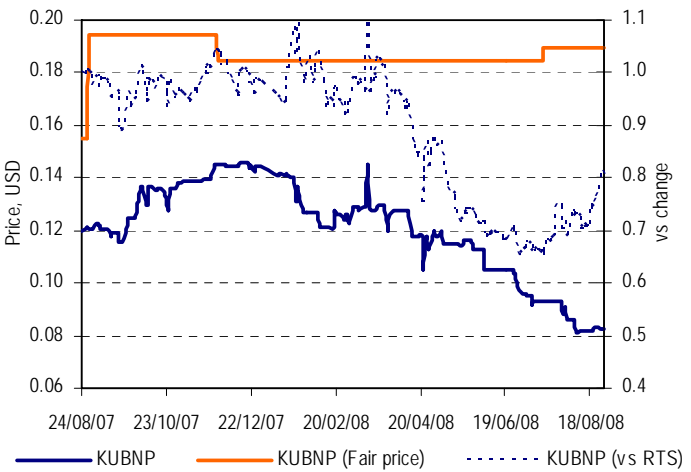
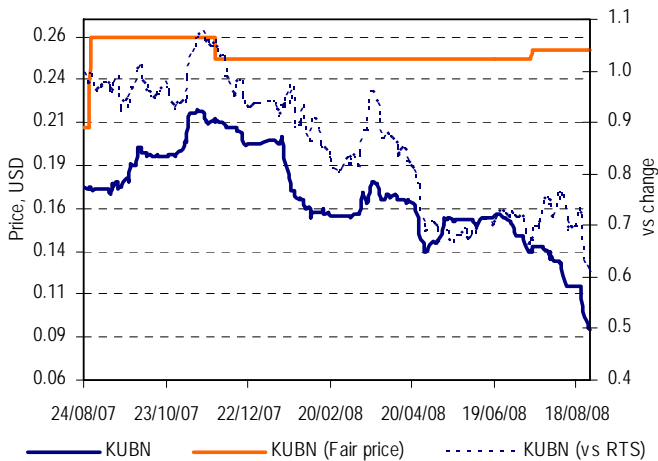
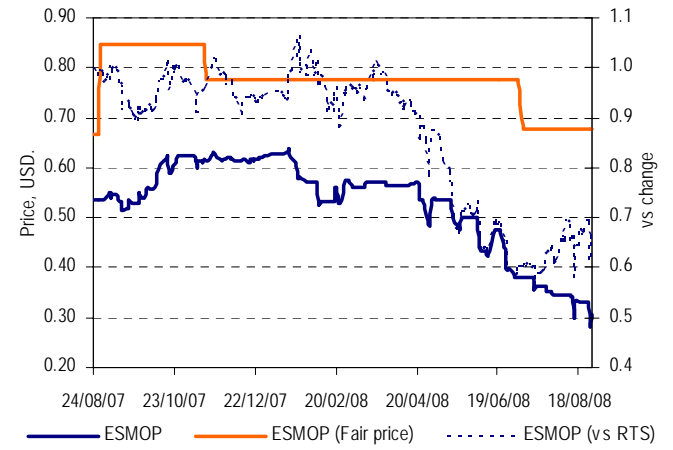
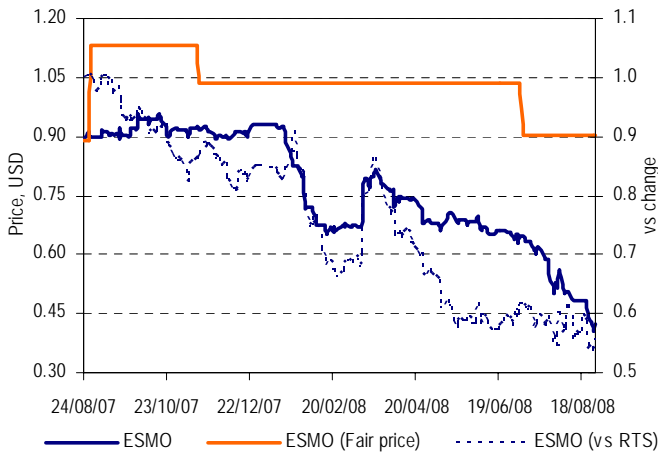
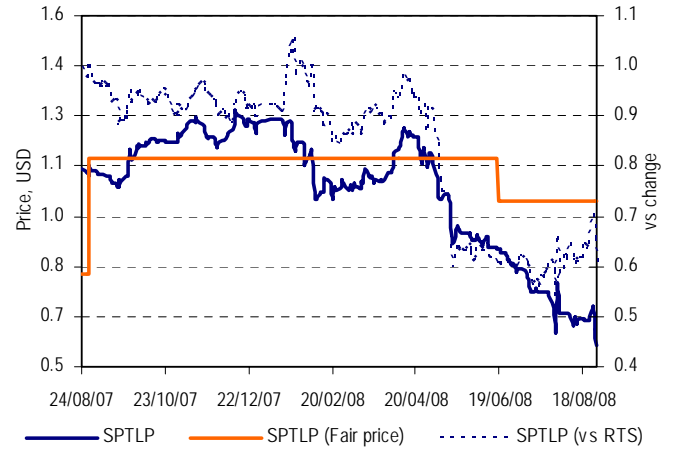
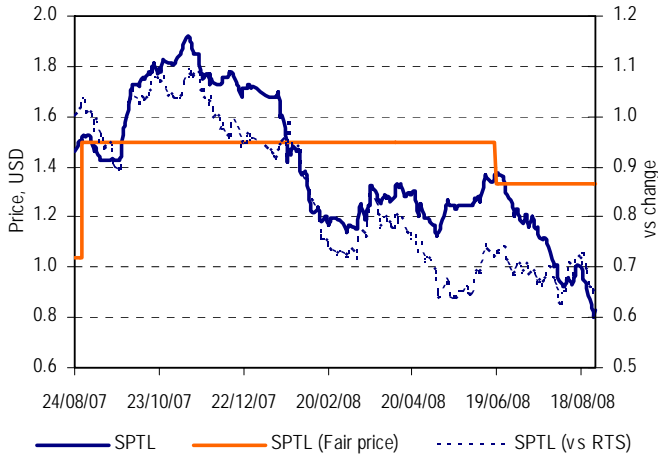
Ticker RTS	KUBN / KUBNP
Market price (cs), USD	0.0895
Market price (ps), USD	0.0825
Min / max price during last year (cs), USD	0.0895 / 0.2180
Min / max price during last year (ps), USD	0.0810 / 0.1458
Fair price at year end (cs), USD	0.2917
Fair price at year end (ps), USD	0.2188
Upside (downside) (cs), %	225.9
Upside (downside) (ps), %	165.2
MC, mn USD	478
EV, mn USD	1,314

