

Upgrading Bharti and Idea to Buy

Upgrading Bharti and Idea to Buy; bad news has peaked

We raise Bharti and Idea from Neutral to Buy on positive outcome of the 2G auction that closed on 14th November. Three factors should drive stock upside: 1) deep (20-40%) underperformance over last 12-months; 2) policy decisions in areas like spectrum pricing could be favorable hereon (unlikely to get worse at least) leading to potentially lower cash outflow from operators, and 3) strong FY14-15 earnings growth (+30-40%) should help to ease valuations. Current EV/EBITDA multiples (~6.5x) are not cheap at 15% premium to GEM wireless average but may revert to 25-30% premium as policy risks fade.

Policy direction likely to improve; lifting POs by 10-15%

We lift our PO to Rs340 for Bharti and to Rs105 for Idea factoring 10% discount to DCF vs 17-20% discount factored earlier. We think industry inputs to policy-makers are more likely to be considered favorably hereon. In the medium term, two policy changes look likely: (1) reserve prices for the four not-bid circles could be lowered - Bharti is mkt. leader in most of these circles; (2) benchmarking of future auctions (eg 900MHz) to the recent one will likely be careful; this may lower re-farming outgo, though higher 1,800MHz availability makes re-farming likely.

2G auction outcome - a positive surprise

The 2G (1800MHz) auction outcome surprised us on three fronts: (1) neither Delhi nor Mumbai circles had any takers despite Telenor's interest in Mumbai – among the metros, we expected only Delhi to fail; (2) of the 18 circles that saw bids, the winning price did not exceed the reserve price for 17 circles; and (3) fears of irrational behavior by new entrants (eg, Videocon) proved misplaced.

Rationality prevailed unlike aggressive 3G auctions in 2010

The government raised Rs94bn from the 2G spectrum auctions versus a target of Rs280bn if available spectrum had been sold at the reserve price. All bids in the auction, except Bihar, closed at the reserve price reflecting rational industry behavior. Delhi, Mumbai, Karnataka and Rajasthan circles did not see any bids; in three of these, the reserve price as a percentage of all-India was higher than the revenue contribution as a percentage of the industry. Interestingly, players like Telenor and Videocon were restrained. Telenor won only six circles vs its shortlist of nine for India operations. Similarly, Videocon mostly stuck to low-priced circles.

Earnings outlook unchanged; tariffs offer room for upside

Our earnings outlook for the industry, including Bharti and Idea, is unchanged after the 2G auctions. We have not built any tariff hikes into our forecasts, but the auction reaffirmed our recent view that competitive pressures are moderating. Large tariff hikes may be deferred in anticipation of policy softening but floor for tariffs could rise given that players like Telenor have won relatively expensive circles & industry seems unanimous about the need for better price economics.

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Reena Verma Bhasin, CFA >> +91 22 6632 8667

Research Analyst
DSP Merrill Lynch (India)
reena.verma@baml.com

Amit Rathi >>

+91 22 6632 8660

Research Analyst
DSP Merrill Lynch (India)
amit.rathi@baml.com

Table 1: Valuation summary

Bharti @ Rs290	FY13E	FY14E	FY15E
EPS (Rs/share)	7.7	10.6	14.9
EPS growth (%)	-31.0%	36.8%	41.2%
PE (x)	37.5x	27.4x	19.4x
EV/EBITDA (x)	6.9x	6.6x	5.7x

Idea @ Rs95	FY13E	FY14E	FY15E
EPS (Rs/share)	3.1	4.1	5.4
EPS growth (%)	20.9%	33.2%	32.0%
PE (x)	31.0x	23.3x	17.6x
EV/EBITDA (x)	7.5x	6.6x	5.7x

