HDFC securities
Institutional Research

Morning Note

September 20, 2010

Indices	Last Close	% Chg 1-d	% Chg mtd
Sensex	19,595	0.9	9.0
Nifty	5,885	1.0	8.9
CNX 500	4,877	1.1	7.5
BSE Bank	13,745	0.7	12.7
BSE IT	5,844	0.5	8.7
BSE Oil & Gas	10,736	1.8	8.2
Dow Jones	10,608	0.1	5.9
Nasdaq	2,316	0.5	9.5
FTSE	5,508	(0.6)	5.4
DAX	6,210	(0.6)	4.8

Mkt Breadth	Advance	Decline	Unchanged
Nifty	36	14	0
Sensex	24	6	0

Turnover	INR Bn	% Chg
BSE Cash	50	-5.3
NSE Cash	170	3.8
NSE F&O	1,165	-21.1
Total	1,385	

Fund Flows	US $ mn	MTD	YTD
FII Equity	247	2,564	15,445
MF	77	(290)	(3,645)

Forex/Bond	Last Close	Chg 1-d	Chg mtd
INR/USD	45.85	(0.31)	(1.23)
USD/EUR	1.305	(0.00)	0.04
YEN/USD	85.9	0.07	1.64
10 yr G-Sec	7.99	0.01	0.04

Commodities	Last Close	% Chg 1-d	% Chg MTD
Brent ($/bbl)	78.2	(0.3)	4.3
Gold ($/oz)	1,274	(0.1)	2.2
Copper ($/mt)	7,720	0.3	3.8
Aluminium ($/mt)	2,180	0.7	5.9

Most Traded

Scrip	Last Close	% chg	Value*
Reliance Inds	1,027	2.5	8.7
Tata Steel	605	1.1	7.4
SBI	3,093	(0.4)	5.1
ICICI Bank	1,114	0.3	4.0
DLF	353	1.9	3.8

* INR Bn.

ADR GDR

Scrip	Last Close*	% chg	% Prem.
Dr Reddy's	31.6	(0.6)	(1.9)
HDFC Bank	182.1	1.4	15.9
ICICI Bank	47.8	0.7	(1.6)
ITC	3.7	1.4	0.0
Infosys	65.1	0.2	0.4
Satyam	5.1	(1.9)	27.6
Ranbaxy	11.6	5.2	(0.8)
Reliance	44.8	2.5	(0.0)
Wipro	13.8	0.1	50.2
SBI	134.0	(0.2)	(0.7)
Tata Motors	23.3	(1.2)	3.2

* US$

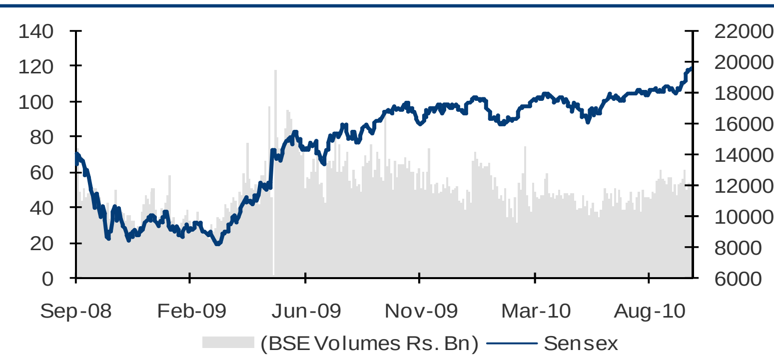
Contents

- Telecom Sector – Initiating Coverage
- Weekly Note

Headlines

- Private Equity players Sandstone Capital and Sequoia Capital have picked up a minority stake in Micromax for about Rs 2bn. (ET)
- Daimler is reportedly planning to introduce a range of trucks in the 6-49 tonnes category under a new brand by 2012. (ET)
- Bharti Airtel has announced its entry into the fast growing mobile handset business as group firm Beetel Teletech Ltd launched eight handsets in the Rs 1750-7000 price range. (Mint)
- The Hero Group and Honda Motor of Japan have reportedly reached an understanding where Honda will divest its 26% stake in the joint venture firm Hero Honda and dissociate itself from brand Hero, However it will continue to provide technology support even after 2014. (FE)
- Essar Steel has entered into deals with private iron-ore miners from Orissa for supplies over a 10 year period. (ET)
- ITC is reportedly interested at foraying into the Rs 13bn instant noodles market through its Sunfeast packaged foods brand. (ET)
- DLF is reportedly in talks with Moet Hennessy Louis Vuitton to open Sephora Cosmetics stores in India. (ET)
- NCDEX has decided to sell a 26% stake to Jaypee Capital through the issue of fresh equity in order to raise the equity capital of the exchange to Rs 500mn from the current 375 mn. (ET)
- Chinese Telecom vendors Huawei and ZTE have been awarded orders from Sistema-Shyam for rolling out and managing its network in different regions in a deal worth Rs 1.5bn. (ET)
- Housing Development and Infrastructure (HDIL) has reportedly emerged as the front-runner to buy Gurgaon based Artemis Hospitals from Apollo Tyres. (ET)
- Ansal Properties and Infrasructure reportedly plans to invest Rs 45 bn to develop the second phase of its 2500 acre hi-tech city adjoining greater Noida. (ET)
- Infrastructure developer Ashoka Buildcon's Rs 2.3bn IPO will hit the capital markets between September 24 and September 28. (ET)
- Tata Motors is reportedly planning to hike the prices of its passenger cars, Indica and Indigo by a 'significant' amount with effect from 1st October. (ET)
- The Government of India has asked banks to ensure that the micro finance institutions they lend to, do not charge beyond 24% interest from the final borrowers. (ET)
- Bharti Airtel has agreed in principle to outsource information technology requirements for its Africa operations to IBM in a deal worth $1.3bn. (Mint)
- Hindustan Petroleum Corp. Ltd (HPCL) is reportedly interested in buying a 5.2% stake in Petronet LNG Ltd that is currently held by the Asian Development Bank. (Mint)

Sensex



From the Blogosphere

Calculated Risk: The two key housing problems (Source)

I think there are two key problems for the housing market: 1) the excess supply of existing housing units, and 2) negative equity. The excess supply is keeping pressure on residential investment, and therefore on employment and economic growth. As new households are formed, the excess supply will be absorbed - but this is happening very slowly. It takes jobs to create households, and usually housing is the key driver for employment growth in the early stages of a recovery. So this is a trap: the excess supply means weak employment growth, leading to few new households, so the excess supply is absorbed slowly - putting off more robust employment growth. The excess supply is also pushing down house prices (prices are just starting to fall again). Lower prices will eventually help clear the market, however lower prices will push more homeowners into negative equity. And negative equity is the other key problem for housing. It is difficult for homeowners with negative equity to sell, it is difficult to move for employment or other reasons, it is hard to refinance, and it is demoralizing for many homeowners (especially those with substantial negative equity). Negative equity frequently leads to distressed sales (short sales or foreclosures), and losses for lenders. It is important to note that falling house prices helps clear the excess supply, although more jobs and more households is the preferred solution. However falling prices makes the negative equity problem worse. The "good" news is the banks were stress tested for much lower house prices. Based on the stress test results, the large banks should be able to handle further price declines - and falling prices will help clear the excess supply.

