Price war now history, Bharti to benefit most

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Supreme Court (SC) has cancelled all 122 telecom licences given out in 2008 in a scam-ridden process. Idea, Tata Tele, Uninor, Sistema, Loop, Videocon, Etisalat, STel will be adversely impacted. These operators will be allowed to operate for the next four months and in the meantime, the Telecom Regulatory Authority of India (TRAI) will auction the cancelled spectrum.

Older GSM operators like Bharti Airtel to benefit most: The cancelled licences are likely to reduce competitive intensity leading to pricing power for older operators like Bharti and Vodafone. Cost structure of new GSM operators will worsen if they acquire spectrum in auctions. Dual-sim holders may shift usage towards older GSM.

Idea's 7 new circles to be impacted; but highly positive in other 15 circles: SC's decision will impact Idea's operations in seven circles—Assam, Jammu & Kashmir, Kolkata, North East, Orissa, Tamil Nadu, and West Bengal—which contributed 3.8% of revenues in Q2FY12 (TRAI data). Idea's new circles, including Mumbai and Bihar, along with the seven cancelled circles, contributed 11% of its Q3FY12 revenues with EBITDA losses of Rs1.72bn. We believe Idea will be keen to bid spectrum in order to retain its existing circles. 3G and BWA spectrum in these seven circles was auctioned at Rs23bn and Rs28bn respectively (Exhibit 1). If the price for 2G spectrum is 1.3x 3G price, Idea's net debt to FY12 and FY13 EBITDA ratio will increase to 3.02x (from 2.5x) and 2.45x (from 2.03x), respectively.

Increase in available 2G spectrum: The cancelled 2G licences will free up the 13-18MHz spectrum in most circles (Exhibit 3). Since the spectrum auction will be based on competitive bidding (against the first-come first-served policy earlier), we believe that the spectrum price will be higher than 2001 prices and will lead to selective bidding by the participants. Earlier recommendations from TRAI indicated 2G pricing at 1.3x 3G prices but as of now there is no clarity about the base price for 2G spectrum auctions. We believe high 2G spectrum will not be viable due to stretched balance sheet, and higher supply of 2G spectrum.

2G auctions to drive new operators cost to maintain operations: The ruling will drive-up the cost structure of new operators, just to continue their operations. Telenor had committed peak funding of Rs155bn for India. Till Q3CY12, Uninor had cumulative EBITDA losses of Rs62.13bn and investment of Rs46.2bn. With ongoing legal issues between the partners, we expect Uninor to concentrate on bidding in only selective circles for 2G, in case the auction prices go high. We believe that operators like Loop, Videocon, Etisalat, STel will participate only if they get cheap spectrum.

Valuation and outlook: Bharti trades at 7x FY13 EV/EBITDA; we maintain Buy with target of Rs467. Idea trades at 7x FY13 EV/EBITDA; we maintain Add with target of Rs100. We continue to have a positive outlook on telecom with incremental regulatory clarity (may affect Bharti and Idea adversely), declining competitive intensity leading to tariff hikes, and accelerating revenue from 3G services.

Peer valuation (Rs mn)

Company	CMP	Net sales		EBITDA		Net profit		EV/EBIDTA (X)		P/E (X)		Rating
	(Rs)	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E	
Bharti Airtel	386	712,541	825,835	244,716	304,582	53,267	97,754	8.7	7.0	27.5	15.0	BUY
Idea Cellular	96	194,251	231,530	51,256	63,280	7,046	11,579	8.7	7.0	45.7	27.8	ADD

Source: BRICS Research

Exhibit 1: 3G and BWA spectrum prices in Idea's 7 cancelled circles (Rs mn)

Circles	3G Spectrum prices	BWA Spectrum prices	Revenue contribution (Q2FY12)	Subscriber share (Jan-12)
Assam	415	330	0.2%	0.3%
J& K	303	213	0.2%	0.1%
Kolkata	5,443	5,232	0.6%	1.1%
North East	423	213	0.2%	0.2%
Orissa	970	636	0.5%	0.9%
Tamil Nadu	14,649	20,695	1.4%	1.9%
West Bengal	1,236	710	0.8%	1.8%
Grand Total	**23,439**	**28,028**	**3.8%**	**6.3%**

Source: TRAI, COAI, BRICS Research

Exhibit 2: Company-wise licence cancellation

Operator	Number of circles
Uninor	22
Loop	21
Sistema	21
Videocon	21
Etisalat	15
Idea	9
Stel	6
Spice	4
Tata	3
Grand Total	**122**

Source: TRAI, BRICS Research

Exhibit 3: Spectrum availability (MHz)

Circle	Total Spectrum Freed		Already available spectrum	Total available spectrum
	1800 MHz	800 MHz	1800 MHz	1800 MHz
Andhra Pradesh	17.6	2.5	15.0	32.6
Delhi	4.4	2.5	11.6	16.0
Gujarat	13.2	2.5	4.4	17.6
Karnataka	17.6	2.5	11.8	29.4
Kolkata	13.2	2.5	23.0	36.2
Maharashtra	17.6	2.5	6.0	23.6
Mumbai	8.8	2.5	5.0	13.8
Tamil Nadu	17.6	2.5	25.4	43.0
Kerala	13.2	2.5	28.0	41.2
Punjab	13.2	2.5	1.4	14.6
Haryana	17.6	2.5	4.4	22.0
UP(W)	13.2	2.5	8.2	21.4
UP(E)	13.2	2.5	-	13.2
Rajasthan	13.2	-	3.2	16.4
Madhya Pradesh	13.2	2.5	18.0	31.2
West Bengal	13.2	2.5	4.0	17.2
Himachal Pradesh	8.8	2.5	6.4	15.2
Bihar	13.2	2.5	-	13.2
Orissa	13.2	2.5	18.0	31.2
Assam	13.2	5.0	3.8	17.0
North East	13.2	5.0	7.0	20.2
J&K	13.2	5.0	6.4	19.6
Grand Total	**294.8**	**60.0**	**211.0**	**505.8**

Source: Wireless Planning Commission, BRICS Research

BRICS RECOMMENDATION SCALE	
BUY:	More than 15% upside
ADD:	Upside up to 15% (between 0% and 15%)
REDUCE:	Downside up to 15% (between 0% and –15%)
SELL:	More than 15% downside

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