Company report

Telecoms, Media & Technology
Wireless Telecoms
Equity – India

HSBC Global Research

Bharti Airtel (BRTI)

Overweight (V)

Target price (INR)	786
Share price (INR)	647
Potential total return (%)	21.5

Mar	2008a	2009e	2010e
HSBC EPS	33.54	43.78	49.25
HSBC PE	19.3	14.8	13.1

Performance	1M	3M	12M
Absolute (%)	-10.4	-4.5	-26.0
Relative^ (%)	-3.0	2.1	50.8

Note: (V) = volatile (please see disclosure appendix)

21 January 2009

Rajiv Sharma*
Analyst
HSBC Securities and Capital Markets (India) Private Limited
+9122 2268 1239
rajivsharma@hsbc.co.in

Tucker Grinnan*
Analyst
The Hongkong and Shanghai Banking Corporation Limited
+852 2822 4686
tuckergrinnan@hsbc.com.hk

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Reiterate OW(V): Counting the cost of a price war

- **Price war with RCOM means risk of near-term share price weakness, but Bharti story still most compelling**
- **Market is overreacting; giving free minutes away is a flawed and unsustainable business model**
- **Cut target price 7% to INR786 (INR843) to factor in growing competition and slowing economy**

Overreacting: The 15% fall in Bharti's share price since the launch of RCOM's GSM service in December is an overreaction, in our view. Instead, investors should focus on Bharti's market leadership strengths and RCOM's longer-term structural limitations of operations in 1800MHz which require additional base stations. We believe the combination of low revenue yields and bloated cost structure will reduce the scope for disruptive pricing and competitive intensity will become more rational. In our view, Bharti is well placed to limit damage to its earnings on the back of its strong balance sheet, high revenue market share, brand positioning, and scale. Reference can be made to the Korean experience, which suggests that changes in subscriber market share do not translate into changes in FCF/revenue market share.

Impact on traffic: While RCOM's aggressive entry into GSM will hurt Bharti's earnings to some extent, the damage will be limited by the delayed implementation of Mobile Number Portability (MNP). We estimate FY10e traffic growth of 32% against the historical average of c70% and cut our FY10-11e EPS by 7% and 4%, respectively (11% and 8% below consensus) to factor in increasing competition and the slowing economy.

Blended valuation approach: The core business is valued at INR645 on 13.7x FY10e core earnings based on a 15% premium to HSBC's Sensex target of 11.9x; the tower business is valued at INR141 using DCF, which reflects a 36% discount to recent transaction multiples. Retain OW(V) but cut target price 7% to INR786.

Catalysts and risks: We expect consensus earnings to be cut further after Bharti reports Q309 numbers this week. As a result, we expect near-term weakness in Bharti's share price as investors focus on RCOM's subscriber growth. Upside catalysts are early 3G auctions and positive surprises on the back of rural penetration. Risks are early implementation of MNP, rollout of flat rate plans, higher than estimated slowdown in usage, higher than estimated decline in margins on the back of rural penetration, lower termination charges and higher spectrum charges.

Index^	BOMBAY SE IDX
Index level	9,330
RIC	BRTI.BO
Bloomberg	BHARTI IN

Source: HSBC

Enterprise value (INRm)	1264589
Free float (%)	32
Market cap (USDm)	25,244
Market cap (INRm)	1,227,861

Source: HSBC

Financials & valuation

Financial statements

Year to	03/2008a	03/2009e	03/2010e	03/2011e
Profit & loss summary (INRm)				
Revenue	270,250	370,279	447,110	528,192
EBITDA	113,715	150,289	168,900	203,744
Depreciation & amortisation	-37,260	-42,551	-47,184	-53,279
Operating profit/EBIT	76,455	107,739	121,716	150,465
Net interest	-3,352	-9,897	-4,532	-1,555
PBT	76,536	97,272	117,325	151,327
HSBC PBT	73,102	96,575	117,325	151,327
Taxation	-8,378	-10,866	-20,540	-35,311
Net profit	67,008	83,678	93,347	112,290
HSBC net profit	63,574	82,981	93,347	112,290
Cash flow summary (INRm)				
Cash flow from operations	119,741	140,592	150,592	175,926
Capex	-138,467	-153,501	-111,126	-73,577
Cash flow from investment	-140,724	-158,249	-111,126	-73,577
Dividends	0	0	0	-47,250
Change in net debt	-744	-2,662	-58,780	-54,862
FCF equity	-21,012	-9,412	42,836	103,414
Balance sheet summary (INRm)				
Intangible fixed assets	40,247	40,128	39,422	38,787
Tangible fixed assets	313,407	332,771	443,994	464,927
Current assets	113,782	123,132	215,678	305,196
Cash & others	54,948	45,129	135,016	218,395
Total assets	472,643	554,109	758,096	868,604
Operating liabilities	149,982	183,102	196,295	213,677
Gross debt	97,063	84,582	115,689	144,206
Net debt	42,115	39,453	-19,327	-74,189
Shareholders funds	222,585	276,500	435,847	500,377
Invested capital	262,506	267,800	367,783	376,837

Ratio, growth and per share analysis

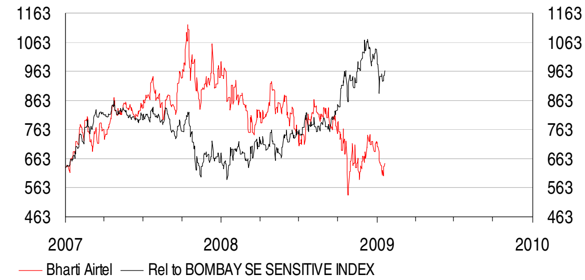
Year to	03/2008a	03/2009e	03/2010e	03/2011e
Y-o-y % change				
Revenue	45.9	37.0	20.7	18.1
EBITDA	52.6	32.2	12.4	20.6
Operating profit	55.1	40.9	13.0	23.6
PBT	56.6	27.1	20.6	29.0
HSBC EPS	61.1	30.5	12.5	20.3
Ratios (%)				
Revenue/IC (x)	1.2	1.4	1.4	1.4
ROIC	29.6	33.9	31.6	32.9
ROE	35.5	33.3	26.2	24.0
ROA	18.6	19.8	15.8	15.1
EBITDA margin	42.1	40.6	37.8	38.6
Operating profit margin	28.3	29.1	27.2	28.5
EBITDA/net interest (x)	33.9	15.2	37.3	131.0
Net debt/equity	18.7	13.8	-4.3	-14.5
Net debt/EBITDA (x)	0.4	0.3	-0.1	-0.4
CF from operations/net debt	284.3	356.4		
Per share data (INR)				
EPS reported (fully diluted)	35.35	44.14	49.25	59.24
HSBC EPS (fully diluted)	33.54	43.78	49.25	59.24
DPS	0.00	0.00	0.00	14.40
Book value	117.43	145.87	229.93	263.98