Safe Haven: United States versus China (Source)

The Chinese government, in an effort to maximize exports and minimize US imports prints their yuan to buy dollars. This prevents their currency from rising and the dollar from falling. Then it loans those same dollars back to America by buying US debt. In 2009 U.S. imports from China were worth $296.4 billion. U.S. exports to China equaled $69.5 billion. In the first half of 2010 the U.S. trade gap with China equaled $119.5 billion. With midterm elections in November and the Obama Administration vulnerable in the House and Senate there's the very real possibility that President Obama will pass a law that restricts Chinese exports into the US - Obama did promise to get tough on China over its currency practices in his election campaign and he is now facing bipartisan pressure. Many economists, and most US manufacturers, estimate China's currency is undervalued by up to 40 percent. An undervalued yuan means that Chinese products are cheaper for U.S. consumers but American products cost more for Chinese consumers. The US Treasury is required to submit to Congress twice a year (April and October) a report Congress can use to identify whether any of the US's major trade partners have manipulated their currencies to boost their exports to the US or make U.S. goods more expensive in their markets. Will the US declare China a Currency Manipulator this October? Capital controls and trade restrictions have been absolutely necessary for China to reach this stage in its economic development. The US could put in place their own capital controls.

Institutional Research

Telecom Sector

Entering the 2nd phase of growth

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Executive Summary

We initiate coverage on the Indian wireless telecom with a bullish view. India's Wireless Industry is embarking on a new growth phase led by stable tariffs as competitive pressures ease. New streams of revenues like data and value-added services (VAS) will act as a buffer. Strong revenue growth will drive surge in cash flows, with peak capex now behind the sector. We believe the worst of negative surprises on the regulatory front are over given (a) India's huge mobile subscriber base and the customer centric approach of government and (b) the industry's debt burden of Rs1trillion. Bharti, Idea and Rcom are our top BUYs, with Tata Tele (Mah) as SELL.

Stock recommendation

	CMP	TP	+/(-) %	Rating
Bharti	359	479	33	Buy
Idea	77	96	24	Buy
Rcom	167	198	19	Buy
TTML	23	17	(26)	Sell

15% revenue Cagr over FY10-13

India's first phase of wireless growth was driven by rising subscriber base and growing revenues with increasing penetration and revenue accretive tariffs. The 2nd leg of revenue growth will be led by a) rising rural subscriber penetration b) stable/increasing tariffs and c) additional stream of revenue with the launch of new value added and data services, primarily wireless internet. We expect industry to witness ~15% revenue CAGR between FY10-13 crossing Rs1.6 trillion (US$ 35bn) from Rs1.1 trillion (US$ 24bn) in FY10.

Absolute stock performance

%	1-m	3-m	6-m	12-m
Bharti	13.5	34.4	20.4	(17.1)
Idea	8.6	41.0	19.9	1.1
Rcom	0.5	(13.0)	3.5	(46.7)
Ttml	(4.1)	2.4	(0.8)	(33.2)
Sensex	8.6	11.2	12.0	17.3

Source : Bloomberg

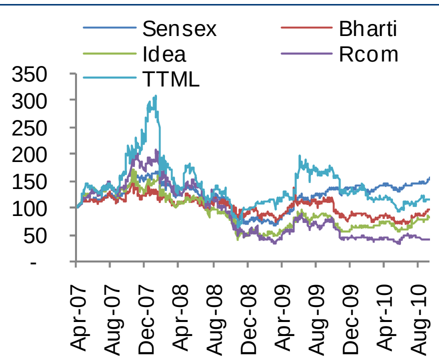
Operating margin expansion in medium term

Industry EBITDA margins shrunk ~1200 bps to 22% over FY08-10 due to a) falling tariffs driven by hyper-competition b) entry of new players and c) expansion of service across region and technology by incumbents. Going forward we expect margins to expand for all the players led by lower subscriber acquisition cost, improved capacity utilization and capex/opex savings from 3G services. Lower license fee to government could surprise positively. However, we expect EBIT/PAT margins would remain under pressure due to higher depreciation/amortization and interest cost.

Increase in tariffs – a potent kicker

We expect revenue/minute (RPM) for leading GSM telcos to fall another 8-10% before stabilizing to 40p by FY12, from current levels of 45p. However, any positive surprise in tariffs, even marginal, will drive a meaningful re-rating of stocks. We see implementation of 3G as the biggest potential driver for increase in tariffs, given the improvement in voice service and introduction of new VAS and data services. Moreover, special tariff vouchers are nearing the end of their one-year validity period and we do not expect operators to renew them at same tariffs, given their large investment in 3G. We estimate that every one paisa change in RPM can boost EBITDA by 10% for telcos.

Sensex vs stock movement



Source : Bloomberg

Free cash flows to turn positive with robust cash generation

With Rs1.1 trillion net investments (operating cash flows less capex) over FY08-10 on subscriber acquisition, network expansion and 3G/BWA licenses, we expect telcos' focus to return to profitability and cash generation. Going forward, we expect the telcos under our coverage to generate FCF of Rs444bn between FY10-13 (ex 3G/BWA license pay-out) against negative FCF of Rs246bn between FY08-10 driven by rising operating profits and lower capex intensity. Improving profitability and cash flows will also drive down leverage, which had risen due to 3G spectrum acquisition. From net debt/EBITDA level of >3x, we expect net debt/EBITDA to decline to 1.2x-1.4x for Bharti/Idea and 2.6x for Rcom by FY13.

Valuation matrix

Company	MCap ($ mn)	EV/EBITDA (x)		P/E (x)		P/B (x)		ROE %	
		FY11E	FY12E	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E
Bharti	28,593	8.9	6.8	17.9	14.4	2.7	2.4	16.4	17.5
Idea	5,336	9.7	7.0	27.5	31.9	2.1	1.9	7.8	6.3
Rcom	7,058	8.8	7.1	22.9	21.4	1.7	1.5	8.3	8.2
TTML	957	17.5	12.5	nmf	nmf	nmf	nmf	nmf	nmf

Source : HDFC Securities Institutional Research

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Stock recommendation

Company	Recom.	Target Price	Implied Upside/ (Downside)	Investment argument
Bharti Airtel	Buy	479	33	• Leading telecom operator with 22% subscriber and 33% revenue market share. Best positioned to capitalize on the 2nd leg of telecom growth story from increasing rural penetration and 3G services. • Estimate Bharti to register revenue, EBITDA and earnings CAGR of 16.1%, 21.6% and 29.8% respectively between FY11 and FY13. • Cash generation to remain robust with estimated $20bn FCF between FY12-FY16. Zain acquisition being a leveraged buy-out will expand earnings and return ratios for Bharti • New business (DTH, Sri Lanka) contributed negatively to Bharti's consolidated earnings to the tune of 4.5% and 8.5% respectively in FY09 and FY10. Stabilization of losses in these businesses to support earnings growth trajectory.
Idea Cellular	Buy	96	24	• Idea is a niche play in the domestic telecom market that has significantly strengthened its position from a regional to a national player and is one of the fastest growing telecom operators. • Reduction in losses from new circles to improve margins. Growth for Idea however has been at the expense of margin erosion driven by new circle losses and consolidation of low margin Spice operations. New circles accounted for 6% and 12% of Idea's loss in FY09 and FY10 respectively. • Listing of Indus tower to unlock value and could also help Idea deleverage the balance sheet. Idea's consolidation of high margin JV Indus towers augurs well for the consolidated business. Indus EBITDA registered CAGR growth of 21% in past five quarters for Idea.
Rcom	Buy	198	19	• India's second-largest mobile operator (#5 in GSM) – is set for a turnaround on the back of industry tailwinds. • After remaining stagnant over the past two years, we expect Rcom's revenues to grow at a robust 15.7% Cagr over FY11-13E. Revenue growth should return as RPMs stabilize, driven by our industry call of rational tariffs. • Rcom's revenue market share – a key concern in the past – should improve given its 3G presence in 13 circles, including the lucrative metro circles. • Despite the recent failure of the GTL deal, we believe management will continue efforts to monetize tower assets. Strategic stake sale remains a key re-rating trigger.
TTML	Sell	17	(26)	• High net debt/EBITDA (8.6x), closure of USO subsidy scheme from FY11, decade of loss making operations, dual technology and regional operations with high competition that curtails economies of scale, absence of 3G spectrum in Mumbai circle and relatively higher proportion of revenue from post-paid subscribers and data services remain key concerns. • Vendor financing and / or equity raising remains inevitable to improve the poor financial position coupled with improvement in operating performance.