Changes of IRCs' recommendations

Company, shares	Market price, USD	Fair price, USD		Recommendation		Growth (fall) potential, %
		Old	New	Old	New	
NWTelecom, cs	0.8300	1.3290	1.3503	HOLD	BUY	62.68
NWTelecom, ps	0.5650	0.9967	1.0127	ACCUMULATE	BUY	79.24
Centertelecom, cs	0.4250	0.9018	1.0463	BUY	BUY	146.19
Centertelecom, ps	0.3075	0.6763	0.7847	BUY	BUY	155.20
STC, cs	0.0895	0.2526	0.2917	BUY	BUY	225.91
STC, ps	0.0825	0.1895	0.2188	BUY	BUY	165.17

Source: RTS, Estimation: Veles Capital

History of fair estimations



Source: RTS, Estimation: Veles Capital

Recommendations for shares within sector

Our recommendations

Share	Ticker	Current price, USD	Target for year end, USD	Current growth potential, %	Recommendation	Date of recommendation revision	Investment idea
Traditional telephony							
Volgatelecom, cs	NNSI	2.7500	6.0110	118.6	BUY	3/14/2008	High effectiveness and low debt make company into an attractive subject for investing
Volgatelecom, ps	NNSIP	2.0000	4.5083	125.4	BUY	8/28/2007	
Dalsvyaz, cs	ESPK	2.4000	7.4457	210.2	BUY	8/28/2007	Prospects of improving the effectiveness of activity due to the new services
Dalsvyaz, ps	ESPKP	2.5000	5.5842	123.4	BUY	8/28/2007	
NWT, cs	SPTL	0.8500	1.3503	58.9	BUY	8/27/2008	Company's management gets maximum out of regulated services, however a growth potential can be seen after the fall
NWT, ps	SPTLP	0.6095	1.0127	66.2	BUY	8/27/2008	
Sibirtelecom, cs	ENCO	0.0555	0.0902	62.5	BUY	8/18/2008	The drop of quotes earlier this year, allows to hope for a significant growth potential
Sibirtelecom, ps	ENCOP	0.0450	0.0676	50.3	BUY	8/18/2008	
Uralsvyazinform, cs	URSI	0.0311	0.0573	84.4	BUY	3/13/2008	High debt load limits growth potential
Uralsvyazinform, ps	URSIP	0.0240	0.0430	79.2	ACCUMULATE	8/28/2007	
Centrtelecom, cs	ESMO	0.4050	1.0463	158.4	BUY	8/27/2008	The fall of quotes, in spite of aggressive investment program, makes company's shares attractive.
Centrtelecom, ps	ESMOP	0.2800	0.7847	180.3	BUY	8/27/2008	
STC, cs	KUBN	0.0900	0.2917	224.1	BUY	8/27/2008	Significant fall of quotes after year's start intends a growth potential up to fair price
STC, ps	KUBNP	0.0810	0.2188	170.1	BUY	8/27/2008	
Alternative telephony							
Comstar-UTS	CMST	6.6900	13.4790	101.5	BUY	4/24/2008	Growth potential due to development of regional markets
Long-distance communication							
Rostelecom, cs	RTKM	11.5000	4.4800	-61.0	SELL	7/21/2008	An extremely high market price, resulted from buyup of shares, yet unsupported by fundamental factors
Rostelecom, ps	RTKMP	1.1750	3.3600	186.0	BUY	7/21/2008	
Cellular communication							
Vimpelcom	VIMP	23.12	39.99	73.0	BUY	6/6/2008	Change of marketing policy intending growth of profitability, possible transformation into a universal operator (carrier)
MTS	MTSS	10.05	19.59	94.9	BUY	8/13/2008	
Media							
CTC Media	CTCM	19.46	32.60	67.5	BUY	7/30/2008	Growth of ad market, prices and spread business, due to merger with other companies
RBC	RBCI	7.00	9.86	40.9	BUY	10/2/2007	
Other							
Sitronics	SITR	0.1025	0.0854	-16.7	SELL	5/6/2008	Company demonstrates record losses and low effectiveness, determining its low fundamental value

Data: Bloomberg; Estimation: Veles Capital

Brief investor's guide

Methods, used for company's share evaluation				
Income approach			Comparables approach	Expenses approach
	DCF method	EVA method	Multiplicative method	Net assets method
Concept of evaluating the unified object (EV) *	FCFF discounting	EVA discounting		
Shareholders' value direct calculation (SV) **	FCFE discounting	EVA for shareholders discounting (Edwards-Bell-Ohlson method)		

*

Debt cost is calculated separately and then subtracted from the sum total cost of business (target EV), formed considering the cash flows/ economic profits of firm.

**

Debt is accounted integrated -via annual coverage. So the fair cost of shareholders' value (target SV) is formed directly - considering the cash flow / economic profits for holders.