Valuation data

Year to	03/2008a	03/2009e	03/2010e	03/2011e
EV/sales	4.7	3.4	2.7	2.2
EV/EBITDA	11.1	8.4	7.1	5.6
EV/IC	4.8	4.7	3.3	3.1
PE*	19.3	14.8	13.1	10.9
P/Book value	5.5	4.4	2.8	2.5
FCF yield (%)	-1.7	-0.8	3.5	8.4
Dividend yield (%)	0.0	0.0	0.0	2.2

Note: * = Based on HSBC EPS (fully diluted)

Price relative



Source: HSBC

Note: price at close of 19 Jan 2009

HSBC

Contents

HSBC

Damage limitation

- Bharti's cheap lifetime plans will undercut RCOM's short-term efforts to attract subscribers
- We find Bharti's EPS falls 1.5% for every 1% decline in usage
- Cutting our FY10e traffic growth estimate by 9.4%

Bharti takes a long-term view

Reliance Communication's (RCOM IN, Neutral (V), INR185, target INR202) launch of its GSM service in December has triggered a price war among leading operators. Bharti, for example, responded by reducing new lifetime connections to INR99 with a minimum recharge option of INR200 in six months. This is a sound long-term strategy as we believe RCOM's splashy entrance has a short-term feel about it that may in time burn out.

In our 12 January report on RCOM ("Retain N(V), cut TP 14% to INR202: At least a year from being a contender"), we suggested RCOM was giving away capacity in a bid to qualify for more spectrum, which, in turn, would put it in a position to tap into higher ARPU subscribers.

However, we think there is a contradiction between RCOM's long- and short-term strategies. For example, should RCOM succeed in attracting high ARPU subscribers once it has additional spectrum it will have to reposition its cut-price packages.

At the same time, we note that RCOM's launch deals are valid for only six months which, in our view, will not create subscriber "stickiness". We note that there may be capacity problems if it extends its "free minutes" offers.

Bharti is trying to exploit the disconnect between RCOM's long- and short-term strategy by increasing stickiness among subscribers through low value lifetime packages. This will not only help Bharti withstand the challenge from RCOM but also allow it to match cut-price offers from Idea Cellular in markets like Bihar and Orissa.

It is worth highlighting that in just three years lifetime plans have come down from INR999 to as low as INR27. We would not be surprised to see zero value lifetime plans in the market soon.

Marginal/rural segment driving growth

The marginal subscriber segment has been driving growth for Bharti since the introduction of lifetime plans. Bharti has combined low-priced entry plans with penetration of semi-urban and rural markets to grab more market share and a higher portion of subscriber net additions.

The cost to RCOM

In the short term, RCOM's launch offers are likely to attract subscribers from major operators like Bharti despite the retaliatory introduction of cut-price lifetime plans. But sooner or later, we believe RCOM will have to shift to profitable plans.

We estimate the free minutes RCOM is offering will total c8bn over the next 4-5 months. As a result, we think RCOM will discontinue these packages once it attracts enough subscribers to qualify for additional spectrum in each operating area, or circle.

Impact on Bharti

To be conservative and given Bharti's strong presence in the marginal/rural segment, we are assuming that c45% of the free minutes on offer from RCOM will come from Bharti customers.

We are also worried about the impact the general economic slowdown in India will have on telecom traffic, especially usage the business and corporate segment. We have cut our MOU per subscriber by 4% for FY10e from our earlier estimate of yearly growth of 5%. The combination of excess capacity and a price war will hurt revenue and result in more free minutes.

Our base case

We are using the total minutes estimated in Q3 FY09e as the starting point for our calculations. We are more focused on the growth in total minutes than per sub as we believe the phenomenon of double SIMs will distort subscriber metrics going forward.

We use three components:

- Traffic from existing subscriber base
- Traffic from new subscriber additions
- Traffic growth on the back of the lag phenomenon.

We have assumed that traffic from existing subscriber base grows at an average rate of 6% on a quarterly basis, against our current average of 12%. This is an attempt to factor in lower elasticity in usage and the slowing economy.

After 87% growth in wireless traffic in FY08 and an estimated 70% in FY09e, we are modelling for 32% in FY10e. We believe our assumptions are cautious and reflect the increase in competition and the economy in general.

We highlight possibilities of positive surprises in usage growth in Q1 FY10 on the back of national elections. Some economic recovery in H2 FY09e is an upside risk to our estimates.

Computation of the potential cost of free minutes to RCOM over next 4-5 months

Market category	Metros	Circle A	Circle B
Number of markets	3	5	6
Subscribers for additional spectrum (m)	0.5	0.8	0.8
Total number of subscribers required (m)	1.5	4.0	4.8
Additional margin of safety	15%	15%	15%
Adjusted subscriber base RCOM likely to achieve in m	1.7	4.6	5.5
Free talk time for 90 days (minutes)	900	450	450
Total free minutes offered per market (m)	1,553	2,070	2,484
Additional impact assumed on back of free night calling (bn)			2.0
Total free non revenue generating minutes (bn)			8.1

Source: HSBC forecasts

HSBC

Forecasts for Bharti MOU per sub for FY10e

Period	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10
Minutes in m (a)	128,715	128,715	128,715	128,715	128,715	128,715
Bharti burden of free minutes (m)		-3,600	-1,800	-1,800	-1,800	-1,800
New subs per quarter ('000)		7,850	6,796	6,796	6,796	6,796
MOU per new sub		300	300	300	300	300
Incremental minutes from new additions in m (b)		7065	6117	6117	6117	6117
Growth on existing minutes		5%	7%	0%	6%	6%
Minutes from existing base adjusted for growth in m (c)		135,151	144,611	144,611	153,288	162,485
Minutes on back of lag impact in m (d)			4,338	4,338	4,599	4,875
Adjusted minutes (m) (a+b+c+d)		138,615	153,266	153,266	162,203	171,676
Incremental minutes (m)			14,651	0	8,937	9,473
Total minutes (m)						640,411
Average subs in "000						107,056
MOU per sub						498

Source: HSBC forecasts

EPS sensitivity

Earnings from Bharti's core business are highly sensitive to usage. For every 1% drop in usage, we find EPS declines 1.5% and EBITDA 0.9%. Our worst-case analysis suggests that a 6% decline in usage and 7% decline in revenue per minute will lead to EPS of INR44.

Competitive intensity changing the rules

Increasing competition is likely to make subscriber-based metrics irrelevant, particularly as we are expecting the phenomenon of double SIMs to increase. Given this, data points such as subscriber market share, share of subscriber net additions, ARPU and MOU per sub will start losing relevance. We suggest investors instead focus on revenue market share and traffic growth.

We believe growing double SIM usage will result in a spurt of non-active subscriber accounts immediately after free offers are withdrawn. In our view, it is better to focus on revenue generating subscribers.

Impact on Bharti

Subscriber market share

As RCOM has only rolled out its GSM service in 11,000 towns, the subscriber share of net additions may not be significant. We also note that RCOM is not offering free minutes in the eight markets where it already operates GSM. About 25% of Bharti's subscriber base comes from these markets and account for c20% of the company's total revenue.

Headline rates

Most GSM operators are unwilling to drop their headline rates. This follows the poor elasticity seen when charges for long distance plans were cut, making it difficult to increase them going forward.