Source : HDFC Securities Institutional Research

Valuation matrix

Company	MCap ($ bn)	EV ($ bn)	Net Debt ($ bn)	Net Debt/ EBITDA (x)	EV/EBITDA (x)		P/E (x)		P/BV (x)		ROE (%)	
					1FY	2FY	1FY	2FY	1FY	2FY	1FY	2FY
Global telcos												
Vodafone	130.0	190.2	60.2	2.7	8.3	8.3	10.2	9.9	0.9	0.9	9.2	8.6
China Mobile	201.2	139.7	(61.6)	(2.0)	4.5	4.3	11.4	11.1	2.4	2.1	21.8	19.9
China Telecom	43.6	42.0	(1.5)	(0.2)	4.6	4.4	18.8	15.5	1.3	1.2	6.9	8.0
China Unicom	36.4	36.7	0.3	0.0	5.1	4.6	42.7	29.0	1.2	1.1	2.9	4.1
Deutsche Telekom	58.5	123.1	64.6	2.5	5.0	5.0	13.7	13.2	1.2	1.2	8.8	9.1
NTT DoCoMo	76.2	69.6	(6.6)	(0.4)	4.0	4.0	12.2	11.8	1.3	1.2	10.5	10.2
KDDI Corp	22.4	37.6	15.2	1.4	3.2	3.2	7.8	7.7	0.8	0.8	11.6	11.2
Softbank Corp.	33.0	60.7	27.7	2.8	6.1	5.8	16.2	13.5	4.5	3.5	31.1	29.6
SK Telecom	11.4	13.8	2.4	0.6	3.8	3.6	8.6	7.4	1.2	1.1	12.8	13.9
Singtel	36.2	39.9	3.7	0.8	9.3	8.9	12.1	11.4	1.9	1.8	16.5	16.2
Telekom Malaysia	3.9	4.7	0.8	0.8	5.0	4.8	23.0	21.0	1.8	1.8	7.4	8.5
Telenor ASA	24.9	28.5	3.5	0.8	6.7	6.0	12.9	11.5	1.7	1.6	17.1	14.4
France Telecom SA	55.5	96.5	41.0	2.1	5.2	5.2	9.0	9.3	1.6	1.5	17.5	16.5
AT&T INC	165.0	212.0	47.0	1.1	5.4	5.2	11.9	11.2	1.6	1.5	13.4	13.7
Verizon Comm	87.3	176.7	89.3	2.6	5.3	5.2	14.0	13.4	2.2	1.7	11.9	12.9
Sprint Nextel	13.6	28.7	15.0	2.6	5.1	5.0	0.0	0.0	0.9	0.9	(16.6)	(10.5)
Telstra Corp.	32.3	50.2	17.9	1.9	4.8	4.7	10.5	10.2	2.7	2.7	26.3	27.3
Emirates Telecom	22.2	22.1	(0.1)	(0.0)	4.3	4.2	9.0	9.3	2.0	1.9	22.8	21.6
Telecom Italia	24.8	72.1	47.3	3.3	5.1	5.1	9.3	8.6	0.7	0.7	8.2	8.3
MTN Group	32.2	26.8	(5.4)	(0.8)	4.8	4.3	12.9	10.8	2.8	2.4	23.0	23.4
Indian telcos												
Bharti	28.5	41.5	13.0	2.6	8.9	6.8	17.9	14.4	2.7	2.4	16.4	17.5
Idea	5.3	7.7	2.4	3.2	9.7	7.0	27.5	31.9	2.1	1.9	7.8	6.3
Rcom	7.0	13.1	6.1	4.2	8.8	7.1	22.9	21.4	1.7	1.5	8.3	8.2
TTML	1.0	1.8	0.9	8.7	17.5	12.5	nmf	nmf	nmf	nmf	nmf	nmf

Source : Bloomberg, HDFC Securities Institutional Research

Valuation of leading domestic telcos at 6.8-7x FY12E EV/EBITDA is at 35-40% premium to global peers. However in our opinion, this is justified due to the high growth rate and the expansion in return ratios that Indian telcos would witness. Further, the enterprise value and hence the valuation and return ratios remain distorted for domestic telcos due to the investment made in acquisition of 3G/BWA license and acquisition of Zain by Bharti, returns from which would remain back-ended.

Bharti Airtel – Global Indian telecom goliath

Recommendation	BUY
CMP	359
Target	479
Stock Return	33%

Key Stock Data	
Sector	Telecom
Reuters Code	BRTI.BO
BLOOMBERG Code	BHARTI IN
No. of Shares (mn)	3,798
Market Cap (Rs bn)	1,363
Market Cap ($ mn)	29,728
6 mth avg traded value (Rs. mn)	2,148

Stock Performance (%)

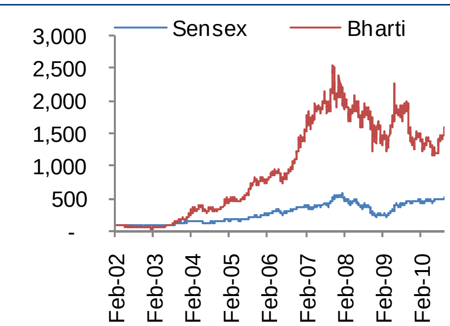
52 - Week high / low	Rs 485/230		
	3M	6M	12M
Absolute (%)	34.4	20.4	(17.1)
Relative (%)	23.1	8.4	(34.3)

Shareholding Pattern

%	FY08	FY09	FY10	Q1 FY11
Promoters	65.9	67.2	67.8	67.9
FIs & Local MFs	4.6	7.4	7.9	8.8
FIIs	25.0	20.7	18.0	16.7
Public & Others	4.6	4.8	6.2	6.6

Source: Company, BSE

Sensex and Stock Movement



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We are initiating coverage on Bharti Airtel (Bharti) with a one year DCF based target price of Rs479, implying an upside of 33% from current levels. We expect Bharti to post revenue, EBITDA and earnings CAGR of 16.1%, 21.6% and 29.8% respectively between FY11-13. Bharti's robust cash generation, strong positioning in the domestic market coupled with declining competitive intensity and stabilization of tariffs, reduction in losses from new operations (DTH/Bangladesh) and turnaround of Africa operations will support/accelerate its growth trajectory.

