

Global Telecoms, Media &  
Technology  
Telecoms  
Equity – India

# Indian telecoms

## 2QFY12 earnings preview

- ▶ **Seasonality in minutes and forex losses to affect 2Q earnings**
- ▶ **Likely marginal improvement in Bharti revenue per minute**
- ▶ **We like Bharti Airtel (OW, TP INR488) given its high-quality subscriber base and recent tariff hikes**

**Seasonality and forex MTM losses to affect 2Q earnings:** Historically, 2Q has been a weak quarter driven by seasonality, and we believe this trend will continue with sector MOUs declining by c3%. However, we expect minutes to bounce back in 3Q FY12e given the festive season, which along with noticeable improvements in revenue per minute in 3Q should be good near-term catalysts for Bharti, in our view. In addition to seasonality, the c10% depreciation of INR vs USD will meaningfully affect Bharti's 2Q PAT this quarter (we estimate this at INR6.3bn, assuming some hedging benefits).

**Separately, we expect revenue per minute for the quarter** to be flat on a q-o-q basis for the sector overall, however, we expect a c1% increase in Bharti's revenue per minute this quarter driven by tariff hikes in early June this year. We believe improvements in revenue per minute for Idea Cellular will be visible from 3QFY12e onwards only given its lower proportion of on-net calling versus Bharti. Furthermore, we believe Bharti would report c4% growth in usage with a marginal decline in ARPU for the Africa business and do not expect any margin decline.

**3G no progress to be muted:** While investors will be keen to understand the take-up on 3G services, we do not see any meaningful positive coming this quarter. Moreover, given historical seasonality issues with 2Q, any development on 3G was unlikely. However, given the festive season in 3Q, a good percentage of subscribers generally use this festive season to purchase new handsets, replacing older ones. A slow pick-up for 3G services in 3Q would raise some serious concerns about India 3G demand, in our view.

**Valuation and rating:** We like Bharti (BHARTI IN, INR401.6, OW, TP INR488), given its high-quality subscriber base (c90% active subscribers, highest active subscriber market share of 25%) and recent tariff hikes by the company. The key downside risk would be acceptance of the recommendations made by the regulator, TRAI, in their current format.

7 October 2011

**Rajiv Sharma\***

Analyst  
HSBC Securities and Capital Markets  
(India) Private Limited  
+9122 22681239  
rajivsharma@hsbc.co.in

**Tucker Grinnan\***

Regional Head of Telecoms Research  
The Hongkong and Shanghai Banking  
Corporation Limited  
+852 2822 4686  
tuckergrinnan@hsbc.com.hk

View HSBC Global Research at:  
<http://www.research.hsbc.com>

\*Employed by a non-US affiliate of HSBC Securities (USA) Inc, and is not registered/qualified pursuant to FINRA regulations

Issuer of report: HSBC Securities and  
Capital Markets  
(India) Private Limited

## Disclaimer & Disclosures

This report must be read with the disclosures and the analyst certifications in the Disclosure appendix, and with the Disclaimer, which forms part of it

Figure 1: 2QFY12e forecasts quick summary

Company	Revenue Q1FY12e	% change q-o-q	EBITDA Q2FY12e	% change q-o-q	PAT Q2FY12e	% change q-o-q
Bharti Airtel	176,061	3.7%	59,854	4.9%	11,932	-1.8%
RCOM	52,583	6.4%	17,505	9.3%	1,320	-16.1%
Idea Cellular	46,268	2.3%	11,734	-2.5%	1,291	-27.2%