Sensitivity to MOU and RPM on FY10e EPS (Base is RPM decline of 5% and MOU decline of 4%)

		RPM				
		-3%	-4%	-5%	-6%	-7%
MOU	-2%	50	49	48	48	47
	-3%	49	48	48	47	46
	-4%	48	48	47	46	46
	-5%	48	47	46	46	45
	-6%	47	46	46	45	44

Source: HSBC analysis

Comparison of the recent tariff plans by Indian telcos

Particulars	Bharti 2 year validity pack	Bharti lifetime plans	RCOM – customer experience plan	Idea Cellular- low value lifetime
Value of SIM card (INR)	60	99	25	25 (Mumbai only)
Validity	2 years	lifetime	6 months	lifetime
Free night talk time	no	no	yes for 6 months 11pm -6am	yes for 2 months 11pm-6am
Call rates				(only for 6 months)
Local (INR)	1.0	1.0	1.0	0.6
STD (INR)	1.5	1.5	1.5	1.0
Free talk time on net	100	10	INR10 per day for 90 days	INR5
Min recharge condition		INR200 in every 180 days		INR 200 in every 180 days

Source: HSBC estimates, Company data

Subscriber churn

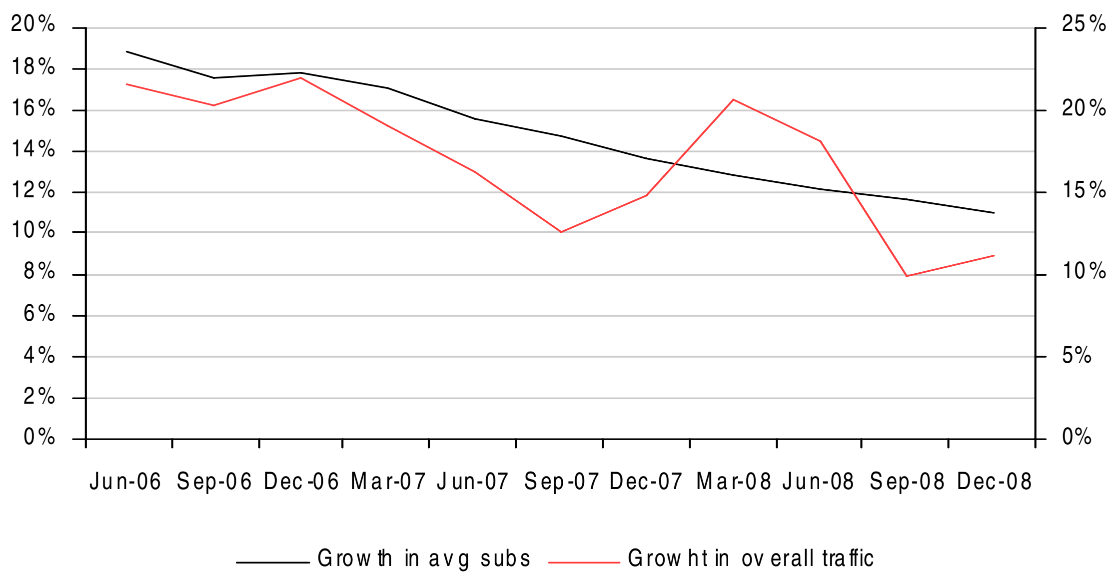
Churn (currently 4%) should rise as competition intensifies but the aggressive sale of lifetime plans by Bharti could act as a brake.

Worries for the regulator

We think RCOM's GSM launch will be a matter of concern for the telecom regulator. The release of additional spectrum is linked to subscriber numbers and the acceleration of the double SIM phenomenon will increase double-counting of subscribers, as will the lifetime plans being marketed by Bharti.

The regulator may revisit the framework for providing additional spectrum. This could have an impact on RCOM's ability to procure additional spectrum, which, in turn, might force RCOM to revisit its GSM strategy.

Bharti - Quarterly growth in subscribers and wireless traffic



Source: HSBC, Company data

Looking further ahead

- Longer-term structural limitations of RCOM's GSM operations in 1,800 MHz (new markets) and dual networks favour Bharti
- We do not believe RCOM's launch strategy is sustainable; is likely to be short-lived
- Auction of 3G spectrum will aid Bharti and help take the heat out of the price war

To understand the medium- to long-term impact of RCOM's entry into GSM on Bharti, it is important to look at what strategies RCOM may use in the future rather than focus only on its current free minutes plan.

Higher cost structure will prevent tariff cuts

India's wireless space is largely voice-centric, so it is difficult for operators to differentiate their services, highlighting the importance of scale and stable cost structures.

Cutting prices is one obvious approach in a competitive market but this has to be a function of a lower cost structure and stronger balance sheet. In our view, RCOM is at a disadvantage on the cost structure side as it operates in 1,800 MHz in all the 14 markets where it has launched GSM, rather than the 900 MHz.

The 900 MHz band requires fewer towers and hence has a lower cost structure. Our analysis

Advantage 900 MHz band

Spectrum - 900 MHz	Subscriber mkt. share Oct-07	Subscriber mkt. share Oct-08	Revenue mkt. share Sep-07	Revenue mkt. share Sep-08
A CIRCLE				
Andhra Pradesh	57%	57%	61%	66%
Gujarat	64%	62%	69%	65%
Karnataka	62%	61%	67%	70%
Maharashtra	50%	52%	53%	56%
Tamil Nadu	59%	60%	45%	45%
B CIRCLE				
Haryana	58%	56%	57%	64%
Kerala	62%	63%	64%	69%
Madhya Pradesh	71%	70%	66%	64%
Punjab	66%	63%	48%	53%
Rajasthan	68%	68%	74%	78%
Uttar Pradesh (East)	71%	70%	80%	76%
Uttar Pradesh (West)	49%	48%	57%	57%
West Bengal	55%	56%	62%	57%
Average pan India - A&B Circle	**61%**	**60%**	**62%**	**63%**

Source: HSBC, TRAI

suggests the margin differential between 900MHz and 1,800MHz could be as high as 15%. Note that Bharti/Vodafone and Idea Cellular operate on 900 MHz band in most of the 14 markets where RCOM has launched GSM

Over time, Bharti's size and relatively strong balance sheet has consistently allowed it to offer lower prices than its competitors.

Taking CDMA operations in consideration

RCOM's CDMA operations also have a big impact on the company's cost structure. Running two networks means higher network operating costs. For example, our global telco team suggests that a large European operator might experience a 3ppt fall in margin as a result of running a 3G network covering 80% of the population over its 2G coverage.

Network congestion

Poor network quality due to lack of spectrum is a problem for GSM incumbents.

We believe RCOM's 1,800MHz based service may offer better network quality in the short term because relatively few customers are using it. However, this advantage may not prove to be sustainable as the network becomes more crowded and pressure on RCOM's stretched tower system increases.

RCOM is hoping that its network quality will attract high ARPU subscribers. However, we believe the absence of MNP will make many subscribers reluctant to switch operators.

Another challenge for RCOM is that its stretched balance sheet has forced it to scale back its tower deployment plans.

