Equity Research
April 2, 2009
BSE Sensex: 9902

INDIA

Telecom

Rural, the reigning flavour

Reason for report: Initiating coverage

Bharti Airtel
BUY (Rs615)

Reliance Communications
HOLD (Rs180)

Idea Cellular
HOLD (Rs50)

- **Rural offers vast growth opportunity**
- **Tower – Shaky foundation with low sharing and likely overbuild**
- **New entrants – Short-term disruption, long-term consolidation**
- **BUY on Bharti Airtel; HOLD on Reliance Communications & Idea Cellular**

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"In '08, the China Mobile Group has taken full advantage of the reform and development of rural areas driven by the State. By consistently pushing for a strategy of 'lower ARPU, lower MoU, lower cost', the Group furthered its rural market development. The rural market, which continues to serve as a key growth driver, contributed to nearly half of the subscriber growth in the year." – China Mobile, Annual Report '08

The Indian Telecom sector is at a critical point as net adds approach peak and competition intensifies. We expect a tussle between incumbents & new entrants, GSM & CDMA services and for 3G licences. Amidst all this, rural India offers telcos a new leg of growth as they extend coverage to hinterlands. We expect that by FY15E, rural net adds will contribute ~45% to total net adds. Though tower sharing is in the spotlight, we expect modest value creation from tower companies as incumbents will likely use captive tower companies, leading to overbuild and low sharing ratio for the industry. We are bearish on new entrants and expect consolidation in due course.

We initiate coverage on Telecom with a Neutral stance as net adds slow down and competition rises, though growth opportunities abound in rural India. We recommend cherry picking among telcos as individual company dynamics outweigh sector dynamics. We initiate coverage on Bharti Airtel (BAL) with BUY and on Reliance Communications (RCom) and Idea Cellular (Idea) with HOLD.

- **Mobile subscriber growth – Running out of steam.** Mobile subscriber additions in India are likely to slowdown FY10 onwards as urban penetration has become high and mobile operators try to maintain momentum by expanding into rural areas. We estimate the Indian mobile penetration to rise to 64% by FY15E. Growth, going forward, is likely to depend on the pace at which telcos extend coverage to low-density rural areas.
- **Rural India – Small part of a large number is still large.** Rural India offers unbridled growth potential, accounting for 70% population, 56% income and 64% expenditure. We expect 33% teledensity in rural India by FY15E, driven by coverage and rising affordability. However, difficulty in expanding network coverage to rural areas will pose a challenge to achieving high rural penetration.
- **Tower sharing – Shaky foundation.** We expect the tower sharing ratio in India to be a modest 2.3x by FY15E as tower companies will essentially cater to in-house demand. The tower sector is progressing towards an overbuild, though the ongoing credit crunch might reduce the likelihood.
- **Valuations – BUY BAL; HOLD RCom & Idea.** We recommend a selective approach for investing in telecom. BAL offers unhindered growth as the company shifts focus to rural India. We believe RCom's dual network approach has long-term revenue potential though on high costs. Idea offers limited returns as it is bearing the costs of expansion into new circles.

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I-Sec Telecom universe – Valuations

	CMP (Rs)	Target price (Rs)	Reco	EPS (Rs)			P/E (x)			EV/E (x)		
				FY09E	FY10E	FY11E	FY09E	FY10E	FY11E	FY09E	FY10E	FY11E
BAL	615	733	BUY	44.8	54.4	65.8	13.7	11.3	9.3	7.9	6.9	5.7
RCom	180	169	HOLD	28.1	22.7	22.7	6.4	7.9	7.9	5.5	4.7	3.9
Idea	50	48.4	HOLD	3.0	2.8	3.4	16.6	17.7	14.8	7.7	5.5	4.3

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COMPANIES

Prices and Sensex as on April 1, 2009 unless otherwise mentioned

Investment argument

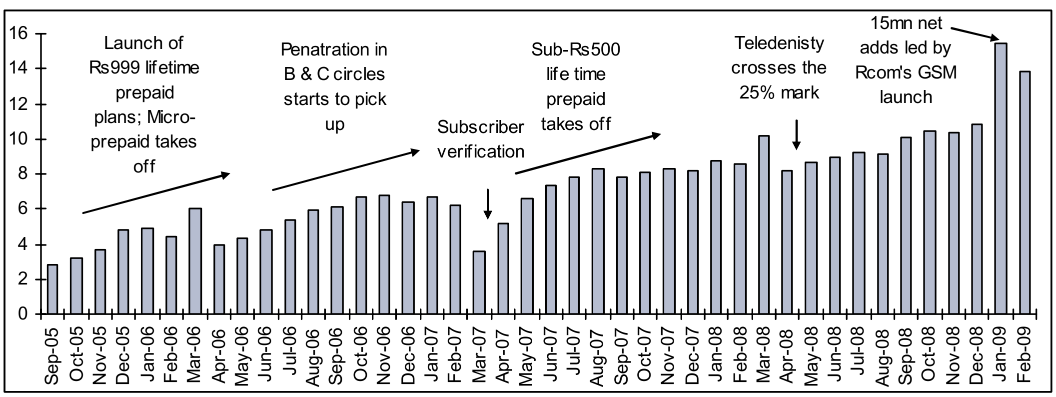
Mobile subscriber growth – Running out of steam

We expect the mobile subscriber net adds to start trending downwards FY10E onwards even as mobile operators aggressively expand into rural areas to try to maintain momentum. We estimate the Indian mobile penetration and teledensity to rise to 64% and 67% driven by urban mobile penetration of 132% and rural mobile penetration of 31% by FY15E. So far, operators have driven growth largely through metros and A-circle urban areas, but the challenge is to reach to the hinterlands. While the growth drivers for mobility are intact in terms of lower tariffs, increasing coverage and raising per capita spend, the low density of rural population spread across 593,731 villages will make it challenging to expand coverage. However, mobile subscriber growth will likely become irrelevant for financial performance of telcos in the wake of high growth being driven by aggressive promotional plans, which will increase the churn and strain ARPUs.

Mobile subs to grow to 607mn by FY11E

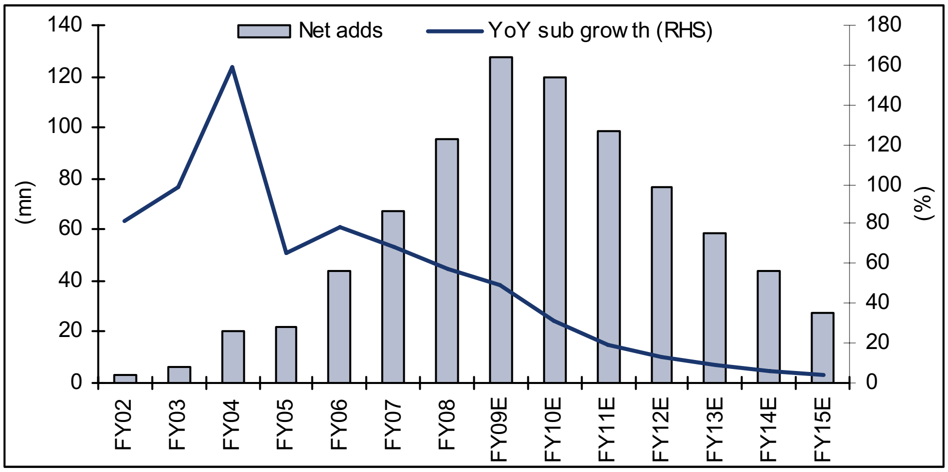
We expect the mobile subscriber base to grow to 607mn in India by FY11E based on average monthly additions of 10mn in FY10E and 8.2mn in FY11E. Our estimates are significantly lower than the high monthly net adds of 15.3mn and 13.4mn in January '09 and February '09 respectively on the back of Reliance Communications' (RCom) promotional offer of free minutes on its GSM network, which is unlikely to be sustainable. The industry is likely to see significant churn post the expiry of the promotional period, though this churn may not get reflected immediately in the reported subscriber numbers.

Chart 1: Monthly industry net additions – Stellar growth so far….



Source: COAI, AUSPI, TRAI, I-Sec Research

Chart 2: ….but expect subscriber net adds to slow down FY10 onwards



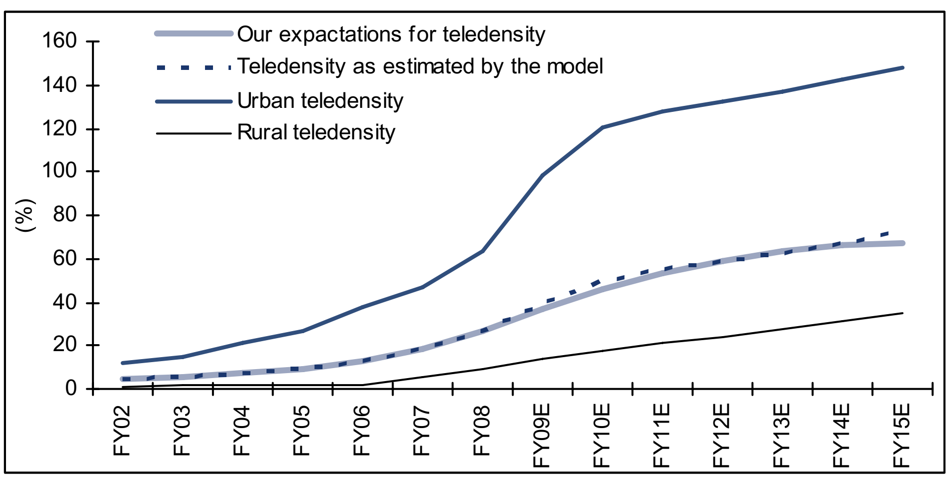
Source: COAI, AUSPI, TRAI, I-Sec Research

Mobile penetration of 64% possible by FY15E

In order to arrive at the teledensity potential by FY15E, our model uses the parameters of per capita income & the share of household income spent on communications. We have assumed 5.7% of per capita income to be spent on communication for urban consumers and 1.5% for rural by FY15E, implying that the total spend on communications will increase to 3% of per capita income from 2.2% in FY08.

As per our model, teledensity can potentially rise up to 73% by FY15E, and mobile penetration to 69%, with 140% urban penetration and 33% rural penetration. However, these projections hold good given complete rural coverage (we believe this will peak at 90%) and we have toned down these estimates and expect mobile penetration to rise to 64% by FY15E with 132% urban penetration and 31% rural penetration. Assuming five people per rural household, rural mobile penetration of 31% implies 1.5 phones per household in rural India, which we believe is achievable.

Chart 3: Expect 67% teledensity and 64% mobile penetration by FY15E



Source: TRAI, I-Sec Research

Table 1: Teledensity estimation model

	FY09E	FY12E	FY15E
Population (mn)	**1,165**	**1,214**	**1,266**
Urban	355	387	421
Rural	810	828	844
Per capita income (Rs)	**36,757**	**49,521**	**66,745**
Urban	**59,224**	**78,827**	**104,919**
Top 20%	144,161	191,878	255,389
20-40%	64,505	85,856	114,274
40-60%	42,915	57,120	76,027
60-80%	28,424	37,832	50,355
80-100%	16,117	21,451	28,551
Rural	**26,920**	**35,831**	**47,691**
Top 20%	64,815	86,268	114,823
20-40%	28,479	37,906	50,453
40-60%	19,141	25,476	33,909
60-80%	13,672	18,198	24,221
80-100%	8,493	11,305	15,047
% spend on communications	**2.6**	**2.9**	**3.0**
Urban	6.3	6.2	5.7
Rural	1.0	1.3	1.5
ARPUs (Rs/month)	**280**	**268**	**285**
Urban	315	308	337
Rural	166	164	175
Calculated teledensity (%)	**39**	**59**	**73**
Urban	99	133	148
Rural	13	24	35
Calculated mobile penetration (%)	**36**	**55**	**69**
Urban	92	125	141
Rural	12	23	34

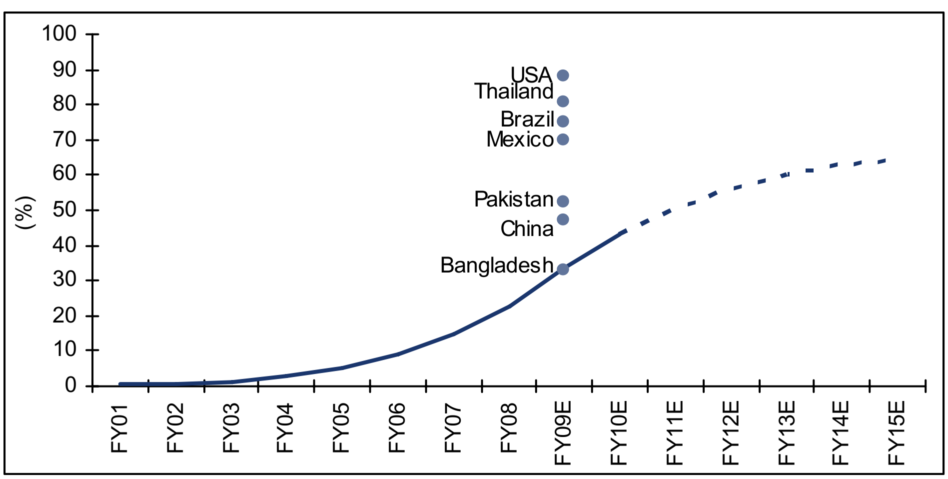
Source: TRAI, CSO, I-Sec Research

This is the potential teledensity as calculated in the model. We have tones down our estimates and expect teledensity of 67% and mobile penetration of 64% by FY15E

According to the McKinsey report on the Indian consumer market '*The Bird of Gold: The rise of the Indian consumer market*', the average household consumption on communications is expected to rise from 2% to 3% by '15E and to 6% by '25E. Globally, the spend on communication ranges within 1.5-2% of per capita income. However, for developing countries, the share of communication spend is likely to be higher and the current telecom spend as a percentage of per capita income for India still suggests huge headroom for growth. Moreover, many developing countries with similar or lower per capita income have achieved higher mobile penetration than India, indicating that potential remains for mobile subscriber growth in India.

Many countries with similar or lower per capita income have achieved higher mobile penetration than India

Chart 4: Benchmarking Indian mobile penetration with other countries

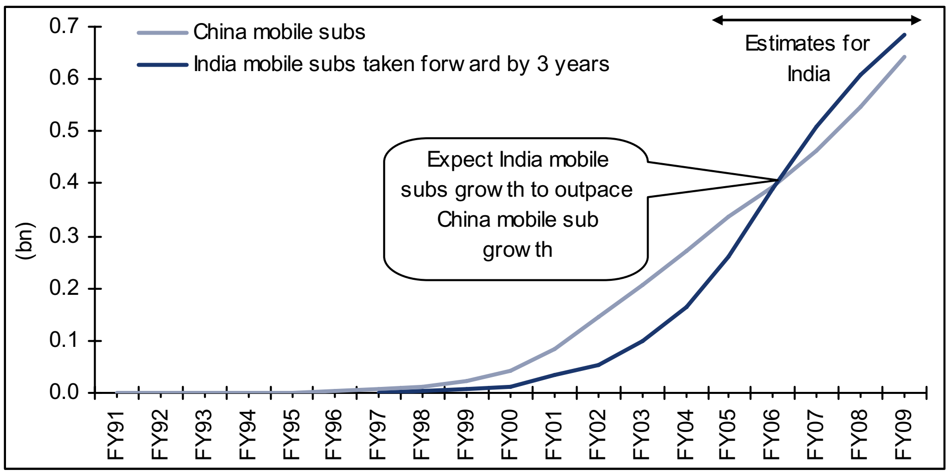


Source: Country data, Bloomberg, I-Sec Research

India skips wireline for wireless, closely tracking China's subscriber growth

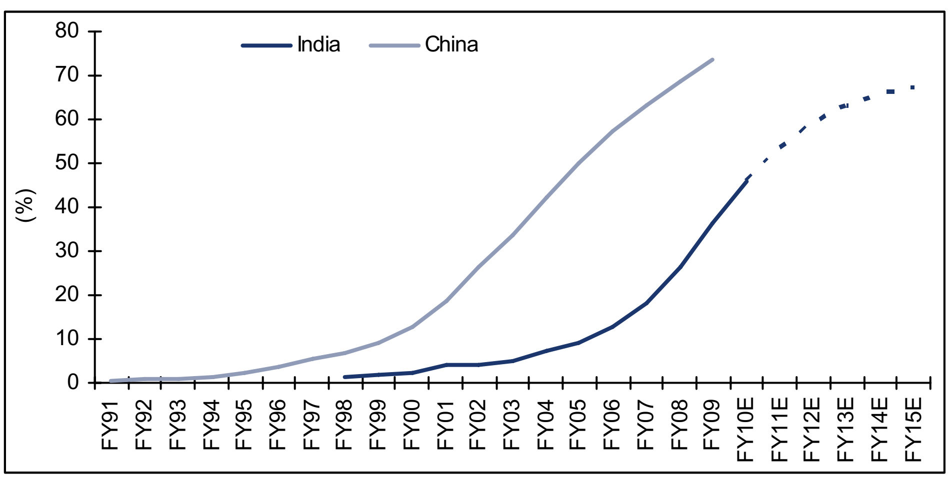
So far, the mobile subscriber growth in India has taken a similar J-curve as that in China, with a time lag. However, India might be able to outpace China in mobile subscriber growth as India has skipped the wireline growth in favour of wireless and the low wireline penetration gives more opportunity for higher mobile penetration. As of December '08, China had a teledensity of 73.5%, which is 48% of mobile penetration and 26% of wireline teledensity as compared with India's teledensity of 33%, with 30% mobile penetration and only 3.2% wireline teledensity. Our estimate of 607mn subs by FY11E implies a mobile penetration of 51%, which is similar to China's mobile penetration today.

Chart 5: India may be able to outpace China mobile sub growth due to low wireline penetration



Source: Bloomberg, TRAI, I-Sec Research
Note: FY91 refers to CY90 for China and so on

Chart 6: Indian teledensity in FY15 to remain lower than China's current teledensity



Source: Bloomberg, TRAI, I-Sec Research

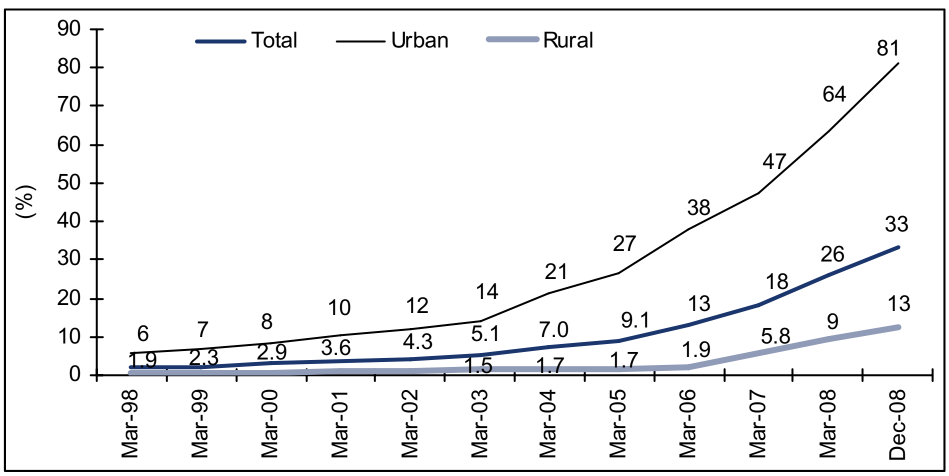
Rural India – Small part of a large number is still large

Rural India represents a vast buying power, but it is scattered and comes in low ticket sizes. Rural India has seen a boom in consumption in the past four years due to increase in buying power driven by better agricultural income. Going forward, in 20 years, the rural Indian market is expected to be ~4x that of the Indian urban market today. So far, subscriber growth has been largely driven by increasing penetration in urban areas but going forward we estimate the next leg of growth in telecom to be driven by increased mobile penetration in rural India. We expect that by FY15E, rural net adds will contribute ~45% of total net adds.

Rural subscriber growth backed by many drivers…

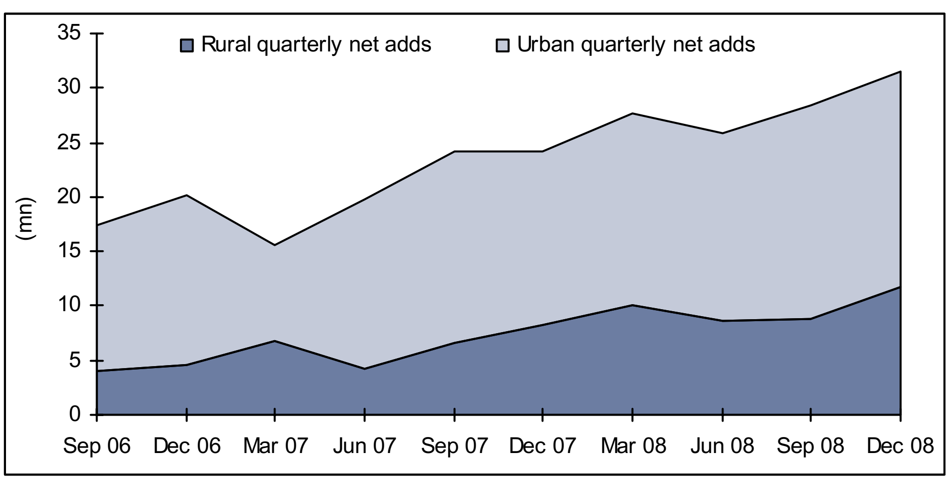
As of December ’08, urban teledensity was at 81.4%, while rural teledensity was only 12.6%. The high urban penetration is expected to result in saturation and slowing growth in urban areas, while the low penetration in rural areas is indicative of a huge potential and operators will increasingly look to expand coverage in rural areas to maintain subscriber growth momentum.

Chart 7: Rural teledensity significantly lags urban teledensity…



Source: TRAI, I-Sec Research

Chart 8: …but growth shifting to rural areas



Source: TRAI, I-Sec Research

At present, rural India constitutes ~70% of the population and though the per capita income in rural areas is just over half of that in urban areas, rural areas constitute 56% of the income, 64% of expenditure and 33% of savings. The rural share of spending on popular consumer goods and durables ranges within 30-60%. As per the McKinsey report on consumer spending in India, rural household spend is estimated to grow at 5.1% CAGR over the next 20 years.

Affordability in rural India is increasing owing to improving economic profile of rural households (leading to higher rural living standards) and as the cost of owning handsets and tariffs are already among the lowest globally and are further declining, enabling easy percolation of mobile phones in the rural areas.

The low wireline penetration in rural India (1.4% versus 8% in urban areas as of September '08) will also be a key driver – the wireless capex per subscriber is much lower than that in wireline and this will be a key driver.

…though bottlenecks exist

While low tariff and cheap handsets make high penetration possible in India, there are several challenges for driving rural penetration. The key challenge is the expansion of network coverage to rural India. As per ITU data, as of December '08, developing countries such as China and Brazil with larger geographical areas and lower population densities than India had achieved greater population coverage for mobile services than India.

Table 2: Mobile coverage in India much lower than peers

Country	% population coverage
Pakistan	90.0
Philippines	99.0
South Africa	99.8
Sri Lanka	95.0
China	97.0
Brazil	91.0
India	**60.9**

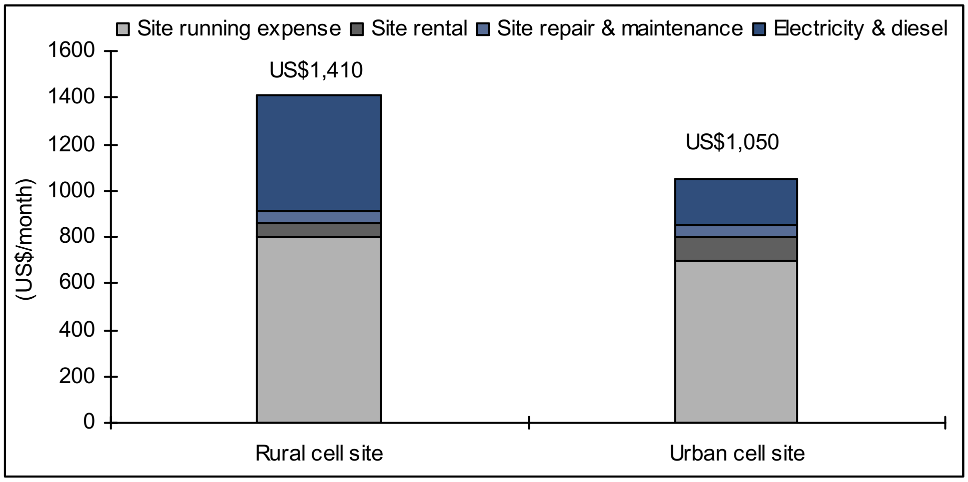
Source: ITU World Telecom Indicators '08

Rural India is spread across ~0.6mn villages, while mobile coverage as of March '08 was limited to only 407,112 villages (69%). Given the large geographical spread of the villages and low population density, the expansion of mobile coverage to rural India will require setting up shared infrastructure quickly.

Though rural India provides significant growth opportunities, asset utilisation and return on capital are likely to be low. Capex required for network roll-out in rural India will largely be driven by coverage as against capacity in case of urban areas. The number of subscribers per cell site will be much lower in rural areas than in urban areas, leading to higher capex for achieving the same number of subscribers in rural areas. Profitable venturing into rural India will require sharing of infrastructure and quick execution – Operators' inability to do so may delay the target for rural penetration.

Operating & maintenance cost of cell sites in rural areas are also higher due to lower availability of electricity because of which operators are forced to depend on diesel for power supply. According to FICCI-BDA wireless broadband report, cell site operating costs in rural areas are estimated to be ~25% higher than in urban areas.

Chart 9: Rural cell site's operating expenses ~25% higher than urban's



Source: FICCI-BDA wireless broadband report
Note: Data comparison for a GSM operator

Apart from significant capex and opex required from the operators and tower companies to set up towers, there are several other hurdles in achieving adequate rural network coverage – Difficulty in acquiring land, lack of continuous power supply, providing backhaul connectivity cheaply etc.

Though we expect rural subscriber growth to drive incremental subscriber growth in the telecom sector, rural subscribers will be added at lower ARPUs & minutes of usage (MoU) than their urban counterparts due to lower per capita income and low expected utilisation. It will be a tight rope walk for the operators to achieve the first-mover advantage in network roll-out without affecting asset utilisation and profitability too much.