Cash generation to remain robust; Zain acquisition is earnings accretive

With peak of the capex intensity already behind, we estimate Bharti will generate gigantic free cash flows between FY12-16 totaling $20bn i.e. average $4bn per annum. This is excluding further acquisitions and license renewal cost. Further, Zain being a leveraged buy-out will enhance the earnings and return ratios for Bharti. We expect Zain to be earnings accretive for Bharti from FY12E supported by relatively low cost of funding. We expect cash ROCI ($10.7bn) to average 14-15% between FY12-FY16 on Zain.

New businesses set to stabilize

Bharti's investment in DTH and Sri Lanka contributed negatively to the extent of 4.5% and 8.5% to FY09/FY10 earnings respectively. Stabilization in these new businesses will support Bharti's earnings growth.

Passive Infrastructure sharing = operating leverage = value unlocking: Bharti, with significantly high captive tower portfolio (~70k towers including proportionate share of Indus towers); remains best positioned in the industry to capitalize on the operating cost leverage and benefit from potential cash generation on network sharing. Formation of Indus Towers provides visibility on assured tenancy.

Potential upside

Higher than expected subscriber growth, minutes of usage per subscriber or increase in RPM can provide additional upside to our target price. Robust operating performance is likely in H2FY11 with low base effect, industry consolidation and tower company value unlocking will remain potential stock price catalysts.

Valuations and Risk

Bharti is currently trading at 8.9x and 6.8x on FY11E and FY12E EV/EBITDA. At our target price, Bharti would trade at an implied EV/EBITDA of 11.0x and 8.5x. On Price/Operating CF basis, Bharti is trading at implied multiple of 5.9x and 6.5x FY11E and FY12E, in line with global peers despite relatively strong growth trajectory, financial positioning and return ratios. Key risks include uuncertain regulatory policies, MNP and execution failure in Africa.

Table 1: Financial summary

Rs million	FY09	FY10	FY11E	FY12E	FY13E
Revenues (Rs m)	369,615	418,472	598,155	707,988	806,815
Growth (%)	*36.8*	*13.2*	*42.9*	*18.4*	*14.0*
EBITDA (Rs m)	151,680	168,609	217,567	271,898	321,566
Growth (%)	*33.4*	*11.2*	*29.0*	*25.0*	*18.3*
EBITDA Margin (%)	41.0	40.3	36.4	38.4	39.9
Adj. Net Profit (Rs m)	84,112	91,249	75,927	94,641	127,060
EPS (Rs)	22.2	24.1	20.0	24.9	33.5
Growth (%)	30.2	8.5	(16.8)	24.6	34.3
P/E (x)	16.2	14.9	17.9	14.4	10.7
EV/EBITDA (x)	9.2	8.2	8.9	6.8	5.4
P/Op CF (x)	10.7	8.8	6.0	6.6	5.4
ROE (%)	30.4	24.1	16.4	17.5	20.6
ROCE (%)	26.2	18.6	10.9	10.2	13.1

Source : HDFC Securities Institutional Research

Idea Cellular – Growth momentum intact

Recommendation	**BUY**
CMP	**77**
Target	**96**
Stock Return	**24%**

Key Stock Data	
Sector	Telecom
Reuters Code	IDEA.BO
BLOOMBERG Code	IDEA IN
No. of Shares (mn)	3,301
Market Cap (Rs bn)	246
Market Cap ($ mn)	5,555
6 mth avg traded value (Rs. mn)	484

Stock Performance (%)

52 - Week high / low Rs 79/47

	3M	6M	12M
Absolute (%)	41.0	19.9	1.1
Relative (%)	29.8	7.9	(16.1)

Shareholding Pattern

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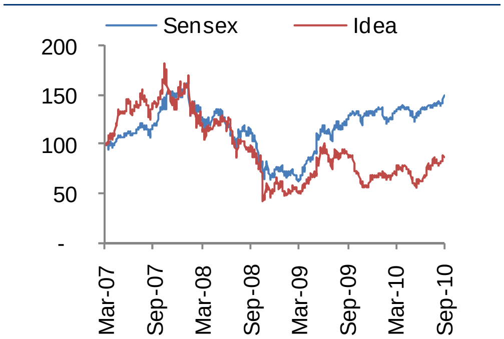
FIIs	7.7	7.0	7.4	6.1
Public & Others	32.0	36.1	38.1	39.3

Source: Company, BSE

Sensex and Stock Movement



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We are initiating coverage on Idea Cellular (Idea) with one year forward DCF based target price of Rs96, implying an upside of 24% from current levels. We expect Idea to post revenue, EBITDA and earnings CAGR of 17.4%, 28.4% and 30.5% respectively between FY11-13. Idea has been one of the fastest growing telcos. However, consolidation of low margin Spice operations and expansion into new circles has dragged down the EBITDA and earnings growth of the company. Reduction in losses from new circles of operations will support revenue and earnings growth. Robust cash generation, coupled with improving performance of Indus tower and consequent value unlocking will improve the net debt/equity and net debt/EBITDA for Idea.

Fastest growing telecom operator

Idea has significantly strengthened its positioning as a domestic player with its expansion from regional to national player. Idea launched operations in nine new circles in the past two years in addition to the acquisition of Spice operations in two circles. Idea reported highest revenue growth among the telcos, albeit on lower base registering 7.1% revenue CAGR in the past nine quarters against 3.2% for Bharti and 4.2% for Vodafone in a highly competitive environment.

Reduction in new circle losses to improve margin

Although Idea has been able to witness highest revenue growth, capacity expansion, new circle rollouts and consolidation of low margin Spice operations pulled down its EBITDA and earnings performance. EBITDA losses due to new circles accounted for ~6% and 12% of Idea's operations in FY09 and FY10 respectively. Stabilization of losses in new circles will boost margin for Idea.

Consolidation / value unlocking from Indus Tower to lift performance

Idea consolidates Indus on a proportionate basis for its 16% joint venture share. Indus accounted for 8% of Idea's consolidated EBITDA and has been growing at 21% CAGR for past five quarters. While the revenue contribution from Indus remained negative, consolidation of high margin Indus operations will boost Idea's overall performance. Further, listing of Indus tower will help Idea unlock value and could also result into de-leveraging of its balance sheet.

Valuation and Key risk

Idea is currently trading at 9.7x and 7x on FY11E and FY12E EV/EBITDA. At our target price, Idea would trade at an implied EV/EBITDA of 11.3x and 8.2x. On Price/Operating CF basis, Idea is trading at implied multiple of 7.3x and 6x FY11E and FY12E. Key risk includes uncertain regulatory policies remains major risk. MNP and execution failure on 3G services remains additional risk.