Source: BofA Merrill Lynch Global Research estimates

15 November 2012

Table 2: Summary of 1,800MHz auction outcome

	Reserve		Winning		Bharti		Vodafone		Idea		Telenor (Telewings)		Videocon		Industry total			
	Price/1.25MHz block	Rs mn	Price/1.25MHz block	Rs mn	Block/s	(Rs mn)	Block/s	(Rs mn)	Block/s	(Rs mn)	Block/s	(Rs mn)	Block/s	(Rs mn)	Block/s	(Rs mn)		
Metro Circle																		
Delhi		6,931																
Mumbai		6,785																
Kolkata		1,137		1,137						4	4,549				4	4,549		
Cat A circles																		
Maharashtra		2,628		2,628			1	2,628				4	10,512			5	13,141	
Gujarat		2,248		2,248								4	8,994	4	8,994	8	17,987	
AP		2,869		2,869								4	11,476			4	11,476	
Karnataka		3,301															-	
TN		3,061		3,061							4	12,244				4	12,244	
Cat B circles																		
Kerala		653		653			1	653								1	653	
Punjab		673		673			1	673								1	673	
Haryana		465		465			2	930					4	1,861	6	2,791		
UP(W)		1,074		1,074			2	2,148				4	4,296	4	4,296	10	10,741	
UP(E)		762		762			1	762				4	3,047	4	3,047	9	6,855	
Rajasthan		671															-	
MP		540		540			2	1,080						4	2,160	6	3,239	
WB		258		258			2	517	5	1,292					7	1,809		
Cat C circles																		
HP		78		78			1	78								1	78	
Bihar		425		464			2	929	1	464	4	1,857	4	1,857	11	5,107		
Orissa		203		203			2	405	4	811					6	1,216		
Assam		87		87	1	87	2	173	4	347					7	607		
NE		88		88			2	177	4	354					6	530		
J&K		63		63			2	127	4	253					6	380		
Total		35,000		17,352			1	87	23	11,279	30	20,313	24	40,183	24	22,214	102	94,076

Source: DoT, BofA Merrill Lynch Global Research estimates

Table 3: Valuation comparison of GEM wireless majors

Co Name	BofAML	Market Cap	Sh Price	P/E (x)		EPS CAGR	EV/EBITDA (x)		EBITDA CAGR	ROE (%)	P/B	Dividend Yield (%)		FCF Yield (%)	Net debt/EBITDA (x)		Capex/Rev
				CY12	CY13		CY12	CY13E				CY13	CY13		CY13E	CY13E	
Bharti	BHTIF	19551	283	33.7	29.2	-10.8%	7.1	6.6	7.4%	6.9	1.9	0.4	-2.1	2.5		22.0%	
Idea	IDEAF	5553	92	31.3	23.7	-23.8%	7.5	6.8	13.9%	9.1	2.0	0.7	5.2	1.7		14.3%	
RCom	RLCMF	2272	61	24.3	19.5	-0.5%	7.1	6.9	-2.2%	2.0	0.4	0.7	22.5	4.6		8.1%	
China Mobile	CHLKF	219396	86	10.9	11.7	-3.3%	4.4	4.5	-0.8%	15.6	1.8	3.7	7.0	-1.7		22.2%	
China Unicom	CHUFF	34296	11	30.5	17.2	72.6%	4.0	3.4	16.9%	5.8	1.0	2.9	4.0	1.1		23.6%	
China Telecom-H	CHJHF	42186	4	17.6	13.6	9.4%	4.3	3.1	12.6%	7.2	1.0	3.0	-8.2	1.1		24.2%	
Chunghwa Telecom	CHWAF	24601	92	18.3	16.8	-4.6%	8.1	7.8	-2.1%	11.6	1.9	5.4	6.1	-0.9		15.0%	
Taiwan Mobile	TWMBF	12132	104	19.7	16.3	16.4%	10.5	9.3	7.7%	33.3	5.2	5.5	6.3	0.2		9.4%	
Far EasTone	FEOTF	7843	70	22.1	16.0	26.9%	9.1	7.4	15.0%	19.2	3.0	6.3	7.0	-0.5		9.2%	
SingTel	SNGNF	40946	3	13.5	13.0	2.4%	8.1	7.8	1.0%	16.6	2.1	5.4	7.0	1.3		12.9%	
StarHub	SRHBF	5121	4	17.7	16.8	8.6%	9.5	9.1	5.6%	767.3	99.1	5.5	6.0	0.5		11.5%	
M1	MBOFF	1926	3	15.6	14.7	-1.7%	9.1	8.7	0.0%	43.6	6.1	5.4	6.8	0.8		10.6%	
Axiata Group	XLMTF	16501	6	19.7	17.0	7.8%	7.9	7.5	6.1%	14.3	2.4	4.1	5.0	0.6		20.8%	
Maxis	MAXSF	16140	7	20.8	20.8	-3.0%	12.6	12.5	2.1%	33.3	7.2	6.1	5.6	1.2		11.0%	
DiGi	DIGBF	12288	5	28.2	20.6	20.8%	12.6	11.8	7.0%	240.8	47.7	4.9	5.3	-0.2		10.8%	
PLDT	ZHPLF	13241	2550	15.1	14.5	-6.5%	7.7	7.5	4.3%	24.7	3.5	6.5	9.0	0.7		20.0%	
Globe Telecom	GTMEF	3645	1134	15.0	13.9	4.0%	5.3	4.9	5.6%	21.2	2.9	5.8	5.9	1.4		34.1%	
Advanced Info	XVDIF	18302	189	15.6	14.3	21.5%	8.8	8.4	7.8%	86.4	12.1	7.0	4.4	0.2		18.3%	
DTAC	TACPF	6401	83	16.6	17.1	-1.0%	7.6	7.3	1.2%	27.0	4.6	5.9	-3.9	1.0		21.6%	
TRUE Corp	TCPJF	2315	5	NM	NM	-36.4%	7.1	6.0	13.6%	-6.8	4.1	0.0	18.2	3.4		17.8%	
Telkom	TLKMF	19788	9450	14.0	13.0	15.8%	5.3	5.1	5.6%	27.1	3.3	5.8	10.0	0.0		18.4%	
Indosat	PTITF	3753	6650	25.7	16.8	70.5%	5.3	5.1	5.6%	11.2	1.9	3.0	4.1	1.5		26.1%	
XL Axiata	XAESF	5535	6250	16.6	14.7	6.9%	6.3	6.1	5.8%	21.5	3.0	3.1	3.5	0.9		29.2%	
INDIA Average				32.5	27.3	-2.9%	7.2	6.6	7.9%	6.9	1.8	0.5	1.4	2.5		19.3%	
ASIA -(EMERGING) AVG				16.3	14.5	6.9%	6.1	5.8	3.8%	30.4	4.5	4.1	5.0	-0.2		19.8%	
Mobily	XEHTF	13859	74	8.8	8.2	11.8%	6.7	6.2	11.4%	26.8	2.0	7.1	8.8	0.3		17.5%	
Zain	XOMBF	11446	1	10.5	11.7	-6.5%	5.8	6.1	-3.8%	11.8	1.4	8.0	10.8	0.4		11.5%	
MTN Group	MTNOF	35387	167	13.9	12.1	13.7%	6.0	5.6	8.1%	24.5	2.8	6.0	7.4	-0.4		17.9%	
MTS	MBT	17389	17	8.7	9.2	11.7%	3.7	3.7	3.4%	27.8	2.5	8.7	10.6	0.7		18.8%	
Orascom Telecom	XORSF	3199	4	7.7	6.3		3.7	3.7	2.0%	19.8	1.1	7.9	23.8	1.1		11.9%	
Partner	PTNRF	884	23	6.6	7.3	-5.0%	5.1	5.3	-10.0%	72.9	4.8	9.5	13.6	2.7		9.7%	
Turkcell	TKCZF	13092	11	12.4	12.6	30.6%	7.1	6.4	8.2%	14.2	1.7	4.4	7.1	-1.5		12.4%	
VimpelCom	VIP	17829	11	9.9	9.9	51.5%	4.5	4.7	9.9%	11.7	1.1	7.3	10.4				
Vodacom	XVDF	19845	119	15.0	14.8	7.6%	8.1	7.9	7.0%	64.9	9.6	6.7	6.0	0.3		12.8%	
Wataniya	XNMF	3857	2	10.3	10.1	-45.9%	4.0	3.7	-19.2%	11.5	1.1	2.5	12.5	-0.3		17.4%	
America Movil	AMX	88176	23	9.9	9.3	19.9%	5.3	5.0	4.3%	32.7	3.2	2.4	9.6	1.0		14.2%	
GEM AVG (Inc Asia)				14.4	13.0	9.7%	5.8	5.6	4.1%	29.5	4.0	4.3	6.2	-0.1		17.7%	