Source: HSBC estimates

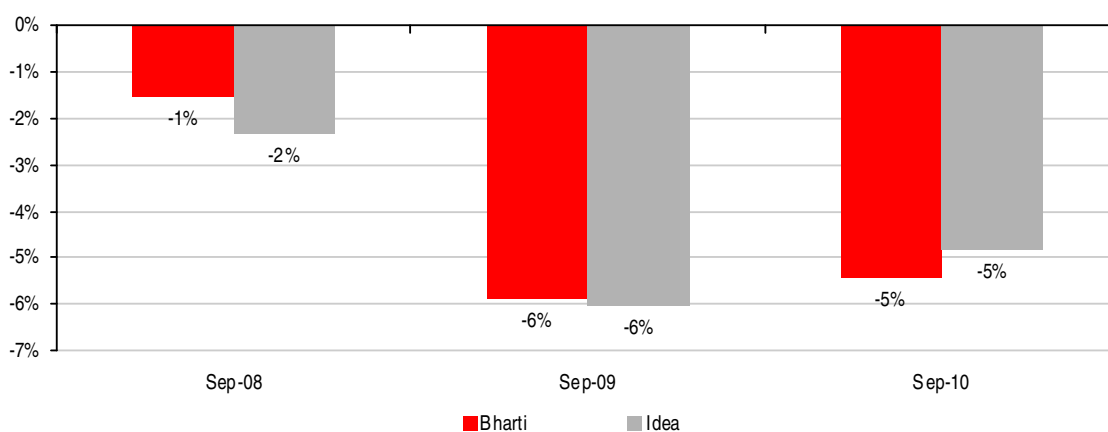
## 2QFY12 results snap-shot

Figure 2: 2QFY12e earnings preview for our telecom stock universe (INRm)

Company	Revenue Q1FY12e	% change q-o-q	EBITDA Q2FY12e	% change q-o-q	PAT Q2FY12e	% change q-o-q	Key issues to watch for
Bharti Airtel	176,061	3.7%	59,854	4.9%	11,932	-1.8%	1) Focus on tariffs stabilisation, ie, RPM; 2) progress on African operations and impact of rate cuts on elasticity
RCOM	52,583	6.4%	17,505	9.3%	1,320	-16.1%	1) Capital raising plans and status on sale of towers; 2) strategy to overcome loss in CDMA business
Idea Cellular	46,268	2.3%	11,734	-2.5%	1,291	-27.2%	1) EBITDA margins for overall business and for new circles; 2) 3G roll-out progress
MTNL	8,500	0.8%	-3,451	-3.8%	-8,900	-4.7%	1) Clarity on roaming agreements with private operators; 2) update on employee-related costs
TCOM	33,069	1.5%	3,417	4.7%	-2,132	2.3%	1) Further clarity on its South African subsidiary Neotel; 2) status on the sale of land
TTML	6,339	7.4%	1,219	-2.1%	-1,281	-7.3%	1) GSM EBITDA margins; 2) 2G capex and likely spends on improving capacity
GTL Infrastructure	3,704	164%	2,115	166%	-683	19%	1) Progress on corporate debt restructuring and funding requirements of the company
Tulip telecom	7,338	4%	2,013	5%	876	13%	1) Details of new government projects won; 2) penetration in other corporate segments like IPLC, DLC and corporate internet

Source: HSBC estimates

Figure 3: MoU change of Bharti and Idea in September quarters (past three years)



Source: Company reports

## Valuation and rating: Bharti Airtel

We have an Overweight rating on Bharti with a target price of INR488. We value Bharti using a blend of SOTP-based DCF analysis and PE. Our valuation has two components: India and the African operations. We value the tower division along with the India business, which we value on a mix of equally weighted PE and DCF. For our DCF analysis, we assume a WACC of c12%, cost of equity of 13% (cost of debt 10.5%) to arrive at a value of INR560 per share. For the purpose of our PE methodology, we use a PE of 18x and have applied this to our FY13e EPS to arrive at a fair value INR521 per share. Our target price includes a negative adjustment for the TRAI recommendations of INR20; however, we see a very limited chance of these recommendations being accepted in the current format. We remain cautious on Bharti's African business and value it at -INR33 per share.

Under HSBC's research model, for non-volatile Indian stocks, the Neutral rating band is 5 percentage points above and below a hurdle rate of 11%, or 6-16% potential return. Our target price of INR488 implies a potential return of 38%, which is above the Neutral band; thus, we rate the shares Overweight. Key downside risks include refarming of spectrum in 900 MHz band. Key catalysts include faster-than-estimated margin improvement in Africa and accelerated enrolment of subscribers for 3G services.

Figure 4 : Bharti Target price computation

Particulars	Assumptions	Value per share (INR)
India business	PE and DCF method	541
Africa business	DCF	-33
Adjustment for TRAI recommendations		-20
Target price		488

Source: HSBC estimates

# Disclosure appendix

## Analyst Certification

The following analyst(s), economist(s), and/or strategist(s) who is(are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and/or any other views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Rajiv Sharma and Tucker Grinnan

## Important disclosures

### Stock ratings and basis for financial analysis

HSBC believes that investors utilise various disciplines and investment horizons when making investment decisions, which depend largely on individual circumstances such as the investor's existing holdings, risk tolerance and other considerations. Given these differences, HSBC has two principal aims in its equity research: 1) to identify long-term investment opportunities based on particular themes or ideas that may affect the future earnings or cash flows of companies on a 12 month time horizon; and 2) from time to time to identify short-term investment opportunities that are derived from fundamental, quantitative, technical or event-driven techniques on a 0-3 month time horizon and which may differ from our long-term investment rating. HSBC has assigned ratings for its long-term investment opportunities as described below.