Table 1: Financial summary

Rs million	FY09	FY10	FY11E	FY12E	FY13E
Revenues (Rs	101,544	124,470	160,688	195,133	221,637
Growth (%)	*50.7*	*22.6*	*29.1*	*21.4*	*13.6*
EBITDA (Rs m)	28,364	34,250	39,549	53,653	65,209
Growth (%)	*25.0*	*20.7*	*15.5*	*35.7*	*21.5*
EBITDA Margin	*27.9*	*27.5*	*24.6*	*27.5*	*29.4*
Adj. Net Profit	8,816	8,881	9,245	7,972	15,747
EPS (Rs)	2.8	2.7	2.8	2.4	4.8
Growth (%)	(28.1)	(5.4)	4.1	(13.8)	97.5
P/E (x)	27.1	28.7	27.5	31.9	16.2
EV/EBITDA (x)	9.8	9.3	9.7	7.0	5.3
P/Op CF (x)	10.6	10.0	7.3	6.0	4.9
ROE (%)	9.7	7.2	7.8	6.3	11.3
ROCE (%)	8.0	5.6	5.9	6.8	9.3

Source : HDFC Securities Institutional Research

Rcom – poised for a turnaround

Recommendation	**BUY**
CMP	**167**
Target	**198**
Stock Return	**25%**

Key Stock Data	
Sector	Telecom
Reuters Code	RLCM.BO
BLOOMBERG Code	RCOM IN
No. of Shares (mn)	2,064
Market Cap (Rs bn)	344
Market Cap ($ mn)	7,508
6 mth avg traded value (Rs. mn)	1,354

Stock Performance (%)

52 - Week high / low Rs 320/132

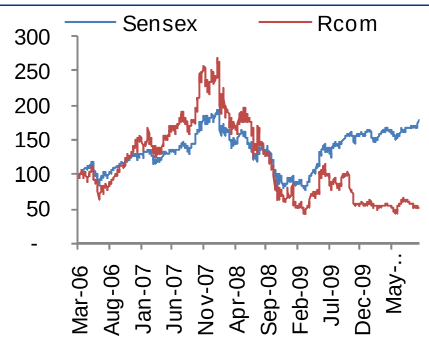
	3M	6M	12M
Absolute (%)	(13.0)	3.5	(46.7)
Relative (%)	(24.2)	(8.5)	(63.9)

Shareholding Pattern

%	FY08	FY09	FY10	Q1 FY11
Promoters	66.1	67.3	67.6	67.7
FIs & Local MFs	9.0	9.5	9.8	9.4
FIIs	10.0	7.4	7.7	8.0
Public & Others	14.9	15.8	15.0	14.9

Source: Company

Sensex and Stock Movement



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We believe Rcom – India's second-largest mobile operator (#5 in GSM) – is set for a turnaround on the back of industry tailwinds. Revenue growth should return as RPMs stabilize, driven by our industry call of rational tariffs. We expect revenues to grow at 15.7% Cagr driving a healthy 17.1% ebitda cagr over FY11-13E. Despite the recent failure of the GTL deal, we believe management will continue efforts to monetize tower assets. Strategic stake sale remains a key re-rating trigger. Even at our DCF-based target price of Rs198 the stock would trade at a 10% discount to Bharti as against historic premium. Initiate coverage with a BUY.

Revenue growth set to accelerate with improving margins

After remaining stagnant over the past two years, we expect Rcom's revenues to grow at a robust 15.7% Cagr over FY11-13E. We forecast wireless revenues (81% of total) to grow at 17% led by stabilization in ARPUs, driven by a modest 8-10% decline in RPMs. Non-wireless/global revenues, a drag on the topline for the past few quarters should also stabilize going forward as the company gains new clients. Finally, Rcom's industry revenue share – a key concern in the past – should improve given its 3G presence in 13 circles, including the lucrative metro circles.

Stake sale remains a key re-rating trigger

RCom's balance sheet has been a major investor concern given the high net debt to EBITDA (4.1x as at end-1QFY11). However, as revenue growth accelerates and capex outflows ebb, we expect Rcom's cashflows to improve. While the recent failure of the GTL-Tower asset deal was a negative, we believe Rcom will continue to explore avenues to monetize its tower assets (estimated at Rs52/share). We also view stake sale (in the consolidated entity) to a strategic partner as a key positive for improving RCom's balance sheet. Our current estimates factor in an improvement in RCom's Net Debt/Ebitda to 2.6x by FY13E without any fund infusion.

Valuation and Rating

RCom has underperformed the markets by 64% and peer, Bharti by 30% over the last one year, on back of disappointing financials and deterioration in operating parameters. At current price, the stock trades at 8.8x and 7.1x FY11E and FY12E EV/EBITDA. At our DCF based target price of Rs198, which assumes a 12.9% WACC and 3% terminal growth rate, stock would trade at an implied EV/EBITDA of 7.8x FY12E. Initiate coverage with a BUY.

Table 1: Financial summary

Rs million	FY09	FY10	FY11E	FY12E	FY13E
Revenues (Rs m)	227,891	221,323	221,443	259,090	296,425
Growth (%)	*19.5*	*(2.9)*	*0.1*	*17.0*	*14.4*
EBITDA (Rs m)	91,453	78,206	74,804	89,650	102,613
Growth (%)	*11.3*	*(14.5)*	*(4.3)*	*19.8*	*14.5*
EBITDA Margin (%)	*40.1*	*35.3*	*33.8*	*34.6*	*34.6*
Adj. Net Profit (Rs m)	45,543	46,927	15,667	16,775	28,469
EPS (Rs)	22.1	22.7	7.6	8.1	13.8
Growth (%)	*8.9*	*3.0*	*(66.6)*	*7.1*	*69.7*
P/E (x)	8.3	12.6	22.9	21.4	12.6
EV/EBITDA (x)	6.8	7.6	8.8	7.1	5.9
P/Op CF (x)	5.3	3.6	5.5	6.6	6.1
ROE (%)	25.8	15.9	7.8	7.8	11.9
ROCE (%)	10.1	6.4	5.3	5.9	7.4

Source : HDFC Securities Institutional Research

TTML – in difficult terrain

Recommendation	**SELL**
CMP	**23**
Target	**17**
Stock Return	**-26%**

Key Stock Data

Sector	Telecom
Reuters Code	TTML.BO
BLOOMBERG Code	TTLS IN
No. of Shares (mn)	1,897
Market Cap (Rs bn)	44
Market Cap ($ mn)	968
6 mth avg traded value (Rs. mn)	89

Stock Performance (%)

52 - Week high / low Rs 37/17

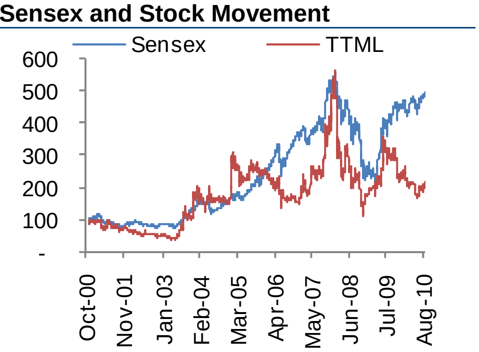
	3M	6M	12M
Absolute (%)	2.4	(0.8)	(33.2)
Relative (%)	(8.8)	(12.9)	(50.5)

Shareholding Pattern

%	FY08	FY09	FY10	Q1 FY11
Promoters	65.8	65.6	77.7	77.7
FIs & Local MFs	2.4	0.3	0.8	0.6
FIIs	2.2	0.1	1.0	1.1
Public & Others	29.7	34.0	20.5	20.6

Source: Company, BSE

Sensex and Stock Movement



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We are initiating coverage on Tata Teleservices Maharashtra Limited (TTML) with a Sell rating and one year forward DCF based target price of Rs17, implying a downside of 26%. High net debt/EBITDA, closure of USO subsidy scheme on rural subscriber acquisition (from FY11) and loss making operations are key concerns. Dual technology and regional operations with high competition that curtails economies of scale, absence of 3G spectrum in Mumbai circle and higher proportion of revenue from post-paid subscribers and data services add to our concern. Vendor financing / equity raising remains inevitable to improve the poor financial position coupled with improvement in operating performance.