Offer more for less

RCOM might also leverage its dual networks (CDMA and GSM) to offer customers a bundled service. While CDMA allows RCOM to bundle data products and offer high-end services, we remain sceptical about RCOM's inability to meet the basic network coverage requirements. We estimate that RCOM must put up at least 60,000 base stations to match GSM rivals on coverage (not capacity).

Flat rate plans likely

RCOM may also modify its existing schemes to leverage its empty networks. We believe RCOM may introduce flat rate plans (with free minutes) without dropping the present tariffs. Bharti's loaded networks would struggle to compete on this front. However, RCOM may also soon face capacity constraints and its inadequate tower deployment may further limit its options.

Bharti's advantage

Balance sheet strength

The poor capital market conditions and global liquidity crunch favour companies with strong balance sheets. Bharti is better placed on this front than RCOM, Idea Cellular, Tata – it has net debt to EBITDA of 0.4x and debt to equity of 0.1x. Bharti also does not have the burden of rolling out in new markets or running dual networks.

We believe 3G spectrum auctions are a positive for Bharti as they will expose balance sheet weakness of other operators and check their 2G expansion plans.

RCOM – Tower deployment plans

	FY08		FY09		FY10	
Towers	Actual	Planned	Revised plan	Earlier plans	Revised plan	Earlier plans
	30,295	36,849	48,000	61,849	About 8,000 by mid of next fiscal year	70,445

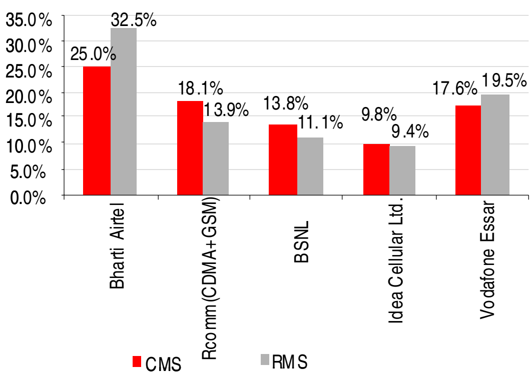
Source: HSBC, Company data, Red herring prospectus of Reliance Infratel

Revenue market share

In the current price war, we think investors should focus on revenue market share than subscriber market share.

This highlights the strength of Bharti, which has 25% subscriber market share and commands 32.5% of revenue market share.

India subscriber market share and revenue market share



Source: TRAI , COAI , AUSPI, HSBC

3G and overseas expansion

Bharti's move to acquire MTN early last year highlighted its desire to expand internationally. Domestic and regional investors have different views on Bharti's expansion strategy. Domestic investors have confidence in Bharti's management and believe international expansion will not hurt minority shareholder interests. Regional investors, on the other hand, prefer to be invested in pure play operators and favour a dividend-based strategy.

We believe Bharti's shift towards international expansion is more because of the regulatory framework which discourages consolidation in India's wireless space. Our bull case for international expansion involves a scenario in which Bharti retains local management and maximises operational synergies and scale. Any lowering of the cost of capital and replicating its low-cost business model would favour Bharti and create value for minority shareholders.

However, in our view, Bharti should focus on growing its domestic business through 3G. With the financial crisis affecting liquidity, we believe Bharti is well placed to emerge a winner at the upcoming 3G spectrum auctions.

The Korea example

We highlight the example of Korean wireless to gain insight into different outcomes based on the introduction of asymmetric regulations. The Korean regulator introduced measures to promote competition in the industry, including:

- One-way MNP
- Differentiated interconnect charges
- Stricter regulation of market leader SKT

In our view, this is the most severe case of asymmetric regulation and it is unlikely to be copied in India. However, it is a useful reference point for the worst- and best-case scenarios for GSM incumbents and new entrants.

MNP is usually referred to as a key tool for asymmetric regulation. We do not fully agree and believe that while MNP can have a damaging impact on the dominant operator (as in Japan), it is unlikely to be anything more than an irritant to key operators in markets with a more balanced structure.

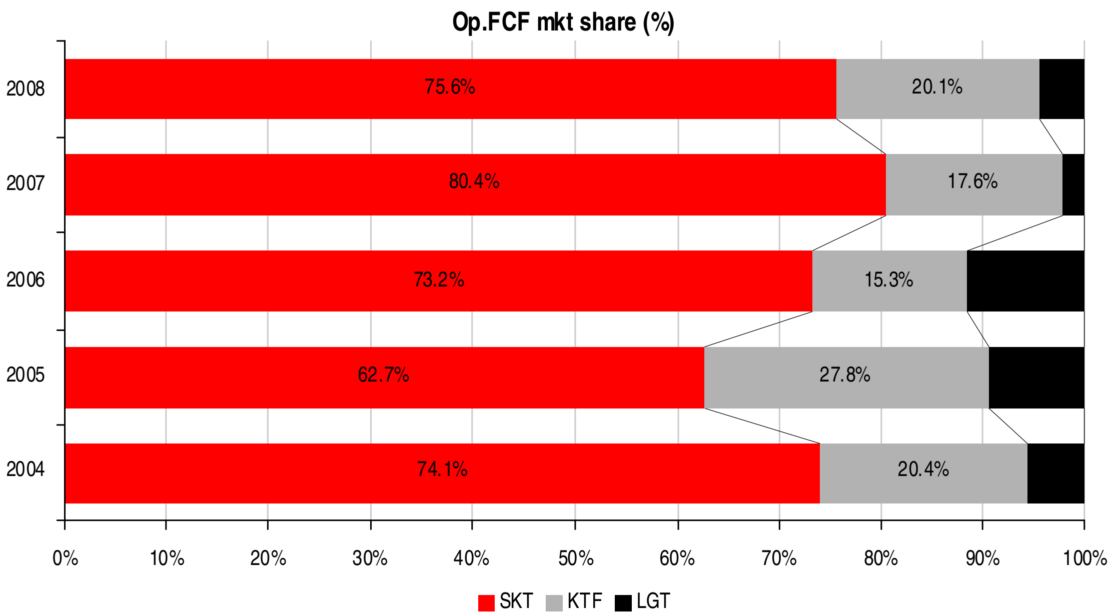
The case of MNP in Korea is somewhat different though. Korea implemented one-way MNP, with smaller operators given an exclusive time period to capture SKT's subscribers. SKT's margins fell 7.5% in 2004 due this one-sided flow of subscribers, largely due to a drop in revenue while fixed costs remained the same.

The Korean regulator still requires SKT to seek regulatory permission for new price plans and SKT still loses out on interconnection charges.

Since 2000, Korean interconnection charges (charges that one operator charges another operator for terminating calls on its network) have been controlled to help the smaller operators grow. SKT's margins contracted in 2002 after the regulator lowered the compensation which SKT received from the fixed line operators for termination of calls. Additionally, smaller players such as KTF and LGT continue to benefit from differential interconnect charges, while SKT loses on interconnection.

Despite all odds, there was no sustained and significant impact on SKT's cash flow market share. We believe the Korean example highlights the importance of scale and a strong balance sheet in the longer term.

