

India Wireless

Alert: Auction Expectedly Muted; Government Back to the Drawing Board?

■ Industry Overview

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- **Subdued bidding is a positive** – Muted bidding in spectrum auction was expected and is a positive as it not only helps reduce competitive intensity through capacity rationalization but could also result in lower hit from potential spectrum related outgo. Sector fundamentals continue to improve and stretched B/S should force everyone to start behaving rationally. Some signs were visible in 2Q – stable rev/min & reduced sub acquisition cost. We prefer Bharti in the sector after Idea's outperformance.
- **Auction details** – Pan-India spectrum price went up only marginally from the base price of Rs140bn. There was no bidding in Delhi, Mumbai, or Karnataka, that together accounted for 50% of the reserve price. Uninor won 6 of 9 circles, Idea won all its cancelled circles, and Videocon won in 6. Vodafone and Bharti topped up in 14 circles and 1 circle, respectively.
- **Uninor didn't win all its interested circles** – Uninor had already disclosed its interest in 9 of 13 circles where it has commercial operations. The company has won 6 of these, which account for 70% of its revenues. It has a 3-7% revenue share in them. Videocon's winning circles account for ~50% of its topline. The company is a marginal player in these markets with a 0-2% revenue share.
- **TPs include impact from spectrum outgo** – The winning spectrum price of the current auction is important as GSM incumbents will need to pay for the spectrum they hold (1800/900MHz) during license renewals benchmarked off the discovered price. Our TPs include the impact – Rs70/sh and Rs52/sh for Bharti and Idea, respectively (based on reserve price). In addition, excess spectrum will also be benchmarked off this price (5-8% additional impact on Bharti/Idea).
- **Government to revisit the maths?** – Given lackluster demand & no bidding in key circles, the Government is likely to revisit these prices, which would be mean that the actual impact could be lower than what is currently included in the TPs.

Figure 1. Statistical Abstract

Company name	RIC Code	Rating	Mk Cap US\$M	Price (Rs)		P/E (x)		EV/EBITDA (x)	
				12-Nov-12	FY13E	FY14E	FY13E	FY14E	
Bharti	BRTI.BO	1	19,462	280	27.7	18.6	6.7	5.8	
RCOM	RLCM.BO	1H	2,234	59	13.0	7.9	7.3	6.3	
Idea	IDEA.BO	1	5,598	92	34.1	20.7	7.3	6.0	

Source: Citi Research Estimates

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Figure 2. Spectrum Auction – Reserve Price vs. The Winning Bid

RsM	Reserve Price	Winning Price
Delhi	6,931	6,931
Mumbai	6,785	6,785
Kolkata	1,137	1,137
Maharashtra	2,628	2,628
Gujarat	2,248	2,248
AP	2,869	2,869
Karnataka	3,301	3,301
TN inc Chennai	3,061	3,061
Kerala	653	653
Punjab	673	673
Haryana	465	465
UP W	1,074	1,074
UP E	762	762
Rajasthan	671	671
MP	540	540
WB	259	258
HP	78	78
Bihar	425	464
Orissa	203	203
Assam	87	87
NE	88	88
J&K	63	63
Pan-India per block	35,000	35,039
Pan-India for 5MHz	140,000	140,156

Source: DoT

Bharti Airtel

(BRTI.BO; Rs282.65; 1)

Valuation

Our target price of Rs325 comprises: (i) Core business value of Rs291/sh based on Sep-13E DCF; (ii) We estimate value accretion from Africa acquisition at Rs17/sh; (iii) We add the towerco value (100% Infratel + 42% of Indus) at Rs87/sh; and (iv) We reduce the potential cash outgo (Rs70/sh). The DCF is based on a WACC of 11.2%, a terminal growth rate of 3% and beta of 0.7. We prefer DCF as peak capex burden is behind us and the company should start to generate significant free cash flows. The core domestic business (ex-towerco) imputes Sep-13E EV/EBITDA of 6.1x, P/CEPS of 7.5x, and P/E of 17.9x.