Regulatory initiatives for encouraging rural coverage

The Department of Telecommunications (DoT) has launched a scheme under the Universal Service Obligation (USO) fund to provide subsidy support for setting up and managing towers for provision of mobile services in specified rural and remote areas. Under the phase-I of this scheme, launched in June '07, 7,871 towers in 500 districts spread over 27 states were proposed to be set up and many tower infrastructure companies bid for setting up and managing these towers. Part-A of the phase-I dealt with setting up towers and part-B was regarding active infrastructure. DoT has recently announced the phase-II of the scheme, in which 11,049 towers are proposed to be set up. The bidding for these towers is yet to take place.

Table 3: USO fund scheme for tower roll-out in rural areas

	Towers	No. of villages	Population covered (mn)	Commissioned as of October '08	% Completed as of October '08
Phase 1	**7,871**	**212,304**	**269**	**1,934**	**24.6**
GTL	421			390	92.6
Quippo	88			88	100.0
Vodafone	331			262	79.2
RCom	472			251	53.2
KEC	384			153	39.8
BSNL	6,175			790	12.8
Phase 2	**11,049**	**242,866**	**276**	No bidding yet	**-**
Total	**18,920**	**455,170**	**545**		

Source: TRAI, DoT, I-Sec Research

The progress of setting up towers under the phase-I of the USO fund scheme has been extremely slow so far. Though the bidders in phase-I were required to set up 50% of the towers within eight months and 100% in one year, only ~38% of the towers (~3,000) were completed by January ’09, 18 months after the roll out in June ’07.

Moreover, the actual requirement for rural towers is much higher than that covered in the two phases of the USO fund scheme. According to the Telecom Regulatory Authority of India (TRAI), based on aggressive estimates of 1,000 subscribers per cell site in rural areas, achieving the target of 200mn rural subscribers by ’12 would require setting up at least 40,875 shared towers, of which only ~19,000 are provided for through the two phases of the USO fund subsidy scheme.

Attaining 1,000 subscribers per cell site in rural areas would be extremely difficult and the requirement for rural towers would likely be much higher than that estimated by TRAI. Given the surplus in the USO fund, operators are expecting subsidies for more tower roll-outs in rural areas and for rural backhaul connectivity, which would significantly improve the profitability for operators. As of March ’08, the size of USO fund was Rs205bn and it is now estimated to have crossed Rs250bn. And, as of September ’08, just 27% of the amount has been utilised, according to TRAI.

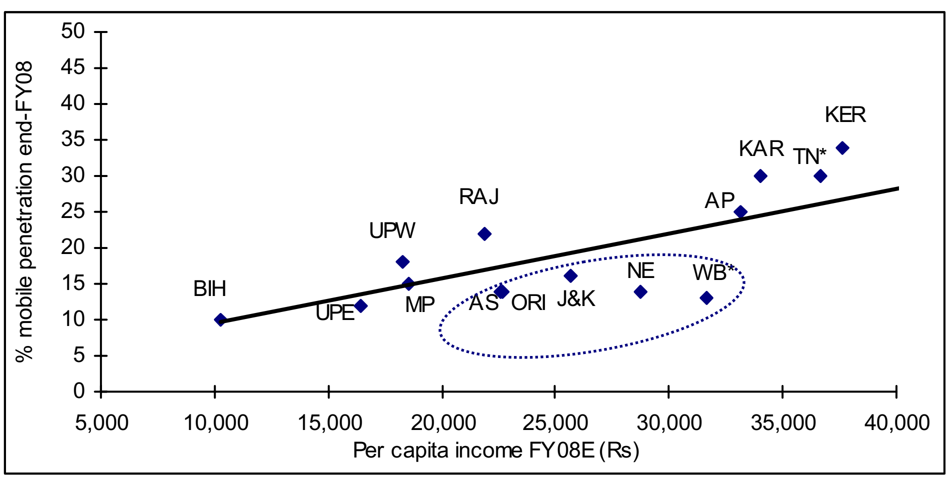
In March ’09, DoT called off its earlier decision to provide 2% reduction in USO levy to operators for achieving 95% coverage of development blocks, including villages in each circle. The withdrawal of the earlier decision was due to failure to gain approval from the cabinet and the timing of implementation of subsidy in USO levy will now depend on the new Government.

Rural penetration closely linked to per capita income

Teledensity has a strong correlation with per capita income and an equitable spread between urban and rural per capita incomes leads to higher teledensity. States in C category are lagging the mobile penetration-per capita income curve owing to low coverage.

Assam, Orissa, North East & West Bengal lag in mobile penetration based on per capita income

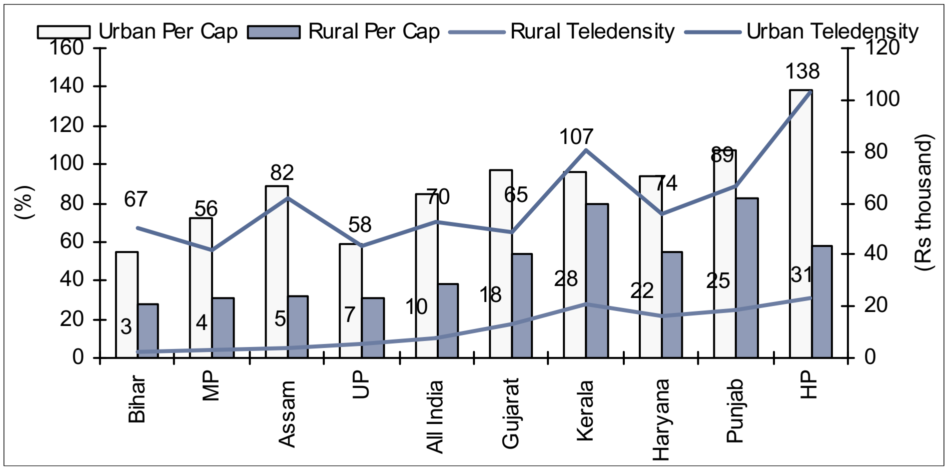
Chart 10: Mobile penetration correlated with per capita income of states



Source: TRAI, I-Sec Research
* TN per capita income includes Chennai also, WB* per capita income includes Kolkata also

There is a wide variation in the rural mobile penetration among Indian states based on the rural per capita income. States, which have low disparity in rural and urban per capita income indicating equitable distribution of incomes, have higher rural mobile penetration. With states such as Kerala, Haryana, Punjab and Himachal Pradesh already achieving 20%+ rural teledensity, we believe 33% rural teledensity by FY15E is plausible.

Chart 11: Rural penetration closely linked to rural-urban income disparity



Source: TRAI, I-Sec Research

BAL likely to reign in rural India

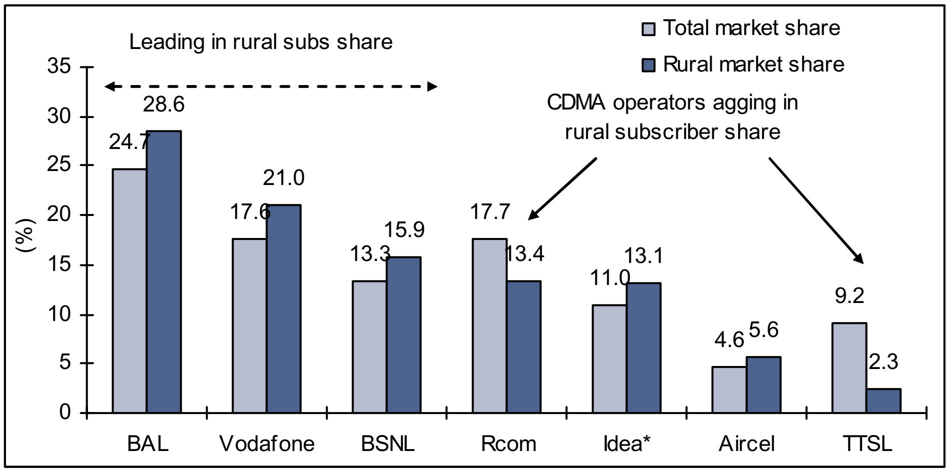
BAL has already made significant strides in garnering rural subscribers and is the leader in terms of rural wireless subscriber market share. As of December '08, BAL had 28.6% share of the total rural subscribers, higher than its 24.5% share of total subs. BAL's population coverage as of December '08 was 79% and its network covered more than 400,000 villages, with plans to extend population coverage to 100% in the next two years.

BSNL is considered to have the best network coverage in rural areas, and as of December '08, the company enjoyed 15.1% share of rural subscribers, higher than its 13.9% share of total subscribers. In spite of not being present in C-category circles till FY09, Vodafone has a relatively large share of rural subscribers, ~21% as of December '08 versus 17.6% total subscriber market share.

RCom's CDMA network coverage currently extends to 25,000 towns and 600,000 villages, while its GSM network covers 14,000 towns and 400,000 villages, with plans of GSM coverage being expanded over the next few months to match its CDMA network. In spite of higher coverage per cell site in the CDMA technology, which is a huge advantage in rolling out network in rural areas, both the existing CDMA players, RCom and Tata Teleservices (TTSL) are lagging in the share of rural subscribers.

Idea and Aircel are yet to attain pan-India coverage, which they are expected to complete over the next few months. Since both operators did not have presence in several circles before March '08, they still have a large urban area yet to be covered, and this reduces their ability to quickly extend network coverage to rural areas.

Chart 12: Rural subscriber share versus total subscriber share



* Idea includes Spice rural subscribers
Source: TRAI, I-Sec Research

Table 4: Operator-wise rural subscribers – December '08

Operator	Total subs (mn)	% market share	Rural subs (mn)	Rural % of subs	% market share of rural subs
BAL	85.7	24.7	26.1	30.5	28.6
Vodafone	60.9	17.6	19.2	31.5	21.0
BSNL	46.2	13.3	14.5	31.4	15.9
RCom	61.3	17.7	12.3	20.0	13.4
Idea*	38.0	11.0	12.0	31.5	13.1
Aircel	16.1	4.6	5.1	32.0	5.6
TTSL	31.8	9.2	2.1	6.8	2.3
MTNL	4.2	1.2	-	-	-
Others	2.7	0.8	0.0	0.1	0.0
Total	**346.9**	**100**	**91.4**		**100**

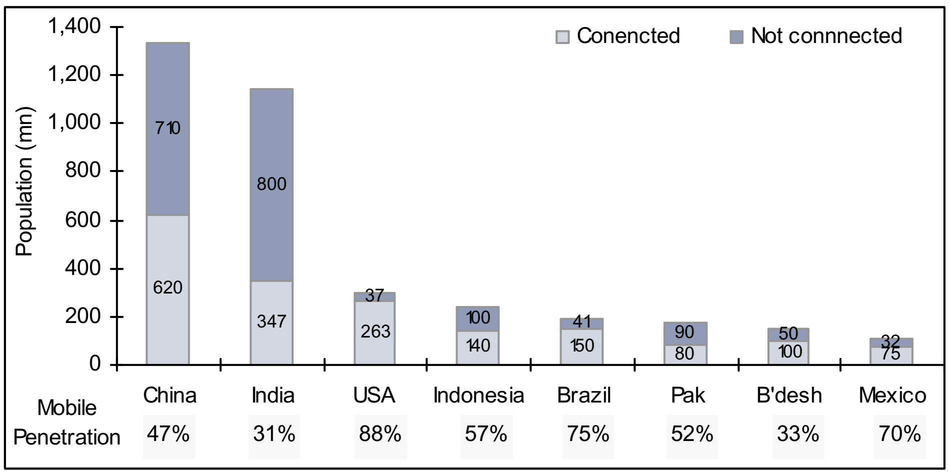
Source: TRAI, I-Sec Research * Idea includes Spice's rural subscribers

New entrants – Short-term disruption, long-term consolidation

Unprecedented competition to come in…

Even though the Indian telecom market was well served with 4-6 players in each circle by '07, in an effort to further increase competition, fresh licences were issued in January '08, leading to five new entrants being given unified access services (UAS) licence to start operations, including four pan-India licences. Further, two existing CDMA players (RCom & TTSL) were given licences to roll out GSM services nationwide and three existing GSM players (Vodafone, Idea and Aircel) are in the process of completing their pan-India roll-outs. The new licencees in the mobile space have received a lot of investment interest from global telcos as the Indian market still has the largest unconnected population.

Chart 13: India still has the largest population unconnected by mobile phones



As of December '08
Source: TRAI, Bloomberg, I-Sec Research

Table 5: New entrants have strong strategic partners and ambitious plans

New entrants	Strategic investments	Profile of strategic investor	License/ Spectrum allocation	Progress so far
Swan Telecom	Etisalat invested US$900mn for a 45% stake	Etisalat is the main telecom service provider in the UAE	13 circles/ 8 circles	Supposed to be in talks with RITL for tower sharing for 13,000 towers in year 1, 20,000 in year 2 and up to 45,000 in year 5
Unitech Telecom	Telenor will invest US$1.23bn (Rs61.2bn) over several stages for 67.5% stake; Telenor has plans to raise stake to 74%	Telenor is the incumbent telecom company in Norway and the seventh largest carrier in the world, with operations in Scandinavia, East Europe and Asia	22 circles/ 21 circles	i) Reached tower sharing deal with TTSL-Quippo for 40,000 sites by '10-end (50-60% population coverage) ii) Agreement with TTSL for provision of transmission services at a fixed monthly rates
Shyam-Sistema Teleservices	Sistema bought 73.7% stake	Sistema is a large Russian holding company, with 66% of revenues from telecoms	22 circles/ 22 circles (CDMA)	i) Announced investment of US$5.5bn over a five-year period with US$1bn already done ii) Launched in Rajasthan, Tamil Nadu and Kerala under the *MTS* brand iii) Roll out in at least 10 circles by '09-end iv) Supposed to be in talks with RCom for Rs50bn passive + active + intra-circle roaming deal v) Currently 70-80% of towers are shared
Datacom	Videocon/Nahata group		22 circles/ 11 circles	i) Announced US$2bn investment, ii) given contract worth Rs5bn to Huawei for providing mobile connections to 8mn subs
Loop	Part of Essar Group		21 circles/ 8 circles	Has announced US$1.5bn investment
S tel	Batelco paid US$225mn for 49% stake	Batelco is the leading integrated communications provider in the Kingdom of Bahrain and the MENA region	6 circles/ 1 circle	

Source: Company data, I-Sec Research

Table 6: New entrants propose, incumbents oppose

New entrants Arguments for business case	Incumbents Arguments against
Rapid subscriber growth to continue	Subscriber growth increasingly shifting to semi-urban and rural areas
B & C circles still under- penetrated	Depth of coverage in B & C circles high for incumbents, difficult to match for New players
High potential for churn in metros; will be further aided by MNP	Incumbents already used to high competition in metros
Clogged networks of incumbents limits flexibility; less populated networks offering better QoS	3G auctions to free up more spectrum and enable better differentiation
Will be able to attract subscribers with differentiated plans and pricing	ARPM already low at ¢1.5/min limits too much price differentiation
Low capex owing to tower sharing	Towers tenancy will help reduce costs and increase valuations of hived-off tower companies
Expected impact on the industry	
Free minutes by new players to reduce industry ARPMs	
Increase in churn to lead to higher subscriber acquisition costs	
Higher tower sharing	

Source: Company data, I-Sec Research

…but impact on sector & incumbents to be limited

Though most of the new entrants have received strategic investments and tie-ups from international players, they are likely to face several challenges:

- **Entry of new players** will lead to 10 players in most markets, limiting the scope of achieving incremental market share of more than 10% on a sustained basis.
- **Urban penetration in India is already close to 70%** and will exceed 80% by FY10E before new players make any convincing foray into the Indian market. Rural market in India is spread across ~0.6mn villages and new players will significantly lag the incumbents in terms of network coverage.
- **Cut-throat competition from incumbents.** The large networks of incumbents offer better operational efficiencies and economies of scale, which gives incumbents more power to undercut on pricing. On the value-add side, incumbents will be able to offer more differentiated offerings as they are more likely to bag 3G licences.
- **Churn has been decreasing** and the value offerings of new players will have to be attractive enough to lure customers away from incumbents.
- **Quality of subscribers will likely be low** leading to lower ARPUs than that for incumbents. Even in the under-penetrated rural areas, new entrants may be late in providing sufficient coverage and may miss on the high ARPU subscribers.
- **Ongoing financial meltdown** is likely to curtail ambitious investment plans of global strategic partners and Indian promoters. The high stakes being diluted by Indian promoters suggest limited ability and intent of Indian partners to invest.

We expect the new entrants to find it difficult to penetrate the market, which is likely to mature in a few years, and expect consolidation down the line.

Business model for new entrants very stretched

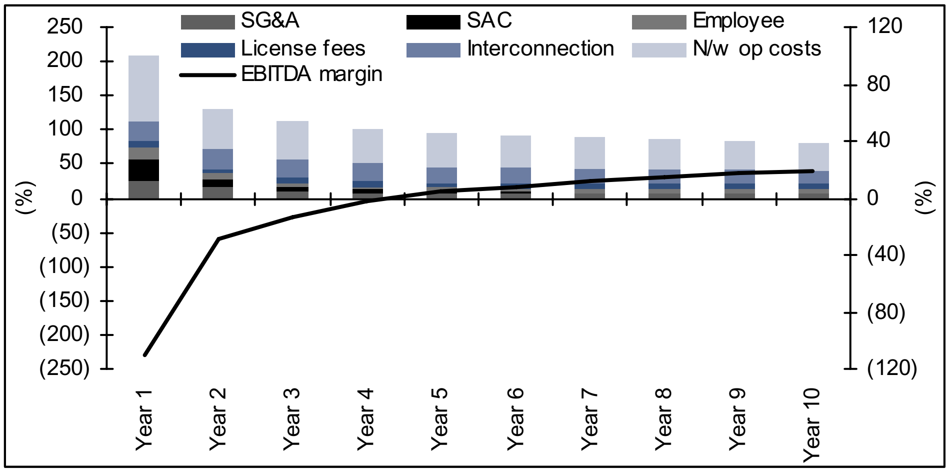
We see the business model for new players entering the 2G space with a pan-India presence to be very stretched with EBITDA break-even only in the fifth year of operation and positive free cashflow (EBITDA less capex) in the sixth year of operation.

Table 7: Key assumptions for new player model

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Net adds share (%)	10.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0
Subscriber share (%)	2.0	2.9	3.5	3.9	4.1	4.2	4.3	4.4	4.5	4.6
ARPU (Rs month)	200.0	180.0	171.0	162.5	159.2	156.0	152.9	149.8	146.8	143.9
No. of cell sites	15,000	30,000	33,000	36,300	39,930	39,930	39,930	39,930	39,930	39,930
Capex per cell sites (Rs mn)	2.0									

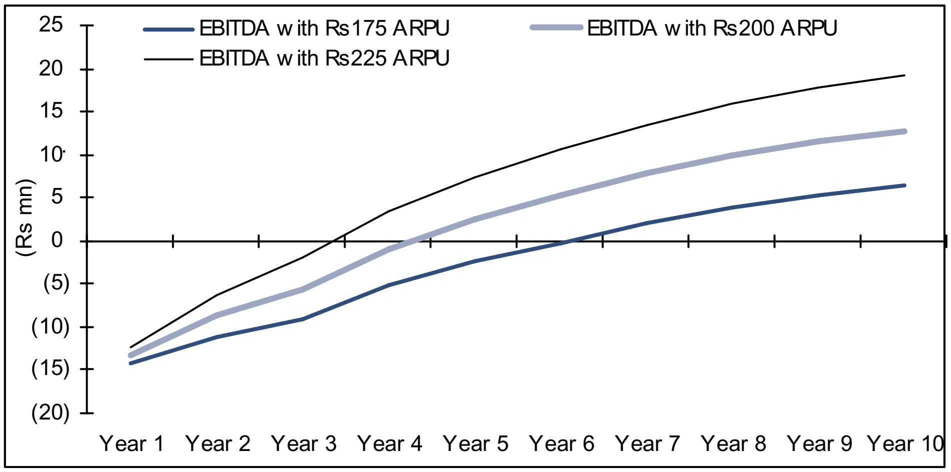
Source: I-Sec Research

Chart 14: EBITDA break-even only in year five



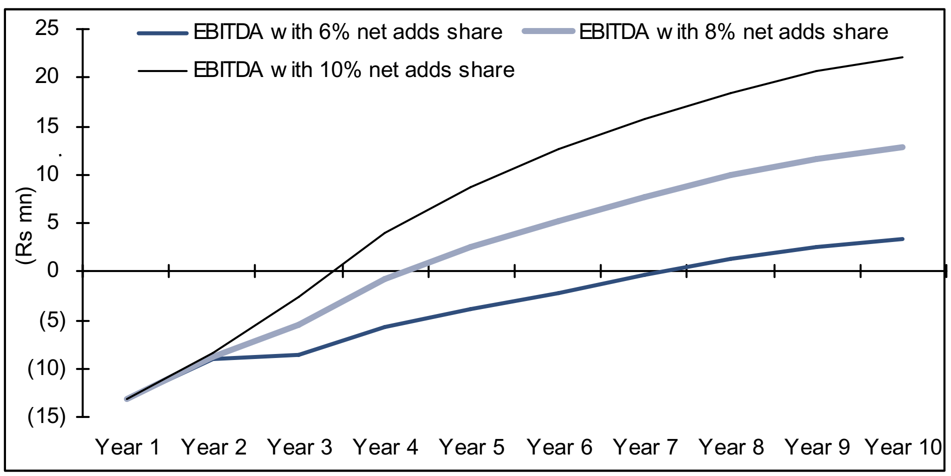
Source: I-Sec Research

Chart 15: EBITDA sensitivity to ARPU (assuming 8% net adds share)



Source: I-Sec Research

Chart 16: EBITDA sensitivity to net add share (assuming Rs200/month ARPU)



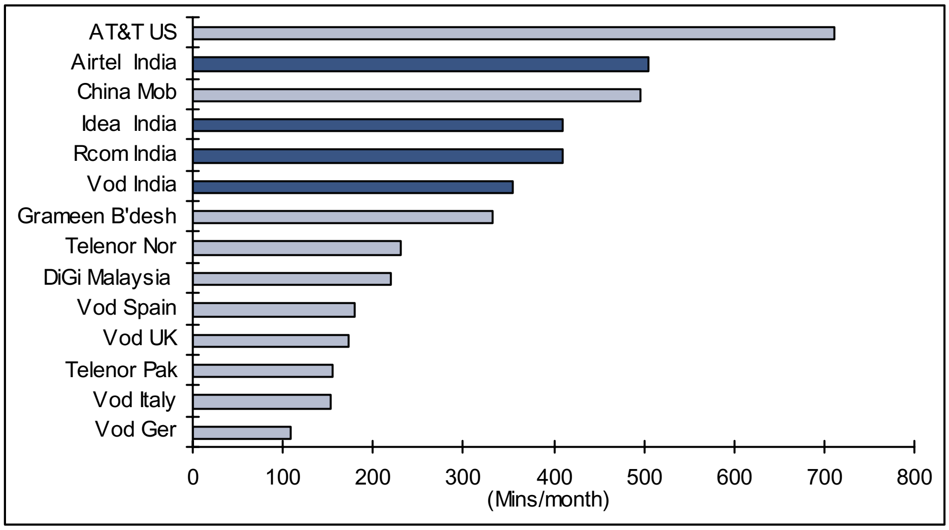
Source: I-Sec Research

ARPUs to continue to wane in short term

Indian MoUs among the highest, while ARPUs among the lowest…

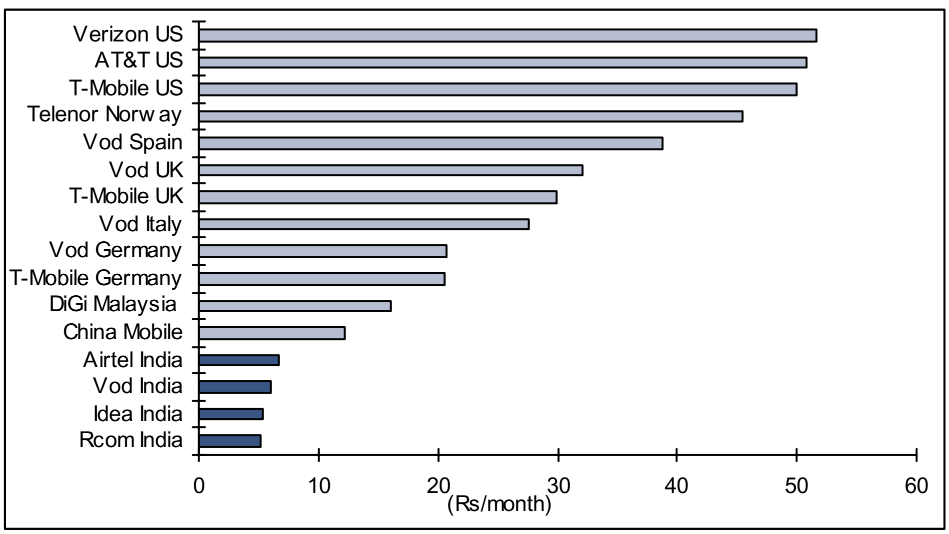
Mobile usage patterns in India have surprised on the upside with Indian operators reporting significantly high MoUs driven by low tariffs. MoUs in India are among the highest in the world, second only to the US and more than 2x that of European operators. Developed countries in Europe evolved to higher usage of data applications while data usage in India has not yet taken off.