Korean wireless FCF



Source: HSBC, Company data

Valuation and risks

- We retain our OW(V) on Bharti but cut target price by c7% to factor in rising competition and overcapacity in the sector
- We continue to value the core business using PE and the tower business using DCF
- Bharti trades at a PEG of 0.9x, a 27% discount to our sample of global telcos

Why we still like Bharti

We have cut our FY09e EPS estimate by 2% and FY10e estimate by 7% because of increasing competition. Despite this, we believe telecoms remains a defensive sector given the visibility of subscriber growth and the unlikelihood of a significant decline in usage levels and exposure to rural economy.

The current market favours companies with strong balance sheets, low leverage, large scale and high ROE. What's more, after the Satyam issue, companies with records of strong corporate governance command a premium.

Bharti ticks all these boxes and is our preferred play in Indian wireless. It is in a stronger financial position than its peers, which face subdued EBITDA numbers on the back of rollouts in new markets and/or technology migrations.

At the current share price, Bharti is trading at a 12-month forward EV/EBITDA of 7.4x, at the low end of its three-year historical range of 8-16x. The stock trades at a PEG of 0.9x, a 27% discount to our sample of EMEA and Latam telcos.

Valuation of core business

We are conservative in our FY10e subscriber estimate for Bharti as players like Idea, Vodafone and Reliance scale up their coverage and the economy slows down. We assume Bharti's monthly subscriber net additions in FY10 at 2.4m vs. the current average of 2.7m.

We base our core business fair value on 13.7x FY10e EPS of INR47.1. Our current multiple reflects a c15% premium to the FY10e Sensex PE of 11.9x. Our assumption of 15% premium is an attempt to capture trough valuation, despite the fact that Bharti has commanded a c40% premium to Sensex PE on a one-year forward basis.

We believe a 15% premium to Sensex is justified given Bharti's integrated business model, low execution risks, unleveraged balance sheet and higher revenue market share. We arrive at INR646 per share as the fair value for the core business based on our PE based approach.

Alternative methodology: DCF check of core business

While we value the stock using PE, we provide a DCF comparison for the core business of INR799 per share, implying c19% discount to our trough valuation.

We use WACC of 12% which includes COE of 13.5%, a risk free rate of 7%, and a market risk premium of 6.5% and beta of 1. We are using a terminal growth assumption of 3%. Our exit EV/EBITDA multiple is 3.5x.

DCF for tower business

We continue to use DCF for the tower component and our fair value is INR141 per share. At our valuation, blended EV/tower for Bharti's tower business is estimated at USD99,934, a c36% discount to the recent transaction multiple of Quipo and Spice deal (EV/tower USD156,000).

The global liquidity crunch, sharp rise in the cost of capital, stretched balance sheets of some existing players, and spectrum allocation to new players are positive for the overall tower industry and we expect Bharti to benefit. In our view, tower sharing will gain momentum as telcos try to maximise ROE, given restricted access to capital markets.

We acknowledge that with most of the telecom operators demerging their tower assets, valuations for the tower business have corrected, very much visible from the difference in transaction multiples for the Bharti Infratel and Quipo Spice deal. The market has moved from market based transaction multiples to cash flow and revenue per tower. We believe that the Indus tower JV, on the back of visible tenancy from Bharti, Vodafone and Idea Cellular, is the best tower business model.

Target price and rating

Our fair value for the core business is INR646 per share on 13.7x FY10e earnings. We value the tower business on DCF, at INR141 per share. We lower our target price from INR843 to INR786, primarily on back of cut in FY10e EPS as we factor in rising competition and regulatory risks.

Under our research model, for stocks with a volatility indicator, the Neutral band is 10ppt above and below the hurdle rate for Indian stocks of 11%. Our 12-month target price of INR786 implies a potential return of c22%, thus we retain our Overweight (V) rating.

Target Price computation

Particulars	Methodology	Fair Value (INR)
Core Business	PER	645
Tower Business	DCF	141
	Target Price	786

Source: HSBC estimates

Risks

- Higher than estimated damage to earnings caused by Vodafone and Idea Cellular in C category circles is a downside risk.
- Early implementation of MNP will be negative for Bharti and favour competitors.
- We view entry of a Gulf-based operator as a long-term risk for India wireless incumbents. In addition to having deep pockets, they may have lower hurdle rate expectations. However, we remain sceptical about the viability of their business plans. We view likely creation of additional capacity by new entrants as a downside risk to our valuation, as it may lead to interim / irrational pricing wars.
- Bharti is an over-owned stock and given that capital market sentiment is poor and redemption pressure strong, we cannot rule out technical pressure on the stock.
- The economic slowdown and rural penetration may have a higher than estimated impact on valuation.
- Given the entry of new players, employee churn may increase.

- Cut in termination charge to INR0.2 from INR0.3 will lower FY10e EBITDA by 7%.

Spectrum charges ambiguity remains

We have no clarity on the proposed hike in spectrum charges proposed by the DoT. DoT has proposed 100bp across the board higher spectrum charge. For operators with spectrum beyond 8MHz the rise in spectrum charge is 200bp. However, we note that savings on licenses fees on back of DoT's new policy for service providers covering 95% of total development blocks may allow Bharti to offset to some extent the higher spectrum charges.

Catalysts

- We are not factoring in any external tenancy upside from new entrants on Indus/Infratel and view ramping up of external tenancy as an upside risk to our valuation.
- Early 3G auctions will allow Bharti to procure additional spectrum and mitigate spectrum constraints and allow it to take advantage of its strong balance sheet.
- Slowdown in competitive intensity would work in favour of Bharti.

Relative valuation

On a PEG basis, Bharti is trading at a 27% discount to the global average PEG of 1.2x. Our sample for the purpose of analysis includes a mix of Latam, Gulf and Asian telcos.

Bharti vs, global telcos on PEG

Companies	FY08e PE	PEG
Bharti Airtel	18.9	0.9
Bouygues	7.0	1.7
Cellcom Israel Ltd	9.1	0.8
China Mobile	15.1	1.4
Iliad	23.4	2.1
KDDI Corp	10.5	0.8
KT Freetel	25.2	0.4
LG Telecom	10.0	0.9
MTN	11.8	0.7
Oman Telecommunication	9.7	0.8
Qatar Telecom	4.2	0.3
SK Telecom	11.9	0.9
Vimpelcom	3.6	1.6
Vivo Participacoes	68.8	0.7
Vodafone Group	8.7	0.9
Wataniya Telecom	8.9	1.6
America Movil	8.6	2.5
Brasil Telecom	4.5	0.4
Deutsche Telekom	8.0	0.7
Etisalat	6.8	1.9
KPN	9.4	0.9
MTNL	26.1	1.4
NTT	16.3	1.6
Saudi Telecom Company	8.5	1.4
Singapore Telecom	10.8	2.0
Sistema Group	1.4	0.1
Swisscom	9.2	3.4
Telecom Egypt	10.0	0.4
Telefonica	11.6	0.6
Telefonica O2 CZ	14.3	2.0
Telekom Austria	8.7	1.7
Telenet	37.2	0.4
Telenor	5.7	0.7
Average PEG		1.2
Bharti's discount to PEG		**27%**