Risks

The key risks to our investment thesis and target price on Bharti are: 1) Higher-than-expected spectrum payments in case the bidding goes beyond the reserve price; 2) Sustained high competition; and 3) Slower turnaround at acquisition.

IDEA Cellular

(IDEA.BO; Rs92.15; 1)

Valuation

Our target price of Rs91 is based on: (i) core business value at Rs120/sh based on Sep-13E DCF; plus (ii) the Indus Towers stake valued at Rs23/sh (Sep-13E DCF); minus (iii) Rs52/sh for the regulatory outgo. The DCF is based on a WACC of 11.0%, a terminal growth rate of 3% and beta of 1. We prefer DCF as peak capex burden is behind us and the company should now start to generate free cash flows. The DCF (incl. spectrum payments) imputes Mar-13E EV/EBITDA of 6.5x, P/CEPS of 5.4x and P/E of 28.3x

Risks

While high leverage is a concern for Idea, it is however mitigated by the track record of superior execution that management has established. Management has done an admirable job in navigating through the rough patch in the telecom sector in the past couple of years, in our view, evident in the revenue share gains the company has made. As a result, we believe any risks arising from having a stretched B/S have reduced. Downside risks that could impede the stock from reaching our target price include: 1) higher-than-expected spectrum payments in case the bidding goes beyond the reserve price and; 2) sustained high competition.

Reliance Communications

(RLCM.BO; Rs60.50; 1H)

Valuation

Our target price of Rs72 comprises (i) core business value of Rs52/sh, based on 5.5x Mar-14E EV/EBITDA; at a discount to Bharti's implied target multiple; plus (ii) towerco value accretion of Rs20/sh based on long-term external tenancy of 0.35x. We believe a discount to Bharti on the core business valuation is justified on account of the inherent risks of dual network and higher leverage. Our towerco net value accretion of Rs20/sh is based on the following assumptions: 1) Long-term tenancy of 2.00x with captive tenancy of 1.65x; 2) Capex recovery of 12%; 3) WACC of 11.3% and terminal growth rate of 3%. Note that the incremental value accretion to RCOM is calculated after netting off the contribution from the captive tenancy. Thus, it only reflects the value of the external revenues.

Risks

We assign a High Risk rating to RCOM given that the stock is deemed to be relatively volatile by our quantitative risk-rating model (based on stock price movements in the past year). Lower than expected hit from the spectrum payments and newsflow around corporate action (stake sale/business tie-up) remain the key upside risks to our target price and investment thesis on RCOM. Key downside risks that could prevent the stock from reaching our target price include: 1) Further deterioration in the core business; 2) Business disruption/balance sheet hit by higher-than-expected spectrum payments; and 3) Inability to deleverage through asset sale or tie-up for asset lease.

Appendix A-1

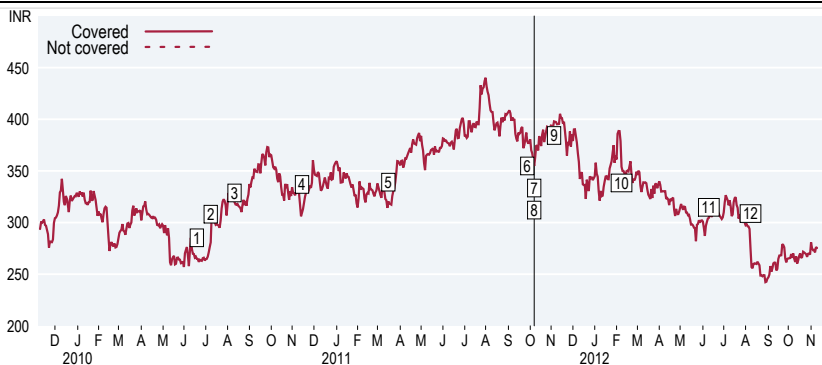
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Bharti Airtel (BRTI.BO) Ratings and Target Price History Fundamental Research