Chart 17: Indians among the most talkative



Note: Data as of quarter ending December '08
Source: Company data, I-Sec Research

Chart 18: In spite of high MoUs, Indian ARPUs are low due to the low ARPMs



Note: Data as of quarter ending December '08
Source: Company data, I-Sec Research

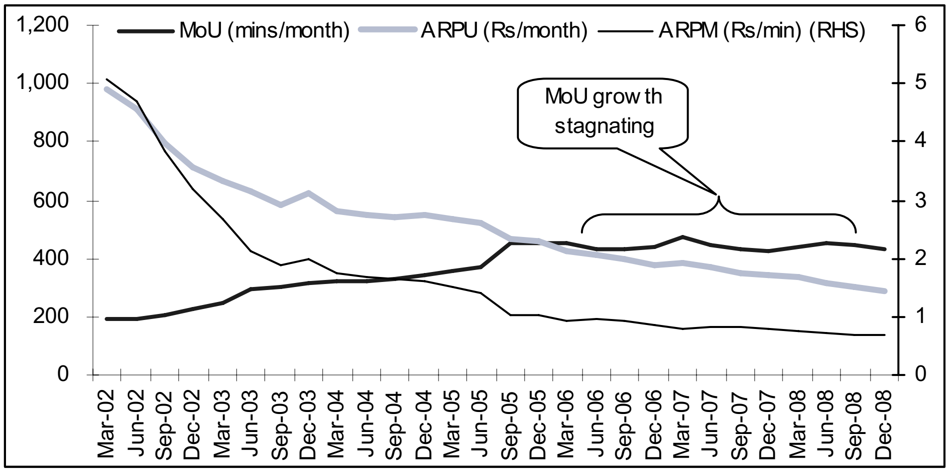
….going forward tariffs will continue to decline but MoU increase will be limited

Tariffs in India are among the lowest in the world, but still have scope of going down due to:

- **Regulation.** In the past, changes in interconnection usage charges (IUC) and access deficit charges (ADC) have driven the reduction in tariffs as operators tried to pass on the benefits of reduced charges to customers by lowering tariffs. The TRAI has phased out ADC over a period of time, with the final step being phased out September ’08 onwards. As regards IUC, the TRAI recently directed a reduction in termination charges from Rs0.3/minute to Rs0.2/minute effective April ’09 onwards, while NLD interconnect charges were kept capped at Rs0.65. Further cuts in termination charges and carriage charges remain a possibility as TRAI will try to make the industry more competitive by providing a more level-playing field to the new entrants.
- **New networks mean vacant networks.** Competition is set to increase manifold with GSM network roll-outs by RCom and TTSL, entry of new players and extension of networks by existing GSM players. The new networks being rolled out will have few subscribers and will be relatively empty, which may encourage the operators to undercut the competition on pricing. RCom launched its pan-India GSM operations by offering Rs900 worth free minutes to subscribers in many circles. A similar tactic may be adopted by other operators as well, leading to a price war and forcing the average industry tariffs down. Further the DoT has recently approved TRAI’s recommendations for allowing the entry of mobile virtual network operators (MVNOs), which may lead to a further increase in competition.
- **Mobile number portability.** The impending introduction of mobile number portability (MNP) will pressurise tariffs as churn increases and operators are likely to offer lower tariffs and freebies so as to retain existing subscribers.

In the past, even though tariffs have steeply corrected, usage increased as a result of declining tariffs, which ensured that ARPUs declined only marginally. While during December ’02-December ’05, ARPMs declined 68%, the fall in ARPU was restricted to only 36% due to usage increasing more than 100%. However, MoU elasticity has been on the decline in the recent past. During December ’05-December ’08, ARPMs declined 33%, while MoUs decreased 5%, leading to ARPU declining 37%.

Chart 19: MoUs not increasing with tariff declines in the recent past



Source: Company data, I-Sec Research
Note: Weighted average data for four operators – BAL, Vodafone, RCom and Idea

Table 8: Declining MoU elasticity

	Dec-02	Dec-03	Dec-04	Dec-05	Dec-06	Dec-07	Dec-08
ARPM	3.20	1.99	1.63	1.04	0.87	0.80	0.68
2-year change (%)			*(49)*	*(48)*	*(47)*	*(23)*	*(22)*
MoU	224	315	341	454	442	423	430
2-year change (%)			*52*	*44*	*30*	*(7)*	*(3)*
ARPU	716	631	554	464	373	331	285
2-year change (%)			*(23)*	*(26)*	*(33)*	*(29)*	*(24)*
MoU elasticity			**1.06**	**0.92**	**0.63**	**(0.30)**	**(0.12)**

Source: Company data, I-Sec Research
Note: Weighted average data for four operators – BAL, Vodafone, RCom and Idea

We expect the elasticity of MoUs, with tariffs to decline significantly due to already high MoUs in India compared with most other countries and expected low usage by incremental subscribers, mostly from rural areas and B & C circles. As mobile tariffs will continue to fall owing to competition and regulatory changes without a corresponding increase in MoUs, we expect a sharp fall in ARPUs in the short term. SMS usage is also expected to go down as rural subscribers will be more dependent on voice. Further, limited content development on VAS caps the potential of data ARPUs to curb the decline in voice ARPUs (Annexure 4).

TRAI recently reduced the termination charges for all domestic calls (fixed to fixed, fixed to mobile, mobile to fixed and mobile to mobile) to Rs0.2/min from Rs0.3/min April '09 onwards, which will further aid tariff declines, pressurising gross ARPUs for the industry. However, the impact on net ARPUs (after interconnect charges) will be determined by the proportion of incoming minutes of use and the proportion of off-net minutes in the outgoing minutes. Incumbent operators such as BAL and Vodafone, which have a high proportion of incoming calls, will see higher declines in ARPUs.

Though ARPUs will continue to decline sharply in the short term, we expect the decrease to start moderating after 2-3 years. The share of low-ARPU net adds, relative to the total subscriber base, will decrease over time, which will reduce the pressure on ARPUs. Also, the scramble by the operators to grab subscribers will lead to subscriber & net adds market share losing their importance as metrics and the focus of the operators should move to revenue market share after that.

Tower sharing – Shaky foundation

Infrastructure sharing, especially tower sharing (or passive infrastructure sharing), is in the spotlight as both existing and new players are focussing on reducing costs and time to roll out networks, especially in rural areas. Though, we consider tower sharing a win-win situation for the industry on the whole, we do not see high sharing possibilities. The business case for tower companies is excessively being built on new entrants and new services (3G & WiMAX). New entrants and new services are expected to be the key drivers of tower sharing since most incumbents have already aligned network roll-out plans with their own tower companies. However, we are pessimistic on the future of new players and are mildly optimistic on 3G and WiMAX taking off in India, and as a result, expect tower demand from new entrants and new services (3G & WiMAX) to be limited.

- **Rise in competition and sharing – Counteracting forces in the industry.** We do not expect the new entrants to make significant dents in the market share of incumbents and therefore, consider it futile to factor in a strong tower demand from new players, which is imperative for high overall sharing in the industry. Further, we believe that the financial meltdown will force new operators to reconsider their aggressive expansion plans. Even if our expectations of low competition and hence, lower tower demand from new entrants go amiss, higher competition from new entrants and hence, increased tower sharing should balance out the equation for incumbents.

- **Slowdown will force sharing, but will limit expansion of new players and new services.** The slowdown and the ensuing credit crunch is expected to limit inordinate expansion in the tower industry and operators are expected to focus more on infrastructure sharing to reduce cost of network roll out. On the other hand, the slowdown is also likely to curb the network expansion of new players and postpone the investment by operators in new services such as 3G and WiMAX.

- **Number of operators in rural areas to be low.** Network roll-out in rural areas is another important driver for tower sharing, but it is not financially viable for multiple operators to exist in sparsely populated rural areas. Rural areas with high profitability are already covered and sharing in these areas will be limited. Assuming 30% penetration in rural areas, setting up towers will be profitable only in 10,000+ population areas. Further, operators are likely to roll out rural networks in the 900MHz band (where available), which has higher range and hence requires lower number of cell sites than 1,800MHz for the same coverage.

- **Legacy issues for incumbents.** Since the roll out of existing operators is in mature stages, existing towers are not equipped for multiple tenants and upgradation of these towers for multiple tenancies will imply high cost. Also, there is significant overlapping in tower coverage for urban areas, which will further limit sharing. However, demand for higher network quality in densely populated urban areas, would require high density of cell sites, which should drive tower demand in urban areas.

- **High competition makes business case further unattractive.** The business case for individual tower companies is further weakened by high number of contenders, over-building by the tower companies and the lack of differentiation in the towers business. Standalone tower companies may start charging rentals at marginal cost if they do not get significant deals with operators and the lack of differentiation in the towers business may lead to rentals converging at a lower level.

Expect towers to grow 2.3x over FY08-13E and tenancy to reach 2x

We expect towers to grow 2.3x over FY08-13E, while tenancy is expected to increase from 1.2x as of FY08-end to 2x as of FY13E-end, including 3G and WiMAX cell sites. The number of 2G cell sites is expected to increase 3.2x from ~245,000 in FY08 to ~800,000 in FY13E and is expected to contribute to 1.8x tenancy by FY13E, with the rest being contributed by 3G and WiMAX cell sites. We have not factored in any new towers being built exclusively for 3G/WiMAX, but expect 3G/WiMAX cell sites to be tenants on towers built for 2G.

Our expectations are based on the belief that there is little scope of sharing existing towers, with significant overlaps in urban areas and that higher build out of towers would lessen the chances of sharing new towers. The subscriber per cell sites ratio is expected to decline since operators will strive to improve network quality in urban areas and increase coverage in sparsely populated rural areas.

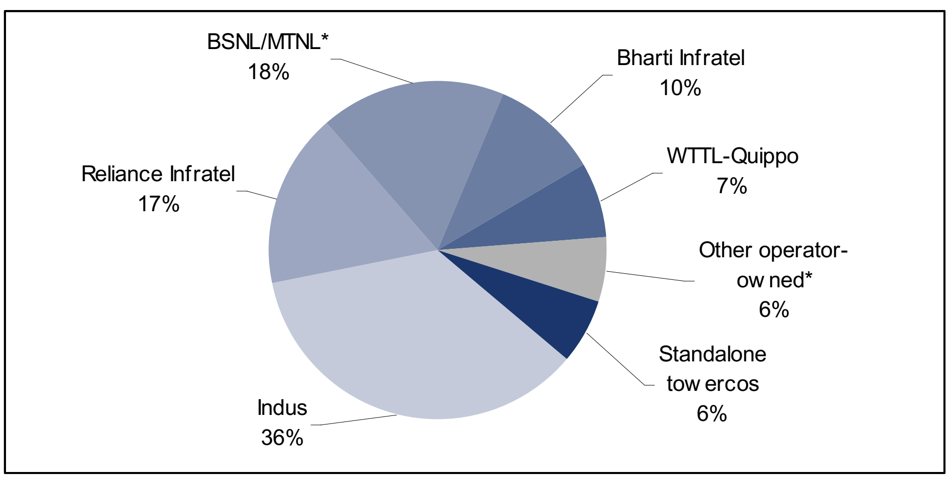
Table 9: Tower and tenancy expectations for the industry

	FY08	FY09E	FY10E	FY11E	FY12E	FY13E
Towers	**197,691**	**284,703**	**340,925**	**399,810**	**432,482**	**454,762**
2G cell sites	245,211	385,496	521,898	646,839	733,320	801,193
2G Tenancy	1.2	1.4	1.5	1.6	1.7	1.8
Total cell sites	245,211	385,496	547,993	724,460	828,652	913,360
Total Tenancy	1.2	1.4	1.6	1.8	1.9	2.0
Wireless subs (mn)	261	389	508	607	684	743
2G subs/cell sites	1,065	1,008	974	939	932	927

Source: Company data, I-Sec Research

Relative strengths of tower companies

Chart 20: December '08 – Share of tower companies



Source: Company data, I-Sec Research, * Estimates

Table 10: Tower and tenancy estimates of individual tower companies

		FY08	FY09E	FY10E	FY11E	FY12E	FY13E
Indus	**Towers**	**70,000**	**100,507**	**119,348**	**143,007**	**150,266**	**153,815**
	Cell sites	91,000	140,710	216,165	293,446	327,225	354,418
	Total Tenancy	1.30	1.40	1.81	2.05	2.18	2.30
Bharti Infratel	**Towers**	**20,000**	**28,355**	**35,295**	**43,321**	**50,090**	**54,828**
	Cell sites	24,000	34,026	45,229	68,523	91,222	112,309
	Total Tenancy	1.20	1.20	1.28	1.58	1.82	2.05
Reliance Infratel	**Towers**	**30,295**	**50,000**	**62,000**	**69,000**	**76,000**	**83,000**
	Cell sites	39,384	85,000	119,715	150,248	169,945	191,223
	Total Tenancy	1.30	1.70	1.93	2.18	2.24	2.30
WTTL-Quippo	**Towers**	**15,000**	**22,000**	**26,000**	**31,000**	**35,000**	**38,000**
	Cell sites	17,998	27,107	37,566	53,582	65,266	74,015
	Total Tenancy	1.20	1.23	1.44	1.73	1.86	1.95
BSNL/MTNL	**Towers**	**39,750**	**46,683**	**50,368**	**52,923**	**54,887**	**56,204**
	Cell sites	39,750	49,105	64,202	77,580	85,373	92,357
	Total Tenancy	1.00	1.05	1.27	1.47	1.56	1.64
Other operator-owned	**Towers**	**10,356**	**21,391**	**30,564**	**38,841**	**43,134**	**45,812**
Standalone tower cos	**Towers**	**12,290**	**15,766**	**17,350**	**21,718**	**23,104**	**23,104**

Source: Company data, I-Sec Research

- **Indus Towers – Co-opetition model.** Indus is the tower company formed by a three-way JV between the three leading GSM operators, BAL, Vodafone and Idea in 16 of the 23 circles. It is the largest tower company in India with 70,000 towers at FY08-end and ~100,000 towers currently. With three anchor tenants, Indus is assured of high tenancy and since economics of a tower company are driven by tenancy, profitability should not be an issue for Indus. However, it is a difficult task to manage such a large number of towers with three different legacy owners. Also, there maybe significant overlapping in densely populated urban areas, where all three operators may already have towers, thus capping on the overall tenancy.

- **Reliance Infratel – Dual technology and active infra-sharing model.** Reliance Infratel (RITL) is the hived-off, majority-owned telecom infrastructure subsidiary of RCom, which recently transferred its optic fibre assets to RITL to consolidate its entire telecom infrastructure under one company. RITL plans to leverage RCom's dual technology (CDMA & GSM) platform, with ~1.7x internal tenancy at present. RITL has the advantage of being the largest tower company with pan-India presence and is building towers with 4-5 slots, which means there will be enough capacity available for external tenants. However, RITL is incurring higher capex than the industry average for its towers and hence, has higher rentals, which may make it unattractive for external tenants, especially given that towers are standardised with no differentiation. To counter this, RITL is betting on being a one-stop shop for all telecom infrastructure hiring by providing active infrastructure sharing and fibre connectivity along with tower sharing.

- **Bharti Infratel – Strength in low penetration circles.** Bharti Infratel (BITL) is the passive infrastructure subsidiary of BAL, which holds towers in seven non-Indus circles and holds 42% stake in Indus. As of end-Q3FY09, it had 61,355 towers, of which ~35,000 towers have been transferred to Indus in January '09. Bharti Infratel operates in six C-circles and Madhya Pradesh (MP), which have the lowest penetrations currently and hence, the highest potential for future growth. BITL has one of the best coverages in these low penetration circles and since most telcos would be targetting these circles for growth and it is not economically viable to have too many towers in these low capacity circles, we expect Bharti Infratel to be at an advantage.

- **WTTIL-Quippo – Operator and standalone tower partnership.** TTSL and Quippo Telecom Infrastructure, promoted by SREI Infrastructure Finance, swapped 51% and 49% stakes respectively in their infrastructure businesses. As a result of this strategic partnership, Quippo will get management rights in Wireless Tata-Tele Info-Services (WTTIL), the tower arm of TTSL, in return for which Quippo will make a payment of Rs24bn and transfer 5,000 towers to WTTIL, which will have a combined 18,000 towers at an enterprise value of Rs130bn. WTTIL would have the advantage of having an anchor tenant and yet being managed by an independent tower company, which may be attractive to new entrants. WTTIL has already signed a tower-sharing deal with Unitech Telecom (60% owned by Telenor) for 40,000 sites by ’10-end.

- **BSNL and MTNL – Doubtful on sharing.** Though both BSNL and MTNL have announced plans of tower sharing, we have so far not seen any concrete actions. BSNL has announced plans to hive off tower assets into a separate tower companies to rationalise on licence fees paid to the Government. The two public-owned telcos are bound to face several roadblocks in their plans to share infrastructure and we do not expect high external tenancy on their towers. The unbundling of local loop in the wireline infrastructure space, which has long been overdue, is a case in point. However, since BSNL and MTNL have already been allotted 3G spectrum and have started rolling out 3G networks, we expect them to have an edge over other operators in terms of 3G tenancy.

- **Independent tower companies – Fringe players.** Apart from the tower companies being hived off from operators, there are several independent tower companies, the largest of them being GTIL, Essar and Xcel (recently acquired by American Tower Company). Since the roll-out plans of incumbents are aligned with that of their own tower companies, the standalone tower companies are mostly dependent on new entrants for their tenancy. Of the 5-6 new players expected to enter, Unitech Telecom has already signed long-term tower sharing deals with WTTIL, which further worsens the business case for the independent tower companies. The standalone tower companies suffer from lack of scale and pan-India coverage and hence, we believe they will remain marginal players in the tower space.

Table 11: Independent tower companies constitute just ~5% of industry towers

Company	No. of towers*
GTL Infra	6,866
Essar Telecom Tower International	3,500
Xcel/American Tower Company	1,500
Astor	1,000
Tower Vision	700
TVS InterConnect System	550
Others	250
Total independent tower cos	**14,366**

* As of December ’08

Source: Company data, I-Sec Research

Tower company valuations – Very sensitive to tenancy

Our model of a tower company with a single ground-based tower (GBT), derives a value of 1.3x the initial investment with a maximum tenancy of 2x, 0.4x debt to capital ratio and 14% annual rent yield on the investment. The valuation is highly sensitive to maximum tenancy and somewhat relatively less sensitive to monthly rentals and leverage.

Table 12: Key assumptions for single GBT model

Initial investment (Rs mn)	3.0
Maximum tenancy	2x
Increase in tenancy each year	0.5
Debt to capital ratio	0.4
Annual rent yield (%)	14
Rental per month per tenant (Rs)	35,000
Pass through per month per tenant (Rs)	21,000
Other costs per month per tower (Rs)	14,800
Depreciation rate (%)	5
Interest rate (%)	10
Tax rate (%)	33

Source: I-Sec Research

Table 13: Sensitivity to tenancy and rentals

		Maximum tenancy				
		1.0	**1.5**	**2.0**	**2.5**	**3.0**
	12.0	0.5x	0.8x	1.1x	1.3x	1.6x
	13.0	0.5x	0.9x	1.2x	1.5x	1.7x
Rent yield (%)	**14.0**	0.6x	1.0x	**1.3x**	1.6x	1.9x
	15.0	0.6x	1.0x	1.4x	1.7x	2.0x
	16.0	0.7x	1.1x	1.5x	1.9x	2.2x

Source: I-Sec Research

Table 14: Sensitivity to tenancy and leverage

		Maximum tenancy				
		1.0	**1.5**	**2.0**	**2.5**	**3.0**
	0.2	0.6x	0.9x	1.2x	1.5x	1.7x
	0.3	0.6x	0.9x	1.3x	1.5x	1.8x
Debt to total capital ratio	**0.4**	0.6x	1.0x	**1.3x**	1.6x	1.9x
	0.5	0.6x	1.0x	1.3x	1.7x	1.9x
	0.6	0.6x	1.0x	1.4x	1.7x	2.0x

Source: I-Sec Research

There has been a spate of deals in the tower space over the past 18 months, with investments from many foreign investors and PE players. The valuations of the deals have been varied with a high of Rs20mn per tower to Rs4.1mn per tower.

Telcos hived-off their tower assets into separate subsidiaries so that they could unlock value by raising capital through stake sale and monetising tower assets through external tenancy. Though telcos have been quick in hiving-off physical infrastructure and setting up valuation benchmarks, they have lagged behind in gaining significant external tenancies, which is the key value creator. We expect that going forward, valuations of telecom tower companies will be highly dependent on external tenancies.

Also, relatively limited data availability in the public domain on the potential tower-sharing possibilities and financial performance of tower companies should limit investor enthusiasm. Lack of clarity in roll-out schedule of new entrants and timing of 3G/WiMAX auctions remain areas of concern.

Table 15: Varied valuations per tower for deals

Tower co	Transaction details	Equity valuation	Towers	Implied valuation per tower	Deal announced
RITL	PE investment for 5% equity at US$337.5mn	US$6.75bn	~14,000	Rs20mn	Jul-07
BITL	PE investment for 10.8% to 13.5% equity at US$1.35bn	US$10-12.5bn	~50,000	Rs8.5-10.6mn	Dec-07
Spice Communications	Sale of 875 towers at Rs6bn	Rs6bn	875	Rs6.86mn	Dec-07
Aditya Birla Telecom (ABTL)	PE investment for 16% equity at US$428mn	US$428mn	~14,000	Rs9.3mn	May-08
WTTIL-Quippo	Quippo took 49% in WTTIL; Quippo contributed 5,000 towers and paid Rs24bn cash	Rs98bn	13,000+5,000	Rs6.1mn	Jan-09
Xcel Towers	Acquired by American Tower Company for Rs7bn	Rs7bn	1,700	Rs4.1mn	Mar-09

Source: Company data, I-Sec Research

Valuations – Shift from macro to micro

We believe that the investment theme for the telecom sector in India is likely to diverge from sector to company, based on the relative strength. We expect the tide of subscriber additions to no longer drive returns which was true during the high growth phase till '07, when all investors, primary, secondary or direct, realised high RoI. We believe the stock drivers going forward will depend on the micro factors such as relative competitive strength, growth stage of the company and balance sheet strength.

We initiate coverage on the telecom sector with a Neutral view and expectations of a divergent stock performance with BUY recommendation on BAL (Rs733/share target price, 19% upside), HOLD on RCom (Rs169/share target price, 6% downside) and HOLD on Idea (Rs48.4/share target price, 3% downside).

We believe that BAL offers a relatively safe bet in the Indian telecom space as a leader with strong balance sheet. We believe RCom faces a challenging phase as the company extends its dual network and high leverage restricts its ability to invest in 3G. Idea offers limited gains from the current levels as the company is likely to compete in an aggressive market.

Table 16: Valuation snapshot

Stock	Recommendation	Target price (Rs)	CMP (Rs)	Return (%)
BAL	BUY	733	615	19
RCom	HOLD	169	180	(6)
Idea	HOLD	48.4	50	(3)

Source: I-Sec Research

Divergent stock performance post financial meltdown

The telecom sector in India has seen significantly divergent stock performance during the recent correction. BAL has significantly outperformed the sector whereas Idea and RCom have underperformed, which is contrary to the view that telcos are defensive. We see the divergence owing to investor preference of companies with strong balance sheet, stable market share, high free cashflow and strong corporate governance. We believe that it is time for a shift in investment theme from macro to micro, in which case BAL stands out.

Table 17: Performance of stocks in the bull-run and during slowdown

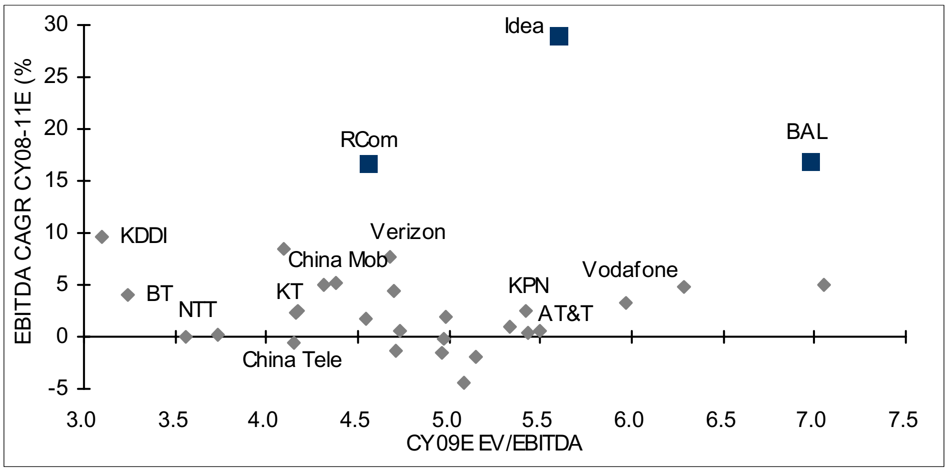
	Annualised return (%)		Average P/E		Average EV/EBITDA	
	'02-'07	'08-till date	'02-'07	'08-till date	'02-'07	'08-till date
BAL	73.1	(29.5)	20.2	16.0	11.0	9.4
RCom	67.5	(68.4)	21.5	15.1	12.1	10.3
Idea	113.1	(55.1)	32.7	26.1	13.5	7.9

Source: Bloomberg, I-Sec Research

Indian telco valuations have corrected well in line with global peers

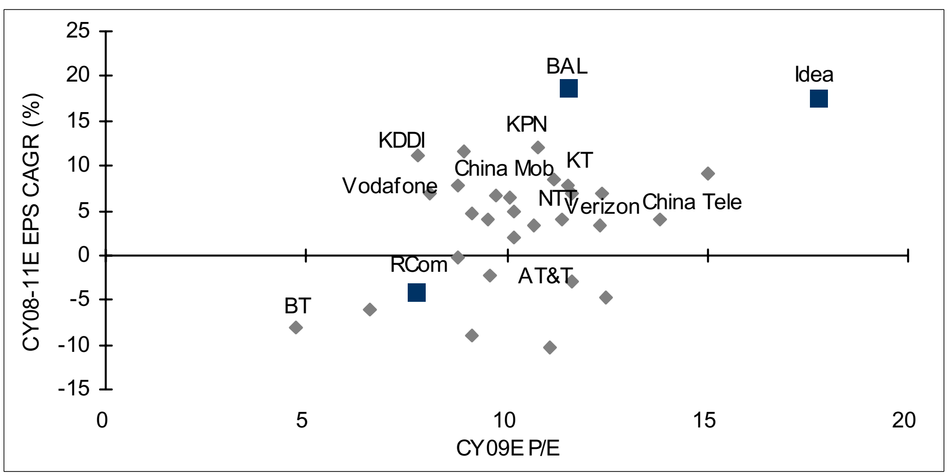
The performance of Indian telcos has been mixed post '08 but valuations have corrected in line with global telcos' valuations. In the US and Europe, telcos are currently trading at an average of CY09E P/E of 9.4x and EV/EBITDA of 5x, whereas telcos in the Asian emerging markets (ex-India) are trading at CY09E P/E of 11.4x and EV/EBITDA of 4.4x. As compared with the emerging markets, BAL trades at higher ratios, but offers superior growth and higher RoE. While RCom looks cheap based on FY10E valuations, it offers limited growth and lower RoEs.