Source: BofA Merrill Lynch Global Research estimates

Price objective basis & risk

Bharti (BHTIF, C-1-7, Rs283.00)

Our PO of Rs340/sh values Bharti at an FY14E EV/EBITDA of around 7-7.5x and is backed by DCF. On a sum-of-parts basis, our PO values Bharti's wireless business in India at nearly 25-30% premium vs GEM wireless majors on EV/EBITDA justified by stronger growth over the medium term. Upside risks to our PO stem from 1) steeper-than-expected tariff hikes by the industry in India, 2) sooner-than-expected industry consolidation in India, 3) favorable policy changes in India, and 4) unforeseen topline growth in Africa. Renewed competitive intensity in India, dramatic regulatory changes and poor growth in Africa pose downside risks.

Idea Cellular (IDEAF, C-1-9, Rs92.20)

Our PO of Rs105/sh for Idea is based on around 10% discount to DCF using a WACC of 12% and terminal growth rate of 5%. Our PO implies a valuation of around 7-7.5x FY14-EV/EBITDA, i.e. 25-30% premium vs GEM wireless majors. Valuations could be hurt if industry competition on tariffs gets more intense. Stronger than expected 3G revenue ramp-up, sooner-than-expected industry consolidation and stronger-than-anticipated Indus profitability present potential upside to our PO.

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Media & Telecom

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Address – Mafatlal Centre, 8th Floor, Nariman Point, Mumbai, India. 400021

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