Analyst: Gaurav Malhotra, CFA
Covered since June 18 2010



	Date	Rating	Target Price	Closing Price
1	18-Jun-10	2L	*303.00	264.85
2	8-Jul-10	2L	*300.00	280.85
3	11-Aug-10	2L	*350.00	319.70
4	15-Nov-10	*1L	*400.00	309.50

	Date	Rating	Target Price	Closing Price
5	16-Mar-11	1L	*415.00	320.45
6	28-Sep-11	1L	*453.00	378.75
7	7-Oct-11	Stock rating system changed		
8	7-Oct-11	*1	453.00	354.80

	Date	Rating	Target Price	Closing Price
9	4-Nov-11	1	*452.00	397.95
10	8-Feb-12	1	*425.00	354.00
11	11-Jun-12	1	*420.00	304.55
12	8-Aug-12	1	*325.00	274.40

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Bharti Airtel (BRTI.BO) Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Gaurav Malhotra, CFA
Covered since June 18 2010



	Date	Rating	Target Price	Closing Price
1	11-May-11	*ADD MP	-	366.35

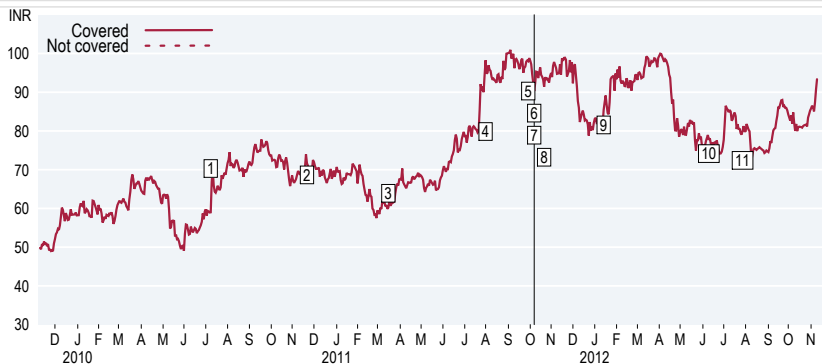
	Date	Rating	Target Price	Closing Price
2	13-Sep-12	*REM MP	-	253.65

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

IDEA Cellular (IDEA.BO) Ratings and Target Price History Fundamental Research

Analyst: Gaurav Malhotra, CFA
Covered since June 18 2010



	Date	Rating	Target Price	Closing Price
1	8-Jul-10	3M	*50.00	59.00
2	22-Nov-10	3M	*72.00	71.65
3	16-Mar-11	*1M	*79.00	60.20
4	31-Jul-11	*1L	*105.00	94.35

	Date	Rating	Target Price	Closing Price
5	29-Sep-11	1L	*120.00	98.00
6	7-Oct-11	Stock rating system changed		
7	7-Oct-11	*1	120.00	90.30
8	21-Oct-11	1	*118.00	91.40

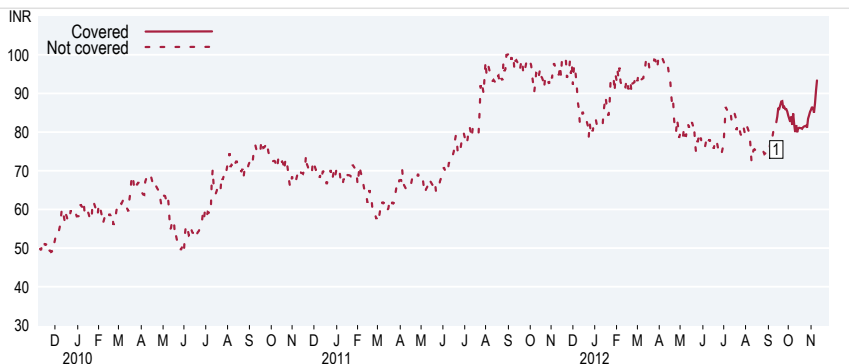
	Date	Rating	Target Price	Closing Price
9	13-Jan-12	1	*111.00	85.45
10	11-Jun-12	1	*107.00	77.70
11	27-Jul-12	1	*91.00	80.00