Chart 21: Global telcos –CY09E EV/EBITDA versus CY08-11E EBITDA CAGR



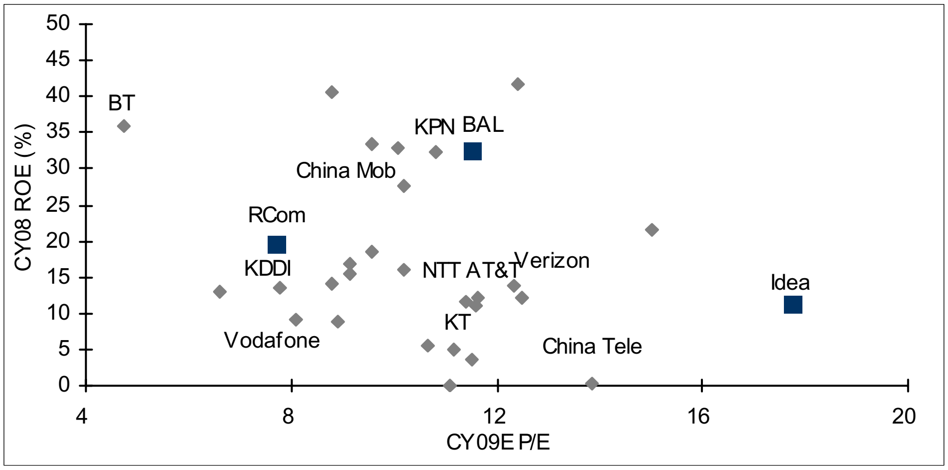
Source: Bloomberg, I-Sec Research
Note: For Indian and UK telcos CY08 refers to FY09 and so on

Chart 22: Global telcos – CY09E P/E versus CY08-11E PAT CAGR



Source: Bloomberg, I-Sec Research
Note: For Indian and UK telcos CY08 refers to FY09 and so on

Chart 23: Global telcos – P/E versus RoE



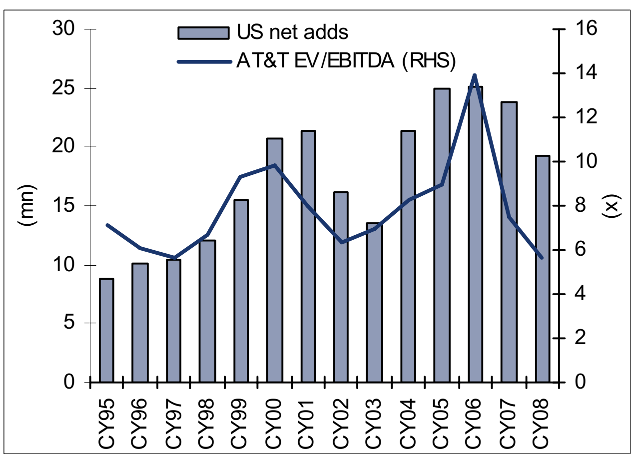
Source: Bloomberg, I-Sec Research
Note: For Indian and UK telcos CY08 refers to FY09 and so on

Telecom valuations peak with net adds

Globally, Telecom valuations have peaked with net additions. We believe net additions in India have peaked in FY09 and further stock performance will be driven by earnings growth as opposed to valuation multiple expansions.

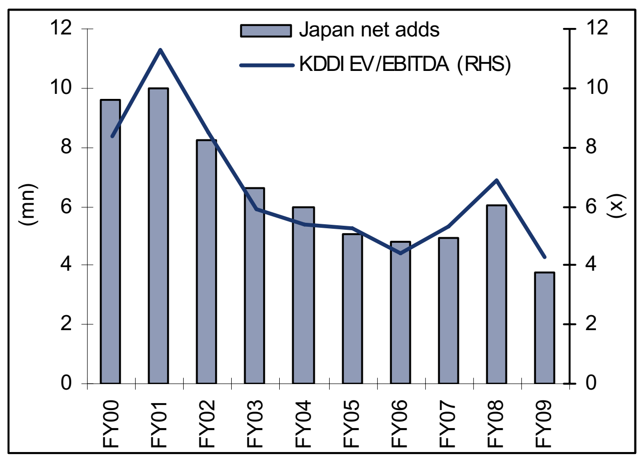
Chart 24: Globally, sector valuations peak along with net adds

US



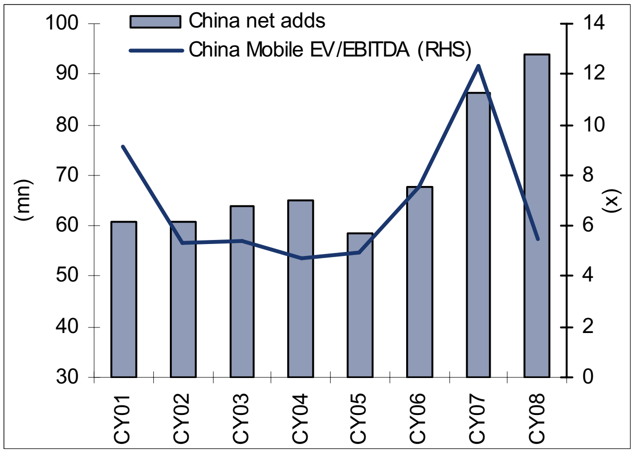
Source: CTIA, Bloomberg, I-Sec Research

Japan



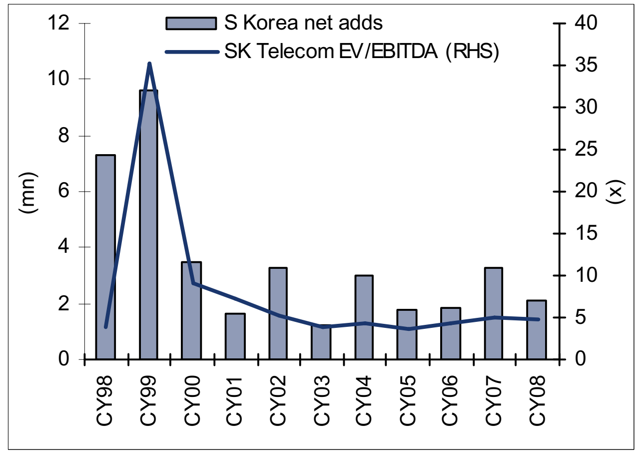
Source: Telecom Carriers Association, Bloomberg, I-Sec Research

China



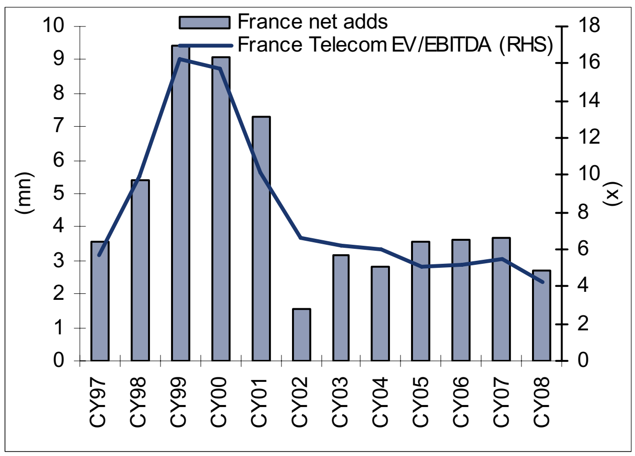
Source: Bloomberg, I-Sec Research

South Korea



Source: Company data, Bloomberg, I-Sec Research

France

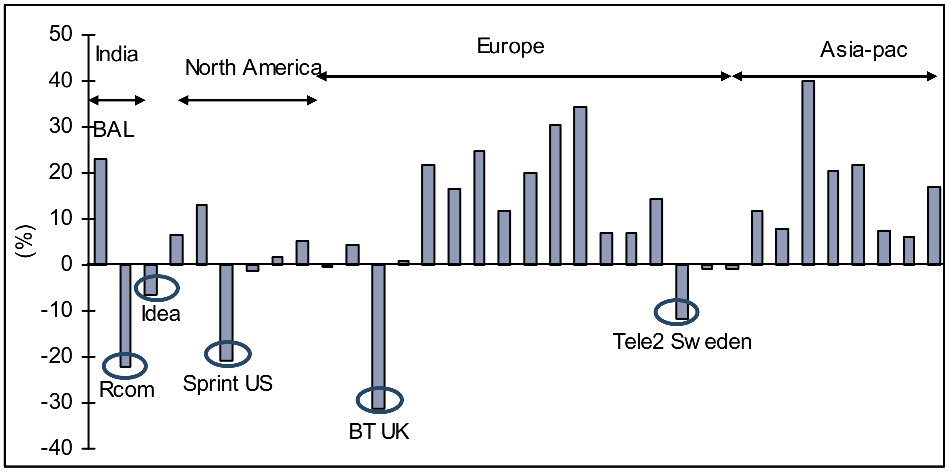


Source: ARCEP, Bloomberg, I-Sec Research

Globally, telco stocks have emerged as defensive plays

Globally, post the correction in the stock market (from January '08 till date) most telco stocks have outperformed local indices, excluding cases which have had stock-specific issues. While telcos offer a defensive play visibly, we believe that the divergence in stock performance will continue owing to short-term disruption that is expected in the market. We recommend a Neutral rating on the sector on rising competition and believe that uncertainty compensates for high growth expectations.

Chart 25: Performance of telco stocks vis-à-vis local indices



Source: Bloomberg, I-Sec Research

Foreign interest high in the Indian telecom space

Recent deals in the telecom space do not signify any benchmark valuation, especially given that the ability of new entrants to post positive cashflow in the next 5-6 years is low.

Table 18: Valuations benchmarks of recent deals

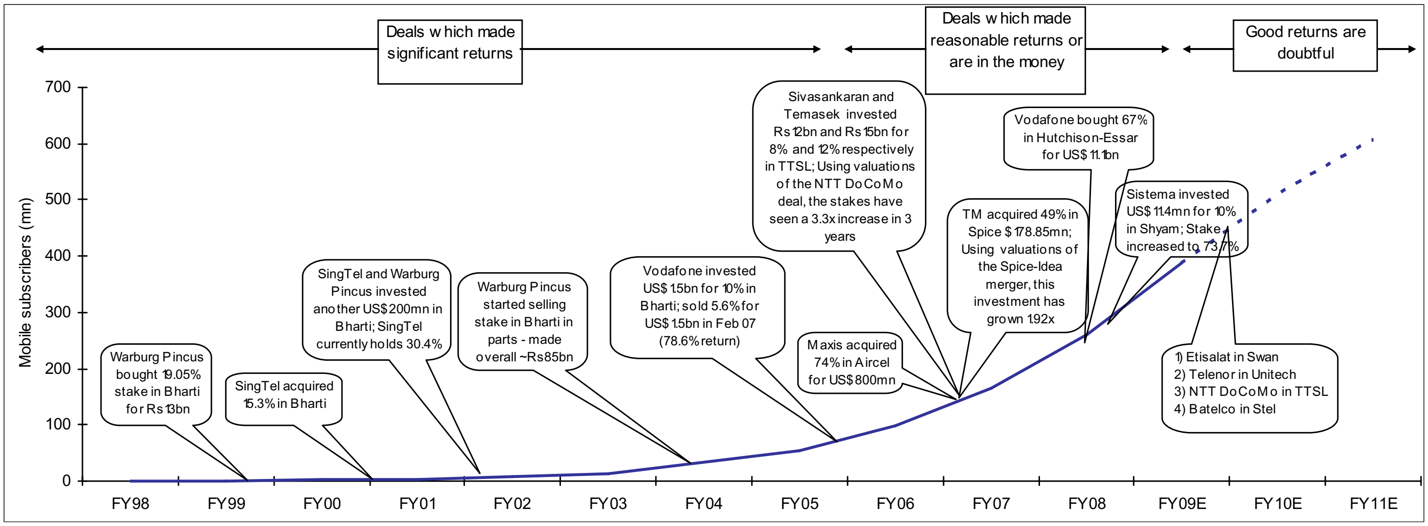
New telcos	Investor	Investments received	Implied Valuations
Swan Telecom	Etisalat	US$900mn for a 45% stake	US$2bn (~Rs98bn)
Unitech	Telenor	US$1,230mn (Rs61.2bn) over several stages for 60% stake; Plans to raise Telenor's stake to 74%	US$2.05bn (~Rs102bn)
Shyam Telelink	Sistema	US$11.4bn for 10% stake; Sistema's stake was increased to 73.7% over a period of time	US$114bn
TTSL	NTT DoCoMo	US$2.7bn for 26% stake	US$10.3bn (~Rs505bn)
S Tel	Batelco	US$225mn for 49% stake	US$459bn (~Rs22.5bn)

Source: Company data, I-Sec Research

In spite of a weak business case for new entrants, foreign players are keen to get a foothold in the Indian market due to the following reasons:

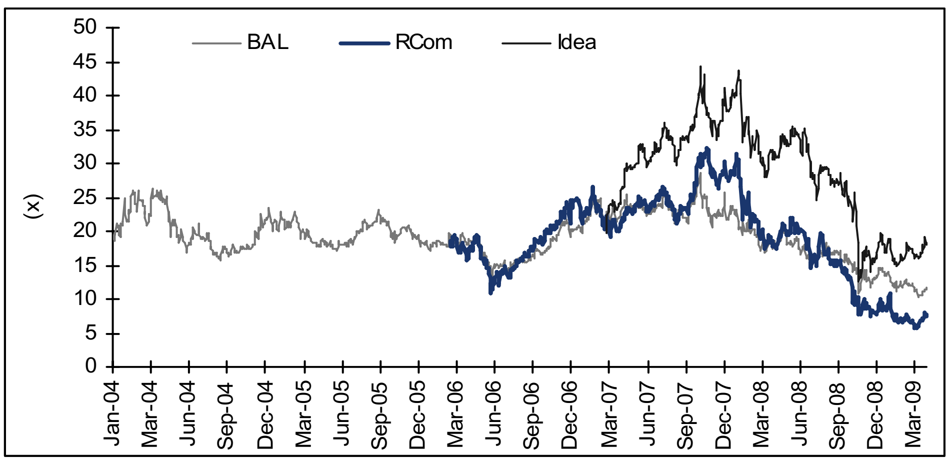
- The India telecom market has till date been kind to both strategic investors and private equity players, in terms of returns leading to the hype (Chart 26).
- With some large global telcos such as SingTel, Vodafone, Telecom Malaysia and Maxis having presence in India, the remaining players felt left out and found the issue of licences to new players as an opportune time to enter.
- The opportunity to invest in new entrants who have been issued fresh licences was the last chance for global players to enter the second largest mobile subscriber market, next only to China.
- In spite of a large subscriber base, India still offers robust growth and therefore fits in well with the long-term strategy of presence in emerging countries for global telcos, who have limited opportunity for organic growth or for reinvesting surplus cash, since they operate in near-saturated telecom markets.
- With the ongoing slowdown, even within emerging markets, the mobile industry is one of the few remaining growth stories before a recovery happens.
- High RoE of well-entrenched incumbents is attractive.

Chart 26: Indian mobile space – Honey pit for funding, but may not remain so going forward



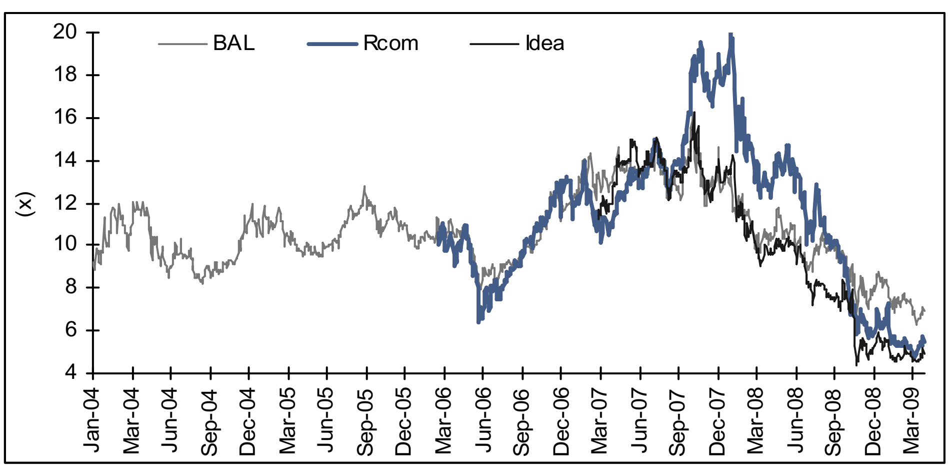
Source: Company data, I-Sec Research

Chart 27: P/E



Source: Bloomberg, I-Sec Research

Chart 28: EV/EBITDA



Source: Bloomberg, I-Sec Research

Table 19: Global sectoral valuations

	Last Price (Local currency)	Market cap (US$ mn)	P/E (x)				EV/EBITDA (x)				EBITDA Margin (%)	RoE (%) CY08E	RoCE (%) CY08E
			CY07	CY08E	CY09E	CY10E	CY07	CY08E	CY09E	CY10E			
India													
BAL*	626	23,412	18.5	14.0	11.5	9.5	10.8	8.1	7.0	5.8	40.9	32.7	25.1
RCom*	175	7,113	8.9	6.2	7.7	7.7	6.3	5.4	4.6	3.8	40.4	19.5	8.7
Idea*	50	3,061	12.6	16.6	17.7	14.8	9.3	7.7	5.6	4.3	26.6	11.2	18.9
Average			**13.3**	**12.3**	**12.3**	**10.7**	**8.8**	**7.1**	**5.7**	**4.7**			
North America													
AT&T	25.5	148,276	9.2	9.0	11.6	10.9	5.2	5.1	5.4	5.2	35.2	12.2	8.6
Verizon	31.0	85,842	13.0	12.1	12.3	11.6	5.6	5.3	4.7	4.5	32.3	13.9	11.5
Qwest	3.5	5,998	6.4	8.6	11.1	11.8	4.7	4.8	5.1	5.2	33.1	-	8.9
Bell Canada	25.1	15,726	12.0	11.8	10.7	10.8	4.7	4.7	4.7	4.7	39.2	5.7	6.1
Telus	34.8	8,682	9.8	10.1	10.2	9.9	4.7	4.6	4.5	4.5	39.1	16.0	11.7
Rogers	30.8	14,943	20.9	14.3	15.0	13.3	7.5	6.6	6.3	5.9	36.2	21.4	11.7
Average			**11.9**	**11.0**	**11.8**	**11.4**	**5.4**	**5.2**	**5.1**	**5.0**	**33.7**	**9.3**	**9.7**
Europe													
Vodafone*	122.8	86,789	10.3	8.8	8.1	7.7	6.9	6.3	6.0	5.9	38.7	9.2	8.5
BT*	78.2	7,977	3.4	5.4	4.7	4.5	3.0	3.5	3.2	3.2	27.8	36.0	28.9
Bouygues	26.9	12,209	6.7	6.2	6.6	6.9	4.3	4.2	4.4	4.7	11.8	13.1	12.0
France Telecom	17.2	59,322	8.8	8.5	8.8	8.5	4.6	4.6	4.7	4.7	35.8	14.2	6.1
Telefonica	15.0	93,486	10.3	9.4	8.8	8.0	5.3	5.3	5.3	5.2	38.8	40.7	10.5
Duetsche Telecom	9.4	54,060	14.9	12.9	11.5	10.9	4.4	4.4	4.2	4.2	31.4	3.6	4.2
Portugal Telecom	5.8	6,914	9.0	9.5	9.7	8.8	5.2	4.9	5.0	4.9	36.1	73.9	12.3
Belgacom	23.6	10,553	8.6	9.1	9.6	9.8	4.7	5.0	5.1	5.2	33.1	33.4	17.2
KPN	10.1	22,815	12.8	12.4	10.8	9.5	5.8	5.6	5.4	5.3	34.7	32.4	11.6
Elisa	11.0	2,418	8.4	9.6	9.5	8.8	5.3	5.5	5.5	5.4	32.0	18.5	12.4
Tele2	69.5	3,814	29.5	10.3	8.9	8.1	5.4	4.6	4.3	4.1	20.2	8.8	7.5
TeliaSonera	3.6	21,444	10.1	9.7	9.1	8.7	7.8	7.7	7.0	6.7	31.1	15.4	11.4
Average			**11.1**	**9.3**	**8.9**	**8.4**	**5.2**	**5.1**	**5.0**	**4.9**	**31.1**	**23.1**	**11.0**
Asia ex-India													
China Mobile	67.5	174,672	14.2	10.6	10.2	9.7	5.3	4.7	4.4	4.2	52.6	27.6	25.7
China Telecom	3.2	33,417	9.8	11.2	13.8	12.0	3.5	3.5	3.7	3.6	44.2	0.4	8.4
Chungwa Tele	61.9	17,700	14.8	11.6	12.5	12.5	4.8	4.9	5.0	5.0	49.1	12.1	12.1
TAC	26.5	1,768	10.1	7.0	9.1	8.6	4.3	3.9	4.2	3.9	31.9	16.8	12.7
Telkom Ind	7,550	13,009	11.4	13.1	12.4	11.6	4.6	5.0	4.7	4.4	54.9	41.6	33.6
Indosat	4,725	2,194	12.6	12.4	11.6	11.0	4.9	4.5	4.1	3.7	49.8	11.1	9.9
Philippines LD	2,195	8,533	11.6	11.1	10.1	9.7	5.3	5.1	5.0	4.8	60.8	32.9	22.0
KDDI	462,000	20,856	10.2	9.1	7.8	7.1	4.0	3.6	3.1	2.9	21.8	13.6	10.2
NTT DoCoMo	133,700	59,148	12.4	12.2	11.4	11.0	3.8	3.7	3.6	3.7	34.3	11.6	10.4
KT Corp	38,500	7,702	9.5	15.6	11.2	9.9	3.5	3.9	4.2	4.0	30.5	5.1	4.9
Average			**11.6**	**11.4**	**11.0**	**10.3**	**4.4**	**4.3**	**4.2**	**4.0**	**43.0**	**17.3**	**15.0**

* For Indian and UK telcos, CY08 refers to FY09 and so on
Note: Prices are as of March 31, ’09
Source: Bloomberg, I-Sec Research

Key risks to recommendations

3G spectrum auctions

3G licencing through the auction route is expected in ’09 in India. The auction can significantly swing fortunes for Indian telcos based on who gets the spectrum, at what price and when. As of now, BAL is placed to gain from the earlier 3G auctions, while RCom is better off with a delay in 3G.

Tower sharing

We expect tower sharing arrangements to be decided by the new players in the short term. Any formation of partnership and sharing agreements can change our expectations significantly. RCom has relatively low external tenancy and can be the prime beneficiary from sharing with new players.

Regulation

Any changes in regulation regarding IUC charges, MNP, reduction in licence fees and one-time spectrum fees can be the key triggers for stock performance.

Competition

While we expect high competition but muted impact in the telecom space due to the entry of new players, we will revisit our expectations given any major disruption due to the entry of new players.

Annexure 1: Subscriber & penetration estimates

Table 20: Subscribers by operators

(mn)

	FY07	FY08	FY09E	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E
Aircel	5.5	10.6	18.1	28.6	38.6	46.2	52.1	56.5	59.3
BAL	37.1	62.0	93.6	119.2	139.9	156.3	169.1	178.5	184.6
BPL Mobile	1.1	1.3	2.1	2.6	2.8	2.9	3.0	3.0	3.1
BSNL	31.0	40.8	50.7	52.6	54.3	56.1	57.6	58.7	59.4
Idea*	16.7	28.2	42.9	56.6	67.5	76.0	82.5	87.3	90.3
MTNL	2.9	3.5	4.5	4.6	4.7	4.7	4.8	4.8	4.8
RCom	29.0	45.8	72.7	101.2	120.4	133.6	143.8	151.3	156.0
TTSL	16.0	24.3	34.8	42.7	52.0	60.2	66.4	71.1	74.1
Vodafone	26.4	44.1	68.2	87.3	102.0	113.5	122.2	128.7	132.6
Others	0.2	0.4	0.9	13.0	24.9	34.1	41.1	46.4	49.7
Total	**166.1**	**261.1**	**388.6**	**508.4**	**607.1**	**683.6**	**742.5**	**786.3**	**814.0**

* Idea includes Spice subs also; Source: TRAI, I-Sec Research

Table 21: Subscriber share of operators

(%)

	FY07	FY08	FY09E	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E
Aircel	3.3	4.1	4.7	5.6	6.4	6.8	7.0	7.2	7.3
BAL	22.4	23.7	24.1	23.4	23.0	22.9	22.8	22.7	22.7
BPL Mobile	0.6	0.5	0.5	0.5	0.5	0.4	0.4	0.4	0.4
BSNL	18.7	15.6	13.1	10.3	8.9	8.2	7.8	7.5	7.3
Idea*	10.1	10.8	11.0	11.1	11.1	11.1	11.1	11.1	11.1
MTNL	1.8	1.4	1.1	0.9	0.8	0.7	0.6	0.6	0.6
RCom	17.4	17.5	18.7	19.9	19.8	19.5	19.4	19.2	19.2
TTSL	9.7	9.3	9.0	8.4	8.6	8.8	8.9	9.0	9.1
Vodafone	15.9	16.9	17.6	17.2	16.8	16.6	16.5	16.4	16.3
Others	0.1	0.2	0.2	2.6	4.1	5.0	5.5	5.9	6.1
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

* Idea includes Spice subs also; Source: TRAI, I-Sec Research

Table 22: Net adds by operators

(mn)

	FY07	FY08	FY09E	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E
Aircel	2.9	5.1	7.5	10.5	10.0	7.7	5.9	4.4	2.8
BAL	17.6	24.8	31.6	25.6	20.7	16.4	12.8	9.5	6.1
BPL Mobile	(0.3)	0.2	0.8	0.5	0.2	0.1	0.1	0.1	0.1
BSNL	11.3	9.8	9.9	1.9	1.7	1.8	1.4	1.1	0.7
Idea*	7.4	11.5	14.7	13.8	10.9	8.5	6.5	4.8	3.0
MTNL	0.9	0.6	0.9	0.2	0.1	0.0	0.0	0.0	0.0
RCom	8.8	16.8	26.9	28.5	19.2	13.2	10.2	7.5	4.7
TTSL	7.6	8.3	10.5	7.8	9.4	8.1	6.2	4.7	3.0
Vodafone	11.1	17.7	24.1	19.0	14.8	11.4	8.8	6.4	3.9
Others	0.0	0.2	0.5	12.1	11.9	9.2	7.1	5.3	3.3
Total	**67.2**	**95.0**	**127.5**	**119.9**	**98.7**	**76.4**	**59.0**	**43.8**	**27.7**

* Idea includes Spice subs also; Source: TRAI, I-Sec Research

Table 23: Net adds share of operators

(%)

	FY07	FY08	FY09E	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E
Aircel	4.3	5.4	5.9	8.7	10.1	10.0	10.0	10.0	10.1
BAL	26.1	26.1	24.8	21.4	21.0	21.4	21.7	21.6	21.9
BPL Mobile	(0.4)	0.2	0.7	0.4	0.2	0.1	0.1	0.1	0.2
BSNL	16.7	10.3	7.8	1.5	1.7	2.4	2.4	2.6	2.7
Idea*	11.1	12.1	11.5	11.5	11.0	11.1	11.0	11.0	10.9
MTNL	1.3	0.6	0.7	0.1	0.1	0.1	0.1	0.1	0.1
RCom	13.0	17.7	21.1	23.8	19.4	17.3	17.3	17.2	17.1
TTSL	11.3	8.7	8.2	6.5	9.5	10.6	10.6	10.6	10.8
Vodafone	16.5	18.6	18.9	15.9	15.0	15.0	14.8	14.7	14.1
Others	0.1	0.2	0.4	10.1	12.0	12.0	12.0	12.0	12.0
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

