12 February 2008 | 33 pages

Indian Wireless

New World, Old Rules

- **New competitive dynamics hit estimates, target prices** — We downgrade core sector business value by 7-15% on lower rev/min, EBITDA%, higher capex/min and lower share of net adds. We cut estimates for Bharti (by 4-5%) and Idea (by 7-13%) and raise RCOM's by 6% for its GSM upside. However, towerco valuations benefit from more players. Though Bharti remains our top pick, RCOM (Rs760) and Idea (Rs140) become Buys on ~15-20% relative correction vis-a-vis Bharti.

- **New entrants can (or will) not rock the boat** — The economics of a new entrants indicates potential for +ve NAV, but only just and that too at base case RPMs. NAV drops sharply if they do 5-10% lower rev/min. The recent proactive tariff cuts by incumbents are aimed at reducing this elbow room further. EBITDA breakeven of ~24 months minimizes risk of disruptive pricing.

- **Market share reworked, but new entrants capped at 5%** — Incorporating two new national entrants starting end-FY09, in addition to Vodafone (7 circles), Maxis (14), RCOM (14) and Idea (2+9). Notwithstanding easy access to towercos, which will help new entrants build coverage, we cap share of net adds at 5% each for the start-ups given the fine balance between rev/min, market share and NAV.

- **Towerco gains on tenant visibility** — Core business loss is towercos' gain. Based on 7.5-8.0% rental yields, we value Bharti's stake in towercos at US$10.5bn (Rs220/share vs. Rs170 earlier). For RCOM, high capex recovery assumptions (10% our base case, company guidance 11-13%) means value accretion is only US$7.1bn (Rs140/share vs.Rs50 earlier) vs. est. towerco value of US$10.4bn. We also incorporating value of Idea's 16% stake in Indus (US$13.4bn).

Rahul Singh[1]
+91-22-6631-9863
rahul.r.singh@citi.com

Gaurav Malhotra, CFA[1]
gaurav.a.malhotra@citi.com

Anand Ramachandran, CFA[2]
+852-2501-2448
anand.ramachandran@citi.com

India Wireless – Statistical Abstract

Company name	Rating	M Cap US$M	Target price	Price 2/12/2008	P/E (x) FY08E	P/E (x) FY09E	P/E (x) FY10E	EV/EBITDA (x) FY08E	EV/EBITDA (x) FY09E	EV/EBITDA (x) FY10E
Bharti	1L	41,113	1,150	859	24.1	19.3	16.0	14.9	11.2	9.0
RCOM	1L	30,699	760	590	22.2	16.7	13.9	15.4	11.1	8.8
Idea	1L	7,066	140	106	27.3	23.0	19.6	14.9	11.7	10.0

Source: Citi Investment Research estimates

See Appendix A-1 for Analyst Certification and important disclosures.

[1]Citigroup Global Markets India Private Limited; [2]Citigroup Global Markets Asia

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New entrants will have to toe the line

The biggest question over the past six months, since the TRAI spectrum recommendations first came to fore, was with regard to the impact of new spectrum norms for a number of new players, margins and return parameters. While we quantified the impact in Bharti, RCOM & Idea's estimates through lower share of net adds, lower rev/min & EBITDA/min and higher capex/min in subsequent sections, there is no allowance in the economics of new entrants to break the rules (read tariffs, EBITDA margins) set by incumbents. Our indicative model for a new entrant is based on a representative "A" category circle, based on following assumptions.

Figure 1. New Entrant Business Assumptions

Item	Assumption	Comment
Entry fee	Rs1,000m	Average for A category circle
Upfront capex	Rs3,000m	Assuming only active capex and with 100% outsourced towers
Running capex	60% of Bharti's bases case capex/min	Assuming only active capex
Market share	1% in FY09E, 4% in FY10E and 5% in FY11E	
ARPU	10-15% discount to Bharti	
Rev/min	Same as new estimates for Bharti	
Variable costs	30%	Access/interconnect + license fees
Fixed costs	Rs1,300-1,500m per year	Based on data on Idea's 3 new circles + towerco rentals
WACC	13%	Assuming implied ROE of 15-16%
Terminal growth rate	4%	

Source: Citi Investment Research estimates

It is evident to us that the EBITDA breakeven will take 24 months. Given that Idea's three new circles will take 18 months to become EBITDA +ve, we think these results are fair as: i) tariffs are lower than when Idea launched (Oct 06), ii) basic coverage requirements have risen, increasing upfront investments, and iii) tower sharing will put additional burden on EBITDA of new entrants though the impact will be not very meaningful as it would most likely be the second or third tenant on most towers. The indicative working, however, suggests a potential for circle to be NAV +ve; our estimate is US$50m for a large-size circle as ROCEs remain healthy.

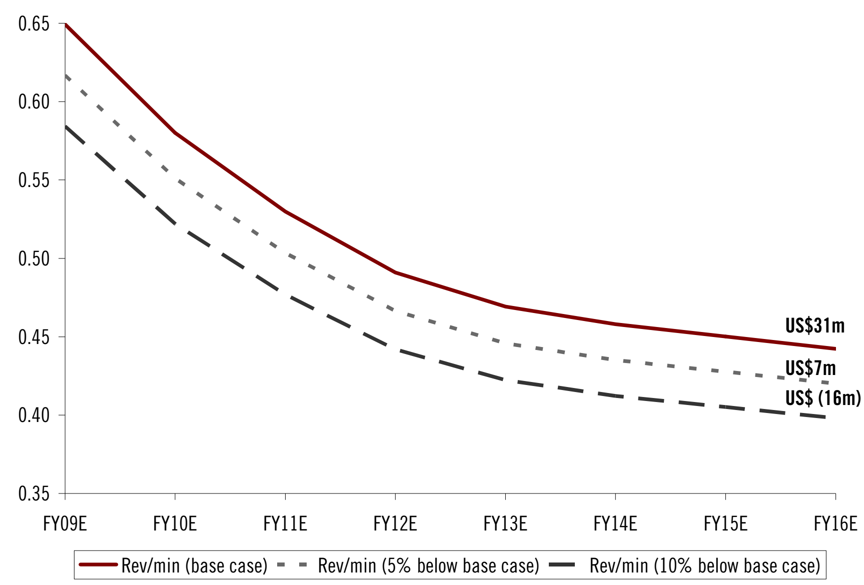
Figure 2. New Entrant Business Model

Rs m	FY09E	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E	FY16E
Revenues	26	573	1,370	2,010	2,601	2,886	3,077	3,217
EBITDA	-232	-899	-241	107	421	520	594	629
EBITDA margin %	-881%	-157%	-18%	5%	16%	18%	19%	20%
Free Cash Flows	-4,232	-1,276	-851	-453	-138	200	333	369
WACC (%)	13.0%							
Growth rate (%)	4%							
Terminal value	4,097							
NPV (Rs m)	1,224							
NPV (US$ m)	**31**							

Source: Citi Investment Research estimates

To gauge whether new entrants can successfully undercut and still create value, we carried out a sensitivity analysis on rev/min profile at 5-10% lower levels across years. This drastically reduces the NAV, barely breaking even at 10% lower tariffs. We therefore think that a strategy based on lower tariffs would prove unsuccessful for the new entrant because: i) it will not guarantee additional market share, esp. as it will always be catching up on coverage, and ii) incumbents will always be capable of matching the cuts given their much larger scale. This also provides potential reasoning behind Bharti's recent proactive tariff cuts (which was followed by the industry). In a way, it has significantly reduced leeway for a new entrant to attempt disruptive pricing. In fact, one or two smaller cuts by say end-FY09 could make the business models of new entrants very vulnerable.

Figure 3. NPV Sensitivity to Decline in Rev/Min



Source: Citi Investment Research estimates

Not much leeway for new entrants

New entrants could adopt three obvious strategies to achieve differentiation:

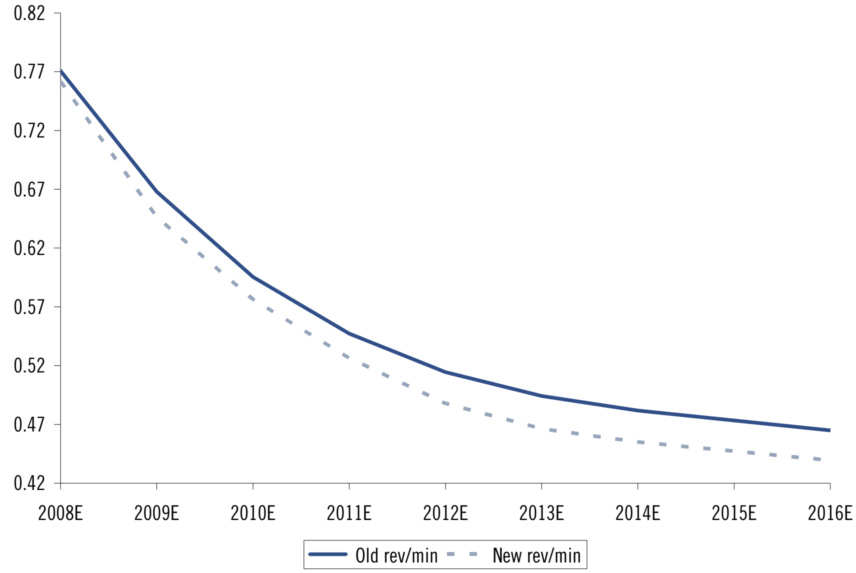
1. **Subsidize handsets** – Unlikely to happen. Indian market dynamics (high proportion of pre-paid) and lack of control systems prevent handset subsidies from gaining traction. Also, note that any strategy based on handset subsidies would push EBITDA breakeven beyond 24 months and dilute NAV significantly.