This report addresses only the long-term investment opportunities of the companies referred to in the report. As and when HSBC publishes a short-term trading idea the stocks to which these relate are identified on the website at [www.hsbcnet.com/research](http://www.hsbcnet.com/research). Details of these short-term investment opportunities can be found under the Reports section of this website.

HSBC believes an investor's decision to buy or sell a stock should depend on individual circumstances such as the investor's existing holdings and other considerations. Different securities firms use a variety of ratings terms as well as different rating systems to describe their recommendations. Investors should carefully read the definitions of the ratings used in each research report. In addition, because research reports contain more complete information concerning the analysts' views, investors should carefully read the entire research report and should not infer its contents from the rating. In any case, ratings should not be used or relied on in isolation as investment advice.

## Rating definitions for long-term investment opportunities

### Stock ratings

HSBC assigns ratings to its stocks in this sector on the following basis:

For each stock we set a required rate of return calculated from the cost of equity for that stock's domestic or, as appropriate, regional market established by our strategy team. The price target for a stock represents the value the analyst expects the stock to reach over our performance horizon. The performance horizon is 12 months. For a stock to be classified as Overweight, the implied return must exceed the required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile\*). For a stock to be classified as Underweight, the stock must be expected to underperform its required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile\*). Stocks between these bands are classified as Neutral.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in price target). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.

\*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However,

stocks which we do not consider volatile may in fact also behave in such a way. Historical volatility is defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility has to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

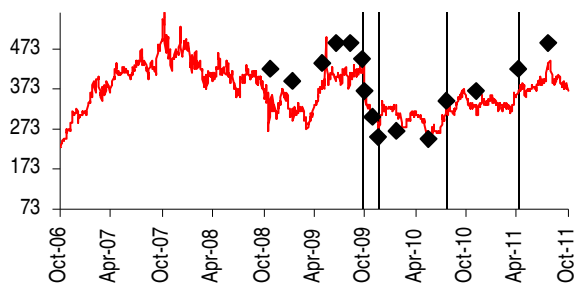
## Rating distribution for long-term investment opportunities

As of 07 October 2011, the distribution of all ratings published is as follows:

<b>Overweight (Buy)</b>	55%	(26% of these provided with Investment Banking Services)
<b>Neutral (Hold)</b>	34%	(22% of these provided with Investment Banking Services)
<b>Underweight (Sell)</b>	11%	(16% of these provided with Investment Banking Services)

## Share price and rating changes for long-term investment opportunities

Bharti Airtel (BRTI.BO) Share Price performance INR Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Overweight (V)	Neutral (V)	30 September 2009
Neutral (V)	Underweight (V)	24 November 2009
Underweight (V)	Neutral (V)	26 July 2010
Neutral (V)	Overweight	12 April 2011
Target Price	Value	Date
Price 1	421.50	03 November 2008
Price 2	393.00	21 January 2009
Price 3	438.00	04 May 2009
Price 4	488.50	22 June 2009
Price 5	488.50	18 August 2009
Price 6	448.00	30 September 2009
Price 7	368.00	07 October 2009
Price 8	305.00	01 November 2009
Price 9	254.00	24 November 2009
Price 10	270.00	24 January 2010
Price 11	250.00	20 May 2010
Price 12	341.00	26 July 2010
Price 13	370.00	08 November 2010
Price 14	425.00	12 April 2011
Price 15	488.00	25 July 2011

Source: HSBC

## HSBC & Analyst disclosures

### Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
BHARTI AIRTEL	BRTI.NS	366.10	07-Oct-2011	5, 6, 7