* Idea includes Spice subs also; Source: TRAI, I-Sec Research

Table 24: Circle-wise subscribers

(mn)

	FY07	FY08	FY09E	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E
Chennai	4.7	7.1	9.2	10.0	10.6	10.9	11.1	11.3	11.5
Delhi	12.1	16.3	21.5	23.7	25.2	25.9	26.4	26.8	27.3
Kolkata	5.2	7.8	11.6	13.4	14.7	15.5	15.8	16.2	16.6
Mumbai	9.9	13.6	19.1	23.0	24.7	25.4	26.0	26.5	27.1
METRO TOTAL	**31.9**	**44.8**	**61.4**	**70.1**	**75.2**	**77.7**	**79.3**	**80.9**	**82.5**
AP	13.1	20.6	31.0	41.9	48.6	53.8	57.7	60.3	61.7
Gujarat	11.2	17.0	23.8	31.1	35.6	39.1	41.7	43.5	44.4
Karnataka	11.4	17.0	23.5	30.4	35.1	38.7	41.4	43.2	44.2
Maharashtra	12.7	21.1	31.0	40.9	47.5	52.6	56.4	59.0	60.3
TN	10.5	18.3	27.6	35.7	40.8	44.7	47.7	49.7	50.7
A Circle TOTAL	**58.9**	**94.0**	**137.0**	**180.0**	**207.6**	**228.7**	**244.9**	**255.8**	**261.3**
Haryana	4.5	6.4	9.3	11.5	13.5	15.2	16.3	17.3	17.9
Kerala	7.5	11.7	16.2	20.1	22.6	24.4	25.7	26.6	27.0
MP	7.2	13.2	20.4	28.1	36.0	42.2	47.1	51.2	54.4
Punjab	8.4	11.7	14.7	17.1	18.8	19.9	20.6	21.1	21.2
Rajasthan	8.0	13.6	22.7	28.9	33.9	37.7	40.6	42.6	43.5
UP E	10.4	16.2	26.7	39.9	52.0	61.5	69.0	74.5	77.8
UP W	7.9	12.9	19.2	26.3	32.8	37.9	41.9	44.9	46.8
WB	5.2	9.4	15.6	22.0	28.5	33.6	37.3	39.8	41.2
B Circle TOTAL	**59.2**	**95.1**	**144.7**	**193.7**	**238.0**	**272.3**	**298.6**	**318.0**	**329.8**
Assam	2.4	3.9	5.8	8.2	11.0	13.3	15.0	16.3	17.2
Bihar	6.5	11.5	20.7	30.7	42.2	52.2	60.5	67.1	72.0
HP	1.5	2.3	3.8	4.6	5.4	6.1	6.6	7.0	7.4
J & K	1.5	2.2	3.4	4.6	6.0	7.2	8.2	9.1	9.8
North East	1.2	2.1	3.3	4.4	6.0	7.3	8.4	9.3	10.1
Orissa	3.0	5.2	8.4	12.0	15.8	18.8	21.1	22.8	24.0
C Circle TOTAL	**16.1**	**27.2**	**45.4**	**64.6**	**86.4**	**104.8**	**119.7**	**131.7**	**140.5**
Total	**166.1**	**261.1**	**388.6**	**508.4**	**607.1**	**683.6**	**742.5**	**786.3**	**814.0**

Source: TRAI, I-Sec Research

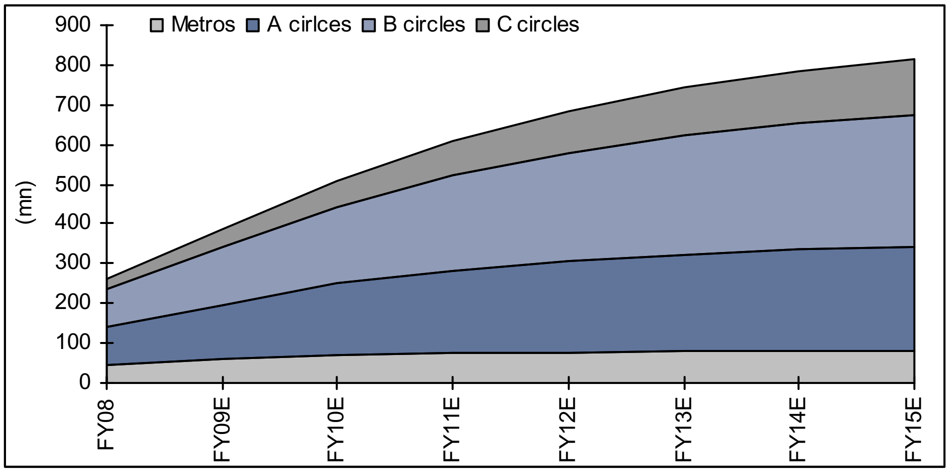
Table 25: Circle-wise mobile penetration

(%)

	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15
Chennai	63.5	93.0	116.0	125.0	131.0	133.0	133.5	133.8	134.0
Delhi	72.9	92.0	117.1	127.0	133.0	135.0	135.5	136.0	136.5
Kolkata	39.6	61.0	87.0	99.0	107.0	111.0	112.0	113.0	114.0
Mumbai	58.3	75.0	101.0	120.0	127.0	129.0	130.0	131.0	132.0
METRO TOTAL	**59.0**	**79.6**	**104.9**	**117.5**	**124.2**	**127.3**	**128.1**	**128.8**	**129.6**
AP	16.2	25.0	36.3	48.3	55.3	60.3	63.8	65.8	66.3
Gujarat	20.0	31.0	41.8	53.8	60.8	65.8	69.3	71.3	71.8
Karnataka	20.1	30.0	39.8	50.8	57.8	62.8	66.3	68.3	68.8
Maharashtra	14.0	26.0	36.8	47.8	54.8	59.8	63.3	65.3	65.8
TN	17.6	30.0	43.6	55.6	62.6	67.6	71.1	73.1	73.6
A Circle TOTAL	**17.1**	**28.0**	**39.2**	**50.9**	**57.9**	**62.8**	**66.3**	**68.3**	**68.8**
Haryana	19.2	29.0	40.3	49.3	57.3	63.3	67.3	70.3	71.8
Kerala	22.0	34.0	45.4	55.4	61.4	65.4	67.9	69.4	69.4
MP	7.9	15.0	22.3	30.3	38.3	44.3	48.8	52.3	54.8
Punjab	30.8	44.0	52.9	60.9	65.9	68.9	70.4	70.9	70.4
Rajasthan	12.6	22.0	35.3	44.3	51.3	56.3	59.8	61.8	62.3
UP E	8.1	12.0	19.1	28.1	36.1	42.1	46.6	49.6	51.1
UP W	11.5	18.0	25.8	34.8	42.8	48.8	53.3	56.3	57.8
WB	7.0	13.0	20.7	28.7	36.7	42.7	46.7	49.2	50.2
B Circle TOTAL	**11.6**	**18.6**	**27.2**	**36.0**	**43.6**	**49.1**	**53.1**	**55.7**	**57.0**
Assam	8.1	14.0	19.8	27.8	36.8	43.8	48.8	52.3	54.3
Bihar	5.3	10.0	17.3	25.3	34.3	41.8	47.8	52.3	55.3
HP	22.6	30.0	48.2	57.2	66.2	73.2	78.2	82.2	85.2
J & K	12.8	16.0	23.5	31.5	40.5	48.0	54.0	59.0	63.0
North East	9.1	14.0	20.8	27.8	36.8	44.3	50.3	55.3	59.3
Orissa	7.7	14.0	21.9	30.9	39.9	46.9	51.9	55.4	57.4
C Circle TOTAL	**7.2**	**12.6**	**20.1**	**28.3**	**37.3**	**44.6**	**50.3**	**54.5**	**57.4**
Total	**14.7**	**22.8**	**33.3**	**43.0**	**50.7**	**56.3**	**60.3**	**62.9**	**64.3**

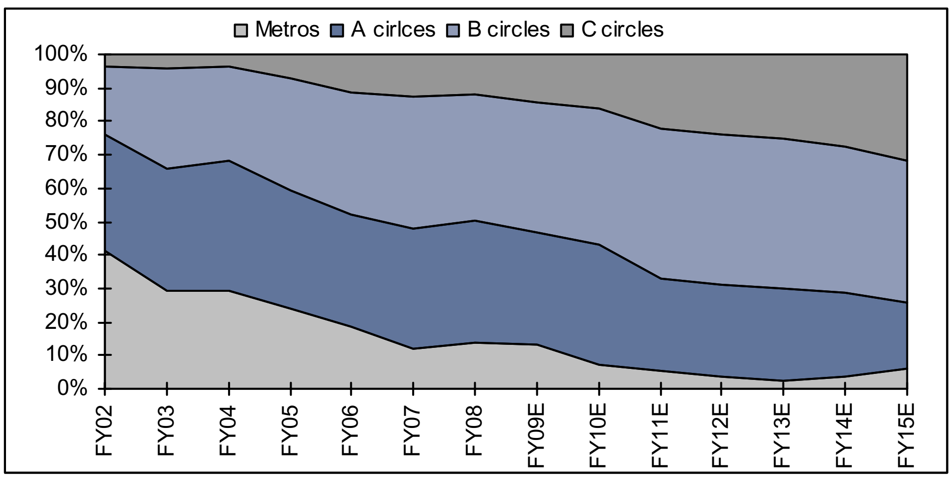
Source: TRAI, I-Sec Research

Chart 29: Subscribers from different circle categories



Source TRAI, I-Sec Research

Chart 30: Net adds share of different category circles



Source: TRAI, I-Sec Research

Annexure 2: Regulation – Pending issues

Licence & spectrum fees

At present, Indian telcos make payments for various levies such as licence fee, spectrum fee and taxes. For wireless operators, the current spectrum fee is 2-6% of adjusted gross revenues (AGR) depending on the amount of spectrum. TRAI had recommended increasing the spectrum charges for the spectrum held above 8MHz, while DoT suggested 1% higher charges than that recommended by TRAI. The TRAI has decided to go along with the proposal of DoT, as a result of which, the spectrum charges are set to increase 1-2% of AGR depending on the amount of the spectrum.

Table 26: AGR share of spectrum fees

(%)

Amount of spectrum	Current	Recommendations by TRAI	Recommendations by DoT	DoT versus current
Up to 2x4.4 MHz/2x2.5MHz	2	2	3	1
Up to 2 x 6.2 MHz	3	3	4	1
Up to 2 x 8 MHz	4	4	5	1
Up to 2 x 10 MHz	4	5	6	2
Up to 2 x 12.5 MHz	5	6	7	2
Up to 2 x 15 MHz	6	7	8	2
Beyond 15 MHz	NA	8	9	NA

Source: DoT, TRAI, I-Sec Research

In March ’08, DoT proposed to implement a one-time spectrum enhancement charge for operators who currently hold spectrum in excess of 6.2MHz. The exact amount of the one-time fee is yet to be decided and will be based on the market valuation of spectrum. The operators will have to pay the fee retrospectively.

Table 27: Spectrum enhancement charges

	Recommendations by TRAI	Recommendations by DoT
Above	10MHz	6.2MHz
Metros and category A	Rs16bn/MHz	
Category B	Rs8bn/MHz	Not defined yet
Category C	Rs3bn/MHz	

Source: DoT, TRAI, I-Sec Research

For wireless operators, the AGR share of licence fee is 10% for metros and category A circles, 8% for category B circles and 6% for category C circles, while NLD and ILD operators pay 6% of their revenues as licence fees. To encourage deeper roll-out of wireless networks, in August ’07, TRAI had suggested 2% reduction in licence fee share for wireless operators in circles where they have crossed 75% coverage of development blocks, which it reiterated in its recommendation on achieving rural penetration released in March ’09. DoT had announced 2% reduction in licence fees for crossing 95% population coverage, starting April ’09 but recently postponed the implementation.

Table 28: Reduction in licence fees for achieving 95% coverage of development blocks

	Current charges (%)	If 2% reduction in USO levy is implemented (%)	Reduction (%)
Metros	10	8	(20.0)
Category A	10	8	(20.0)
Category B	8	6	(25.0)
Category C	6	4	(33.3)

Source: DoT, TRAI, I-Sec Research

3G & broadband wireless access auctions

- **Reserve price.** The reserve price for pan-India 3G spectrum suggested by DoT in its 3G auction guidelines is Rs20.2bn, twice the price suggested by TRAI in '06 at Rs10.5bn. The Finance Ministry has suggested increasing the reserve price to 2x that suggested by DoT.

Table 29: Circle-wise reserve price for 3G and BWA services

(Rs bn)

	No. of circles	For 2 x 5MHz 3G spectrum	For 20MHz of BWA spectrum
Delhi, Mumbai and Category A circles	7	1.6	0.8
Kolkata and Category B circles	9	0.8	0.4
Category C circles	6	0.3	0.15
Pan-India		**20.2**	**10.1**
License period		20 years	15 years

Source: DoT, I-Sec Research

Table 30: Roll-out obligations

	End of two years	End of five years
Metros	None	90% of metro area for 3G and BWA
A, B and C	(i) None for 3G (ii) For BWA, 25% rural SDCA area	(i) For 3G, 50% of DHQs or cities in the circle, of which 15% of the DHQs should be rural SDCAs (ii) For BWA, 50% rural SDCA area

Source: DoT, I-Sec Research

- **Share of revenues.** As per 3G guidelines announced by DoT, the annual fees for holding the spectrum will be 1% of the AGR second year onwards. It is as of yet undecided if this is 1% of the total AGR of the operator or 1% of the AGR from 3G services. In case of the former, existing operators will be at a disadvantage since they will have to make large payments to the DoT apart from the licence & spectrum fees. However, identifying the proportion of 3G revenues would be difficult as suggested by TRAI.

- **Spectrum availability.** Though as per DoT's guidelines, up to 10 licenses will be auctioned in each circle, the availability of 3G spectrum across different circles is an issue with different number of blocks being available in different circles. In two circles, Rajasthan and the North East, no blocks are currently available, while in Delhi, spectrum is available to accommodate only two operators, of which one will be MTNL, leaving enough spectrum for just one private player. While DoT's guidelines suggest auctioning only those blocks where the spectrum is already available, the Finance Ministry has suggested auctioning 10 blocks in all circles irrespective of spectrum availability.

Table 31: Availability of 3G spectrum blocks across circles services

Category	Circle	No. of 3G spectrum blocks available	Category	Circle	No. of 3G spectrum blocks available
Metro	Delhi	2	B	Punjab	4
Metro	Mumbai	4	B	Rajasthan	0
Metro	Kolkata	4	B	UP E	4
A	Andhra Pradesh	4	B	UP W	3
A	Gujarat	2	B	WB	1
A	Karnataka	4	C	Assam	4
A	Maharashtra	4	C	Bihar	4
A	Tamil Nadu	4	C	HP	3
B	Haryana	4	C	J & K	4
B	Kerala	4	C	North East	0
B	Madhya Pradesh	4	C	Orissa	4

Source: DoT, I-Sec Research

- **3G spectrum for CDMA players.** There is still no clarity as to when the 3G spectrum for CDMA players will become available. According to DoT's 3G guidelines, UASL CDMA operators may have the option to seek 2x1.25 MHz spectrum in 800MHz band, when it becomes available at a price equal to the highest winning bid in 2.1GHz auction prorated to a per 2x1.25 MHz price, with seniority based on subscriber base. Since RCom has the highest subscriber share among CDMA players in all circles, it is assured of a 3G spectrum in 800MHz band, for providing EV-DO services when the spectrum becomes available.

Inter-connect usage charges

Continuing with its efforts to make the industry a more level-playing field for the new operators vis-à-vis the existing operators, TRAI recently amended the inter-connect usage charges. These changes will be effective April 1, '09. The key changes are:

- Termination charges for all domestic calls (fixed to fixed, fixed to mobile, mobile to fixed and mobile to mobile) were reduced to Rs0.2/min from Rs0.3/min.
- For all incoming international calls, termination charges were increased to Rs0.4/min from the existing charge of Rs0.3/min.
- Termination charges for 3G voice calls shall be same as that for 2G voice calls.
- Ceiling on carriage of domestic long distance calls has been retained at Rs0.65/min.
- Transit/carriage charge from level-II trunk automatic exchange to short distance charging area (SDCA) has been cut to Rs0.15/min from the existing Rs0.2/min. Intra-SDCA transit charge is capped at Rs0.15/min from the existing cap of Rs0.2/min.

MNP

In August '08, DoT announced the guidelines for the implementation of intra-circle MNP with a timeline of implementation in metros by mid-'09 and across the country by '09-end. The DoT has divided the country into two geographic zones, each of 11 circles for the effective implementation of the MNP services and the centralised operators for implementing MNP were finalised in March '09. Syniverse will cover northern and western states, while MNP Interconnection Telecom Solutions India, a JV of Telcordia, will cover the southern and eastern states. The centralised operators are required to roll out MNP in the metros and A-category circles within six months of receiving the licence and extend it to the other circles in the next six months.

MVNOs

In August '08, TRAI had recommended allowing MVNOs in India, which the DoT approved in February '09, but some issues remain regarding the number of operators with which an MVNO can tie-up in a given circle. While TRAI had suggested that MVNOs should be restricted to tie-up with a single operator in each circle, DoT has recommended allowing tie-ups with multiple operators.

Long distance calling cards

TRAI had recommended allowing prepaid calling cards by NLD and ILD operators in August '08, which DoT recently approved. Long-distance carriers would have to enter into mutual interconnect agreements with operators and, if the operators do not agree on interconnect agreements, TRAI would step in to facilitate the signing contracts and implementation of calling cards. NLD and ILD operators will not be allowed to provide local calls and other intelligent network-based and value-added services through their calling cards.

Internet telephony

TRAI recommended allowing unrestricted internet telephony by internet service providers (ISPs) in August ’08. Although UAS & CMTS licence permits access service providers to provide internet telephony, it has not yet been started by the providers. ISPs, on the other hand, have been allowed to provide only restricted internet telephony. The final approval by DoT regarding unrestricted internet telephony by ISPs is still awaited.

Annexure 3: Global examples of towers sharing

1) United States. Tough zoning laws in the US make the setting up of new towers almost impossible, making tower sharing almost compulsory. It is frequently the case that each tower represents somewhat of a monopoly in a specific region and any carrier not on that tower risks a dead spot in the network, leading to poor signal quality, dropped calls or insufficient data speeds. This has led to the success of independent tower companies in the US, with three companies American Tower, Crown Castle and SBA Communications owning about 46% of the towers as of March ’08. These tower companies built up their portfolio of towers by building them and acquiring towers from existing operators over the years. Tower companies in the US enjoy long-term recurring revenues with predetermined rent increases, low tenant churn and low operating and maintenance costs.

2) Europe. Most countries in Europe are close to or above 100% mobile penetration and have strong entrenched players in all the markets, because of which basic 2G coverage is more or less becoming a commodity and large overlaps exist between the coverage of individual towers. This combined with the fact the number of operators in most European countries is limited to 3-4, there is limited opportunity for multiple tenants, making the economics for passive infrastructure sharing in 2G networks in Europe less favourable.

Back in ’00-01, many operators in Europe paid large sums to acquire 3G spectrum and were short of cash to quickly roll out 3G networks, pressurising operators to share infrastructure and cut deployment costs but only a few sharing deals reached successful conclusions. More recently, infrastructure sharing deals have started developing at a faster pace since operators are not yet close to making 3G network coverage as ubiquitous as 2G networks.

Examples of infrastructure sharing in Europe:

- In the UK, Orange and Vodafone started sharing their 2G and 3G towers in February ’08, though they had earlier agreed to share towers and base stations (active infrastructure). Together the two operators owned ~27,000 towers across the UK and the deal was expected to lead to ~15% (~3,000) reduction in towers in the first two years.
- 3 UK and T-Mobile (UK) signed an agreement in December ’07 to combine their 3G networks (towers and active infrastructure), which would lead to almost complete population coverage for 3G services across the UK by end of ’08.
- Orange and Vodafone Spain agreed in November ’06 to share their 3G infrastructure in rural Spain in towns with less than 25,000 people in 19 states across the country. The agreement, which covered 1,000 base cell sites, was expected to allow both operators to increase coverage ~25%, while reducing the estimated total number of sites needed ~40%.
- Spanish mobile operators, Yoigo and Telefonica entered a five-year network sharing agreement in March ’08 (to take effect from June ’08) that would allow Yoigo to extend its 2G and 3G coverage.
- Vodafone and Telefónica entered into an infrastructure sharing deal in March ’09 to jointly build new sites and consolidate existing ones in Germany, Spain, Ireland and the UK.

Annexure 4: VAS issues & concerns overweigh drivers, at least for now

In spite of the several drivers for mobile VAS, we remain sceptical on the success of mobile VAS in the short term due to the following reasons:

- Scarcity of 2G spectrum in congested areas, especially metros where most of the VAS demand is expected to come from
- Affordability of devices and services in semi-urban & rural markets remains questionable
- The focus of operators is expected shift from customer acquisition to revenue share once subscriber growth starts to plateau, but this is still sometime away
- Implementation of MNP is expected to push operators to differentiate through VAS but regulatory delays in implementation of MNP continue
- New technologies (3G) is expected to expand the bouquet of value-added products & services and facilitate better distribution but the timing of 3G introduction has been pushed forward time and again. Further, 3G could end up being just a spectrum driver for the operators rather than usage driver
- For VAS to go beyond metros and top urban markets, localisation of products & services is essential since subscribers in rural areas and B & C circles prefer voice-based VAS (due to high illiteracy) and localised language preferences mean there is more demand for regional content
- VAS providers believe that innovation in mobile VAS can only be supported once content providers start getting their revenue share. The revenue share ratio between telcos and VAS providers in India is 70:30, substantially more skewed in favour of telcos than in other countries; even in other emerging economies such as China & Thailand, more that 80% revenue is shared in favour of VAS providers
- While services like m-commerce and m-banking seem very attractive in a country where internet penetration remains low, lack of interest and trust on the part of the consumers is an issue. Consumers are not aware of the finer points of VAS such as pricing, instrument requirements etc

Annexure 5: Index of Tables and Charts

Tables

Charts

Equity Research
April 2, 2009
BSE Sensex: 9902

Bharti Airtel

BUY

Geared for growth

Rs615

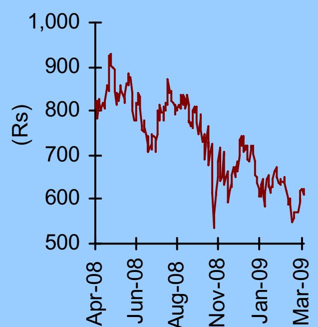
Reason for report: Initiating coverage

Telecom

Shareholding pattern

	Jun '08	Sep '08	Dec '08
Promoters	66.5	67.0	67.2
Institutional investors	29.3	28.7	28.5
MFs and UTI	2.9	2.9	3.0
Insurance Cos.	2.8	3.2	3.5
FIIs	23.6	22.6	22.0
Others	4.2	4.3	4.4

Price chart



Bharti Airtel (BAL) remains the undisputed leader in Indian mobile space, in terms of subscriber and revenue share. We believe that market hype, as regards increasing competitive intensity, is exaggerated and expect BAL to take forward growth to rural areas, thereby circumventing competition; BAL already has a significant lead in rural penetration due to its superior network coverage. We believe the company is strategically well-placed to leverage on the expected rise in demand for towers via Bharti Infratel (BITL) and Indus Towers (Indus). The company's balance sheet strength gives it enough flexibility to participate in 3G auctions and pursue other initiatives. We initiate coverage on BAL with BUY recommendation and sum-of-the-parts (SOTP)-based target price of Rs733/share, which implies upside of 19%. We expect value unlocking in Indus through listing to be a key catalyst for the stock.

- **Mobile services – Unfazed by competition.** In spite of increasing competition, we expect BAL to lose market share only marginally over FY09E-12E due to its first-mover advantage and best-in-class network coverage. BAL has a head start over other players, in terms of penetration in rural areas and C circles, which are expected to be the next growth avenues.
- **Towers – Transforming threat into opportunity.** Rise in competition opens up opportunity for BAL to participate in the increase in demand for towers via BITL and Indus. While three anchor tenants ensure higher tenancy and profitability for Indus, BITL is also likely to have high tenancy due to presence in seven under-penetrated circles.
- **Balance sheet well placed for 3G, new ventures and acquisitions.** The credit-constrained environment has emerged as an opportunity for BAL on the back of its strong balance sheet at a time when competitors are facing liquidity issues.
- **Valuations – Best play in Indian Telecom.** We initiate coverage with BUY recommendation and SOTP-based target price of Rs733/share, implying 19% upside. Our target price implies FY10E P/E and EV/EBITDA of 13.5x and 8.1x respectively. We expect that BAL's rural penetration lead and partnership model in tower sharing will drive growth for the company vis-à-vis competition. In our view, near-term pressure of price-based competition and regulatory risks are already factored in the valuations.