2. **Lower tariffs** – Unlikely to happen. Bharti's (and the others) strategy is to proactively reduce rev/min to an extent that it constrains new entrants' ability to undercut and be profitable at the same time, as demonstrated in the preceding section. Another factor is that price elasticity experienced by operators with every incremental tariff cut is not likely to continue forever and will eventually plateau. We are not implying no net impact from regulatory changes on the rev/min trends; in fact our new estimates factor in 5-6% lower rev/min across the board esp. in FY09-10E (see figure 15). However lower tariffs combined with new entrants' gestation periods would make any new commercial launch based solely on tariffs a non-starter.

3. **Better coverage** – Not possible. New entrants will launch services as tenants on towercos, i.e. while they might benefit from an accelerated roll-

out, their coverage would at best match incumbents' coverage, but not exceed it.

Figure 4. Sharper Decline in Rev/Min Assumed to Reflect New Competitive Scenario



Source: Citi Investment Research estimates

Sub adds growth revised upwards…again

Subscriber growth momentum continues to increase

We upgrade our subscriber estimates for India and now expect 452m subs by FY10E. Greater intensity of on-ground roll-out with separation of operator towercos, combined with sharper declines in rev/min due to higher competition with the entry of new players means India will reach 38% penetration faster (FY10E) than anticipated. Our new estimates factor in:

1. RCOM, Vodafone, Idea (two circles) and Maxis having already been allotted 4.4 MHz start-up spectrum, will launch services by 3Q-4QFY09.

2. We also assume start-up spectrum will be allotted to two new national players, Spice (four circles) and Idea (nine circles) by mid-CY08 with service commencement by 4QFY09.

3. Formation of towercos will increase the pace of rollout for existing players as well as new entrants. While this is more positive for the new entrants, on the whole it will lead to acceleration in sub growth.

4. Lower rev/min will trigger acceleration in subscriber acquisition.

Figure 5. Indian Wireless – Revised Subscriber Numbers

	FY09E		FY10E		FY16E	
	Old	New	Old	New	Old	New
Subscriber Estimates ('000)	347,584	351,758	437,606	451,906	712,468	750,740
Net additions ('000)	8,017	8,366	7,502	8,346	2,039	1,705
Population (Million)	1,164	1,164	1,182	1,182	1,292	1,292
Penetration (%)	29.9%	30.2%	37.0%	38.2%	55.1%	58.1%

Source: Citi Investment Research estimates

Market share changes incorporate two new national entrants

Bharti had it relatively easy in FY08 as peers faced constraints with: 1) Maxis, Vodafone, and RCOM's lack of spectrum to roll-out GSM services in new circles, and 2) capacity constraints faced by BSNL due to issues surrounding the tender. While this position of strength does get impacted to an extent with entry of new players by 3Q-4QFY09, the unrealistic assumptions of the market of ascribing their incremental market share gains only at the expense of Bharti is not logical. Though Bharti's share of net adds will come under pressure, this is true for all incumbents and the effect is likely to be even more severe in case of smaller players that lack the scale and reach of the larger peers.

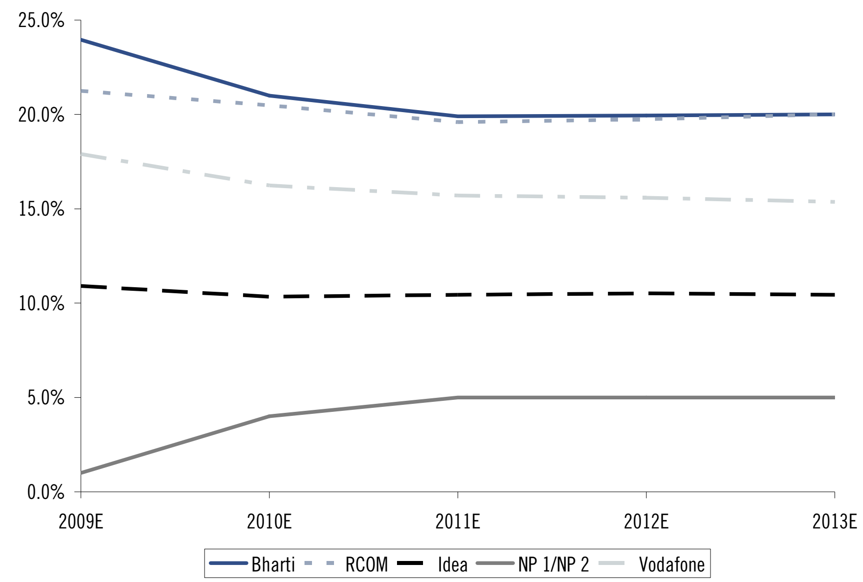
We assume a stable share of net adds for the two new national entrants at 5% by FY11E. As a result, we cut Bharti's share of net adds from 23-24% to ~20%, Idea from ~10% to ~8%. We now incorporate RCOM's GSM launch explicitly (we were including a GSM option value earlier) and hence the gain in market share of 200-300bps over FY09-10E before it also tapers off as new entrants make an entry.

Figure 6. Subscriber and market share revisions

	FY09E		FY10E		FY16E	
Bharti	**Old**	**New**	**Old**	**New**	**Old**	**New**
Subscriber Estimates ('000)	84,612	85,823	105,138	106,855	167,784	166,614
Market share of net adds (%)	23.7%	24.0%	22.8%	21.0%	23.0%	20.2%
Market share (%)	24.3%	24.4%	24.0%	23.6%	23.5%	22.2%
Idea	Old	New	Old	New	Old	New
Subscriber Estimates ('000)	34,079	33,593	43,268	42,278	71,640	66,424
Market share of net adds (%)	10.2%	9.9%	10.2%	8.7%	10.2%	8.1%
Market share (%)	9.8%	9.5%	9.9%	9.4%	10.1%	8.8%
RCOM						
Subscriber Estimates ('000)	63,721	68,384	79,999	88,897	131,386	148,529
Market share of net adds (%)	18.0%	21.3%	18.1%	20.5%	20.0%	20.9%
Market share (%)	18.3%	19.4%	18.3%	19.7%	18.4%	19.8%

Note: Idea's sub base assumes only for the 13 circles (incl. Mumbai and Bihar)
Source: Citi Investment Research estimates

Figure 7. Market Share of Net Adds (%)



Source: Citi Investment Research estimates

Spectrum availability and new norms leave room for two more national entrants

While the new norms are still "interim", they will remain in force when the next round of spectrum release occurs, expected by mid-08. We have assessed the spectrum availability in each circle based on requirements of incumbents on projected sub base as on Jun-08 (around the likely date of spectrum allotment for the new entrants) and on the assumption of an approximate Defence releases of 25Mhz.

Figure 8. DoT Notified Revised Subscriber Base Spectrum Criteria

Service area	2 X 4.4	2X 6.2	2X 7.2	2X 8.2	2X 9.2	2 X 10.2	2 X 11.2	2 X 12.2	2 X 13.2	2 X 14.2	2x 15.0
Metro Service Areas	Start-up spectrum	0.5	1.5	1.8	2.1	2.6	3.2	4.0	4.8	5.7	6.5
A & B circles	Start-up spectrum	0.8	3.0	4.1	5.3	6.8	8.2	9.0	9.8	10.7	11.6
C Circles	Start-up spectrum	0.6	2.0	3.1	4.2	5.2	6.2	7.0	7.8	8.7	9.6

Source: DoT

Out of the spectrum availability below, one round of spectrum has already been allotted to Vodafone, Maxi, Idea and RCOM, which is equivalent to two nation-wide operators. Given the uncertainty regarding 25Mhz (or less) being available from Defence and the pending applications of Idea (9 circles) and Tata Tele (for crossover spectrum in 22 circles), we think there is room for only two more operators to get nation-wide spectrum. These national players could be amongst Unitech, Videocon and Shyam Telelink depending upon the criteria which Government finalises to decide the queue for the spectrum.

Figure 9. Surplus Spectrum Availability Based on New Norms (as on Jun-08)

	Surplus spectrum for new entrants[1]
Metros	
Delhi	23.6
Mumbai	21.6
Chennai	26.8
Kolkata	29.8
A Circles	
Maharashtra	29.6
Gujarat	28.4
AP	27.2
Karnataka	27.8
Tamil Nadu	29.6
B Circles	
Kerela	31.6
Punjab	31.6
Haryana	35.2
UP(W)	31.6
UP(E)	30.0
Rajasthan	33.4
MP	33.4
WB and Assam	30.8
C circles	
HP	32.6
Bihar	35.2
Orissa	35.2
Assam	35.2
NE	38.8
J&K	41.4

[1] Doesn't deduct spectrum allotted to RCOM, Maxis (14 circles), Idea (2) and Vodafone (7)

Source: Citi Investment Research, TRAI

Earnings changes: -ve for Bharti/Idea, +ve for RCOM

We revise our FY08E full-year financials to align them with the 9MFY08, recent price cuts and MOU elasticity. We further revise FY09-10E EBITDA/EPS for all wireless stocks to reflect market share changes, higher capex/min and RCOM's GSM launch. Please note that all the estimates remain pre-towerco, without explicitly factoring the impact of tower rentals on EBITDA

Bharti — We revise FY09-10E EBITDA down by 1-4% primarily due to sharper decline in rev/min. We revise EPS down by 4-5% as a result of lower EBITDA, higher depreciation/interest charge due to increased capex/incremental min as a result of substantially tighter spectrum norms. EBITDA margin estimates are also down 100-150bps over FY09-10 vis-à-vis earlier forecasts.