Source: HSBC

- 1 HSBC\* has managed or co-managed a public offering of securities for this company within the past 12 months.
- 2 HSBC expects to receive or intends to seek compensation for investment banking services from this company in the next 3 months.
- 3 At the time of publication of this report, HSBC Securities (USA) Inc. is a Market Maker in securities issued by this company.
- 4 As of 31 August 2011 HSBC beneficially owned 1% or more of a class of common equity securities of this company.
- 5 As of 31 August 2011, this company was a client of HSBC or had during the preceding 12 month period been a client of and/or paid compensation to HSBC in respect of investment banking services.
- 6 As of 31 August 2011, this company was a client of HSBC or had during the preceding 12 month period been a client of and/or paid compensation to HSBC in respect of non-investment banking-securities related services.
- 7 As of 31 August 2011, this company was a client of HSBC or had during the preceding 12 month period been a client of and/or paid compensation to HSBC in respect of non-securities services.
- 8 A covering analyst/s has received compensation from this company in the past 12 months.
- 9 A covering analyst/s or a member of his/her household has a financial interest in the securities of this company, as detailed below.
- 10 A covering analyst/s or a member of his/her household is an officer, director or supervisory board member of this company, as detailed below.
- 11 At the time of publication of this report, HSBC is a non-US Market Maker in securities issued by this company and/or in securities in respect of this company

Analysts, economists, and strategists are paid in part by reference to the profitability of HSBC which includes investment banking revenues.

For disclosures in respect of any company mentioned in this report, please see the most recently published report on that company available at [www.hsbcnet.com/research](http://www.hsbcnet.com/research).

\* *HSBC Legal Entities are listed in the Disclaimer below.*

### Additional disclosures

- 1 This report is dated as at 07 October 2011.
- 2 All market data included in this report are dated as at close 06 October 2011, unless otherwise indicated in the report.
- 3 HSBC has procedures in place to identify and manage any potential conflicts of interest that arise in connection with its Research business. HSBC's analysts and its other staff who are involved in the preparation and dissemination of Research operate and have a management reporting line independent of HSBC's Investment Banking business. Information Barrier procedures are in place between the Investment Banking and Research businesses to ensure that any confidential and/or price sensitive information is handled in an appropriate manner.

# Disclaimer

*\* Legal entities as at 04 March 2011*

*'UAE' HSBC Bank Middle East Limited, Dubai; 'HK' The Hongkong and Shanghai Banking Corporation Limited, Hong Kong; 'TW' HSBC Securities (Taiwan) Corporation Limited; 'CA' HSBC Securities (Canada) Inc, Toronto; HSBC Bank, Paris Branch; HSBC France; 'DE' HSBC Trinkaus & Burkhardt AG, Düsseldorf; 000 HSBC Bank (RR), Moscow; 'IN' HSBC Securities and Capital Markets (India) Private Limited, Mumbai; 'JP' HSBC Securities (Japan) Limited, Tokyo; 'EG' HSBC Securities Egypt SAE, Cairo; 'CN' HSBC Investment Bank Asia Limited, Beijing Representative Office; The Hongkong and Shanghai Banking Corporation Limited, Singapore Branch; The Hongkong and Shanghai Banking Corporation Limited, Seoul Securities Branch; The Hongkong and Shanghai Banking Corporation Limited, Seoul Branch; HSBC Securities (South Africa) (Pty) Ltd, Johannesburg; 'GR' HSBC Securities SA, Athens; HSBC Bank plc, London, Madrid, Milan, Stockholm, Tel Aviv; 'US' HSBC Securities (USA) Inc, New York; HSBC Yatirim Menkul Degerler AS, Istanbul; HSBC México, SA, Institución de Banca Múltiple, Grupo Financiero HSBC; HSBC Bank Brasil SA – Banco Múltiplo; HSBC Bank Australia Limited; HSBC Bank Argentina SA; HSBC Saudi Arabia Limited; The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch*

**Issuer of report**

**HSBC Securities and Capital Markets (India) Private Limited**

Registered Office

52/60 Mahatma Gandhi Road

Fort, Mumbai 400 001, India

Telephone: +91 22 2267 4921

Fax: +91 22 2263 1983

Website: [www.research.hsbc.com](http://www.research.hsbc.com)