Source: HSBC

Bharti - HSBC vs. consensus estimates

Particulars(INRm)	FY09e	FY10e	FY11e
Sales			
HSBC	370,279	447,110	528,192
Mean	373,345	465,766	547,351
High	390,519	331,508	414,266
Low	355,031	178,074	313,359
Variance	-1%	-4%	-4%
EBITDA			
HSBC	150,289	168,900	203,744
Mean	151,583	186,367	219,617
High	157,582	197,803	231,877
Low	135,759	164,860	194,433
Variance	-1%	-9%	-7%
Net Income			
HSBC	83,678	93,347	112,290
Mean	84,302	104,763	121,795
High	90,991	115,586	135,194
Low	75,587	80,454	96,007
Variance	-1%	-11%	-8%

Source: HSBC estimates, IBES

Change in estimates (INRm)

	FY09e	FY10e	FY11e
Sales			
New	370,279	447,110	528,192
Old	373,509	485,134	578,328
Change	-1%	-8%	-9%
EBITDA			
New	150,289	168,900	203,744
Old	152,387	177,984	211,706
Change	-1%	-5%	-4%
Net Income			
New	83,678	93,347	112,290
Old	85,476	100,068	116,515
Change	-2%	-7%	-4%
EPS (INR)			
New	44.16	49.27	59.26
Old	45.11	52.81	61.49
Change	-2%	-7%	-4%

Source: HSBC estimates

Bharti – Consolidated income statement

Year end 31 Mar (INR m)	FY09e	FY10e	FY11e
Revenues	370,279	447,110	528,192
EBITDA	150,289	168,900	203,744
EBITDA margin	40.6%	37.8%	38.6%
Depreciation and amortization	-42,551	-47,184	-53,279
Other income	697	0	0
EBIT	107,170	121,857	152,882
Interest and FX income	8,085	3,608	6,654
Finance cost	-17,983	-8,140	-8,210
Pre-tax profits	97,272	117,325	151,327
Current tax expense	-10,866	-20,540	-35,311
Minorities	-2,728	-3,438	-3,726
Reported PAT	83,678	93,347	112,290
Adjusted net profit	83,678	93,347	112,290

Source: HSBC estimates

Bharti - Key growth rates

(%)	FY09e	FY10e	FY11e
Revenue	37%	21%	18%
EBITDA	32%	12%	21%
EBIT	34.2%	13.7%	25.5%
Net profits	24.9%	11.6%	20.3%
Diluted EPS	24.9%	11.6%	20.3%
2-year forward Revenue CAGR (%)	41%	29%	19%
2-year forward EBIT CAGR (%)	43%	24%	19%
2-year forward EPS CAGR (%)	40%	18%	16%

Source: HSBC estimates

Bharti – Consolidated balance sheet

Year end 31 Mar (INR m)	FY09e	FY10e	FY11e
Equity shareholders funds	276,500	435,847	500,377
Minority Interest	9,925	10,264	10,343
Debt	84,582	115,689	144,206
Total Capital	371,007	561,800	654,926
Assets			
Cash	45,129	135,016	218,395
Other current assets	78,003	80,662	86,801
Total current assets	123,132	215,678	305,196
Current liabilities & provisions	-183,102	-196,295	-213,677
Net working capital	-59,971	19,383	91,519
Tangible assets	332,771	443,994	464,927
Other assets	57,913	58,835	59,528
Investments	166	166	166
Intangible assets (entry fee)	40,128	39,422	38,787
Total Fixed assets	430,978	542,417	563,408
Total Assets	371,007	561,801	654,927

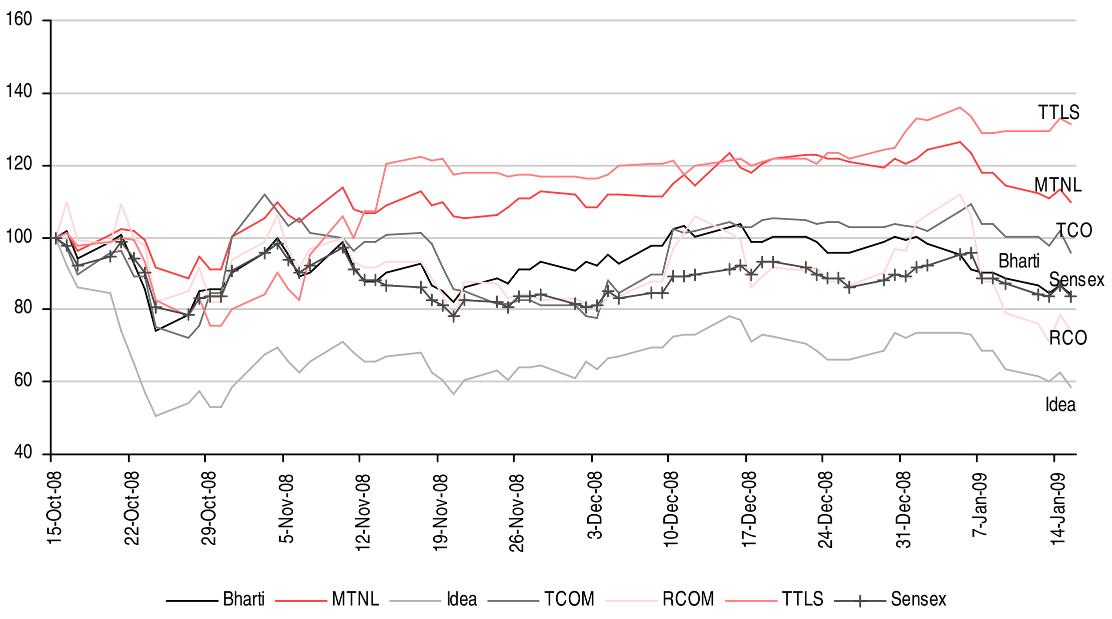
Source: HSBC estimates

Bharti – Consolidated cash flow statement

Year end 31 Mar (INR m)	FY09e	FY10e	FY11e
EBITDA	**150,289**	**168,900**	**203,744**
Change in Working capital	14,563	10,133	10,114
Assocaite Dividend received	-1,174	-290	1,960
Interest Paid	-9,897	-5,875	-1,813
Tax paid	-10,866	-20,540	-35,311
Other Cash flows	-2,323	-1,737	-2,768
CFO	**140,592**	**150,592**	**175,926**
Capex (incl. entry fee)	**-153,501**	**-111,126**	**-73,577**
(Purchase)/Sale of assets/investments	-4,748	0	0
Interest/dividend received			
CFI	**-158,249**	**-111,126**	**-73,577**
CFF	**11,486**	**6,979**	**28,280**