Figure 10. Capex/incremental min revisions (Rs/min)

	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Old	0.79	0.69	0.65	0.61	0.61	0.64	0.72	0.82	0.88
New	0.85	0.74	0.69	0.66	0.65	0.69	0.79	0.90	0.98
Change (%)	7.6%	7.2%	6.8%	7.3%	6.5%	7.4%	9.8%	9.8%	12.1%

Source: Citi Investment Research estimates

Idea — FY09-10E EBITDA revised down by 7-9%. In addition to issues faced by Bharti, this is due to Idea's entry in Mumbai and Bihar, which we believe will take ~24 months to break even at the EBITDA level. As yet, we do not factor its entry in the remaining nine circles due to lack of clarity on timing of allotment of startup spectrum.

Figure 11. EBITDA margins (%)

	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Old	34.1%	35.4%	36.9%	38.6%	39.6%	40.9%	40.9%	40.9%	41.0%
New	33.4%	33.0%	33.3%	35.3%	37.3%	37.9%	38.9%	38.9%	39.3%
Change (%)	-0.7%	-2.4%	-3.7%	-3.3%	-2.3%	-3.0%	-2.0%	-1.9%	-1.6%

Source: Citi Investment Research estimates

RCOM — We revise RCOM's EBITDA/EPS up by 4-6% incorporating its GSM entry in the 14 circles by 3Q-4QFY09. Please note that we factor in lower EBITDA margin for RCOM in FY10E (41% as against 42% earlier) to reflect lower revenue yields and likely cost implications of a dual network. We also maintain a 150bps differential vs. Bharti's FY10E margins to factor in that risk. (70bps earlier). Higher capex targets, however, limit the EPS upgrade to ~6%.

Figure 12. RCOM's Subscriber Net Adds and Market Share of Net Adds

	FY09E		FY10E		FY11E		FY12E	
	Old	New	Old	New	Old	New	Old	New
Net adds per month	1,441	1,778	1,357	1,709	1,178	1,488	992	1,316
Market share of net adds	18.0%	21.3%	18.1%	20.5%	18.1%	19.6%	18.4%	19.7%

Source: Citi Investment Research estimates

Figure 13. Change in Earnings Estimates

	2007A	2008E	2009E	2010E	3-yr CAGR (FY07-10E)
Bharti					
EBITDA					
Old	74,125	116,743	157,592	189,384	36.7%
New	74,125	113,521	151,156	186,907	36.1%
Change %	NM	-2.8%	-4.1%	-1.3%	
yoy growth %		53%	33%	24%	
EPS					
Old	22.45	36.23	46.94	56.13	35.7%
New	22.45	35.61	44.52	53.76	33.8%
Change %	NM	-1.7%	-5.2%	-4.2%	
yoy growth %		59%	25%	21%	
Idea Cellular					
EBITDA					
Old	14,653	22,765	31,970	40,055	39.8%
New	14,653	22,010	29,855	36,450	35.5%
Change %	NM	-3.3%	-6.6%	-9.0%	
yoy growth %		50%	36%	22%	
EPS					
Old	1.94	4.12	4.99	6.24	47.7%
New	1.94	3.89	4.62	5.41	40.9%
Change %	NM	-5.6%	-7.4%	-13.3%	
yoy growth %		101%	19%	17%	
RCOM					
EBITDA					
Old	56,405	82,140	113,022	137,873	34.7%
New	56,405	81,176	117,179	146,478	37.5%
Change %	0.0%	-1.2%	3.7%	6.2%	
yoy growth %		44%	44%	25%	
EPS					
Old	15.23	26.44	33.15	39.88	37.8%
New	15.23	26.50	35.24	42.40	40.7%
Change %	0.0%	0.2%	6.3%	6.3%	
yoy growth %		74%	33%	20%	

Source: Company reports, Citi Investment Research estimates

Target prices: Core business loss offset by towerco gains

Figure 14. Bharti target price

	Rs/share
Core business	930
Bharti Infratel (standalone)	103
Indus Towerco*	117
Total	1,150

Source: Citi Investment Research

* Bharti's 42% stake

Bharti — Our revised target price at Rs1,150/share (Rs1,200 earlier) is based on Sep-08 DCF value of Rs930/share (1,010 earlier) with EBITDA/EPS 1-5% lower factoring in new market realities (read higher competition). The DCF value imputes FY09E EV/EBITDA at 12.1x (12.5x earlier) and P/E at 20.9x. Meanwhile, Bharti's direct and indirect stake in the towercos rises to Rs220/share (Rs170 earlier)

RCOM — We upgrade RCOM to BUY as the stock has under-performed Bharti by ~20% since our downgrade to Hold (dated November 5) and the valuations now do not build excessive optimism regarding their GSM launch and/or value accretion from Reliance Infratel.

New target of Rs760 (Rs835 earlier) incorporates:

i. Core business value at Rs620/share explicitly includes GSM launch by 3-4QFY09 and is based on 9.2x FY10E EV/EBITDA (by when RCOM's GSM roll-out would be fully evolved), i.e. at 5% discount to Bharti's imputed multiple (ex-towerco). Notwithstanding narrowing of the leadership gap vs. Bharti, we believe that the dual network strategy carries inherent risks of cost duplication and/or execution, which prompts us to retain the valuation discount.

ii. Net towerco value increases to 140/share (Rs50 earlier) with increased visibility of higher external tenancy in the new regulatory framework.

iii. Removing Flag's incremental value of Rs 20/share with lack of clarity on the amount/timing of value unlocking.

Figure 15. RCOM's SOTP Value (Rs/share)

	New	Old
Core business	620	650
GSM option value	NM	115
Net towerco value	140	50
Flag's potential value unlocking	0	20
SOTP	760	835

Source: Citi Investment Research estimates

Idea — We upgrade Idea to Buy as the stock has underperformed Bharti by ~10% since our downgrade to Hold and does not factor in the positives arising out of the Indus towerco as well as potential option on 9 additional licenses. Target price remains unchanged at Rs140, but now includes Sep-08 DCF valued at Rs108 (Rs127 earlier) and Idea's 16% stake in Indus valued at Rs32/share. We also remove the 10% M&A premium with easier availability of spectrum. The core business implies FY09E EV/EBITDA at 11.8x, P/E at 23.4x and P/CEPS of 11.6x.

We outline our valuation comparison of Bharti, RCOM and Idea. The same comparison at our target prices (for the core business only) is also outlined.

Figure 16. Indian Wireless – Peer Valuation Comparison (At Core Business Target Values)

	EV/EBITDA(x)		PER (x)		P/CEPS (x)		EBITDA CAGR (FY07-010E)	EPS CAGR (FY07-010E)
	2009E	2010E	2009E	2010E	2009E	2010E		
Bharti	12.1x	9.7x	20.9x	17.3x	13.2x	10.9x	36.1%	33.8%
Idea	11.8x	10.1x	23.4x	19.9x	11.6x	9.5x	35.5%	40.9%
RCOM	11.6x	9.2x	17.6x	14.6x	11.4x	9.4x	36.8%	39.5%
RCOM's % prem/(disc) to Bharti	-4.1%	-5.0%	-15.8%	-15.5%	-13.4%	-14.2%		
Idea's % prem/(disc) to Bharti	-2.5%	4.2%	12.0%	15.3%	-12.0%	-13.4%		

Source: Citi Investment Research estimates

Figure 17. Indian Wireless – Peer Valuation Comparison (At Current Prices)

	EV/EBITDA(x)		PER (x)		P/CEPS (x)		EBITDA CAGR (FY07-010E)	EPS CAGR (FY07-010E)
	2009E	2010E	2009E	2010E	2009E	2010E		
Bharti	11.2x	8.9x	19.2x	15.9x	12.1x	10.1x	36.1%	33.8%
Idea	11.7x	10.0x	23.0x	19.6x	11.4x	9.3x	35.5%	40.9%
RCOM	10.8x	8.6x	16.3x	13.6x	10.6x	8.7x	36.8%	39.5%
RCOM's % prem/(disc) to Bharti	-3.2%	-3.5%	-15.1%	-14.8%	-12.8%	-13.6%		
Idea's % prem/(disc) to Bharti	4.2%	11.6%	19.7%	23.3%	-5.9%	-7.4%		