Market Cap	Rs1,167bn/US$23.3bn
Reuters/Bloomberg	BRTI.BO/BHARTI IN
Shares Outstanding (mn)	1,898
52-week Range (Rs)	928/534
Free Float (%)	32.9
FII (%)	22.0
Daily Volume (US$'000)	70,000
Absolute Return 3m (%)	(12.8)
Absolute Return 12m (%)	(25.4)
Sensex Return 3m (%)	(0.6)
Sensex Return 12m (%)	(37.1)

Year to March	FY08	FY09E	FY10E	FY11E
Revenue (Rs mn)	270,122	372,511	465,630	548,949
Net Income (Rs mn)	64,236	84,943	103,203	124,918
EPS (Rs)	33.8	44.8	54.4	65.8
% Chg YoY	57.8	32.2	21.5	21.0
P/E (x)	18.2	13.7	11.3	9.3
CEPS (Rs)	53.9	70.1	82.8	98.9
EV/E (x)	10.6	7.9	6.9	5.7
Dividend Yield (%)	-	-	-	1.6
RoCE (%)	27.7	25.1	22.6	22.0
RoE (%)	38.7	32.7	29.2	27.4

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TABLE OF CONTENT

Investment argument

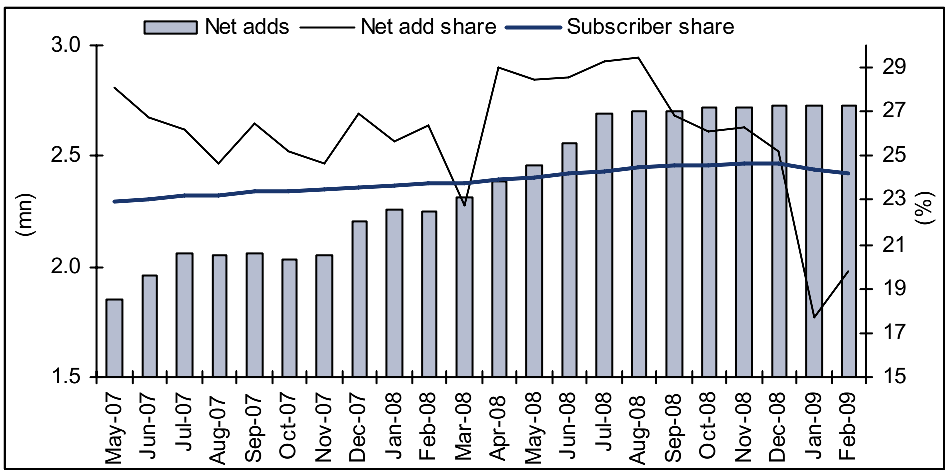
Mobile services – Unfazed by competition

Market leadership to continue

BAL has consistently strengthened its wireless subscriber market leadership, witnessing acceleration in subscriber net-adds run rate over the past two years. In terms of subscriber share, BAL has steadily widened the gap from 4.9% at end-FY07 to 7% in December '08 with the #2 player, Reliance Communications (RCom). Although BAL lost some share of net adds over January-February '09 due to RCom's nation-wide GSM launch with aggressive promotional offers, it did not witness decline in absolute net adds; we expect RCom's high share of net adds to be shortlived.

RCom saw 5mn and 3.4mn net adds in January-February '09, but we expect impact of RCom's GSM launch on net adds' share to be shortlived

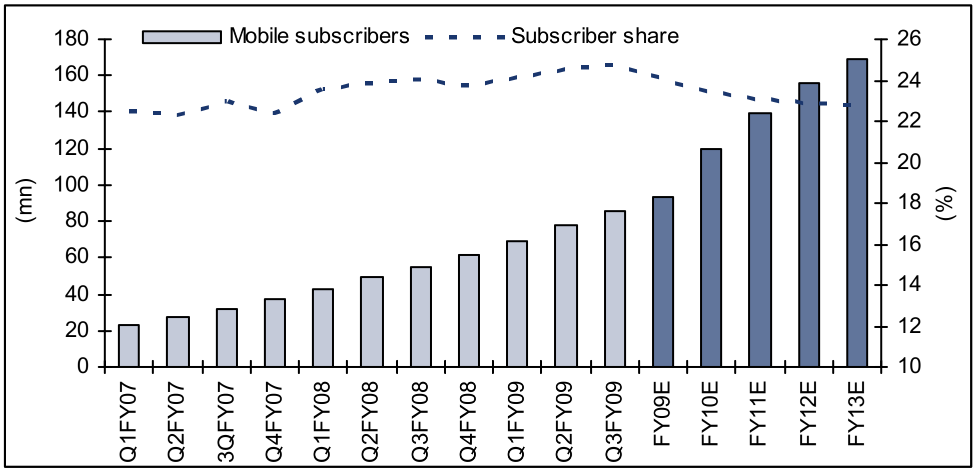
Chart 1: Monthly net-adds run rate continues unabated



Source: Telecom Regulatory Authority of India (TRAI), I-Sec Research

Past few months have seen an increase in competition, with RCom's GSM launch and existing GSM players (Vodafone, Idea and Aircel) expanding coverage. Further, Tata Teleservices (TTSL) is expected to roll out its GSM network and several new players are likely to enter the market over FY10E-11E. However, BAL's first-mover advantage and best-in-class network coverage have given it a matchless lead over competitors. Thereby, in spite of decline in net-adds share due to increasing competition, we expect BAL to lose market share only marginally to ~22.8% by FY12E from 24.7% at end-Q3FY09.

Chart 2: Expect BAL to retain market leadership despite dip in net-adds share



Source: TRAI, I-Sec Research

Table 1: BAL's relative position in various circles

Circles	No of subscribers (mn)	Proportion of total (%)	BAL's position	Market share (%)	Notes on competition
Metros	**12.1**	**13.2**			
Chennai	2.1	2.3	2	23.7	Aircel is the leader with 27% market share
Delhi	4.7	5.1	1	22.2	TTSL & Vodafone are close contenders
Kolkata	2.5	2.7	2	22.0	Vodafone is the leader, but BAL is a close contender
Mumbai	2.8	3.1	3	14.9	Vodafone & RCom are far ahead
A circles	**34.4**	**37.7**			
Andhra Pradesh	8.9	9.8	1	29.9	BAL is the clear leader
Gujarat	4.0	4.4	2	17.0	Vodafone is #1 with 33% share
Karnataka	9.8	10.8	1	42.7	Large gap with #2 player RCom
Maharashtra	5.7	6.2	2	19.1	Idea is #1 with 24% share
Tamil Nadu	6.0	6.6	2	22.6	Aircel is #1 with 29% share
B circles	**29.5**	**32.4**			
Haryana	1.0	1.0	6	10.5	Vodafone is #1with Idea, RCom, BSNL, TTSL ahead of BAL
Kerala	2.2	2.4	5	13.7	Idea is #1 with Vodafone, RCom, BSNL ahead of BAL
Madhya Pradesh	4.5	4.9	2	22.6	Idea is #1 with 25% share
Punjab	3.8	4.1	1	26.3	Large gap with #2 player BSNL
Rajasthan	6.7	7.4	1	30.5	Large gap with #2 player Vodafone
Uttar Pradesh - E	5.7	6.3	2	22.0	Vodafone is #1 with 24% share
Uttar Pradesh - W	2.3	2.5	5	12.2	Vodafone is #1with Idea, RCom, BSNL ahead of BAL
West Bengal	3.5	3.8	2	23.4	Vodafone is #1 with 30% share
C circles	**15.1**	**16.6**			
Assam	1.4	1.6	2	26.0	Aircel is #1 with 29% share, RCom is close to BAL
Bihar	7.2	7.8	1	36.3	Large gap with #2 player RCom
Himachal Pradesh	1.2	1.4	1	35.7	Large gap with #2 player RCom
J&K	1.6	1.7	1	48.8	Large gap with #2 player BSNL
North East	0.9	1.0	2	28.3	Aircel is #1 with 31% share
Orissa	2.8	3.1	1	34.6	Large gap with #2 player RCom
Total	**91.1**	**100**	**1**	**24.2**	

Source: TRAI, I-Sec Research

Rural penetration lead driven by superior network coverage

BAL already has a head start over other players, in terms of penetration in rural areas and C circles, both of which are expected to be the next growth avenues. As of December ’08, BAL boasted of the highest share of rural subscribers at 28.6%, higher than its 24.5% share of total subscribers. In Q3FY09, 60% of the company’s net adds came from rural areas.

BAL’s rural penetration lead is driven by its superior network coverage. The company has the largest network coverage in the country, encompassing 79% of the population and 400,000 villages, as of December ’08; it plans to expand population coverage to 100% over the next two years.

BAL is currently the only private wireless operator, which is not rolling into any new circles vis-à-vis all other incumbents, who are either in the process of achieving pan-India coverage or battling technology changes. Thereby, BAL can focus on driving penetration deeper in low-penetrated areas and improving network quality in high-penetration urban areas.

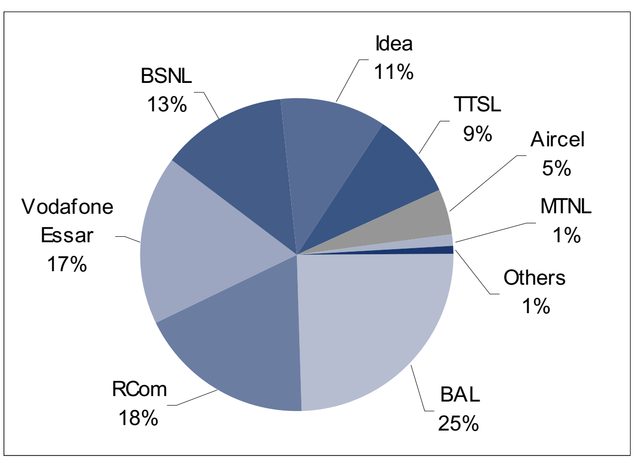
Further, BAL has 900MHz spectrum in 15 of the 22 circles, giving it advantage of rolling out networks in sparsely-populated rural areas. Less cell sites are required to achieve the same coverage in the 900MHz band compared with the 1,800MHz band, thereby reducing both capex required to rollout and network operating expenses.

Not just scale, but quality too

Based on financial data by TRAI, we estimate that BAL’s wireless service revenue market share in Q3FY09 was 31%, higher than 24.7% subscriber market share at end-Q3FY09. Not only is BAL increasing its share of subscribers, it is also continuing to maintain better-than-industry-average MoUs and ARPUs despite higher share of rural subscribers. BAL significantly scores over competition on other metrics too – churn, VAS ARPU and network rollout. BAL has the highest VAS ARPU among operators and significant proportion of corporate connections, indicating that its subscribers are more 3G-ready than competition’s.

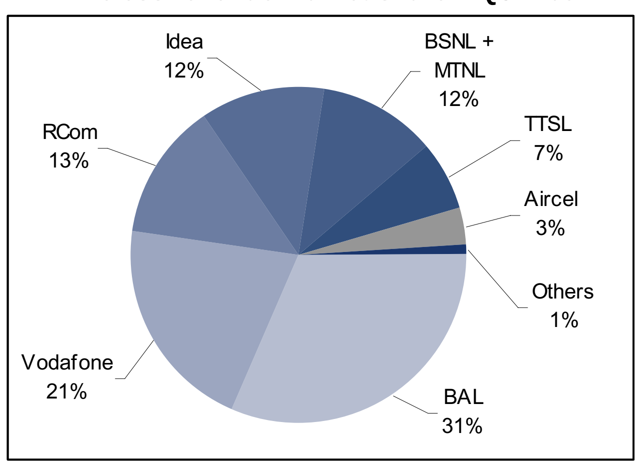
Chart 3: BAL’s revenue share stronger than subscriber share

Wireless subscriber market share – December ’08



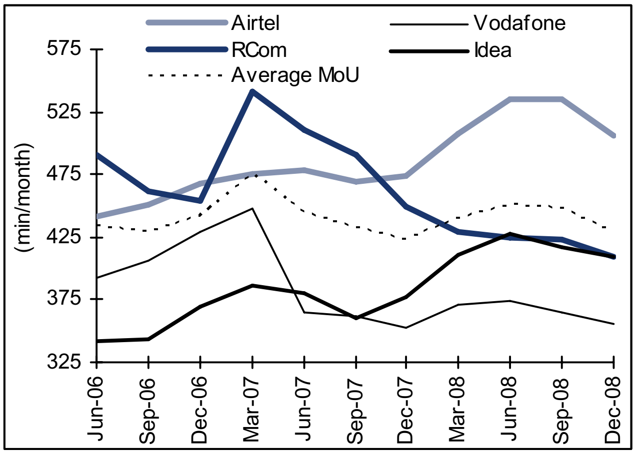
Source: Cellular Operators' Association of India (COAI), Association of Unified Telecom Service Providers of India (AUSPI), TRAI, I-Sec Research

Wireless revenue market share – Q3FY09*

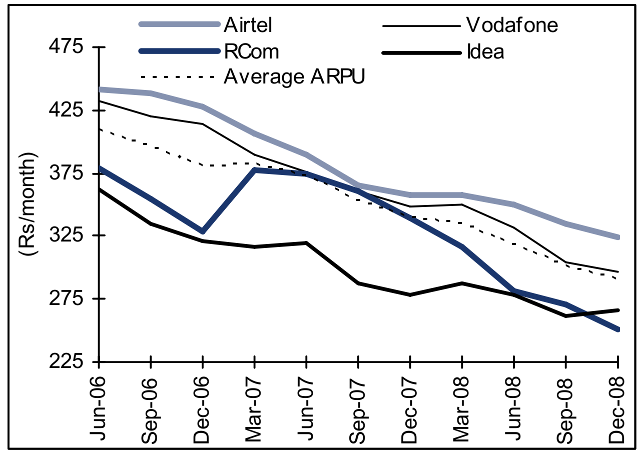


*Estimated, based on TRAI data
Source: TRAI, I-Sec Research

Chart 4: BAL – Industry leader, in terms of ARPUs and MoUs



Source: Company data, I-Sec Research



Source: Company data, I-Sec Research

Table 2: Operator KPI scorecard – BAL, miles ahead

	Q1FY08	Q2FY08	Q3FY08	Q4FY08	Q1FY09	Q2FY09	Q3FY09	Rank
MoU (min/mth)								
BAL	478	469	474	507	534	536	505	1
RCom	510	490	449	430	424	423	410	2
Idea	381	360	377	411	428	417	410	3
ARPU (Rs/mth)								
BAL	390	366	358	357	350	335	324	1
RCom	375	361	339	317	282	271	251	2
Idea	320	288	279	287	278	261	266	3
Prepaid churn (%)								
BAL	4.0	3.8	3.9	4.3	3.8	3.2	2.9	2
RCom	-	1.5	1.4	1.4	1.4	1.3	1.0	1
Idea	4.2	4.5	4.9	4.8	4.1	4.0	4.4	3
VAS ARPU (Rs/mth)								
BAL	38.6	35.9	33.3	33.6	33.9	33.5	30.8	1
RCom	21.4	22.4	21.7	21.9	21.4	19.8	18.6	2
Idea	26.9	23.9	22.3	23.5	24.7	25.6	25.3	3
No of cell sites								
BAL	45,000	52,826	60,299	69,141	75,876	82,554	88,319	1
RCom (Est)	18,320	23,176	28,016	39,384	46,800	48,100	73,950	2
Idea	13,160	17,105	21,197	24,793	27,594	33,377	39,289	3

Source: Company data, I-Sec Research

Expect 18.6% subscriber CAGR through FY09-12E

Driven by 18.6% CAGR subscriber growth through FY09E-12E, we expect BAL's wireless revenues to post CAGR of 15.7%. While voice ARPMs are expected to decline 20% through FY09E-FY12E, MoUs are expected to remain stable, leading to ARPU decline of 18.7%. We expect VAS ARPUs to decline going forward due to growth expected from rural areas and C circles, further pressurising ARPUs and do not expect any positive impact on VAS ARPUs in the short-term from 3G services.

Table 3: Mobile services – Key metrics

	FY08	FY09E	FY10E	FY11E	FY12E
Mobile subs (mn)	62.0	95.2	122.9	145.5	163.4
Growth (%)	*66.9*	*53.5*	*29.1*	*18.4*	*12.3*
Net adds (mn)	24.8	33.2	27.7	22.6	17.9
Growth (%)	*41.5*	*33.5*	*(16.4)*	*(18.6)*	*(20.6)*
ARPU (Rs/mth)	366	324	287	266	254
Growth (%)	*(11.9)*	*(11.5)*	*(11.3)*	*(7.5)*	*(4.6)*
MoU (min/mth)	478	510	510	510	510
Growth (%)	*6.8*	*6.8*	-	-	-
ARPM (Rs/min)	0.77	0.63	0.56	0.53	0.52
Growth (%)	*(17.5)*	*(17.2)*	*(11.3)*	*(6.6)*	*(1.9)*
Voice ARPU (Rs/mth)	331	292	257	237	225
Growth (%)	*(11.1)*	*(11.8)*	*(12.0)*	*(8.0)*	*(5.0)*
VAS ARPU (Rs/mth)	35	32	30	29	29
Growth (%)	*(18.6)*	*(9.5)*	*(5.0)*	*(3.0)*	*(1.0)*
Mobile revenues (Rs mn)	**217,861**	**305,489**	**375,931**	**428,104**	**470,267**
Growth (%)	*54.0*	*40.2*	*23.1*	*13.9*	*9.8*
Operating expenses (Rs mn)	132,380	212,167	262,027	303,353	337,576
Mobile EBITDA (Rs mn)	**85,481**	**93,322**	**113,904**	**124,751**	**132,690**
EBITDA margin (%)	*39.2*	*30.5*	*30.3*	*29.1*	*28.2*

Source: Company data, I-Sec Research

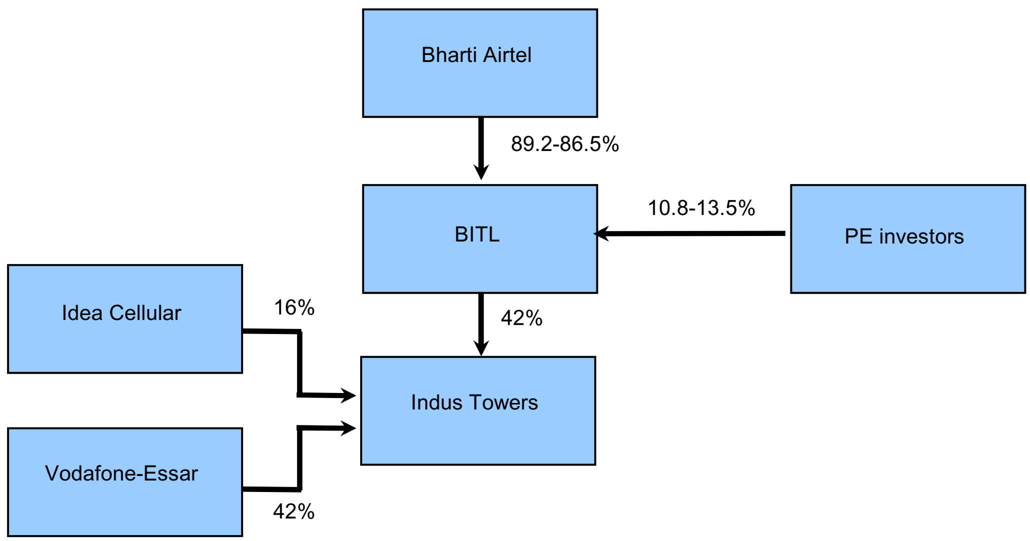
Tower business – Transforming threat into opportunity

The wireless industry is focussed on infrastructure sharing as both incumbents and new entrants are attempting to reduce capex as well as time to rollout. Though the rise in competition creates risk of decline in market share for BAL, it opens up opportunity of participating in the higher demand for telecom towers.

BITL is the majority-owned, passive infrastructure subsidiary of BAL that owns towers in six C-category circles & Madhya Pradesh and has 42% stake in Indus, which operates in the remaining 16 circles; Indus is the company's three-way JV with Vodafone and Idea Cellular. BAL has initiated the partnership model for tower sharing with Vodafone and Idea through Indus in a timely manner. The company is strategically well placed to leverage on the expected demand for towers from new telcos.

By end-Q3FY09, BITL had 61,355 towers, of which ~35,000 were expected to be transferred to Indus in January '09. BAL has guided for FY10E capex of ~US$1bn for its tower business, including capex in BITL in seven circles and proportionate (42%) share of capex in Indus in the sixteen circles.

Chart 5: BAL's tower business – Holding structure



Source: Company data, I-Sec Research

BITL – Opportunity in under-penetrated circles

The seven circles in which BITL operates are the most under-penetrated at present and BAL, being one of the three operators to first receive licenses in the seven circles, has an extensive network of towers in these circles. With the next stage of growth expected to be driven by these circles, we are confident of BITL achieving high tenancy.

Further, there is high possibility of BAL's tower-sharing partnership with Vodafone and Idea in Indus' 16 circles to be extended to the remaining seven, since Vodafone and Idea are expanding into seven and five of these circles respectively. This should further help BITL shore up tenancy.

BITL received funding of US$1.35bn from international private equity (PE) investors at EV of US$10-12.5bn, structured as part direct equity and part interest-free compulsory convertible debentures. This funding implies stake of 10.8-13.5%, with the valuation to be decided by BITL's FY09 financial performance. The PE investors include Temasek, Investment Corporation of Dubai, Goldman Sachs, Macquarie Group, AIF Capital, Citigroup Inc, India Equity Partner and Kohlberg Kravis & Roberts (KKR).

We estimate BITL to have ~50,000 towers by FY12E, reaching tenancy of 1.8x. We value BITL's standalone business, excluding proportionate Indus consolidation, at Rs38/BAL share, implying EV/tower of Rs3.8mn. We have assumed that stake-sale to PE investors will happen at the lower-end of the valuation range, implying BAL's stake in BITL to be 86.5%. The stake sale happening at higher valuations (up to US$12.5bn) is an upside risk to our estimate of the tower business contribution to BAL's valuations.

Table 4: BITL – DCF-based valuation (standalone) attributes Rs38/share

(Rs mn)

	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E	FY16E	FY17E	FY18E	FY19E
Towers	**35,295**	**43,321**	**50,090**	**54,828**	**58,438**	**60,887**	**61,887**	**62,887**	**63,887**	**64,887**
GBT (Ground-based towers)	24,975	31,436	36,919	40,780	43,740	45,760	46,590	47,425	48,265	49,110
RTT (Roof-top towers)	10,320	11,885	13,171	14,048	14,698	15,127	15,297	15,462	15,622	15,777
GBT as a percentage of towers	*71*	*73*	*74*	*74*	*75*	*75*	*75*	*75*	*76*	*76*
Tenants	**45,229**	**68,523**	**91,222**	**112,309**	**129,662**	**141,369**	**146,565**	**151,912**	**157,414**	**163,076**
Internal tenants	32,875	42,531	51,149	57,481	62,459	65,260	66,566	67,897	69,255	70,640
External tenants	12,354	25,992	40,073	54,828	67,203	76,109	79,999	84,015	88,159	92,436
Tenancy	**1.3**	**1.6**	**1.8**	**2.0**	**2.2**	**2.3**	**2.4**	**2.4**	**2.5**	**2.5**
Rental revenues	14,647	21,258	29,884	38,035	45,115	50,383	53,331	55,065	56,843	58,663
Avg rental per tenant per month (Rs)	*30,801*	*31,147*	*31,179*	*31,146*	*31,075*	*30,982*	*30,870*	*30,748*	*30,627*	*30,507*
Pass-through costs	10,086	14,621	20,738	26,686	32,044	36,251	38,897	40,724	42,626	44,607
Avg pass-through per tenant per month (Rs)	*21,210*	*21,422*	*21,636*	*21,853*	*22,071*	*22,292*	*22,515*	*22,740*	*22,967*	*23,197*
Total revenues incl. pass-through	**24,733**	**35,879**	**50,622**	**64,721**	**77,159**	**86,633**	**92,227**	**95,790**	**99,469**	**103,269**
Growth (%)	*38.6*	*45.1*	*41.1*	*27.9*	*19.2*	*12.3*	*6.5*	*3.9*	*3.8*	*3.8*
Semi-fixed costs	7,261	9,181	11,391	13,220	14,622	15,614	16,135	16,407	16,684	16,965
Total opex incl. pass-through	**17,347**	**23,802**	**32,128**	**39,906**	**46,666**	**51,865**	**55,031**	**57,132**	**59,311**	**61,572**
EBITDA	**7,386**	**12,077**	**18,494**	**24,816**	**30,493**	**34,769**	**37,196**	**38,658**	**40,158**	**41,697**
EBITDA margin incl. pass-through (%)	*29.9*	*33.7*	*36.5*	*38.3*	*39.5*	*40.1*	*40.3*	*40.4*	*40.4*	*40.4*
EBITDA margin ex pass-through (%)	*50.4*	*56.8*	*61.9*	*65.2*	*67.6*	*69.0*	*69.7*	*70.2*	*70.6*	*71.1*
EBIT	93	2,791	7,154	11,821	16,251	19,612	21,515	22,667	23,855	25,080
NOPAT	61	1,842	4,721	7,802	10,726	12,944	14,200	14,960	15,744	16,553
Depreciation	7,293	9,286	11,340	12,995	14,242	15,157	15,681	15,991	16,303	16,618
Capex	19,794	24,490	21,153	15,614	12,112	8,221	3,425	3,454	3,483	3,513
Net change in working capital	(8)	212	1,259	892	497	77	(310)	(462)	(433)	(406)
FCFF	(12,432)	(13,574)	(6,350)	4,290	12,359	19,803	26,765	27,959	28,997	30,063
Terminal value	1437210									
Enterprise value	**108,361**									
Net debt	25,842		**Assumptions**							
Equity value	**82,518**		WACC			11.1%				
% holding by BAL	86.5%		Exit EV/EBITDA			5.0x				
BITL contribution/BAL share (Rs)	38									
Indus contribution/BAL share (Rs)	74									
Total BITL contribution/BAL share (Rs)	**112**									
BITL implied EV/tower (Rs mn)	**3.8**									

Note: Tenancy includes 3G tenancy as well. We do not expect any additional towers to be added for 3G

Source: Company data, I-Sec Research

Table 5: BITL (standalone) – DCF-based valuation sensitivity analysis

		Rent yield (%)				
		12.0	13.0	14.0	15.0	16.0
Tenancy variation (%)	(10)	15	22	29	37	44
	(5)	18	26	34	41	48
	0	22	30	**38**	45	53
	5	25	33	42	50	58
	10	29	37	46	54	63

Source: Company data, I-Sec Research

Indus Towers – Well positioned for better tenancy

The economics of a tower company are primarily driven by tenancy and Indus, with its three anchor tenants, is ensured higher tenancy. Further, there is high likelihood of BAL, Vodafone and Idea being the front-runners in the 3G rollout, which should further boost Indus' tenancy. Besides ensuring higher profitability, three anchor tenants also increases possibility of external tenancy for Indus as this would lead to higher discounts in rentals for external tenants.

We estimate Indus to have ~150,000 towers by FY12E, with CAGR of 14.3% through FY09E-12E. By FY15E, we expect Indus to have the highest tenancy in the industry, of 2.5x. We value Indus at Rs75/BAL share, implying EV/tower of Rs4.6mn.