Source: HSBC estimates

Relative performance of Indian telcos



Source: DataStream

DCF and sensitivity to WACC for core business

WACC	Sum of PV (INR)	Terminal value (INR)	EV (INR)	Net Debt	Equity Value (INR)	outstanding shares ('M)	Value per share (INR)
6.00%	1,141,221	3,608,137	4,749,359	31,656	4,781,015	1,895	2,523
6.50%	1,108,895	2,936,670	4,045,565	31,656	4,077,221	1,895	2,152
7.00%	1,077,857	2,440,548	3,518,404	31,656	3,550,060	1,895	1,874
7.50%	1,048,043	2,060,930	3,108,973	31,656	3,140,629	1,895	1,658
8.00%	1,019,398	1,762,534	2,781,932	31,656	2,813,588	1,895	1,485
8.50%	991,865	1,522,927	2,514,792	31,656	2,546,448	1,895	1,344
9.00%	965,392	1,327,169	2,292,561	31,656	2,324,217	1,895	1,227
9.50%	939,931	1,164,931	2,104,862	31,656	2,136,518	1,895	1,128
9.90%	920,258	1,054,254	1,974,512	31,656	2,006,168	1,895	1,059
10.50%	891,857	913,529	1,805,386	31,656	1,837,042	1,895	970
11.00%	869,158	814,941	1,684,099	31,656	1,715,755	1,895	906
11.50%	847,298	730,006	1,577,303	31,656	1,608,959	1,895	849
12.00%	826,238	656,339	1,482,577	31,656	1,514,233	1,895	799
12.50%	805,944	592,062	1,398,006	31,656	1,429,662	1,895	755
13.00%	786,380	535,681	1,322,061	31,656	1,353,717	1,895	714
13.50%	767,516	485,987	1,253,504	31,656	1,285,160	1,895	678
14.00%	749,320	442,001	1,191,321	31,656	1,222,977	1,895	645
14.50%	731,764	402,912	1,134,676	31,656	1,166,332	1,895	616
15.00%	714,819	368,054	1,082,872	31,656	1,114,528	1,895	588
15.50%	698,459	336,866	1,035,325	31,656	1,066,981	1,895	563
16.00%	682,661	308,878	991,539	31,656	1,023,195	1,895	540

Source: HSBC estimates

Bharti – Comparison with global telcos

Companies	One year earnings growth	ROE 2009e	FY10e PE	Net Debt/EBITDA 2009e
Bharti Airtel	11%	33%	11.0x	0.4x
Cellcom Israel Ltd	11%	32%	7.3x	1.3x
Iliad	12%	11%	18.9x	1.7x
KDDI Corp	5%	12%	8.2x	0.6x
MTN	14%	21%	8.5x	0.0x
Partner	11%	37%	8.0x	1.1x
Qatar Telecom	7%	12%	3.2x	1.9x
Vodafone Group	8%	7%	7.2x	1.8x
Bezeq	15%	20%	9.4x	1.0x
Comstar United Telesystem	18%	10%	5.3x	-0.0x
Deutsche Telekom	7%	7%	6.4x	1.8x
Elisa Corporation	7%	13%	9.9x	1.6x
Etisalat	7%	23%	6.4x	-0.4x
France Telecom	6%	11%	9.8x	1.5x
Hutchison Telecomm	10%	2%	-17.7x	-3.3x
Indosat	6%	9%	14.3x	1.3x
KPN	10%	14%	7.7x	2.1x
MTNL	10%	4%	18.6x	-7.2x
OTE (GRD750	10%	12%	7.9x	1.6x
PCCW	14%	12%	10.9x	2.3x
Singapore Telecom	6%	14%	9.8x	1.3x
Sistema Group	19%	15%	1.0x	1.0x
Tele2	17%	10%	9.1x	0.5x
Telecom Italia	8%	6%	9.1x	3.2x
Telefonica	11%	15%	8.3x	1.9x
Telekom Austria	9%	11%	7.9x	1.8x
Telenet	11%	7%	10.5x	3.6x
Telenor	7%	15%	4.9x	1.2x
TPSA	7%	13%	10.6x	0.5x

Source: HSBC estimates

HSBC

Relative valuation table – Indian telcos

Company	Ticker	CMP (INR)	Rating	TP (INR)	PE FY09e	PE FY10e	EV/EBITDA FY09e	EV/EBITDA FY10e
Bharti	BHARTI.IN	647	OW(V)	786	14.6	13.1	8.7	7.4
RCOM	RCOM.IN	185	N(V)	202	6.6	7.6	6.1	5.7
Idea Cellular	IDEA .IN	44	N(V)	44	15.1	12.4	7.4	8.8
MTNL	MTNL.IN	73	N(V)	77	11.1	11.5	-0.3	-0.3
Tata Teleservcies	TTLS IN	22	UW(V)	12	-21.9	-12.1	12.5	12.4

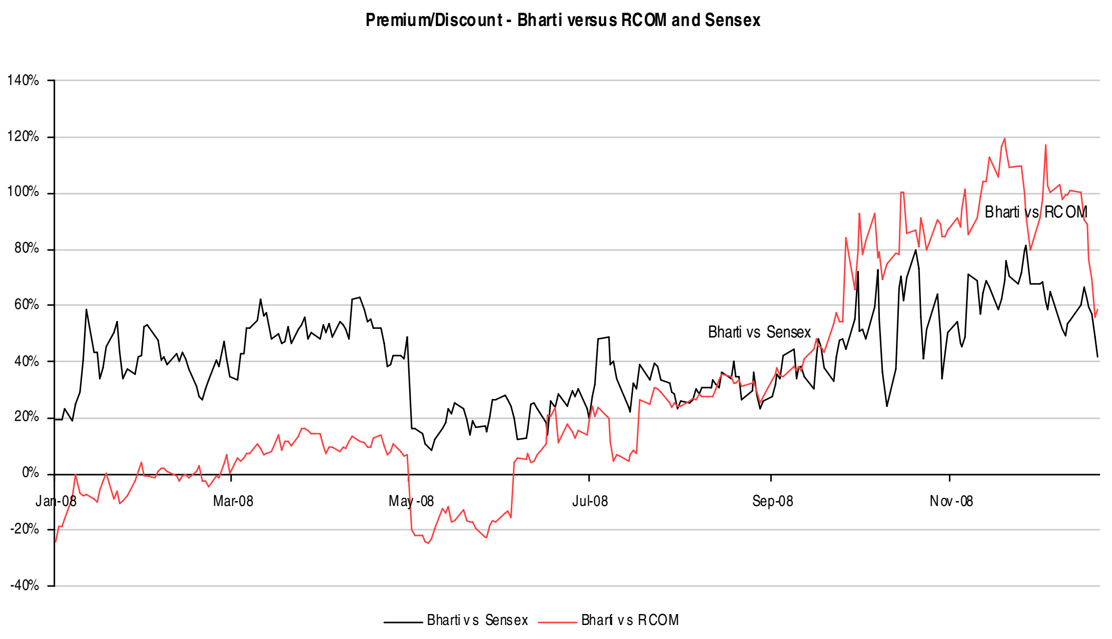
Source: HSBC estimates

Bharti Q3 expectations

(INR m)	Q3FY09e	Q2a-FY09	Q3a-FY08	QoQ growth	YoY growth
Overall					
Revenue	97,913	90,203	69,639	9%	41%
EBITDA	39,434	36,993	29,634	7%	33%
EBITDA Margin	40%	41%	43%	-1%	-5%
PAT	22,208	20,971	17,468	6%	27%
EPS (INR)	11.3	10.8	9.1	5%	24%

Source: HSBC estimates , Company data

Bharti's premium to Sensex and RCOM over last 12 months



Source: HSBC

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Disclosure appendix

Analyst certification

The following analyst(s), who is(are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and 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

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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. Details of these short-term investment opportunities can be found under the Reports section of this website.