Source: Citi Investment Research estimates

Figure 18. Indian Wireless – Key Assumptions

	FY06	FY07	FY08E	FY09E	FY10E
Subs (m)					
Bharti	19.6	37.1	61.8	85.8	106.9
RCOM	17.3	29.0	47.0	68.4	88.9
Idea	7.4	14.0	23.6	33.6	42.3
Blended ARPU (Rs)					
Bharti	441	412	362	323	296
RCOM	435	391	335	318	289
Idea	395	334	292	264	240
EBITDA % - wireless					
Bharti	36.1%	37.6%	40.7%	41.0%	42.5%
RCOM	30.3%	37.1%	40.0%	41.0%	41.0%
Idea	36.0%	33.6%	33.4%	33.0%	33.3%
Wireless Capex (Rs m)*					
Bharti	43,048	71,801	110,174	117,556	104,721
RCOM	NA	47,714	142,898	120,261	100,529
Idea	8079	22,819	51,681	52,701	39,994
Capex to sales (%) - wireless only					
Bharti	52.5%	50.8%	51.3%	41.2%	30.6%
RCOM	NA	44.5%	93.5%	54.5%	36.9%
Idea	27.2%	52.3%	78.3%	58.2%	36.5%
Revenues - wireless (Rs m)					
Bharti	81,981	141,367	214,933	285,638	342,297
RCOM	74,070	107,276	152,837	220,556	272,805
Idea	29,655	43,664	65,984	90,512	109,472
EBITDA - wireless (Rs m)					
Bharti	29,565	53,210	87,566	117,250	145,619
RCOM	22,411	39,844	61,155	90,326	111,899
Idea	10,674	14,653	22,010	29,855	36,450

* Includes towerco capex
Source: Company reports, Citi Investment Research estimates

Tower 'Power'

Revising macro assumptions post regulatory changes

We are revising values for all three towercos – Bharti Infratel (standalone), Indus and Reliance Infratel based on:

1) **Issuance of LoIs** – Entry of new national players (say two of them) increases tenancy visibility as they will likely sit on existing towers to: 1) reduce time to market, and 2) lower funding requirements. While this is negative for the core business, it benefits the towercos. As a result, we have upped industry-wide tenancy assumptions.

Figure 19. Industry Wide Tenancy Assumptions

	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Old	1.40	1.60	1.75	1.90	2.00	2.10	2.20	2.30
New	1.60	1.80	2.00	2.10	2.20	2.30	2.40	2.50
Change (%)	*14.3%*	*12.5%*	*14.3%*	*10.5%*	*10.0%*	*9.5%*	*9.1%*	*8.7%*

Source: Citi Investment Research estimates

2) **Tighter spectrum norms** – DoT in its notification has tightened the spectrum norms by 2-6x (broadly in line with TRAI recos), which basically entails more sites to handle the same traffic.

Figure 20. Monthly MoU Per Site Reduced with Tightening Spectrum Criteria

	FY09E	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E	FY16E
Old	422,797	431,452	433,566	432,848	432,524	434,310	435,661	434,591
New	401,057	409,562	420,574	419,903	419,763	419,364	418,440	412,743
Change (%)	*-5.1%*	*-5.1%*	*-3.0%*	*-3.0%*	*-3.0%*	*-3.4%*	*-4.0%*	*-5.0%*

Source: Citi Investment Research estimates

These revised assumptions lead us to raise our values for all three towercos - Bharti Infratel to US$4.9bn (residual towers excl. contribution to Indus), Indus to US$13.4bn and net value accretion from Reliance Infratel at US$7.1bn.

Bharti Infratel + Indus – Does Reliance Infratel have a reason to be worried?

Bharti Infratel and Indus enjoy a clear advantage over Reliance Infratel with:

1. **Likely competitive rentals** – The Infratel/Indus business model assumes capex recovery of 7-8%/tenant vs. 10-11% by Reliance Infratel, implying higher rentals targeted by Reliance Infratel. It is unclear what capex recovery Infratel would be charging to external tenants, especially in relation to the captive capex recovery of 13%+ escalation. We suspect that even if it brings down the pricing for external tenants, it will remain on the higher side vis-à-vis Indus/Infratel and independent towercos.

2. **Reach/tenancy advantages** – Bharti Infratel/Indus will offer better coverage from day one to the external tenants with more than double the number of towers as Reliance Infratel.

While this was previously the case, the scenario has changed in the past six months with the regulatory framework allowing for easier access to spectrum for new players. With both Idea and Vodafone joining Bharti in providing pan-India services, there will be an empty slot for at best one more operator on their towers, which indirectly helps Reliance Infratel fill up its slots from among the new entrants, i.e. two more national entrants, Maxis, Spice, Tata Tele (GSM). We, however, remain skeptical about Reliance Infratel's target of 11-13% capex recovery. For external tenants, it needs to be in line with the market, i.e. ~8% for them to attract tenants. Our valuation model for Reliance Infratel is therefore based on capex recovery of ~10%, i.e. an average of 11-13% for captive tenancy and lower for external tenants.

Figure 21. Tenancy Comparison

	FY09E	FY10E	FY11E
Bharti Infratel	1.60	2.25	3.00
Reliance Infratel	1.50	2.00	2.70

Source: Citi Investment Research estimates

Figure 22. Number of Towers

	FY09E	FY10E	FY11E
Indus	115,177	133,513	145,533
Reliance Infratel	61,849	70,445	76,705

Source: Citi Investment Research estimates

Increasing towercos' contribution to the target prices

Bharti – Bharti's towerco value rises to Rs220/share (Rs170 earlier) given its 100% stake in Bharti Infratel's residual towers and 42% indirect stake in Indus.

Idea – We now explicitly incorporate towerco value of Idea based upon its 16% stake in Indus at Rs32/share.

RCOM – Our gross equity value of Reliance Infratel is estimated at US$10.2bn (DCF-based and net of end-FY08 debt) and our "net" towerco value increases to Rs140/share (Rs50/share earlier) due to higher visibility of external tenancy.

Why do we take "net" value for Reliance Infratel vs gross for Bharti?

The net towerco value is based on gross value from which we deduct the EBITDA impact on the parent company for dual tenancy from GSM and CDMA. Please note that we assume total tenancy for Reliance Infratel at 3.25x in the terminal year (FY16E) and cap RCOM's captive tenancy usage (GSM+CDMA) at 1.5x as not all towers will be needed for CDMA.

Towerco capex recovery is in the range of 10-11% per tenant as we discussed. This, however, also pushes up the rental, resulting in value depletion from the parentco. The more moderate capex recovery assumptions for Bharti Infratel/Indus at 7.5-8.0%, on the other hand, protect the core business value and prevent depletion

Figure 23. Core Business Value Destruction with High Rentals to be Paid to the Towerco

	FY08E	FY09E	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E	FY16E
RCOM's cost savings via-a-vis base case	-14,371	-15,616	-18,285	-13,980	-14,806	-13,019	-13,335	-13,454	-13,638
Potential EBITDA margin impact	-9.4%	-7.1%	-6.7%	-6.0%	-5.4%	-4.9%	-4.4%	-4.0%	-3.6%
RCOM's tax rate	7%	10%	11%	18%	25%	26%	29%	31%	33%
Post-tax cash flow	-13,365	-14,054	-16,237	-11,463	-11,105	-9,634	-9,468	-9,283	-9,137
NPV (Rs m)	-121,048								
NPV (Rs/share)	-59								
Net towerco value (Rs/share)	140								

Source: Citi Investment Research estimates

Figure 24. Towerco Valuation Comparisons – Higher Capex Recovery = Higher EV/Tower

	No. of towers (end-FY08)	EV (US$ m)	EV/Tower (US$)	Disc to RTIL
Bharti Infratel (standalone)	26,000	4,866	187,137	38.9%
Indus Towerco	90,000	13,421	149,124	51.3%
Reliance Infratel	36,849	11,286	306,279	NM
Spice	875	150	171,429	44.0%

Source: Citi Investment Research estimates

Figure 25. Bharti Infratel (standalone) DCF valuation

Rs m	FY08E	FY09E	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E	FY16E
Bharti owned towers (nos)	26,000	31,770	35,972	38,726	42,545	44,973	45,943	46,310	46,873
Rental per tenant per month (Rs)	50,000	42,000	36,000	31,000	30,500	30,000	30,000	30,000	30,000
Average tenancy on Bharti's towers	1.25	1.60	2.25	3.00	3.00	3.25	3.25	3.25	3.25
Tower rental revenues (Rs m)	19,500	25,619	34,965	43,218	46,715	52,619	53,754	54,183	54,842
EBITDA (Rs m)	7,332	11,132	18,993	26,489	28,846	33,730	34,458	34,733	35,155
EBITDA (%)	38%	43%	54%	61%	62%	64%	64%	64%	64%
Implied RoA	9.4%	11.7%	17.6%	22.8%	22.6%	25.0%	25.0%	25.0%	25.0%
Implied RoA per tenant	7.5%	7.3%	7.8%	7.6%	7.5%	7.7%	7.7%	7.7%	7.7%
Implied Payback (years)	10.6	8.6	5.7	4.4	4.4	4.0	4.0	4.0	4.0
Total capex (Rs m)	37,446	17,333	15,465	11,501	14,942	11,113	6,958	5,234	5,858
FCF (Rs m)	(30,777)	(7,132)	1,865	12,593	11,384	19,654	24,520	26,537	20,594
Terminal Value (Rs m)	305,091								
NPV (Rs m)	193,882								
NPV (US$m)	4,908								
Equity value (US$m)	4,908								