Table 6: Indus – Tower & tenancy expectations

	FY08	FY09E	FY10E	FY11E	FY12E
16-circle 2G cell site requirement					
BAL	49,141	69,740	91,173	105,655	114,671
Idea	21,011	38,895	51,431	57,015	61,112
Vodafone	48,000	67,253	81,173	91,564	99,705
Total	**118,152**	**175,888**	**223,777**	**254,234**	**275,488**
% rented from outside	*23.0*	*20.0*	*20.0*	*10.0*	*10.0*
Internal tenants	**91,000**	**140,710**	**179,022**	**228,811**	**247,939**
Towers					
BAL	32,000	39,851	48,626	59,431	62,548
Idea	11,100	22,226	27,430	32,071	33,334
Vodafone	26,900	38,430	43,292	51,505	54,385
Towers	**70,000**	**100,507**	**119,348**	**143,007**	**150,266**
Internal 2G tenancy	**1.30**	**1.40**	**1.50**	**1.60**	**1.65**
External tenancy			0.25	0.30	0.35
External tenants	-	-	29,837	42,902	52,593
Total 2G cell sites	**91,000**	**140,710**	**208,859**	**271,713**	**300,532**
2G tenancy	**1.3**	**1.4**	**1.8**	**1.9**	**2.0**
3G/WiMAX cell sites	-	-	7,307	21,734	26,693
Total cell sites	**91,000**	**140,710**	**216,165**	**293,446**	**327,225**
Total tenancy	**1.30**	**1.40**	**1.81**	**2.05**	**2.18**

Source: Company data, I-Sec Research

Table 7: Indus – DCF-based valuation attributes Rs74/share

(Rs mn)

	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E	FY16E	FY17E	FY18E	FY19E
Towers	**119,348**	**143,007**	**150,267**	**153,816**	**155,289**	**156,762**	**157,762**	**158,762**	**159,762**	**160,762**
GBT	82,979	101,018	106,640	109,428	110,601	111,790	112,606	113,431	114,265	115,107
RTT	36,370	41,989	43,627	44,388	44,688	44,973	45,157	45,332	45,498	45,656
GBT as a percentage of towers	*69.5*	*70.6*	*71.0*	*71.1*	*71.2*	*71.3*	*71.4*	*71.4*	*71.5*	*71.6*
Tenants	**232,080**	**316,328**	**353,165**	**382,757**	**407,690**	**424,422**	**435,776**	**447,423**	**459,371**	**471,627**
Internal tenants	202,243	273,426	300,572	321,231	337,810	346,041	355,827	365,875	376,192	386,785
External tenants	29,837	42,902	52,593	61,526	69,880	78,381	79,949	81,548	83,179	84,842
Tenancy	**1.9**	**2.2**	**2.4**	**2.5**	**2.6**	**2.7**	**2.8**	**2.8**	**2.9**	**2.9**
Rental revenues	71,021	101,802	124,067	135,926	145,444	152,504	157,023	160,573	164,203	167,913
Avg rental per tenant per month (Rs)	30,939	30,939	30,886	30,784	30,667	30,546	30,424	30,301	30,180	30,060
Pass-through costs	48,688	70,488	86,912	96,491	104,677	111,296	116,203	120,504	124,960	129,579
Avg pass-through per tenant per month (Rs)	21,210	21,422	21,636	21,853	22,071	22,292	22,515	22,740	22,967	23,197
Total revenues incl. pass-through	**119,709**	**172,290**	**210,980**	**232,418**	**250,120**	**263,801**	**273,227**	**281,077**	**289,163**	**297,491**
Growth (%)	*27.5*	*43.9*	*22.5*	*10.2*	*7.6*	*5.5*	*3.6*	*2.9*	*2.9*	*2.9*
Semi-fixed costs	26,874	33,806	38,670	40,600	41,741	42,432	42,835	43,113	43,406	43,713
Total opex incl. pass-through	**75,562**	**104,295**	**125,582**	**137,092**	**146,418**	**153,728**	**159,039**	**163,617**	**168,366**	**173,292**
EBITDA	44,147	67,995	85,398	95,326	103,703	110,072	114,188	117,460	120,797	124,199
EBITDA margin incl. pass-through (%)	*36.9*	*39.5*	*40.5*	*41.0*	*41.5*	*41.7*	*41.8*	*41.8*	*41.8*	*41.7*
EBITDA margin ex pass-through (%)	*62.2*	*66.8*	*68.8*	*70.1*	*71.3*	*72.2*	*72.7*	*73.2*	*73.6*	*74.0*
EBIT	18,717	36,553	49,565	57,788	65,210	70,952	74,586	77,466	80,406	83,405
NOPAT	12,353	24,125	32,713	38,140	43,039	46,828	49,227	51,128	53,068	55,048
Depreciation	25,430	31,442	35,833	37,538	38,493	39,120	39,602	39,994	40,392	40,794
Capex	60,281	73,320	24,251	13,640	7,578	6,369	4,332	4,387	4,443	4,499
Net change in working capital	2,674	5,638	2,920	248	(554)	1,368	943	785	809	833
FCFF	**(25,172)**	**(23,391)**	**41,375**	**61,789**	**74,507**	**78,212**	**83,554**	**85,950**	**88,208**	**90,510**
Terminal value	639,627									
Enterprise value	**460,101**									
Net debt	71,404		**Assumptions**							
Equity value	**388,696**		WACC		11.1%					
% holding by BITL	42%		Exit EV/EBITDA		5.0x					
% effective holding by BAL	36.3%									
Indus contribution/BAL share (Rs)	74									
Indus implied EV/tower (Rs mn)	**4.6**									

Note: Tenancy includes 3G tenancy as well. We do not expect any additional towers to be added for 3G
Source: Company data, I-Sec Research

Table 8: Indus – DCF-based valuation sensitivity analysis

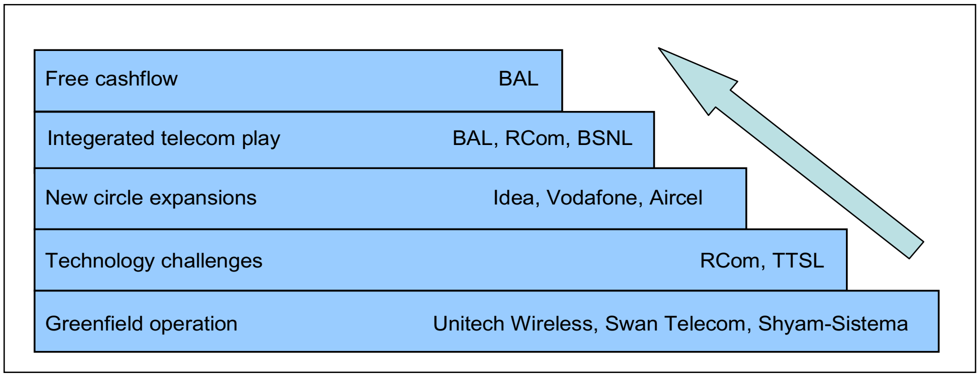
		Rent yield (%)				
		12.0	**13.0**	**14.0**	**15.0**	**16.0**
Tenancy variation (%)	**(10)**	45	55	64	74	84
	(5)	49	59	69	79	90
	0	53	64	**74**	85	95
	5	58	69	80	90	101
	10	62	73	85	96	107

Source: Company data, I-Sec Research

Financial meltdown, a boon for BAL

The global liquidity crunch and credit-constrained environment has emerged as an opportunity for BAL, on the back of its strong balance sheet, at a time when its competitors are facing liquidity issues. The high credit-risk environment is likely to restrain competition in terms of investment and, therefore, reduce risk of over-building in towers and over-bidding in 3G auctions. BAL, with net debt-to-EBITDA of 0.4x and net debt-to-equity of 0.2x, is relatively well-placed to raise capital for 3G or investment in global opportunities vis-à-vis competition, which is struggling to expand operations or battling shift in technology platforms. New entrants in mobile space and most incumbents are expanding networks, which require heavy investments.

Chart 6: BAL ahead on telecom investment curve



Source: Company data, I-Sec Research

Why a boon?

- **Curbs aggression from new players – Sinking valuations, scarce capital.** While players winning new UAS licenses in '08 have been able to sell stake at a premium to strategic global operators, entities investing in the Indian market at hefty premiums have faced the wrath of investors. With valuations sinking globally, we expect new players to judiciously weigh their investments in the Indian mobile space prior to committing huge capital. Re-negotiation of the Unitech Wireless stake by Telenor underlines the capital crunch.
- **Lower risk of irrational bidding for 3G licenses.** 3G services in India are being seen as a means to acquire additional spectrum in spectrum-starved urban areas so as to migrate existing 2G subscribers to 3G spectrum and improve QoS. Availability of limited 3G licenses per circle had increased risk of over bidding. However, with balance sheets of most telecom players stretched at present and limited capital availability, we expect 3G bidding to be more rational, which is a positive for BAL.
- **Tower sharing preferred route for expansion.** While most telcos have hived-off their tower companies to benefit from passive infrastructure sharing, each is independently in the race for building own network and sharing it with others, increasing risk of over-supply in towers that would lead to lower sharing for the entire industry. However, post the slowdown, most players have revisited their tower expansion plans and are also considering consolidation with other tower companies. Recently, in one such deal, Quippo, an independent tower company, merged with Wireless Tata-Tele Info-Services (WTTIL), the passive infrastructure arm of TTSL. As per media, some independent tower players, who face the risk of being fringe players, are looking for consolidation with larger players.

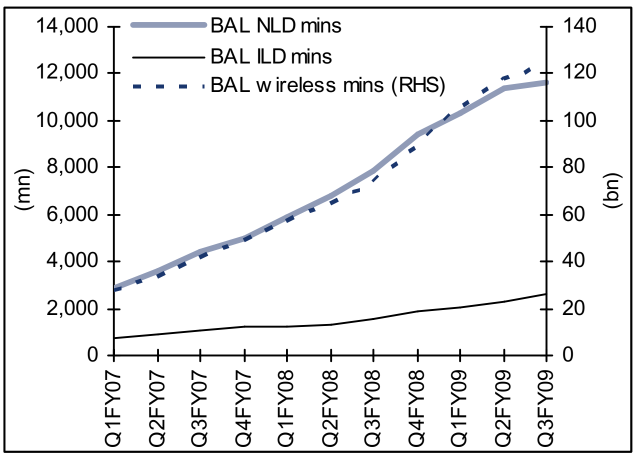
Enterprise business – Growth momentum intact

Enterprise carrier business

BAL's growth in the enterprise carrier/long distance (LD) segment is primarily linked to growth in the mobile services segment, as ~90% of NLD voice traffic, which is the highest component in the enterprise carrier business, is captive. Captive share of NLD voice traffic has risen to ~90% at present from ~67% two years ago on account of other operators such as Vodafone and Idea having built up their NLD operations and migrated from BAL. BAL increased LD carriage charges in Q1FY09, which boosted enterprise carrier EBITDA margins and led to decline in mobile margins.

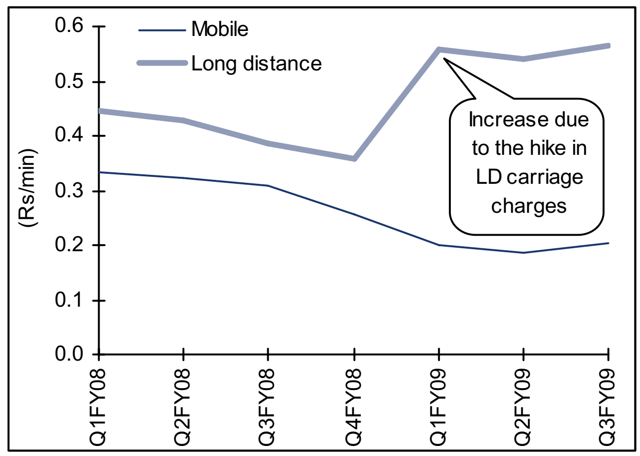
Chart 7: Enterprise carrier business linked with mobile services

Uptick in LD traffic strongly correlated with wireless traffic



Source: Company data, I-Sec Research

LD EBITDA margins increased due to rise in carriage charges in Q1FY09



Source: Company data, I-Sec Research

BAL is in the process of ramping up its submarine cable connectivity. The company is part of four different consortiums that are building undersea links that are likely to become operational in '09-10E.

Table 9: Submarine cable connectivity projects underway

Submarine cables	Connecting countries	BAL's partners
Unity cable project	US-Japan	5 international majors, including internet giant Google
Europe India Gateway (EIG)	UK-India 15,000km undersea link touching 13 countries across 3 continents	15 other global telecommunications majors, including South Africa's MTN and British Telecom
Asia America Gateway (AAG)	SouthEast Asia-US connecting 10 locations in 8 Asian countries and the US West Coast	17-member consortium
India-MiddleEast-Western Europe (IMEWE)	India-France, touching all countries along West Asia	Tata Communications and other telcos

Source: Company data, I-Sec Research

BAL's LD traffic has witnessed a surge over the past two years, with NLD traffic increasing 2.6x to 11.6bn minutes in Q3FY09 from 4.4bn minutes in Q3FY07 and ILD traffic increasing 2.5x to 2.6bn minutes in Q3FY09 from 1.05bn minutes Q3FY07. We expect LD traffic to post CAGR of 14% over FY09E-12E, while revenues are expected post CAGR of 11.4% over FY09E-12E due to decline in revenues/minute, led by competition and regulations. We expect revenues/minute to significantly decline 5% in

FY10E due to complete phase-out of access deficit charges (ADC), September '09 onwards. TRAI has recommended introduction of inter-carrier LD calling cards by NLD and ILD operators, which, if implemented, could be a downside risk to our estimates.

Table 10: Enterprise carrier segment – Key metrics

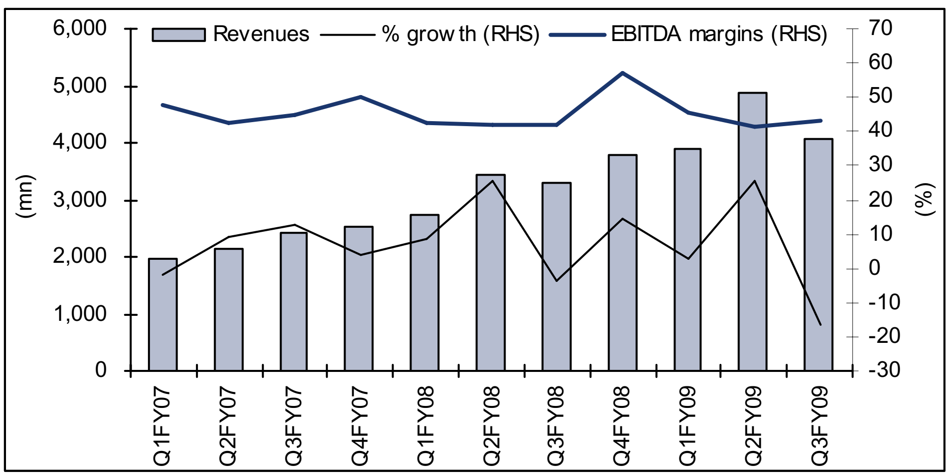
	FY08	FY09E	FY10E	FY11E	FY12E
NLD minutes (mn)	29,926	45,154	55,654	63,361	69,100
Growth (%)	*87.7*	*50.9*	*23.3*	*13.8*	*9.1*
ILD minutes (mn)	6,029	9,901	12,203	13,893	15,151
Growth (%)	*55.1*	*64.2*	*23.3*	*13.8*	*9.1*
Revenues (Rs mn**)**	**43,170**	**68,576**	**76,071**	**82,274**	**89,727**
Growth (%)	*23.7*	*58.9*	*10.9*	*8.2*	*9.1*
Operating expenses (Rs mn)	28,860	38,073	41,901	44,982	48,462
EBITDA (Rs mn)	**14,310**	**30,503**	**34,170**	**37,293**	**41,265**
EBITDA margin (%)	*33.1*	*44.5*	*44.9*	*45.3*	*46.0*

Source: Company data, I-Sec Research

Enterprise corporate business

BAL's enterprise corporate segment is a high-growth, high-margin business and has significantly ramped up over FY06-09. However, revenue growth and margins in the business tend to be lumpy QoQ, due to timing issues in terms of revenues being recognised for considerably large projects.

Chart 8: Growth and margins tend to be lumpy QoQ



Source: Company data, I-Sec Research

We expect revenues from the enterprise corporate segment to post CAGR of 13% through FY09E-12E, while EBITDA margin is expected to remain stable at 44-45%. Though the segment's long-term growth potential is intact, we believe that in the near-term there could be headwinds as corporates trim telecom and IT spends in a worsening macro-environment.

Table 11: Enterprise corporate segment – Key metrics

(Rs mn)

	FY08	FY09E	FY10E	FY11E	FY12E
Revenues	13,217	17,307	19,903	22,490	24,964
Growth (%)	*46.0*	*30.9*	*15.0*	*13.0*	*11.0*
Operating expenses	7,094	9,823	11,035	12,354	13,710
EBITDA	6,123	7,484	8,868	10,136	11,254
EBITDA margin (%)	*46.3*	*43.2*	*44.6*	*45.1*	*45.1*

Source: Company data, I-Sec Research

Looking at growth from multiple avenues

Telemedia Services – Betting on triple play

In the telemedia segment, BAL has followed a cherry-picking strategy and is present in only 95 cities as against its aggressive network rollout in the mobile segment. BAL's strategy for the telemedia business (except DTH) is focussing on cities with high revenue potential. While we expect limited growth in fixed-line voice business, broadband would be the key growth driver. Share of broadband subscribers of the total fixed-line subscribers has increased through Q1FY08-Q3FY09 to 37.9% from 30%, with subscribers growing 70% to 1mn from 0.6mn. Also, BAL caters to SMEs through this segment that may see slowdown in growth momentum in the near-term due to weak macro-economic conditions.

For increasing share of household wallet, BAL has recently initiated triple-play services by launching the DTH/IPTV services. The company intends to leverage its common infrastructure, in terms of customer service, marketing and backend systems, to provide a combined offering of voice, data and video services to its subscribers.

BAL launched its DTH offering in October '08 and at present the 'Airtel Digital TV' offering is available across 120 cities, with plans to expand. The company aims keeping DTH operations ready for the steep J-curve expected in the DTH industry growth. BAL has positioned its DTH offering as a premium service that may result in higher-than-industry ARPUs; but, the business is likely to take three years to achieve EBITDA breakeven due to high competitive intensity and high cost of subscriber acquisition. BAL also launched its IPTV service in Delhi and NCR in January '09, with plans of expansion to other metros.

We would factor in financials of the DTH/IPTV business in our estimates once the company starts reporting key metrics for the business on a regular basis. The regulatory regime in the DTH space is, at present, not operator-friendly; this could be a downside risk to BAL's DTH business.

Table 12: Telemedia segment – Key metrics

	FY08	FY09E	FY10E	FY11E	FY12E
No of subscribers (mn)	2.3	2.7	3.1	3.5	3.8
Net adds (mn)	0.41	0.44	0.40	0.35	0.30
ARPL (Rs/mth)	1,143	1,118	998	929	901
Growth (%)	*(1.7)*	*(2.2)*	*(10.7)*	*(6.9)*	*(3.0)*
MoUs (min)	738	646	614	601	601
Growth (%)	*(11.8)*	*(12.4)*	*(5.0)*	*(2.0)*	-
ARPM (Rs/min)	1.5	1.7	1.6	1.5	1.5
Growth (%)	*11.4*	*11.7*	*(6.0)*	*(5.0)*	*(3.0)*
Revenues (Rs mn)	28,484	33,548	34,965	36,734	39,147
Growth (%)	*26.9*	*17.8*	*4.2*	*5.1*	*6.6*
Operating expenses (Rs mn)	17,077	19,353	19,973	21,100	22,301
EBITDA (Rs mn)	11,407	14,195	14,992	15,634	16,846
EBITDA margin (%)	*40.0*	*42.3*	*42.9*	*42.6*	*43.0*

Source: Company data, I-Sec Research

Sri Lanka operations – Going international

BAL initiated international services via launch of 2G and 3.5G mobile services in Sri Lanka in January '09 under the *Airtel* brand through its subsidiary, Bharti Airtel Lanka. BAL is the fifth operator in the Sri Lanka market, with others being Dialog Telekom (owned by Telekom Malaysia), Celltel (owned by Millicom), Mobitel (owned by state-run Sri Lanka Telecom) and Hutchison Telecommunications Lanka (owned by Hutchison Telecom International).

BAL plans to invest ~US$200mn in its Sri Lanka operations over five years, with ~US$100mn already committed. Dialog, one of the incumbents in Sri Lanka, has ~1,000 towers at present, which is fairly comparable to the number of towers set up by BAL within Sri Lanka; BAL launched with 60% coverage of the population.

Sri Lanka has 50% mobile penetration with considerably low MoUs and high tariffs. BAL intends to leverage on regional and cultural proximity of the Sri Lankan market and the already existing presence for the *Airtel* brand in Sri Lanka. Pricing in the market by incumbents is cluttered and confusing, with non-peak tariffs, peak-hour tariffs, different on-net and off-net outgoing rates and incoming charged in some cases. BAL has followed the entry strategy, of pricing its offering below the market, simplifying the tariff structure and offering completely-free incoming, which, according to the company, has resulted in a good initial response.

Key risks

At the receiving end of regulations

Over the past two years, BAL has been at the receiving end of regulations. New operators have been licensed and allotted spectrum whereas players such as BAL, with congested networks, are subject to stringent subscriber norms for spectrum allocations. While 3G license policy has been delayed to the benefit of PSU incumbents and CDMA players, BAL continues to await 3G licensing. Further, proposed introduction of mobile number portability (MNP) selectively in metros and introduction of mobile virtual network operators (MVNOs) are likely to impact BAL and other incumbents. Reduction of local termination charges from Rs0.3/min to Rs0.2/min is particularly negative for BAL and likely to benefit new players that have higher share of outgoing minutes. More introductions of populist policies favouring new players are likely to create a challenging environment for BAL.

Recent anti-incumbent regulations

- Reduction in interconnect usage charges (IUC)
- Increase in spectrum charges
- Increased subscriber norm for spectrum allocation

Proposed anti-incumbent regulations

- MNP implementation
- Introduction of one-time spectrum enhancement fees
- Entry of MVNOs
- Introduction of calling cards by NLD/ILD operators
- Full-fledged internet telephony by ISPs

Competition – Free minutes and price-based competition

Entry of operators into new circles in the GSM space has been via aggressive price plans and free minutes. As part of its nation-wide GSM launch, RCom introduced lifetime plans at Rs25 with Rs900 worth free talktime in many circles; this resulted in addition of 5mn subscribers in January ’09 and 3.4mn in February ’09 for RCom. Idea adjusted its tariff plans in Mumbai to match the free talktime offered by RCom, while Aircel has recently entered the Delhi circle with a price plan of Rs0.4/min.

As most new players are likely to gauge their performance on subscriber market share as against revenue market share, price-based competition is likely to increase churn and result in lower ARPMs. This may lead to BAL and other operators entering a price war, which would be detrimental to the industry’s overall profitability.

Delay in 3G – Losing some advantage to PSUs

3G spectrum auctions have been repeatedly postponed. Currently, BAL is best positioned in terms of balance sheet strength to bid for 3G, when other players are busy rolling out 2G networks. Delay in granting 3G license may give an unfair advantage to PSUs that have already launched 3G. Also, overbidding in certain circles, especially metros such as Delhi and Mumbai, in the upcoming 3G spectrum auctions is a concern.

Tower sharing delay

Success of Indus and, to an extent, BITL is dependent on quick rollout of cell sites by Idea and Vodafone in particular and the industry in general. In case of any delay in rollout plans of BAL's partners, tenancy in the tower business will move slowly, impacting margins. Also, any delay in 3G launch in the country will limit tenancy of towers. We expect tenancy on Indus and BITL to increase 10% and 7% respectively by FY15E owing to 3G roll out by operators. Particularly for Indus, level of tenancy will depend on winning 3G license by one or more partners.

Table 13: Tenancy with/without 3G

	FY09E	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E
Indus							
Tenancy with 3G	1.4	1.8	2.1	2.2	2.3	2.4	2.5
Tenancy without 3G	1.4	1.8	1.9	2.0	2.1	2.2	2.3
Difference	-	*0.06*	*0.15*	*0.18*	*0.20*	*0.23*	*0.24*
BITL							
Tenancy with 3G	1.2	1.3	1.6	1.8	2.0	2.2	2.3
Tenancy without 3G	1.2	1.2	1.4	1.7	1.9	2.0	2.1
Difference	-	*0.06*	*0.14*	*0.15*	*0.16*	*0.17*	*0.17*

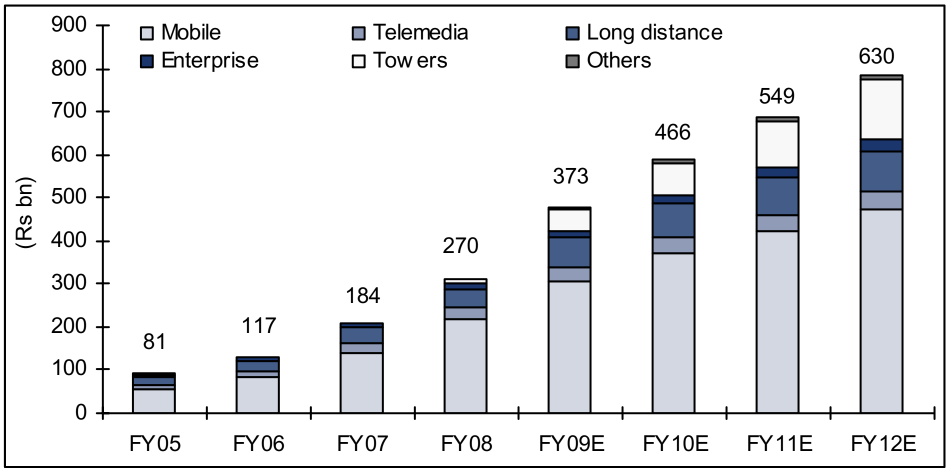
Source: Company data, I-Sec Research

Financials – High visibility and positive cashflow to drive dividends

Revenue growth to remain strong

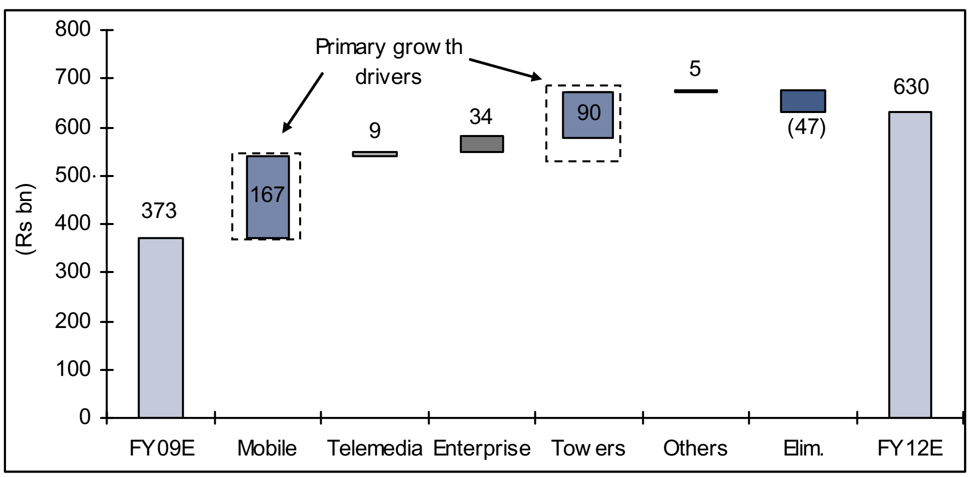
We expect BAL's YoY revenue growth to remain strong at 25% in FY10E and slightly slowdown thereafter; revenue CAGR is likely to be 19.1% through FY09E-12E. The growth will primarily driven by growth in the mobile segment and the towers business.