Absence of USO subsidy to impact FY11 EBITDA

Closure of USO subsidy w.e.f. FY11 will impact TTML's EBITDA by Rs1.2 bn. FY10 included USO subsidy income of Rs1.4bn which would decline to Rs200mn in FY11 as a spill-over from previous years. Management plans to offset the EBITDA decline with better cost optimization and reduced handset subsidy for CDMA subscriber acquisition. However, we believe arresting the decline in EBITDA will be difficult in the light of roll-out of 3G services and also because the GSM business is yet to stabilize.

Equity fund raising inevitable in the medium term

Net debt/EBITDA for TTML remains high at 8.6x on net debt of ~Rs40bn. This is despite receipt of Rs13bn on passive infrastructure sale which got utilized towards the 3G license pay-out of Rs12.6bn. The EBITDA of TTML for FY11 at Rs5bn would primarily be channeled towards servicing the interest cost on debt leaving little room for repayment of principal and capex. This makes fund raising inevitable via equity and/or vendor finance. The management plans to use the undrawn credit and vendor finance for its Rs9bn capex guidance (40% on 3G with balance for GSM services) for FY11.

Higher risk due to high VAS revenue from data services and debtor days

TTML enjoys high composition of VAS revenues at 19% in 1QFY11 against 11-12% for the industry. A large proportion of TTML's VAS revenue is from data cards (Tata Photon+) which has been growing at a fast pace. This could come under pressure post launch of 3G services by competitors. Also, high debtor days at 47 against industry average of 11-12 reveals high component of postpaid revenues (60-70% against 25-30% for peers) and this exposes TTML to tariff decline in postpaid segment post MNP.

Valuation and upside risk

TTML is currently trading at 17.8x and 12.6x FY11 and FY12E EV/EBITDA. At our target price of Rs17, TTML would trade at an implied EV/EBITDA multiple of 10.8x FY12E, 30% premium to implied EV/EBITDA multiple of Bharti/Idea. Better than expected capital allocation through vendor financing, equity fund raising at premium to current market price or phenomenal turnaround in operational performance provides upside risk to our TP.

Table 1: Financial summary

Rs million	FY09	FY10	FY11E	FY12E	FY13E
Revenues (Rs m)	20,581	22,740	23,968	28,367	31,991
Growth (%)	*15.1*	*10.5*	*5.4*	*18.4*	*12.8*
EBITDA (Rs m)	6,001	5,611	5,033	7,078	8,453
Growth (%)	*24.0*	*(6.5)*	*(10.3)*	*40.6*	*19.4*
EBITDA Margin (%)	*29.2*	*24.7*	*21.0*	*25.0*	*26.4*
Adj. Net Profit (Rs m)	(1,700)	(3,534)	(4,650)	(4,888)	(3,920)
EPS (Rs)	(0.9)	(1.9)	(2.5)	(2.6)	(2.1)
Growth (%)	nmf	nmf	nmf	nmf	nmf
P/E (x)	nmf	nmf	nmf	nmf	nmf
EV/EBITDA (x)	12.9	14.9	17.5	12.5	10.3
P/Op CF (x)	11.4	7.5	7.1	5.2	5.0
ROE (%)	nmf	nmf	nmf	nmf	nmf
ROCE (%)	5.1	(1.2)	(27.3)	(1.4)	1.4

Source : HDFC Securities Institutional Research

HDFC securities
Institutional Research

Weekly Note

September 20, 2010

	Last	1w (%)	1m (%)	3m (%)
Indices				
Nifty	5,885	4.4	8.9	12.0
Sensex	19,595	4.2	8.7	11.7
Nifty Junior	12,583	2.4	6.0	14.5
Banking	13,745	5.9	12.3	26.2
IT	5,844	3.2	7.2	8.8
Pharma	5,842	2.9	6.8	5.0
Oil	10,736	5.5	7.5	3.7
Power	3,164	1.4	2.5	2.0
Auto	9,276	2.0	6.1	14.8
Metals	16,489	2.2	9.5	10.6
Real Estate	3,713	4.7	2.2	20.2
FMCG	3,563	2.8	7.7	15.3
Capital Goods	15,511	2.8	7.0	7.8
Top Gainers				
ABB	846	7.9	9.4	(1.8)
Sun Pharmaceutical	1,874	6.8	5.4	10.2
Suzlon Energy	54	6.8	10.2	(3.6)
Top Losers				
Bharat Heavy Electricals	2,444	(2.0)	(0.5)	1.6
State Bank of India	3,093	(1.8)	11.0	30.4
Jindal Steel & Power	708	(1.3)	2.9	5.6
Commodity				
WTI Crude ($/bbl)	73.9	(4.2)	0.1	(7.9)
3m LME Copper ($/MT)	7,720	1.2	6.4	16.9
3m LME Aluminum ($/MT	2,180	2.3	6.9	11.2
3m LME Zinc ($/MT)	2,151	0.3	4.5	21.2
Gold (Rs/10g)	19,130	1.6	2.3	2.1
Debt				
10yr	7.99	2.0 bps	5.8 bps	41.3 bps
5yr	7.79	3.5 bps	10.7 bps	39.3 bps
1yr	6.51	12.7 bps	8.3 bps	114.6 bps
Call	6.05	25.0 bps	80.0 bps	65.0 bps
AAA	8.72	-0.5 bps	-7.5 bps	1.5 bps
Currency				
Rs/USD	45.84	(1.2)	(1.8)	0.2
Yen/USD	85.66	2.4	0.0	(5.9)
USD/EUR	1.31	1.7	2.8	5.9

Institutional	**Last**	**1wk Avg.**	**1m Avg.**	**3m Avg.**
Domestic (net buy/sell)	(16.3)	(21.0)	(6.3)	(6.2)
FII (net buy/sell)	247.0	375.9	169.3	163.4

Indian markets continued on a roll, rising 4% over last week, even taking RBI's mid-policy interest rate hike in their stride. US$2.3bn of FII money has flowed into the markets in Sept, driving the upward momentum. YTD-FII flows have now touched US$15bn – within striking distance of 2009's total of US$17bn. During the week, we visited capital goods companies to confirm our view that power sector execution is on track, and reiterate our positive stance on power equipment players. Our Banks and Property teams also released a joint special report during the week. In these exuberant times, we believe there is a potential for negative surprise from the banking sector's exposure to commercial real estate.