Source: Citi Investment Research estimates

Figure 26. Indus Towerco DCF Valuation

	FY08E	FY09E	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E	FY16E
Indus towers (nos)	90,000	115,177	133,513	145,533	162,197	172,792	177,026	178,626	181,083
Rental per tenant per month (Rs)	50,000	43,000	41,000	37,500	34,000	34,000	33,500	33,500	33,500
Average tenancy on Bharti's towers	1.25	1.50	1.75	2.10	2.50	2.50	2.50	2.50	2.50
Tower rental revenues (Rs m)	67,500	89,147	114,955	137,528	165,441	176,248	177,911	179,519	181,989
EBITDA (Rs m)	25,380	36,626	55,675	74,658	97,318	103,675	103,560	104,496	105,934
EBITDA (%)	38%	41%	48%	54%	59%	59%	58%	58%	58%
Implied RoA	9.4%	10.6%	13.9%	17.1%	20.0%	20.0%	19.5%	19.5%	19.5%
Implied RoA per tenant	7.5%	7.1%	7.9%	8.1%	8.0%	8.0%	7.8%	7.8%	7.8%
Implied Payback (years)	10.6	9.4	7.2	5.8	5.0	5.0	5.1	5.1	5.1
Total capex (Rs m)	142,337	74,053	65,374	48,074	63,090	46,384	28,253	20,731	23,450
FCF (Rs m)	(118,135)	(39,352)	(12,969)	21,637	27,332	50,116	68,409	76,956	62,590
Terminal Value (Rs m)	927,257								
NPV (Rs m)	530,135								
NPV (US$m)	13,421								
Equity value (US$m)	13,421								

Source: Citi Investment Research estimates

Figure 27. Reliance Infratel DCF Valuation

	FY08E	FY09E	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E	FY16E
RCOM owned towers (nos)	36,849	61,849	70,445	76,705	85,384	90,903	93,108	93,941	95,221
Rental per tenant per month (Rs)	54,000	48,000	41,000	35,000	33,000	31,500	31,500	31,500	31,500
Average tenancy on RCOM's towers	1.25	1.50	2.00	2.70	3.00	3.25	3.25	3.25	3.25
Tower rental revenues (Rs m)	13,893	53,438	69,318	86,984	101,437	111,674	114,383	115,407	116,979
EBITDA (Rs m)	5,643	25,234	38,040	53,847	65,575	73,495	75,278	75,951	76,986
EBITDA (%)	41%	47%	55%	62%	65%	66%	66%	66%	66%
Implied RoA	6.1%	16.3%	21.6%	28.1%	30.7%	32.3%	32.3%	32.3%	32.3%
Implied ROA per tenant	4.9%	10.9%	10.8%	10.4%	10.2%	10.0%	10.0%	10.0%	10.0%
Implied Payback (years)	16.3	6.1	4.6	3.6	3.3	3.1	3.1	3.1	3.1
Total capex (Rs m)	57,998	64,803	26,129	20,934	27,451	20,200	12,331	9,066	10,246
FCF (Rs m)	-53,524	-41,498	10,098	31,761	34,775	47238	56,806	60,754	48,613
Terminal Value (Rs m)	720,193								
NPV (Rs m)	445,800								
NPV (US$m)	11,286								
Equity value (US$m)	10,165								

Source: Citi Investment Research estimates

Figure 28. Indian Towercos – Key Assumptions

	FY08E	FY09E	FY10E	FY11E
Number of towers				
Indus	90,000	115,177	133,513	145,533
Bharti Infratel	26,000	31,770	35,972	38,726
RCOM	36,849	61,849	70,445	76,705
Tenancy (x)				
Indus	1.25	1.50	1.75	2.10
Bharti Infratel	1.25	1.60	2.25	3.00
RCOM	1.25	1.50	2.00	2.70
Payback (Years)				
Indus	10.64	9.43	7.19	5.85
Bharti Infratel	10.64	8.56	5.68	4.39
RCOM	16.33	6.13	4.63	3.56
Implied RoA/Tenant (%)				
Indus	7.5%	7.1%	7.9%	8.1%
Bharti Infratel	7.5%	7.3%	7.8%	7.6%
RCOM	4.9%	10.9%	10.8%	10.4%
Rentals/tower/month (Rs)				
Indus	50,000	43,000	41,000	37,500
Bharti Infratel	50,000	42,000	36,000	31,000
RCOM	54,000	48,000	41,000	35,000
EBITDA/tower/month (Rs)				
Indus	23,500	26,500	34,750	42,750
Bharti Infratel	23,500	29,200	44,000	57,000
RCOM	12,761	34,000	45,000	58,500
Capex (Rs m)				
Indus	142,337	74,053	65,374	48,074
Bharti Infratel	37,446	17,333	15,465	11,501
RCOM	57,998	64,803	26,129	20,934
Revenues (Rs m)				
Indus	67,500	89,147	114,955	137,528
Bharti Infratel	19,500	25,619	34,965	43,218
RCOM	13,893	53,438	69,318	86,984
EBITDA (Rs m)				
Indus	25,380	36,626	55,675	74,658
Bharti Infratel	7,332	11,132	18,993	26,489
RCOM	5,643	25,234	38,040	53,847
EBITDA margin (%)				
Indus	37.6%	41.1%	48.4%	54.3%
Bharti Infratel	37.6%	43.5%	54.3%	61.3%
RCOM	40.6%	47.2%	54.9%	61.9%

Source: Citi Investment Research estimates

Company Focus

Bharti Airtel (BRTI.BO)

Buy: Not Bulletproof but Close

Target price change ☑
Estimate change ☑

Buy/Low Risk	**1L**
Price (12 Feb 08)	Rs859.25
Target price	Rs1,150.00
from Rs1,200.00	
Expected share price return	33.8%
Expected dividend yield	0.8%
Expected total return	**34.6%**
Market Cap	Rs1,630,766M
	US$41,113M

Price Performance (RIC: BRTI.BO, BB: BHARTI IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	22,566	11.92	47.4	72.1	17.7	29.5	0.0
2007A	42,571	22.45	88.4	38.3	12.0	37.4	0.0
2008E	67,584	35.61	58.6	24.1	8.0	39.8	0.0
2009E	84,481	44.52	25.0	19.3	5.9	35.3	0.8
2010E	102,017	53.76	20.8	16.0	4.6	32.5	1.3

Source: Powered by dataCentral

- **Revising estimates/target price** — Our revised target price at Rs1,150/share (Rs1,200 earlier) is based on Sep-08 DCF value of Rs930/share (1,010 earlier) with FY09-10E EBITDA/EPS lower by 1-5%, factoring in new market realities (read higher competition). The DCF value imputes FY09E EV/EBITDA at 12.1x (12.5x earlier) and P/E at 20.9x. We estimate the stake in towercos is worth Rs220/share (Rs170 earlier).

- **Earnings downgrade** — We lower FY09-10E EBITDA by 1-4% and EPS by 4-5% based on: 1) lower share of net adds (albeit at accelerated growth), 2) sharper rev/min decline (read tariff cuts) to reduce elbow room for start-ups, and 3) higher capex/incremental min to combat tighter spectrum norms.

- **Towerco value rises on tenancy/PE deals** — We add 100% stake in Bharti Infratel's residual towers, plus a 42% stake in Indus at Rs220/share. Our revised estimates for Indus/Infratel are based on rising visibility on tenancy in the context of new regulatory framework and relatively conservative capex recovery assumptions of 7.5-8.0% and compares well with the valuation on its recent PE.

- **Bharti remains our top pick** — Bharti remains our top pick in the region with its strong execution, setting it apart from the other telcos. We maintain our Buy/Low Risk rating.

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	71.8	38.1	24.0	19.2	15.9
EV/EBITDA adjusted (x)	38.5	22.4	14.8	11.2	9.0
P/BV (x)	17.6	12.0	8.0	5.9	4.6
Dividend yield (%)	0.0	0.0	0.0	0.8	1.3
Per Share Data (Rs)					
EPS adjusted	11.92	22.45	35.61	44.52	53.76
EPS reported	11.92	22.45	35.61	44.52	53.76
BVPS	48.67	71.50	107.47	144.50	186.20
DPS	0.00	0.00	0.00	6.70	10.80
Profit & Loss (RsM)					
Net sales	116,215	185,196	269,660	351,830	422,090
Operating expenses	-88,610	-135,896	-195,585	-249,957	-294,705
EBIT	**27,605**	**49,300**	**74,075**	**101,874**	**127,385**
Net interest expense	-2,512	-1,438	-3,438	-5,484	-4,974
Non-operating/exceptionals	272	999	5,300	3,000	2,000
Pre-tax profit	**25,365**	**48,861**	**75,937**	**99,390**	**124,411**
Tax	-2,539	-5,822	-8,353	-14,908	-22,394
Extraord./Min.Int./Pref.div.	-260	-468	0	0	0
Reported net income	**22,566**	**42,571**	**67,584**	**84,481**	**102,017**
Adjusted earnings	22,566	42,571	67,584	84,481	102,017
Adjusted EBITDA	42,981	74,125	113,521	151,156	186,907
Growth Rates (%)					
Sales	45.2	59.4	45.6	30.5	20.0
EBIT adjusted	47.4	78.6	50.3	37.5	25.0
EBITDA adjusted	44.8	72.5	53.1	33.2	23.7
EPS adjusted	47.4	88.4	58.6	25.0	20.8
Cash Flow (RsM)					
Operating cash flow	**48,320**	**70,548**	**132,196**	**161,058**	**180,012**
Depreciation/amortization	15,376	24,825	39,446	49,283	59,522
Net working capital	7,295	-672	22,049	21,810	13,499
Investing cash flow	**-54,095**	**-72,788**	**-145,537**	**-145,589**	**-129,477**
Capital expenditure	-57,309	-74,798	-145,909	-145,983	-130,060
Acquisitions/disposals	3,631	1,952	0	0	0
Financing cash flow	**5,338**	**7,054**	**17,013**	**-18,078**	**-38,449**
Borrowings	-806	7,428	20,000	2,000	-10,000
Dividends paid	0	0	0	-14,201	-22,892
Change in cash	**-438**	**4,813**	**3,672**	**-2,610**	**12,086**
Balance Sheet (RsM)					
Total assets	**215,681**	**296,690**	**411,872**	**509,849**	**594,167**
Cash & cash equivalent	2,649	7,464	11,136	8,526	20,612
Accounts receivable	14,203	17,982	21,573	24,628	25,325
Net fixed assets	180,971	248,403	355,187	451,887	522,425
Total liabilities	**122,545**	**159,336**	**206,111**	**233,807**	**239,001**
Accounts payable	0	0	0	0	0
Total Debt	34,503	52,461	72,461	74,461	64,461
Shareholders' funds	**93,135**	**137,354**	**205,761**	**276,041**	**355,166**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	37.0	40.0	42.1	43.0	44.3
ROE adjusted	29.5	37.4	39.8	35.3	32.5
ROIC adjusted	21.7	27.0	28.2	27.8	27.7
Net debt to equity	34.2	32.8	29.8	23.9	12.3
Total debt to capital	27.0	27.6	26.0	21.2	15.4