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

IDEA Cellular (IDEA.BO)
Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Gaurav Malhotra, CFA
Covered since June 18 2010



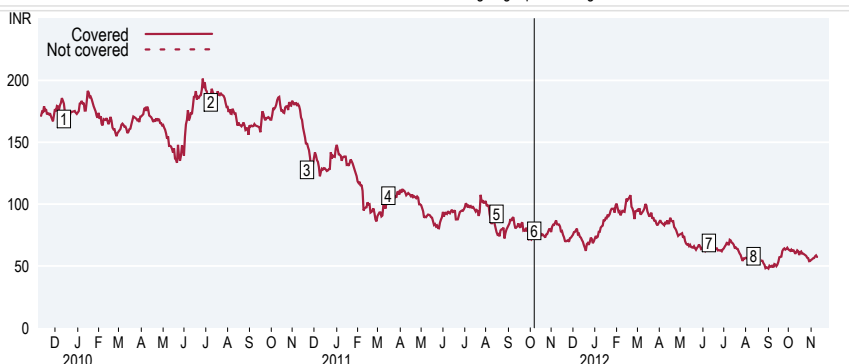
	Date	Rating	Target Price	Closing Price
1	13-Sep-12	*ADD MP	-	82.55

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Reliance Communications (RLCM.BO)
Ratings and Target Price History
Fundamental Research

Analyst: Gaurav Malhotra, CFA
Covered since June 18 2010



	Date	Rating	Target Price	Closing Price
1	12-Dec-09	3M	*160.00	183.65
2	8-Jul-10	3M	*165.00	187.95
3	22-Nov-10	3M	*155.00	149.30

* Indicates change

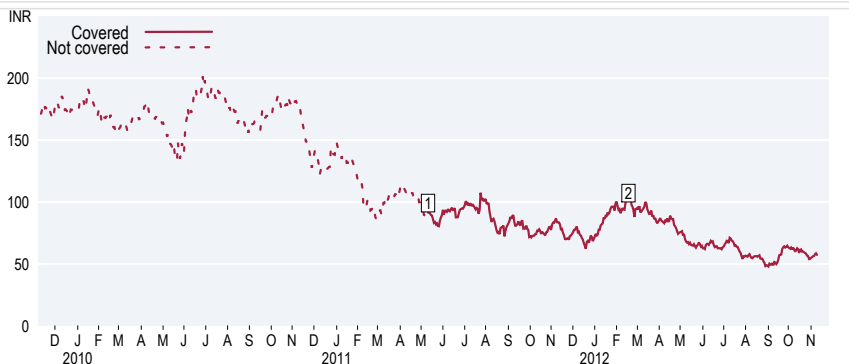
	Date	Rating	Target Price	Closing Price
4	16-Mar-11	*1H	*127.00	102.95
5	16-Aug-11	1H	*117.00	77.40
6	7-Oct-11	Stock rating system changed		

	Date	Rating	Target Price	Closing Price
7	11-Jun-12	1H	*85.00	65.40
8	13-Aug-12	1H	*70.00	55.70
9	10-Nov-12	1H	*72.00	57.25

Rating/target price changes above reflect Eastern Standard Time

Reliance Communications (RLCM.BO)
Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Gaurav Malhotra, CFA
Covered since June 18 2010



	Date	Rating	Target Price	Closing Price
1	11-May-11	*ADD LP	-	91.55

* Indicates change

	Date	Rating	Target Price	Closing Price
2	17-Feb-12	*REM LP	-	104.30

Rating/target price changes above reflect Eastern Standard Time

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