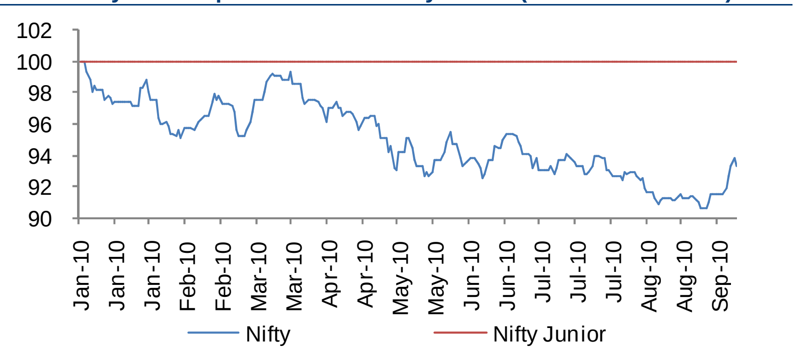
New Report: Artificial Exuberance

Our Banks and Real Estate teams spliced through reams of banking industry data, annual accounts of listed real estate majors and DRHPs of to-be listed real estate players. We were surprised by the results. The banking system has grown its real estate book at 40% CAGR during FY06-10 as compared to 21% in non-food bank credit. Out of the total exposure of Rs957bn (US$21bn), only 22% is to listed players, with the balance to unorganized, small/medium-scale developers who do not have multiple avenues to raise capital. We believe, the long fat tail within real estate space might weigh heavy on banks' asset quality in the times to come. For real estate players, If IPOs do not go through, a large part of the 290msf of residential and commercial supply from these players will get delayed, further impacting the companies' financial position. On the broader market, however, we believe, the impact on pricing would not be significant. Sensitivity suggests that, 10% slippages in loans would impact the FY12E PBT by up to 18% and net-worth by +2%. The most impacted banks are OBC, PNB and BOI.

Power equipment sector – execution on track

Our recent visits to L&T and KEC confirm our bullish view on the power equipment sector, within which we prefer the generation equipment space over the T&D equipment space. L&T's JV with Mitsubishi (MHI) for main plant equipment is on track and it is looking at executing its current orders (worth Rs60bn) over the next 3-4 years. The JV currently has 4GW of capacity that will increase to 6GW by FY13. L&T estimates the total annual demand for boiler-turbine-generator (BTG) to be around 15-25GW and does not foresee an overcapacity in the power equipment market. However, in the T&D EPC segments, our visit to KEC confirmed our view that competition continues to be very intense. A number of new players have entered the T&D equipment and EPC businesses pushing down margins and market share for the existing players. KEC expects large order flows in the 2H11 -2012 on account of PGCIL spending (to meet 11th plan targets) supported by SEBs and private sector spending. Upcoming BOT projects should also be a big opportunity for transmission EPC players.

Chart 1: Nifty relative performance to Nifty Junior (1/Jan/10 base=100)



Source : Bloomberg

Chart 2: Average daily volumes have risen steadily in Sept-10

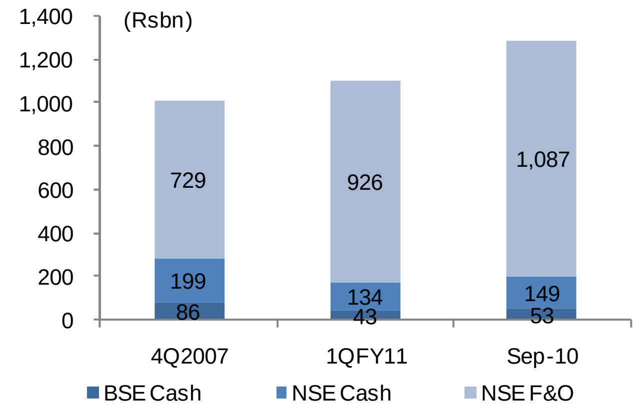


Chart 3: Sensex has sharply outperformed emerging markets from the March-09 lows

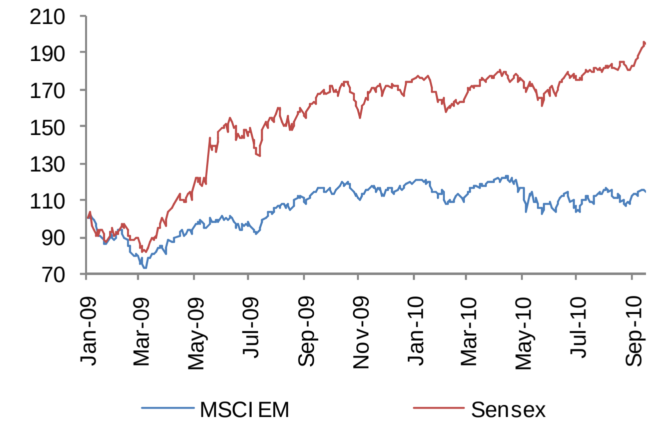


Chart 4: Post-Lehman lows (Sep-08), while China outperformed India, this trend has now been reversed…

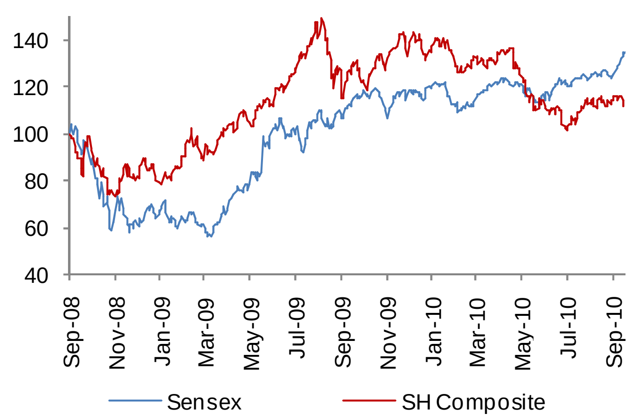


Chart 5: …and from the March-09 lows, the Sensex has sharply out-performed the Shanghai Composite

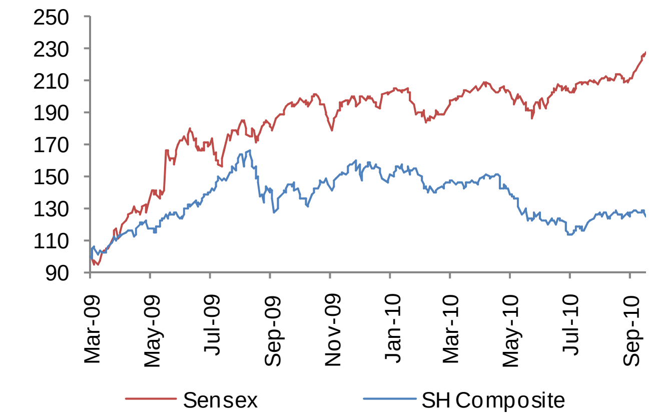


Chart 6: While Autos and Banks have led the Sensex, Banks have stood apart in the recent Sept rally