This document has been issued by HSBC Securities and Capital Markets (India) Private Limited ("HSBC") for the information of its customers only. HSBC Securities and Capital Markets (India) Private Limited is regulated by the Securities and Exchange Board of India. If it is received by a customer of an affiliate of HSBC, its provision to the recipient is subject to the terms of business in place between the recipient and such affiliate. This document is not and should not be construed as an offer to sell or the solicitation of an offer to purchase or subscribe for any investment. HSBC has based this document on information obtained from sources it believes to be reliable but which it has not independently verified; HSBC makes no guarantee, representation or warranty and accepts no responsibility or liability as to its accuracy or completeness. Expressions of opinion are those of the Research Division of HSBC only and are subject to change without notice. HSBC and its affiliates and/or their officers, directors and employees may have positions in any securities mentioned in this document (or in any related investment) and may from time to time add to or dispose of any such securities (or investment). HSBC and its affiliates may act as market maker or have assumed an underwriting commitment in the securities of companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis and may also perform or seek to perform investment banking or underwriting services for or relating to those companies and may also be represented in the supervisory board or any other committee of those companies. The information and opinions contained within the research reports are based upon publicly available information and rates of taxation applicable at the time of publication which are subject to change from time to time. Past performance is not necessarily a guide to future performance. The value of any investment or income may go down as well as up and you may not get back the full amount invested. Where an investment is denominated in a currency other than the local currency of the recipient of the research report, changes in the exchange rates may have an adverse effect on the value, price or income of that investment. In case of investments for which there is no recognised market it may be difficult for investors to sell their investments or to obtain reliable information about its value or the extent of the risk to which it is exposed.

HSBC Securities (USA) Inc. accepts responsibility for the content of this research report prepared by its non-US foreign affiliate. All U.S. persons receiving and/or accessing this report and wishing to effect transactions in any security discussed herein should do so with HSBC Securities (USA) Inc. in the United States and not with its non-US foreign affiliate, the issuer of this report.

In the UK this report may only be distributed to persons of a kind described in Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001. The protections afforded by the UK regulatory regime are available only to those dealing with a representative of HSBC Bank plc in the UK. In Singapore, this publication is distributed by The Hongkong and Shanghai Banking Corporation Limited, Singapore Branch for the general information of institutional investors or other persons specified in Sections 274 and 304 of the Securities and Futures Act (Chapter 289) ("SFA") and accredited investors and other persons in accordance with the conditions specified in Sections 275 and 305 of the SFA. This publication is not a prospectus as defined in the SFA. It may not be further distributed in whole or in part for any purpose. The Hongkong and Shanghai Banking Corporation Limited Singapore Branch is regulated by the Monetary Authority of Singapore. Recipients in Singapore should contact a "Hongkong and Shanghai Banking Corporation Limited, Singapore Branch" representative in respect of any matters arising from, or in connection with this report. In Australia, this publication has been distributed by The Hongkong and Shanghai Banking Corporation Limited (ABN 65 117 925 970, AFSL 301737) for the general information of its "wholesale" customers (as defined in the Corporations Act 2001). Where distributed to retail customers, this research is distributed by HSBC Bank Australia Limited (AFSL No. 232595). These respective entities make no representations that the products or services mentioned in this document are available to persons in Australia or are necessarily suitable for any particular person or appropriate in accordance with local law. No consideration has been given to the particular investment objectives, financial situation or particular needs of any recipient. This publication is distributed in New Zealand by The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch.

In Japan, this publication has been distributed by HSBC Securities (Japan) Limited. In Hong Kong, this document has been distributed by The Hongkong and Shanghai Banking Corporation Limited in the conduct of its Hong Kong regulated business for the information of its institutional and professional customers; it is not intended for and should not be distributed to retail customers in Hong Kong. The Hongkong and Shanghai Banking Corporation Limited makes no representations that the products or services mentioned in this document are available to persons in Hong Kong or are necessarily suitable for any particular person or appropriate in accordance with local law. All inquiries by such recipients must be directed to The Hongkong and Shanghai Banking Corporation Limited. In Korea, this publication is distributed by The Hongkong and Shanghai Banking Corporation Limited, Seoul Securities Branch ("HBAP SLS") for the general information of professional investors specified in Article 9 of the Financial Investment Services and Capital Markets Act ("FSCMA"). This publication is not a prospectus as defined in the FSCMA. It may not be further distributed in whole or in part for any purpose. HBAP SLS is regulated by the Financial Services Commission and the Financial Supervisory Service of Korea.

© Copyright. HSBC Securities and Capital Markets (India) Private Limited 2011, ALL RIGHTS RESERVED. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, on any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of HSBC Securities and Capital Markets (India) Private Limited. MICA (P) 208/04/2011 and MICA (P) 040/04/2011