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Powered by: dataCentral

Company Focus

IDEA Cellular (IDEA.BO)

Upgrade to Buy… But Market Realities Have Sobering Effect

Change in opinion ☑
Rating change ☑
Estimate change ☑

Buy/Low Risk	**1L**
from Hold/Low Risk	
Price (11 Feb 08)	Rs108.40
Target price	Rs140.00
Expected share price return	29.2%
Expected dividend yield	0.0%
Expected total return	**29.2%**
Market Cap	Rs285,673M
	US$7,202M

Price Performance (RIC: IDEA.BO, BB: IDEA IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	1,683	0.74	636.7	145.5	37.6	30.9	0.0
2007A	5,022	1.94	160.0	56.0	12.9	35.5	0.0
2008E	10,261	3.89	101.0	27.8	8.1	36.0	0.0
2009E	12,163	4.62	18.5	23.5	6.0	29.4	0.0
2010E	14,267	5.41	17.3	20.0	4.6	26.2	0.0

Source: Powered by dataCentral

- **Upgrade to Buy, core business declines, but Indus supports target price** — While our target price remains unchanged at Rs140/share, we have revised our Sep-08 DCF downwards to Rs108 (Rs127 earlier), incorporating Indus towerco value at Rs32/share and removing the 10% M&A premium given easier availability of spectrum. The DCF value imputes EV/EBITDA at 11.8x, a 3% discount to Bharti.

- **Estimates factor in new market realities** — We cut EBITDA by 7-9% and EPS by 7-13% factoring in: 1) higher capex/incremental min with tighter spectrum norms, 2) lower EBITDA margin with new circle launches (Mumbai/Bihar), 3) faster rev/min decline to combat higher competition, and 4) higher depreciation/interest charge on account of higher capex. We are, however, not yet factoring its launch in nine circles due to lack of clarity on timing of allotment of startup spectrum. As shown in our earlier analysis, the NAV accretion from new circles is not likely to be very material in the early stages and is highly sensitive to tariff strategies.

- **10% M&A premium now removed** — We had earlier kept the 10% M&A premium, despite new spectrum norms diluting the M&A appeal due to substantial PE holdings (30%) and spectrum/coverage appealing to new entrants. We now remove this premium, however, due to easier spectrum availability and easy access to towercos, which will encourage the new entrants to build coverage.

- **Key risks** — Key risks relate to uncertainty in procuring spectrum for nine circles hitting the roll-out timetable. Also greater competition with entry of new players could impact Idea relatively more than larger peers

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	142.6	54.9	27.3	23.0	19.6
EV/EBITDA adjusted (x)	29.8	21.2	14.4	11.3	9.8
P/BV (x)	36.9	12.6	7.9	5.9	4.5
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Per Share Data (Rs)					
EPS adjusted	0.74	1.94	3.89	4.62	5.41
EPS reported	0.74	1.94	3.89	4.62	5.41
BVPS	2.88	8.41	13.37	17.99	23.40
DPS	0.00	0.00	0.00	0.00	0.00
Profit & Loss (RsM)					
Net sales	29,655	43,664	65,984	90,512	109,472
Operating expenses	-24,476	-35,729	-52,590	-72,995	-88,835
EBIT	**5,179**	**7,935**	**13,394**	**17,517**	**20,636**
Net interest expense	-3,225	-3,051	-3,491	-4,426	-5,284
Non-operating/exceptionals	244	209	1,309	606	714
Pre-tax profit	**2,198**	**5,093**	**11,211**	**13,698**	**16,067**
Tax	-80	-71	-950	-1,534	-1,800
Extraord./Min.Int./Pref.div.	-435	0	0	0	0
Reported net income	**1,683**	**5,022**	**10,261**	**12,163**	**14,267**
Adjusted earnings	1,683	5,022	10,261	12,163	14,267
Adjusted EBITDA	10,674	14,653	22,010	29,855	36,450
Growth Rates (%)					
Sales	31.5	47.2	51.1	37.2	20.9
EBIT adjusted	36.9	53.2	68.8	30.8	17.8
EBITDA adjusted	30.0	37.3	50.2	35.6	22.1
EPS adjusted	636.7	160.0	101.0	18.5	17.3
Cash Flow (RsM)					
Operating cash flow	**12,777**	**16,057**	**26,245**	**34,076**	**27,909**
Depreciation/amortization	5,495	6,718	8,616	12,337	15,813
Net working capital	1,765	1,198	6,384	6,944	-5,554
Investing cash flow	**-5,221**	**-22,756**	**-48,665**	**-50,452**	**-37,681**
Capital expenditure	-5,293	-22,819	-49,986	-51,057	-38,395
Acquisitions/disposals	34	-83	12	0	0
Financing cash flow	**-7,835**	**26,134**	**12,191**	**15,574**	**9,716**
Borrowings	-4,460	9,623	12,495	20,000	15,000
Dividends paid	0	0	0	0	0
Change in cash	**-279**	**19,435**	**-10,229**	**-801**	**-56**
Balance Sheet (RsM)					
Total assets	**56,547**	**85,834**	**117,935**	**157,771**	**182,132**
Cash & cash equivalent	1,493	18,199	7,971	7,170	7,114
Accounts receivable	1,308	1,525	1,532	1,612	1,601
Net fixed assets	28,835	61,100	93,069	134,165	159,123
Total liabilities	**45,211**	**64,036**	**82,689**	**110,361**	**120,455**
Accounts payable	8,693	16,109	20,672	26,351	19,997
Total Debt	32,856	42,505	55,000	75,000	90,000
Shareholders' funds	**11,336**	**21,798**	**35,247**	**47,410**	**61,678**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	36.0	33.6	33.4	33.0	33.3
ROE adjusted	30.9	35.5	36.0	29.4	26.2
ROIC adjusted	11.7	17.6	19.2	16.1	14.4
Net debt to equity	276.7	111.5	133.4	143.1	134.4
Total debt to capital	74.3	66.1	60.9	61.3	59.3

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Powered by: dataCentral

Company Focus

Reliance Communications (RLCM.BO)

Upgrade to Buy: Focus On Execution Now

Change in opinion ☑
Rating change ☑
Target price change ☑
Estimate change ☑

Buy/Low Risk	**1L**
from Hold/Low Risk	
Price (11 Feb 08)	Rs590.40
Target price	Rs760.00
from Rs835.00	
Expected share price return	28.7%
Expected dividend yield	0.3%
Expected total return	**29.1%**
Market Cap	Rs1,218,601M
	US$30,722M

Price Performance (RIC: RLCM.BO, BB: RCOM IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	4,823	2.36	na	nm	10.3	na	0.0
2007A	31,131	15.23	545.6	38.8	5.9	19.4	0.1
2008E	54,661	26.50	74.0	22.3	4.7	23.7	0.2
2009E	72,698	35.24	33.0	16.8	3.8	25.0	0.3
2010E	87,464	42.40	20.3	13.9	3.0	23.9	0.3

Source: Powered by dataCentral

- **Upgrade to buy, revised target price** — We upgrade RCOM to Buy/Low Risk with a revised target price of Rs760/share (RS835 earlier). Our TP is based on core business value of Rs620/share, which remains flat despite explicitly factoring in GSM launch in our subscriber adds and net towerco accretion of Rs140/share (R50 earlier). We are, however, removing Flag's incremental value of Rs20/share, with the lack of clarity on the amount/timing of value unlocking.

- **Core business flat despite GSM** — Our core business value at Rs620/share remains flat and is based on 9.2x FY10E EV/EBITDA (by when RCOM's GSM roll-out would be fully evolved), at 5% discount to Bharti's implied target multiple (ex- towerco). Notwithstanding the narrowing of the leadership gap vs. Bharti, we believe that the dual network strategy carries inherent risks of cost duplication and/or execution, which prompts us to retain the valuation discount. GSM launch fails to be accretive with: 1) substantially higher funding requirements, 2) modest 2-3% market share gains, and 3) lower EBITDA margin for RCOM in FY10E (41% as against 42% earlier) to reflect the likely cost duplication in a dual network.