Note:

DCF methods differ from the methods of economic profit by the way of investments calculation. The methods of unified object evaluation concept differ from these methods of direct calculation of shareholders' value costs - by the way of accounting cost and maintenance of debt liabilities.

Cost calculation within the frames of income approach:

	Business cost calculation (EV) within the frames of united object cost evaluation	Shareholders' capital value calculation (SV)
DCF method (FCFF)	$EV = \sum_{i=1}^n \frac{FCFF_i}{(1+WACC_i)^i} + \frac{TV}{(1+WACC_1)^n} + NA$	$SV = EV - D$
DCF method (FCFE)		$SV = \sum_{i=1}^n \frac{FCFE_i}{(1+k_{SI})^i} + \frac{TV}{(1+k_{SI})^n} + Cash + NA$
EVA method	$EV = IC_1 + \sum_{i=1}^n \frac{EVA_i}{(1+WACC_i)^i} + \frac{TV}{(1+WACC_1)^n} + NA$	$SV = EV - D$
EBO method		$SV = BV_1 + \sum_{i=1}^n \frac{SVA_i}{(1+k_{SI})^i} + \frac{TV}{(1+k_{SI})^n} + Cash + NA$

Signs:

EV	- Enterprise Value
SV	- Shareholders Value
TV	- Terminal Value
Cagr	- development rates within the target period
BV, E	- Balance Value, Equity
EBIT	- operational profit from selling, profit before payments of credit interest and income tax
EBITDA	- operational profit before payment of credit interest, income tax and amortization
EBT	- Earnings Before Tax
EAT	- Earnings After Tax
EPS	- Earnings Per Share
NOPAT	- net operational profit, free from effects of debt financing NOPAT = EBIT * (1 - income tax effective rate)
FCFF	- Free Cash Flow to Firm FCFF = gross cash flow - gross investments Gross cash flow = NOPAT + amortization
FCFE	- Free Cash Flow to Equity FCFE = gross shareholders' cash flow - gross investments Gross shareholders' cash flow = EAT of operational profit (including interest payoffs) - annual debt coverage + attracted borrowed assets + amortization
EVA	- Economic Value Added EVA = economic profit spread * IC = (ROIC - WACC) * IC
SVA	- Shareholders Value Added SVA = spread * E = (ROE - k_s) * E
WACC	- Weighted Average Cost of Capital
k _s	- required shareholders' yield
D	- fair (market) cost of net debt
Cash	- cash assets, along with market securities on the balance
NA	- non-operational assets
IC	- Invested Capital
ROIC	- Return on Invested Capital ROIC = NOPAT / IC
ROE	- Return on Equity
ROA	- Return on Assets

Information disclosure

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The principle of recommendation assignment

The investment recommendations are given based on the evaluation of the company's share yield. The basis for the calculation of the expected company's cost is the evaluation by the discounted cash flows method (DCF). In some estimations the method of comparable coefficients, and also the mixed estimation (by DCF method and by comparable coefficients method) are applied. All recommendations are assigned based on the determined by us the fair cost of the shares within the nearest 12 months.

At the present moment the investment scale of the Investment Company Veles Capital is the following:

BUY – corresponds to the growth potential of the shares within the nearest 12 months by 15% or more.

ACCUMULATE – corresponds to the growth potential of the shares within the nearest 12 months for 5-15%.

HOLD – corresponds to the growth (reduction) potential of the shares within the nearest 12 months from -5% to 5%.

REDUCE – corresponds to the reduction potential of the shares within the nearest 12 months from 15% to 5%.

SELL – corresponds to the reduction potential of the shares within the nearest 12 months by 15% or more.

In some cases the deviations from the evaluation scale given above, based on which the recommendations are assigned, are possible. That fact relates to the high volatility of some securities in particular, and market in the whole, and also to the individual characteristics of one or another issuer.

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