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For each stock we set a required rate of return calculated from the risk free rate for that stock's domestic, or as appropriate, regional market and the relevant equity risk premium 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.

Prior to this, from 7 June 2005 HSBC applied a ratings structure which ranked the stocks according to their notional target price vs current market price and then categorised (approximately) the top 40% as Overweight, the next 40% as Neutral and the last 20% as Underweight. The performance horizon is 2 years. The notional target price was defined as the mid-point of the analysts' valuation for a stock.

From 15 November 2004 to 7 June 2005, HSBC carried no ratings and concentrated on long-term thematic reports which identified themes and trends in industries, but did not make a conclusion as to the investment action that potential investors should take.

Prior to 15 November 2004, HSBC's ratings system was based upon a two-stage recommendation structure: a combination of the analysts' view on the stock relative to its sector and the sector call relative to the market, together giving a view on the stock relative to the market. The sector call was the responsibility of the strategy team, set in co-operation with the analysts. For other companies, HSBC showed a recommendation relative to the market. The performance horizon was 6-12 months. The target price was the level the stock should have traded at if the market accepted the analysts' view of the stock.

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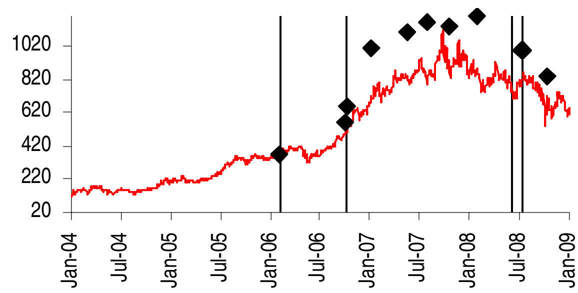
As of 21 January 2009, the distribution of all ratings published is as follows:

Overweight (Buy)	43%	(30% of these provided with Investment Banking Services)
Neutral (Hold)	36%	(34% of these provided with Investment Banking Services)
Underweight (Sell)	21%	(21% 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
N/A	Neutral	24 February 2006
Neutral	Overweight	23 October 2006
Overweight	Overweight	20 June 2008
Overweight	Overweight (V)	30 July 2008
Target Price	**Value**	**Date**
Price 1	376.00	24 February 2006
Price 2	560.00	23 October 2006
Price 3	660.00	02 November 2006
Price 4	1011.00	24 January 2007
Price 5	1110.00	04 June 2007
Price 6	1170.00	21 August 2007
Price 7	1140.00	07 November 2007
Price 8	1206.00	17 February 2008
Price 9	1003.00	30 July 2008
Price 10	1002.00	04 August 2008
Price 11	843.00	03 November 2008

Source: HSBC

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HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
BHARTI AIRTEL	BRTI.NS	616.35	20-Jan-2009	6, 7

Source: HSBC

1 HSBC* has managed or co-managed a public offering of securities for this company within the past 12 months.
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2 All market data included in this report are dated as at close 19 January 2009, unless otherwise indicated in the report.
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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

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Global Telecoms, Media & Technology Research Team

Global
Stephen Howard
Analyst, Global Sector Head
+44 20 7991 6820 stephen.howard@hsbcib.com

Europe
Dominik Klarmann
Analyst
+49 211 910 3720 dominik.klarmann@hsbc.de

Nicolas Cote-Colisson
Analyst
+44 20 7991 6826 nicolas.cote-colisson@hsbcib.com

Luigi Minerva
Analyst
+44 20 7991 6928 luigi.minerva@hsbcib.com

Thorsten Zimmermann
Analyst
+49 211 910 2852 thorsten.zimmermann@ hsbctrinkaus.de

Amit Sachdeva
Analyst
+91 80 3001 3795 amit1sachdeva@hsbc.co.in

Dhiraj Saraf, CFA
Analyst
+91 80 3001 3773 dhirajsaraf@hsbc.co.in

Manish Beria, CFA
Analyst
+91 80 3001 3796 manishberia@hsbc.co.in

Americas
Richard Dineen
Analyst
+1 212 525 6707 richard.dineen@us.hsbc.com

Europe & North America Credit Research
Madeleine King, CFA
Analyst
+44 20 7991 6789 madeleine.king@hsbcib.com

Specialist Sales

Timothy Maunder-Taylor
+44 20 7991 5006 tim.maunder-taylor@hsbcib.com

Annabelle O'Connor
+44 20 7991 5040 annabelle.oconnor@hsbcib.com

Thomas Koenen
+49 211 910 4402 thomas.koenen@trinkaus.de

Myles McMahon
+852 2822 4676 mylesmacmahon@hsbc.com.hk

Asia
Steven C Pelayo
Analyst
+852 2822 4391 stevenpelayo@hsbc.com.hk

Tse-yong Yao
Analyst
+852 2822 4397 tse-yongyao@hsbc.com.hk

Tucker Grinnan
Analyst
+852 2822 4686 tuckergrinnan@hsbc.com.hk

Walden Shing
Analyst
+852 2996 6751 waldenshing@hsbc.com.hk

Carlos Dimas
Analyst
+813 5203 3814 carlos.dimas@hsbc.co.jp

Neale Anderson
Analyst
+813 5203 3826 neale.anderson@hsbc.co.jp

Scott Foster
Analyst
+813 5203 3821 scott.foster@hsbc.co.jp

Henry Lee
Associate
+813 5203 4412 henry.lee@hsbc.co.jp

Percy Panthaki
Analyst
+91 22 2268 1240 percypanthaki@hsbc.co.in

Wanli Wang
Analyst
+8862 8725 6020 wanliwang@hsbc.com.tw

Christine Wang
Analyst
+8862 8725 6024 christineccwang@hsbc.com.tw

Rajiv Sharma
Analyst
+91 22 2268 1239 rajivsharma@hsbc.co.in

Leo Tsai
Associate
+8862 8725 6022 leocytsai@hsbc.com.tw

Suran Seong
Analyst
+822 3706 8753 suranseong@kr.hsbc.com

Global Emerging Markets (GEMs)
Hervé Drouet
Analyst
+44 20 7991 6827 herve.drouet@hsbcib.com

Emerging Europe, Middle East & Africa (EMEA)
Kunal Bajaj
Analyst
+971 4507 7200 kunalbajaj@hsbc.com

Vangelis Karanikas
Analyst
+30 210 696 5211 vangelis.karanikas@hsbc.com

Avshalom Shimei
Analyst
+972 3 710 1197 avshalomshimei@hsbc.com

Bülent Yurdagül
Analyst
+90 212 376 46 12 bulentyurdagul@hsbc.com.tr

Sergey Fedoseev
Analyst
+44 20 7991 6831 sergey.fedoseev@hsbcib.com