

February 9, 2011

Price Performance

Bharti Airtel (Rs334, Hold)

(%)	1M	3M	6M	12M
Absolute	(2)	1	3	8
Rel. to Nifty	9	20	6	(3)

Idea cellular (Rs66, Sell)

(%)	1M	3M	6M	12M
Absolute	2	(0)	(3)	20
Rel. to Nifty	13	18	(0)	8

RCom (Rs95, UR)

(%)	1M	3M	6M	12M
Absolute	(20)	(38)	(37)	(34)
Rel. to Nifty	(12)	(27)	(35)	(41)

- **TRAI seems to be adamant for imposing one time spectrum fee on telcos for holding more than 6.2Mhz of 2G spectrum**
- **Re-pricing of spectrum to be done on the basis of price discovery in 3G spectrum auction. This would result in ~Rs160bn of total inflow for govt.**
- **It's still a recommendation and would require consent of other related parties. We believe the telcos would condemn the TRAI's move as it sounds irrational to re-price spectrum**
- **If implemented then it would erode profitability of Bharti and Idea with yearly outgo of Rs5.8bn and Rs2.3bn, respectively for 7 years. Cost for RCom to remain miniscule at ~Rs20mn**

Re-pricing of spectrum would lead to hefty pay out

TRAI has sent a final recommendation for re-pricing of 2G spectrum, this was a further intimation to recommendations made in May 2010 for re-pricing of spectrum above 6.2Mhz. Re-pricing is recommended for the remaining period (7 years) of spectrum at the price discovered in auction of 3G spectrum. If the recommendations are implemented in the current form it would be hugely negative for the overall telecom industry. Other than Bharti and Idea, BSNL and Vodafone would also be impacted with total outgo of ~Rs70bn and ~Rs31bn respectively. Rcom has excess spectrum only in Bihar circle. Total inflow for government would be at ~Rs160bn.

Regulatory uncertainty remains a big concern for the sector

Re-pricing of spectrum would result in one-time charge for the telcos holding spectrum over the threshold limit proposed by TRAI. Further, the other recommendations of re-farming of 900Mhz spectrum would also be negative for Bharti Airtel as it has 900Mhz in most its circles. If spectrum is re-farmed to 2100Mhz as proposed then it would increase both the capex and opex for the Bharti and would reduce the wireless efficiency enjoyed by the company on 900Mhz.

Outlook and Valuations

With the stabilization in the price war intensity and legal and regulatory issues with the new entrants would put incumbents as the better placed in the industry. Among the incumbents we prefer Bharti over Idea and Rcom. However, the biggest concern for the telecom industry remains the uncertainty in regulatory framework. We reiterate our cautious view on the sector until there is clarity on what operators will have to pay for spectrum.

In past Idea has been trading at 25-30x one year forward earnings, the premium is due speculation of entire stake sale. We believe the premium is not justified. Rcom on the other hand has been under the allegation of having more than prescribed cross holding in erstwhile Swan telecom. Bharti remains the cheapest bet in the industry both with the strong revenue market share and exposure in the foreign markets.

Valuation Snapshot

	Reco	CMP (Rs)	TP (Rs)	EPS			P/E (x)			EV/EBITDA (x)		
				FY 10	FY 11E	FY 12E	FY 10	FY 11E	FY 12E	FY 10	FY 11E	FY 12E
Airtel	Hold	334	345	24.0	16.4	21.7	13.9	20.4	15.4	7.8	8.9	7.0
Rcom	UR	95	UR	22.6	6.5	8.2	4.2	14.7	11.6	6.6	8.1	6.8
Idea	Sell	67	60	2.9	2.6	2.7	23.0	26.1	25.1	8.7	9.2	7.6

Spectrum details and one-time charge for Bharti and Idea

Rs Million	Bharti Spectrum	Charge	Idea Spectrum	Charge
Delhi	10.0	12,305.7	8.0	6,268.9
Mumbai	9.2	12,046.7	4.4	0.0
Kolkata	8.0	1,028.7	4.4	0.0
Maharashtra	8.2	4,666.4	9.8	4,666.4
Gujarat	6.2	0.0	6.2	0.0
A.P	10.0	2,595.2	8.0	2,595.2
Karnataka	10.0	2,986.0	6.2	0.0
T.N including Chennai	9.2	2,768.7	4.4	0.0
Kerala	6.2	0.0	8.0	590.6
Punjab	7.8	541.0	7.8	541.0
Haryana	6.2	0.0	6.2	0.0
U.P (West)	6.2	0.0	8.0	971.5
U.P (East)	7.2	382.8	6.2	0.0
Rajasthan	8.2	606.7	6.2	0.0
M.P	8.0	488.4	8.0	488.4
West Bengal	6.2	0.0	4.4	0.0
H.P	6.2	0.0	4.4	0.0
Bihar	9.2	384.6	4.4	0.0
Orissa	8.0	183.3	4.4	0.0
Assam	6.2	0.0	4.4	0.0
N.E	6.2	0.0	4.4	0.0
J&K	6.2	0.0	4.4	0.0
Total		40,984		16,122

Source: Emkay Research

Current scenario

	Bharti			IDEA			Rcom		
	FY10	FY11E	FY12E	FY10	FY11E	FY12E	FY10	FY11E	FY12E
EPS	24.0	16.4	21.7	3.0	2.6	2.7	13.9	6.5	8.2
P/E	13.9	20.4	15.4	23.0	26.1	25.1	4.2	14.7	11.6
EV/EBITDA	7.8	8.9	7.0	8.7	9.2	7.6	6.6	8.1	6.8
Debt/Equity	0.2	1.2	1.0	0.7	1.1	1.0	0.7	0.8	0.7
Debt/EBITDA	0.4	2.8	2.1	2.3	3.4	2.9	4.1	5.7	4.8

Source: Company, Emkay Research

We believe if the companies have to pay one-time spectrum fee then it would be included in gross block and amortized for next seven years. Following table incorporates Rs5.8bn of yearly outgo and increase in debt by Rs40bn for Bharti and Rs2.3bn yearly outgo and increase in debt by Rs16bn for Idea. With this EPS for FY12E gets diluted by 11.8% and 35.4% for Bharti and Idea, respectively.

	Bharti			IDEA			Rcom		
	FY10	FY11E	FY12E	FY10	FY11E	FY12E	FY10	FY11E	FY12E
EPS	24.0	16.4	19.1	3.0	2.6	1.7	13.9	6.5	8.1
P/E	13.9	20.4	17.5	23.0	26.1	38.9	4.2	14.7	11.8
EV/EBITDA	7.8	8.9	7.0	8.7	9.2	7.7	6.6	8.1	6.9
Debt/Equity	0.2	1.2	1.1	0.7	1.1	1.2	0.7	0.8	0.7
Debt/EBITDA	0.4	2.8	2.4	2.3	3.4	3.2	4.1	5.7	4.8

Source: Company, Emkay Research

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