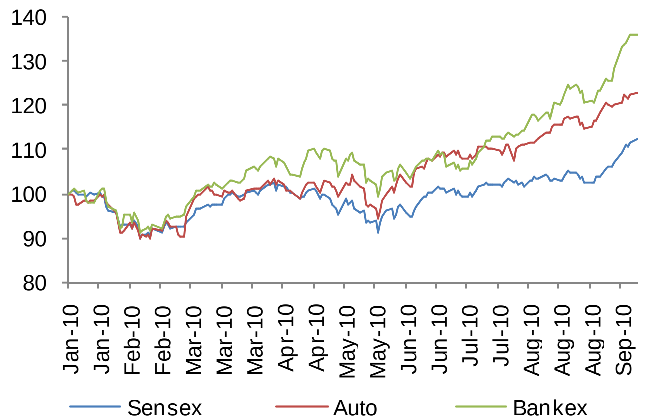
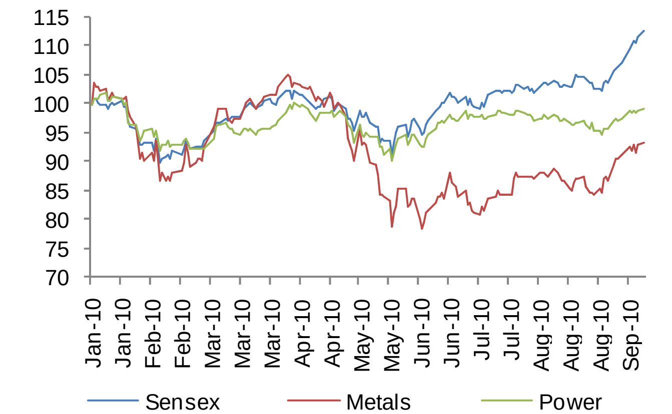


Chart 7: Metals and Power have caught up marginally with the Sensex



Source : Bloomberg

News Roundup

Eco-Political:

- The Reserve Bank of India has raised the repo rate by 25bps to 6% and reverse repo rate by 50bps to 5% in order to tame inflation. (Mint)
- Food Inflation is at 15.10% for the week ended September 4 as compared to 14.6% in the last week. (ET)
- The Employees Provident Fund Organization has raised the interest rate on retirement savings by 100 bps to 9.5% for FY11. (FE)

Company:

- Elder Pharmaceuticals Ltd is reportedly set to acquire NeutraHealth, a UK based supplier of vitamins and supplements for about Rs 880mn. (Mint)
- Rural Electrification Corporation plans to raise $500mn by issuing 5-year bonds by November. (BS)
- Monnet Ispat & Energy is reportedly going to invest over Rs 140bn in order to build a 2.5mn tonne steel plant in Jharkhand. (ET)
- Bharti Airtel is reportedly selling the mobile phone towers of its African arm to Bharti Infratel for around Rs 120-150bn by December 2010. (ET)
- Reliance Industries is seeking a 25% increase in the price of natural gas it produces from the Krishna-Godavari Basin. (ET)
- Bharti Airtel Ltd has received a license from the Reserve Bank of India to launch mobile payment services. (Mint)
- BHEL has received an Rs 26.7bn order for the supply and installation of the main plant package for Dainik Bhaskar Power's 2x600MW coal based thermal power project in Chhattisgarh. (ET)
- SAIL has entered into a JV with Indian Railways' arm RITES to build a wagon making unit at Kulti near Asansol in West Bengal at an investment of Rs 2.1bn. (ET)
- Vodafone has appealed to the Supreme Court against the decision of the Bombay High Court as it remains convinced that there is are no taxes payable on the Hutchison transaction. (Mint)
- Suzlon Energy Ltd reportedly plans to expand its capacity in its plant in China by 67% from the current 600MW by 2013. (Mint)
- ING Vysya Bank has informed the BSE that the GMR Group will no longer be classified as part of its promoter group. (Mint)
- Housing Development and Infrastructure Ltd. (HDIL) has launched a share sale to qualified institutional investors to raise up to $250mn. (ET)

Research Highlights

Bharat Forge – Plant Visit Note

We returned impressed after visiting Bharat Forge's "Centre for Advanced Manufacturing" (CAM) facilities in Baramati. BFL is targeting revenues from its non-auto business to touch 40% by FY12 and 75% by FY15 (cf. 33% in 1QFY11). BFL expects its investments in non auo business to generate revenues of Rs10bn/annum (cf. FY10 consolidated revenues of Rs33bn), which, we believe, is achievable given the company's capabilities and opportunities in targeted sectors. Given its existing leadership in automotive crankshafts, and its investment in the Baramati facilities, we believe the company has a competitive edge in its targeted product portfolio. BFL is also well poised for growth in the Capital Goods segment with its tie-ups with Alstom, NTPC and Areva. Overall, we remain positive on the company and believe earnings momentum remains critical for maintaining current premium valuations.

Banking Sector Update – Management Meet Note

In our recent interactions with senior officials at the Asset Reconstruction Company (ARC), we realized the buildup of NPAs continued across the sectors, partly driven by restructured portfolios of the banking system. Furthermore, as the banks move on to recognize NPAs, NPAs for the banking system could go up. During the first six months, there were no major sales of NPAs in the system mainly due to pricing mismatches between banks and ARCs. We maintain our cautious stance and have built in up to 2x rise in gross NPLs over FY10-12E. Prefer Axis Bank, PNB and Canara Bank.

India Banks & Real Estate – Artificial Exuberance Special Report

We analyze the banks' exposure of US$21bn to real estate sector and the impact of high leverage of real estate companies (listed and to-be listed) on the asset quality of banking system. Approximately US$14-16bn (75-78%) of the bank debt is to the unlisted and unorganized players. More than 80% (US$3.3bn) of the IPO proceeds (for nine real estate companies that are in queue) are to be utilized for the completion of projects and repayment of debt. Companies that have high net D/E (consol.) are Lodha Developers (4.1x) and Ambience (5.2x). In terms of net debt, DLF has US$4.4bn, Unitech US$1.5bn and Emmar MGF US$1.2bn. A 10% slippage in real estate loans would impact the pre-tax profits of banks in our coverage by upto 18%. Banks with higher exposure to the sector are PNB (8.2%), ICICI Bank (7.5%), OBC (7.4%) and Axis Bank (5.2%). We believe the improvement in cash flow position would be critical for companies or there would be pressure on the asset quality of the banking system.

KEC International – Management Meeting Note

We met KEC International (KECI IN) recently. Key takeaways from the meeting include a) large order flows in the pipeline for the T&D sector, b) competition remains intense in the T&D EPC space, c) BOOT projects to provide a big opportunity and d) recent acquisitions to improve market share. KEC International is among our top picks in the transmission tower EPC business on account of a pickup in order flow in 2H11 and attractive valuations. We also like Crompton Greaves and Jyoti Structures in the T&D space.

Economic Events Calendar

Monday	Tuesday	Wednesday	Thursday	Friday	Saturday	Sunday
20-Sep-10	**21-Sep-10**	**22-Sep-10**	**23-Sep-10**	**24-Sep-10**	**25-Sep-10**	**26-Sep-10**
			Food Articles WPI Fuel, Power & Light WPI Primary Articles WPI			
27-Sep-10	**28-Sep-10**	**29-Sep-10**	**30-Sep-10**	**01-Oct-10**	**02-Oct-10**	**03-Oct-10**
			Food Articles WPI Fuel, Power & Light WPI Primary Articles WPI Current Account Balance	India Sept' Markit Manufacturing PMI Exports YoY Imports YoY		
04-Oct-10	**05-Oct-10**	**06-Oct-10**	**07-Oct-10**	**08-Oct-10**	**09-Oct-10**	**10-Oct-10**
			Food Articles WPI Fuel, Power & Light WPI Primary Articles WPI			
11-Oct-10	**12-Oct-10**	**13-Oct-10**	**14-Oct-10**	**15-Oct-10**	**16-Oct-10**	**17-Oct-10**
	Industrial Production YoY		Food Articles WPI Fuel, Power & Light WPI Primary Articles WPI Monthly Wholesale prices			