- **Towerco value increases on external tenancy visibility** — Our gross towerco value increases to US$10.2bn (Rs195/share) given the visibility on external tenancy post issuance of LoIs and resultant higher tenancy ratio of RCOM. However, higher capex recovery assumptions (10-11% per tenant v/s 7-8% for Bharti Infra/Indus) also leads to depletion of value from the parentco, thus leading to estimated 'net' value accretion of Rs140/share (Rs50 earlier).

- **Execution still a key risk** — There are inherent risks in execution of a dual network strategy (i.e. cost duplication, low market share gains), which cannot be wished away. Already RCOM's management has pushed back the GSM launch by 3-6 months to 4QFY09 from 2QFY09 previously.

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	nm	37.8	21.7	16.3	13.6
EV/EBITDA adjusted (x)	na	22.0	15.4	11.0	8.9
P/BV (x)	10.0	5.8	4.6	3.7	2.9
Dividend yield (%)	0.0	0.1	0.2	0.3	0.3
Per Share Data (Rs)					
EPS adjusted	2.36	15.23	26.50	35.24	42.40
EPS reported	2.36	15.23	26.50	35.24	42.40
BVPS	57.48	99.80	124.31	157.30	197.45
DPS	0.00	0.50	1.00	2.00	2.00
Profit & Loss (RsM)					
Net sales	112,884	144,683	188,885	254,475	308,386
Operating expenses	-105,085	-112,931	-135,667	-176,569	-210,941
EBIT	**7,799**	**31,753**	**53,219**	**77,906**	**97,445**
Net interest expense	-2,649	-6	5,874	1,983	1,050
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	**5,150**	**31,746**	**59,093**	**79,888**	**98,495**
Tax	-327	-616	-4,432	-7,190	-11,031
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**4,823**	**31,131**	**54,661**	**72,698**	**87,464**
Adjusted earnings	4,823	31,131	54,661	72,698	87,464
Adjusted EBITDA	24,786	56,405	81,176	117,179	146,478
Growth Rates (%)					
Sales	na	28.2	30.6	34.7	21.2
EBIT adjusted	na	307.1	67.6	46.4	25.1
EBITDA adjusted	na	127.6	43.9	44.4	25.0
EPS adjusted	na	545.6	74.0	33.0	20.3
Cash Flow (RsM)					
Operating cash flow	**21,810**	**111,982**	**147,687**	**123,120**	**156,105**
Depreciation/amortization	16,987	24,653	27,957	39,274	49,033
Net working capital	0	56,192	63,943	8,130	15,658
Investing cash flow	**0**	**-59,316**	**-174,748**	**-160,011**	**-140,279**
Capital expenditure	0	-59,316	-174,748	-160,011	-140,279
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**0**	**61,257**	**20,873**	**-7,659**	**-8,592**
Borrowings	0	62,462	24,226	0	0
Dividends paid	0	-1,196	-2,321	-4,641	-4,641
Change in cash	**21,810**	**113,922**	**-6,188**	**-44,550**	**7,235**
Balance Sheet (RsM)					
Total assets	**319,738**	**538,611**	**689,313**	**776,761**	**878,117**
Cash & cash equivalent	60,038	137,200	141,592	97,042	104,277
Accounts receivable	16,807	18,316	34,104	35,344	29,982
Net fixed assets	214,263	330,423	477,214	597,952	689,198
Total liabilities	**202,223**	**334,624**	**432,892**	**452,283**	**470,816**
Accounts payable	89,956	136,013	209,435	228,826	247,359
Total Debt	92,976	155,438	179,664	179,664	179,664
Shareholders' funds	**117,515**	**203,987**	**256,421**	**324,478**	**407,300**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	22.0	39.0	43.0	46.0	47.5
ROE adjusted	na	19.4	23.7	25.0	23.9
ROIC adjusted	na	14.7	16.5	18.0	17.7
Net debt to equity	28.0	8.9	14.8	25.5	18.5
Total debt to capital	44.2	43.2	41.2	35.6	30.6

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Bharti Airtel

Company description

Bharti Airtel, through its group companies, provides cellular-phone services in all the 23 telecom circles of India. The group also provides fixed-line phone services, broadband, long-distance and enterprise services. The company is listed on The Stock Exchange, Mumbai (BSE) and The National Stock Exchange of India Limited (NSE). Major shareholders are Bharti Telecom, SingTel and Vodafone.

Investment strategy

We rate Bharti Buy/Low Risk (1L). We believe continued robust wireless market expansion in India and Bharti's ability to capture this growth profitably will be a recurring theme. We estimate FY07-10 earnings CAGR of 33.8%, more than double the broader market. We believe that competitive pressures, though intense, will remain rational as low revenue yields and moderate EBITDA margins leave little room for disruptive pricing. Additionally, most regulatory concerns are behind us and 3G recommendations, though discomforting, cannot derail the growth path, in our view. The company has yet to realize the benefits of economies of scale, and we expect a slight strengthening of margins over the next 2-3 years. We also expect the towerco hive-off (Bharti Infratel) to be a value accretive looking beyond the immediate impact on margins, given Bharti's stated intentions to be a minority stake owner in the towerco.

Valuation

Our 12-month forward target price of Rs1,150 is based on Sep-08 core DCF of Rs930 and a towerco option value of Rs220. The DCF is based on a WACC of 10.7%, a terminal growth rate of 4% and beta of 0.9. We prefer DCF as our primary valuation methodology because the wireless market will likely continue to see robust growth requiring upfront capex but should generate significant free cash beyond FY09-10E. Our target price (net of towerco value) represents a FY09E P/E of 20.9x, P/CEPS of 13.2x and EV/EBITDA of 12.1x.

Risks

Our quantitative risk-rating system, which tracks 260-day share price volatility, rates Bharti as Low Risk. We are comfortable attributing a Low Risk rating for the following reasons: 1) Bharti has a track record of profitability and execution; 2) the company's capex plans are fully funded; and 3) SingTel's strategic shareholding leaves us comfortable with execution issues and initiatives. Risks that could prevent the stock from reaching our target price include competition-led tariff pressures, un-remunerative capex, overall market downside, and slower-than-expected execution of the tower-sharing initiative.

IDEA Cellular

Company description

Idea Cellular, a pure-play wireless provider, is the fifth-largest cellular operator in India. It has licenses to provide cellular-phone services in 13 of the 23 telecom circles in India and an active presence in 11 of them. The company listed on the Indian bourse in March 2007 and is part of the Aditya Birla Group.

Investment strategy

We rate Idea Buy/Low Risk. Continued robust wireless market expansion and Idea's ability to regain its growth potential following its restructuring and full control by Aditya Birla Group are key factors in our investment argument. Idea's strong competitive position in its existing circles and comparable operational parameters provide us sufficient comfort in management's ability to execute its plans. With a relatively smaller base compared to larger peers, we estimate earnings CAGR of 41% over FY07-10E, ahead of peers and more than double that of the broader market. However, post the disappointing quality of earnings in 2Q, the Idea stock will likely decouple from Bharti, with a renewed upsurge in investor sentiment probably hinging on a turnaround in operational data points.

Valuation

We have set our 12-month target price at Rs140 based on Sep-08E DCF of Rs108 and towerco option value of Rs32/share through its 16% stake in Indus. We prefer DCF as our primary valuation methodology due to the back-ended nature of free cash flows given the new circle roll-outs. Our DCF assumes a WACC of 10.8% at a target debt to capital of 50.0% and terminal growth rate of 4.0% (similar to Bharti). Our DCF is based on explicit forecasts for FY07-16E with a terminal year EBITDA margin at 39.3% (~600bps below Bharti) and capex/sales of ~8% (in line with Bharti). The DCF value implies an EV/EBITDA of 11.8x, slightly lower than Bharti's target multiples (for the ex-towerco portion of Rs930), which is supported by Idea's higher growth rates notwithstanding Idea's smaller size and relatively less established track record.

Risks

Our quantitative risk-rating system assigns a default Speculative Risk rating to Idea due its trading history of less than 12 months. We see a Low Risk rating as more appropriate due to the higher visibility of Indian wireless growth, Idea's reasonably competitive position and strong parentage. Operationally, the risks facing Idea are slightly higher than its more established peers given the roll-out in new circles. Project cost over-runs, delays in spectrum allocation and hence commercial launches could affect the value accretion opportunity in new circles. Idea will also face competition from established players in new circles and market share gains may be lower than expected. Idea will incur higher capex requirements in the new circles due to the coverage compulsions, which may depress return parameters in the initial years. Any rollout plans beyond 13 circles may also require a fresh equity infusion. These risk factors could impede the stock from reaching our target price.

Reliance Communications

Company description

RCOM is an integrated player in the Indian telecoms sector. It was listed on the Indian stock exchanges following the de-merger of Reliance Industries. RCOM is the second-largest player in the mobile segment, has an 80,000km-long India-wide optic-fiber network and owns the FLAG submarine cable network. RCOM has three business units: 1) Wireless, which includes a nationwide wireless network on CDMA and GSM; 2) Global Business comprising wholesale voice and data; and 3) Broadband for both retail and enterprise.

Investment strategy

We rate RCOM Buy/Low Risk. Continued expansion of the wireless market and RCOM's ability to capture its due market share profitably will, in our view, be a recurring theme. The wireless business has maintained return parameters despite lower revenue yields. Competitive pressures, though intense, should continue to be rational. RCOM's GSM foray has gained visibility with expected launch by 3Q-4QFY09. RCOM has higher market shares in dual technology circles as compared to single technology circles. Yet there are inherent risks in the execution of the dual network strategy (i.e. cost duplication, low market share gains) that cannot be wished away.

Valuation

Our 12-month forward target price of Rs760 is based on a core business fair value of Rs620 and net towerco value of Rs140. We usually value Indian wireless plays on DCF given the back-ended nature of profits and cash flow. For RCOM, however, we use EV/EBITDA. Our 12-month core business value of Rs620 is based on 9.2x FY10E EV/EBITDA (by when RCOM's GSM roll-out would be fully evolved), at 5% discount to Bharti's implied target multiple (ex-towerco).Notwithstanding the narrowing of the leadership gap vs. Bharti, we believe that the dual network strategy carries inherent risks of cost duplication and/or execution which prompts us to retain the valuation discount. Higher-than-average earnings growth (CAGR of 41% over FY07-10E) and the low sensitivity of wireless demand to interest rates should continue to support premium valuations for the sector, in our view.

Risks

Our risk-rating system, which tracks 260-day share price volatility, assigns a High Risk rating to RCOM, but we believe Low Risk is more appropriate. RCOM has been de-merged from Reliance Industries, and its shareholding at the time of listing mirrored the holding of RIL. The stock is therefore unlikely to have risks that are typical of newly listed companies. Besides, growth in the telecoms sector gives visibility to RCOM's prospects. Downside risks to our target price include smaller-than-expected market share, lower-than-anticipated operating leverage due to handset subsidies, cost-overruns in GSM overlay, regulatory and competition risks and un-remunerative capex.

Appendix A-1

Analyst Certification

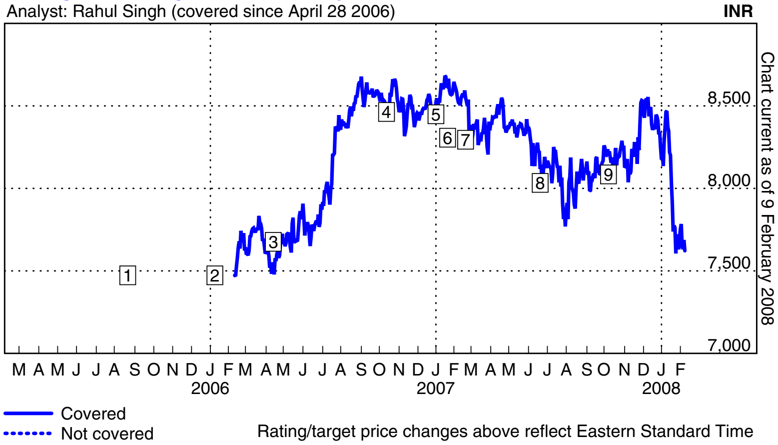
Each research analyst(s), strategist(s) or research associate(s) responsible for the preparation and content of all or any identified portion of this research report hereby certifies that, with respect to each issuer or security or any identified portion of the report with respect to an issuer or security that the research analyst, strategist or research associate covers in this research report, all of the views expressed by that research analyst, strategist or research associate in this research report accurately reflect their personal views about those issuer(s) or securities. Each research analyst(s), strategist(s) or research associate(s) also certify that no part of their compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst, strategist or research associate in this research report.

IMPORTANT DISCLOSURES

Bharti Airtel (BRTI.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Rahul Singh (covered since April 28 2006)



#	Date	Rating	Target Price	Closing Price
1:	22 Aug 05	1M	*400.00	NA
2:	10 Jan 06	1M	*450.00	NA
3:	13 Apr 06	1M	*500.00	7,529.74
4:	12 Oct 06	*1L	*600.00	8,503.07
5:	2 Jan 07	1L	*750.00	8,521.11
6:	23 Jan 07	1L	*800.00	8,615.65
7:	21 Feb 07	1L	*960.00	8,548.11
8:	20 Jun 07	1L	*1,050.00	8,118.22
9:	8 Oct 07	1L	*1,200.00	8,199.27

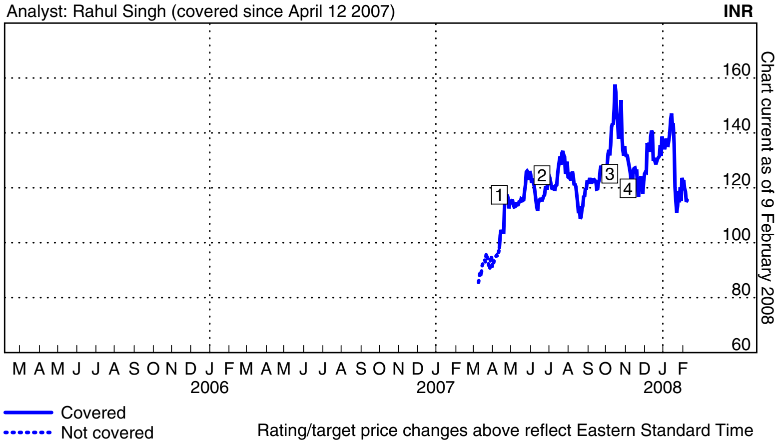
*Indicates change.

Rating/target price changes above reflect Eastern Standard Time

IDEA Cellular (IDEA.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Rahul Singh (covered since April 12 2007)



#	Date	Rating	Target Price	Closing Price
1:	12 Apr 07	1L	112.00	98.15
2:	20 Jun 07	1L	*140.00	115.15
3:	8 Oct 07	1L	*155.00	131.80
4:	6 Nov 07	*2L	*140.00	130.10

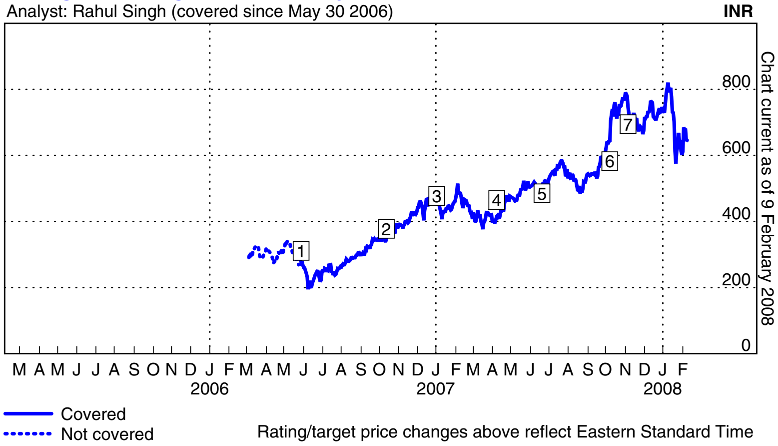
*Indicates change.

Rating/target price changes above reflect Eastern Standard Time

Reliance Communications (RLCM.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Rahul Singh (covered since May 30 2006)



Rating/target price changes above reflect Eastern Standard Time

#	Date	Rating	Target Price	Closing Price
1:	29 May 06	1M	360.00	276.25
2:	12 Oct 06	1M	*430.00	345.95
3:	2 Jan 07	1M	*570.00	470.75
4:	9 Apr 07	1M	*510.00	415.60
5:	20 Jun 07	1M	*600.00	505.90
6:	8 Oct 07	*1L	*750.00	640.90
7:	6 Nov 07	*2L	*835.00	745.40

*Indicates change.

Rahul Singh holds a long position in the shares of Bharti Airtel.

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Citi Investment Research Ratings Distribution

Data current as of 31 December 2007	**Buy**	**Hold**	**Sell**
Citi Investment Research Global Fundamental Coverage (3421)	50%	37%	12%
% of companies in each rating category that are investment banking clients	52%	53%	40%

Guide to Fundamental Research Investment Ratings:

Citi Investment Research's stock recommendations include a risk rating and an investment rating.

Risk ratings, which take into account both price volatility and fundamental criteria, are: Low (L), Medium (M), High (H), and Speculative (S).

Investment ratings are a function of Citi Investment Research's expectation of total return (forecast price appreciation and dividend yield within the next 12 months) and risk rating.

For securities in emerging markets (Asia Pacific, Emerging Europe/Middle East/Africa, and Latin America), investment ratings are: Buy (1) (expected total return of 15% or more for Low-Risk stocks, 20% or more for Medium-Risk stocks, 30% or more for High-Risk stocks, and 40% or more for Speculative stocks); Hold (2) (5%-15% for Low-Risk stocks, 10%-20% for Medium-Risk stocks, 15%-30% for High-Risk stocks, and 20%-40% for Speculative stocks); and Sell (3) (5% or less for Low-Risk stocks, 10% or less for Medium-Risk stocks, 15% or less for High-Risk stocks, and 20% or less for Speculative stocks).

Investment ratings are determined by the ranges described above at the time of initiation of coverage, a change in investment and/or risk rating, or a change in target price (subject to limited management discretion). At other times, the expected total returns may fall outside of these ranges because of market price movements and/or other short-term volatility or trading patterns. Such interim deviations from specified ranges will be permitted but will become subject to review by Research Management. Your decision to buy or sell a security should be based upon your personal investment objectives and should be made only after evaluating the stock's expected performance and risk.

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