Chart 9: Expect revenue CAGR of 19.1% over FY09E-12E



Source: Company data, I-Sec Research

Chart 10: Wireless & tower businesses primary revenue growth drivers

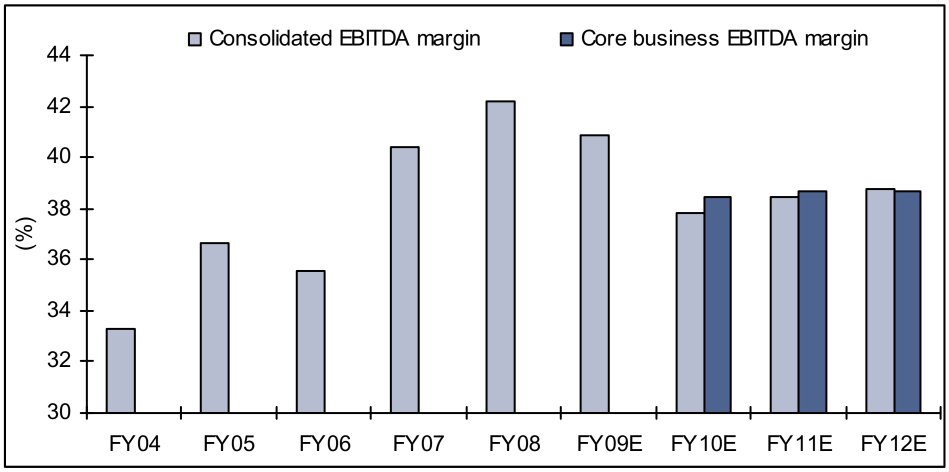


Source: Company data, I-Sec Research

Margins to slightly decline; short-term impact of tower business

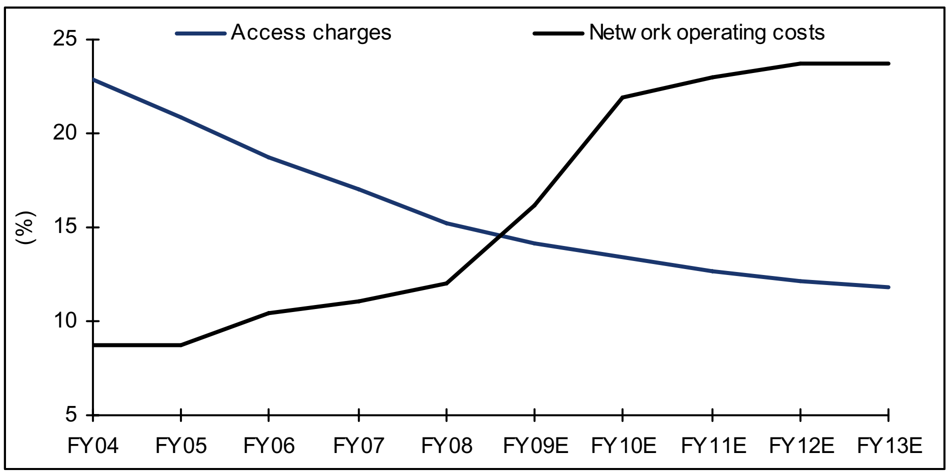
We expect BAL's consolidated EBITDA margin to decline 300bps to 37.8% in FY10E from 40.9% in FY09E, driven by higher network operating expenses. Network operating expenses, as a percentage of revenues, would significantly increase on the back of the tower business. We expect tower business consolidation (BITL+42% Indus) to result in 60bps EBITDA margin dilution in FY10E; the tower business is likely to contribute positively to consolidated margins only FY12E onwards, as tenancy improves.

Chart 11: Tower business to impact consolidated EBITDA margin in near-term



Source: Company data, I-Sec Research

Chart 12: Network operating costs to increase on back of tower business



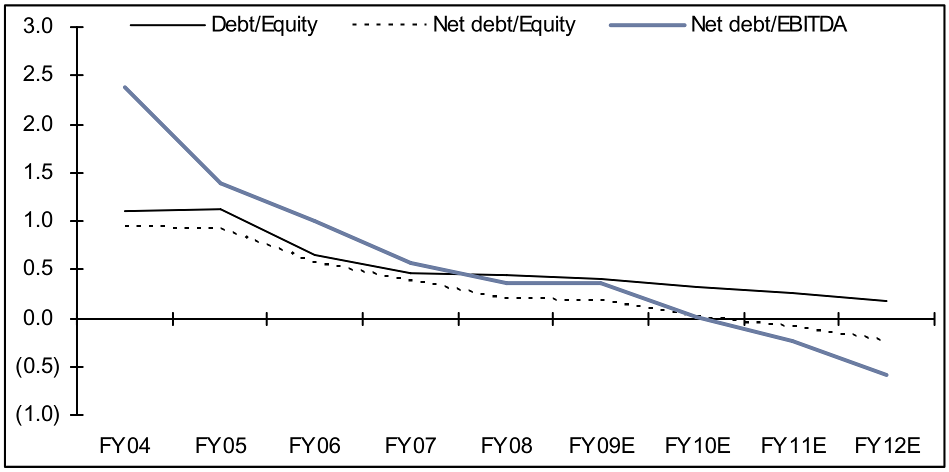
Source: Company data, I-Sec Research

Balance sheet well placed for 3G, new ventures and acquisitions

BAL has a considerably comfortable debt position, with net debt-to-equity of 0.2x at present, while incumbents such as RCom and new entrants are struggling with constrained balance sheets. Internal free cashflow generation will support capex requirements, excluding 3G, and the company will require raising debt only for 3G spend. BAL has an edge over other operators in the upcoming 3G auctions on the back of its strong balance sheet offering support for any debt gearing to fund 3G auctions vis-à-vis other operators who may have funding issues. Besides 3G, the strong balance sheet also gives BAL flexibility to invest in new ventures such as Sri Lanka operations or acquisitions.

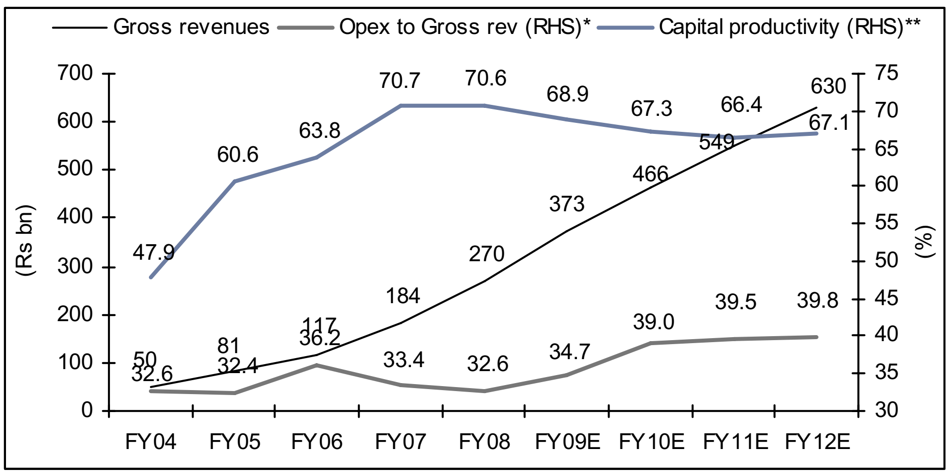
We expect BAL to utilise some free cashflow to pay dividends and have, thereby, factored in 15% dividend payout FY11E onwards. Indus is likely to raise debt to fund its tower rollout and 42% consolidation of the same in BAL's balance sheet will only marginally increase the debt portion for BAL.

Chart 13: Comfortable debt position



Source: Company data, I-Sec Research

Chart 14: BAL performance tracker – Growth to continue, but profitability & capital productivity to slightly decline



*Opex considered is the sum of equipment costs, employee costs, network operations costs and selling, general & administrative costs; **Capital productivity is the ratio of annualised revenues to gross cumulative capex (sum of gross fixed assets, capital work-in-progress and intangibles)
Source: Company data, I-Sec Research

Valuations – Best play in Indian Telecom

Our DCF-based valuation of BAL's core telecom business stands at Rs613/share and the tower business at Rs112/share, implying target price of Rs733/share. Our target price implies FY10E P/E of 13.5x, EV/EBITDA of 8.1x and 19% upside from current levels. We initiate coverage with BUY rating.

BAL offers the best play in the Indian telecom industry, notwithstanding near-term pressure of price-based competition, degenerating external environment and regulatory risks that, we believe, are already factored in the stock valuation. We believe BAL's penetration lead in rural India and partnership model in tower sharing will drive growth whereas competition will have to tackle new circle launches and new technology adoption challenges. However, notably, in the short-term, aggressive price plans and new rollouts may cloud BAL's stock performance. BAL is expected to report EPS of Rs44.8, Rs54.4 and Rs65.8 in FY09E, FY10E and FY11E respectively, representing EPS CAGR of 24.8% over FY08-11E.

Table 14: DCF-based core-business value at Rs621/share; total SOTP-based value at Rs733/share

(Rs mn)

	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E	FY16E	FY17E	FY18E	FY19E
EBIT	114,274	130,013	141,916	159,159	174,590	193,599	213,765	234,901	256,976	280,455
NOPAT	102,323	115,115	124,247	136,211	145,906	157,948	170,153	182,305	194,323	206,466
Depreciation	35,985	40,295	47,715	53,472	56,928	59,563	61,900	64,148	66,301	68,383
Capex	92,695	76,311	61,149	48,722	49,900	51,461	52,457	54,342	56,208	58,091
Net change in working capital	1,659	914	1,672	3,845	2,083	3,740	4,559	5,359	6,148	6,882
FCFF	**43,955**	**78,185**	**109,141**	**137,116**	**150,851**	**162,309**	**175,038**	**186,752**	**198,269**	**209,875**
Terminal value	1,437,210									
Enterprise value (Rs mn)	**1,148,389**									
Net debt	(29,668)		**Assumptions**							
Equity value (Rs mn)	**1,178,057**		WACC		11.9%					
Core business contribution/share (Rs)	**621**		Exit EV/EBITDA		4.0x					
Sum-of-the-parts valuation										
Core business contribution/share (Rs)	621	84.7%								
BITL standalone contribution/share (Rs)	38	5.1%								
Indus contribution/share (Rs)	74	10.2%								
Total value/share	**733**	**100.0%**								
% upside	**19**									
Implied FY10E P/E	13.5x									
Implied FY10E EV/EBITDA	8.1x									

Source: Company data, I-Sec Research

Table 15: Sensitivity analysis – Core business valuations

		WACC (%)				
		10.9	**11.4**	**11.9**	**12.4**	**12.9**
Exit EV/EBITDA	**3.0x**	603	584	566	548	531
	3.5x	634	613	593	574	556
	4.0x	664	642	**621**	601	581
	4.5x	694	671	648	627	606
	5.0x	724	699	676	653	631

Source: Company data, I-Sec Research

Table 16: Scenario analysis suggests 5% upside in pessimistic case

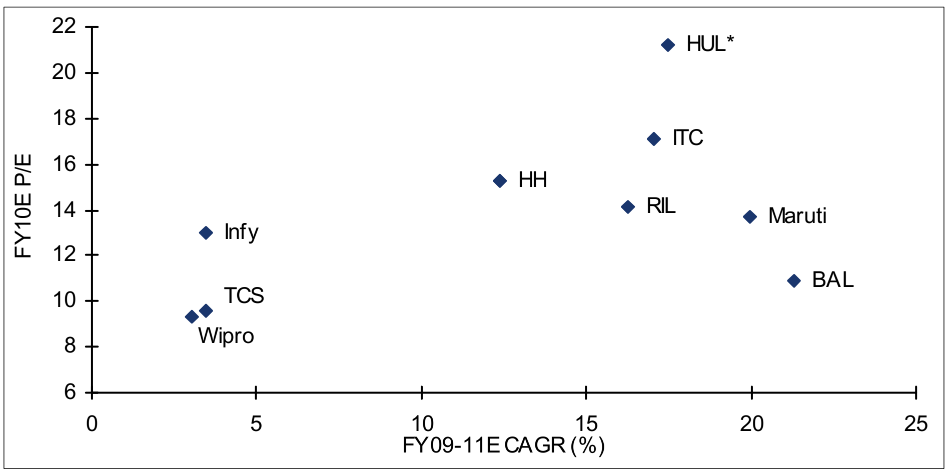
	Scenarios	Core business value/share (Rs)	Tower value/share (Rs)	Total value/share (Rs)	% upside
Optimistic case	i) 7% and 2% decline in voice ARPMs ii) 10% more tenancy in BITL & Indus FY12E onwards	693	130	824	34
Base case	i) 12% and 7% decline in voice ARPMs in FY10E & FY11E respectively ii) 1.8x & 2.2x tenancy in BITL & Indus respectively in FY12E	621	112	733	19
Pessimistic case	i) 17% and 7% decline in voice ARPMs ii) 10% less tenancy in BITL & Indus FY12E onwards	552	94	645	5

Source: Company data, I-Sec Research

Premium for superior execution and market leadership

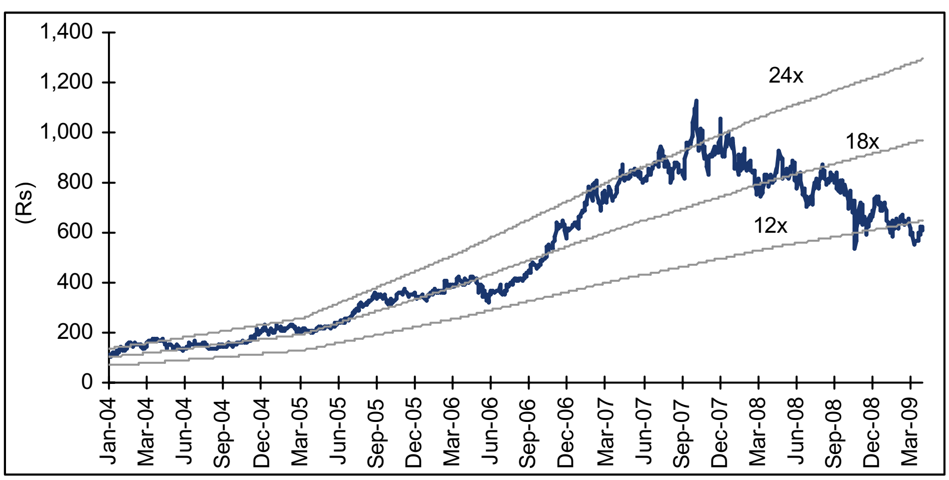
BAL has been able to maintain market leadership despite competition, owing to its superior execution. The company offers better growth profile and cheaper valuations to IT and FMCG sector stocks.

Chart 15: Benchmarking against other growth stocks



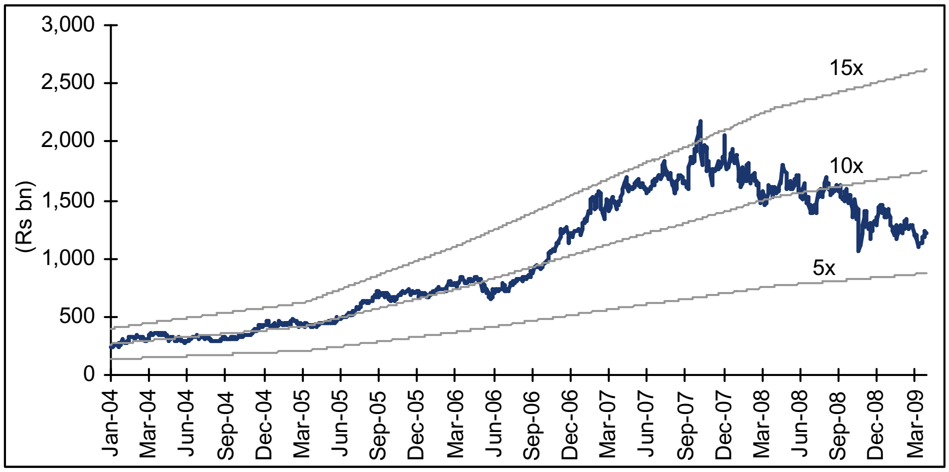
* For HUL, FY09 refers to CY08 and FY10 to CY09
Source: Bloomberg, Company data, I-Sec Research

Chart 16: P/E bands



Source: Bloomberg, Company data, I-Sec Research

Chart 17: EV/EBITDA



Source: Bloomberg, Company data, I-Sec Research

Table 17: BAL – Detailed business model

(Rs mn)

	FY07	FY08	FY09E	FY10E	FY11E	FY12E
Mobile services						
No. of mobile subscribers (mn)	37.1	62.0	95.2	122.9	145.5	163.4
Growth (%)	*89.7*	*66.9*	*53.5*	*29.1*	*18.4*	*12.3*
Net adds (mn)	17.6	24.8	33.2	27.7	22.6	17.9
Growth (%)	*104.3*	*41.5*	*33.5*	*(16.4)*	*(18.6)*	*(20.6)*
ARPU (Rs/mth)	416	366	324	287	266	254
Growth (%)	*(33.5)*	*(11.9)*	*(11.5)*	*(11.3)*	*(7.5)*	*(4.6)*
MoU (min/mth)	448	478	510	510	510	510
Growth (%)	*11.6*	*6.8*	*6.8*	-	-	-
ARPM (Rs/min)	0.93	0.77	0.63	0.56	0.53	0.52
Growth (%)	*(40.4)*	*(17.5)*	*(17.2)*	*(11.3)*	*(6.6)*	*(1.9)*
Voice ARPU (Rs/mth)	373	331	292	257	237	225
Growth (%)	*(33.5)*	*(11.1)*	*(11.8)*	*(12.0)*	*(8.0)*	*(5.0)*
VAS ARPU (Rs/mth)	43	35	32	30	29	29
Growth (%)	*(33.6)*	*(18.6)*	*(9.5)*	*(5.0)*	*(3.0)*	*(1.0)*
Mobile revenues	**141,443**	**217,861**	**305,489**	**375,931**	**428,104**	**470,267**
Growth (%)	*71.7*	*54.0*	*40.2*	*23.1*	*13.9*	*9.8*
Operating expenses	88,190	132,380	212,167	262,027	303,353	337,576
Mobile EBITDA	**53,253**	**85,481**	**93,322**	**113,904**	**124,751**	**132,690**
EBITDA margin (%)	*37.6*	*39.2*	*30.5*	*30.3*	*29.1*	*28.2*
Enterprise Carrier services						
NLD mins (mn)	15,943	29,926	45,154	55,654	63,361	69,100
Growth (%)	*132.5*	*87.7*	*50.9*	*23.3*	*13.8*	*9.1*
ILD mins (mn)	3,888	6,029	9,901	12,203	13,893	15,151
Growth (%)	*87.1*	*55.1*	*64.2*	*23.3*	*13.8*	*9.1*
Revenues	**34,888**	**43,170**	**68,576**	**80,297**	**88,674**	**96,706**
Growth (%)	*42.1*	*23.7*	*58.9*	*17.1*	*10.4*	*9.1*
Operating expenses	21,129	28,860	38,073	44,146	48,349	52,085
EBITDA	**13,759**	**14,310**	**30,503**	**36,151**	**40,325**	**44,620**
EBITDA margin (%)	*39.4*	*33.1*	*44.5*	*45.0*	*45.5*	*46.1*
Enterprise Corporate services						
Revenues	9,050	13,217	17,099	19,664	22,220	24,665
Growth (%)	*26.0*	*46.0*	*29.4*	*15.0*	*13.0*	*11.0*
Operating expenses	4,858	7,094	9,709	10,907	12,210	13,551
EBITDA	4,192	6,123	7,390	8,758	10,010	11,114
EBITDA margin (%)	*46.3*	*46.3*	*43.2*	*44.5*	*45.0*	*45.1*
Telemedia services						
Subscribers (mn)	1.9	2.3	2.7	3.1	3.5	3.8
Net adds (mn)	0.52	0.41	0.44	0.40	0.35	0.30
ARPL (Rs/mth)	1,163	1,143	1,118	1,041	999	979
Growth (%)	*2.4*	*(1.7)*	*(2.2)*	*(6.9)*	*(4.0)*	*(2.0)*
MoUs (min)	837	738	646	614	601	601
Growth (%)	*(14.5)*	*(11.8)*	*(12.4)*	*(5.0)*	*(2.0)*	-
ARPM (Rs/min)	1.4	1.5	1.7	1.7	1.7	1.6
Growth (%)	*19.7*	*11.4*	*11.7*	*(2.0)*	*(2.0)*	*(2.0)*
Revenues	22,454	28,484	33,548	36,453	39,507	42,536
Growth (%)	*49.5*	*26.9*	*17.8*	*8.7*	*8.4*	*7.7*
Operating expenses	16,852	17,077	19,353	20,455	21,960	23,358
EBITDA	**5,602**	**11,407**	**14,195**	**15,998**	**17,546**	**19,178**
EBITDA margin (%)	*24.9*	*40.0*	*42.3*	*43.9*	*44.4*	*45.1*

Source: Company data, I-Sec Research

Annexure 1: Financials

Table 18: Profit & Loss statement

(Rs mn, year ending March 31)

	FY08	FY09E	FY10E	FY11E	FY12E
Service revenues	268,728	370,250	462,962	545,748	625,933
Sale of goods	1,394	2,261	2,668	3,201	3,841
Gross sales	**270,122**	**372,511**	**465,630**	**548,949**	**629,774**
Less: Excise duty					
Net sales	**270,122**	**372,511**	**465,630**	**548,949**	**629,774**
of which Export sales	-	-	-	-	-
of which Domestic sales	*270,122*	*372,511*	*465,630*	*548,949*	*629,774*
Other operating income	-	-	-	-	-
Total operating income	**270,122**	**372,511**	**465,630**	**548,949**	**629,774**
% growth					
Less:					
Network	32,430	60,147	102,226	126,069	149,701
License fee	26,900	38,157	45,782	51,751	58,757
Interconnection	41,111	52,737	62,262	69,376	76,263
Personnel expenses	14,392	16,963	19,452	22,911	25,372
Selling, advertising & promotion expenses	19,058	24,079	27,526	31,239	34,735
Administrative & general expenses	21,025	26,564	30,366	34,463	38,319
Cost of goods sold	1,189	1,551	1,830	2,197	2,636
Pre-operative expenses	-	-	-	-	-
Total operating expenses	**156,105**	**220,197**	**289,443**	**338,006**	**385,782**
EBITDA	**114,018**	**152,313**	**176,187**	**210,943**	**243,992**
EBITDA margin (%)	*42.2*	*40.9*	*37.8*	*38.4*	*38.7*
Depreciation & Amortisation	38,102	48,051	53,959	62,786	74,105
- Depreciation	34,714	-	-	-	-
- Amortisation	3,388	-	-	-	-
Other Income	2,796	1,348	5,675	7,425	9,961
EBIT	**78,712**	**105,610**	**127,903**	**155,582**	**179,847**
EBIT margin (%)	*29.1*	*28.4*	*27.5*	*28.3*	*28.6*
Less: Net Interest	5,279	11,476	8,923	8,738	9,075
Recurring Pre-tax Income	**73,433**	**94,134**	**118,980**	**146,844**	**170,772**
Add: Extraordinary Income	-	-	-	-	-
Less: Extraordinary Expenses	317	167	-	-	-
Less: Taxation	**8,161**	**7,407**	**14,041**	**19,910**	**25,872**
– Current tax	9,353	9,961	13,521	19,299	25,200
– MAT credits	(399)	-	-	-	-
– Deferred tax	(1,196)	(3,029)	-	-	-
– FBT	403	475	520	611	672
Tax rate (%)	*11.2*	*7.9*	*11.8*	*13.6*	*15.2*
Reported net income before minority interest	**64,954**	**86,559**	**104,939**	**126,934**	**144,900**
Earnings from associate companies	-	-	-	-	-
Minority interest	1,000	1,770	1,737	2,016	2,396
Net income (Reported)	**63,954**	**84,789**	**103,203**	**124,918**	**142,505**
Recurring net income	**64,236**	**84,943**	**103,203**	**124,918**	**142,505**

Source: Company data, I-Sec Research

Table 19: Balance sheet

(Rs mn, year ending March 31)

	FY08	FY09E	FY10E	FY11E	FY12E
ASSETS					
Current assets, loans & advances					
Cash & Bank balance	7,034	21,718	85,238	134,912	200,989
Inventory	1,142	1,275	1,454	1,685	1,950
Sundry debtors	28,398	32,484	40,604	47,869	54,917
Loans & Advances	28,403	30,617	38,271	45,119	51,762
Operational	28,403	30,617	38,271	45,119	51,762
Other Current Assets	-	-	-	-	-
Total Current Assets	**64,978**	**86,094**	**165,567**	**229,585**	**309,619**
Current Liabilities & Provisions					
Current Liabilities	**141,235**	**164,434**	**209,719**	**239,690**	**269,029**
Sundry creditors	103,223	126,422	171,707	201,678	231,016
Other Current Liabilities	38,012	38,012	38,012	38,012	38,012
Provisions	**6,903**	**8,222**	**10,486**	**11,984**	**13,451**
Total Current Liabilities and Provisions	**148,138**	**172,656**	**220,205**	**251,674**	**282,480**
Net Current Assets	**(83,160)**	**(86,562)**	**(54,638)**	**(22,089)**	**27,139**
Investments					
Strategic & Group Investments					
Other Marketable Investments	48,097	43,868	43,868	43,868	43,868
Total Investments	**48,097**	**43,868**	**43,868**	**43,868**	**43,868**
Deferred Tax Asset	-	-	-	-	-
Pre-Operative Expenses	-	-	-	-	-
Fixed Assets					
Gross Block	423,224	585,046	708,288	828,791	910,434
Less Accumulated Depreciation	97,730	145,781	199,740	262,526	336,632
Net Block	325,494	439,265	508,548	566,265	573,802
Add: Capital Work in Progress	35,700	38,090	52,654	63,746	74,591
Less: Revaluation Reserve	-	-	-	-	-
Total Fixed Assets	**361,194**	**477,355**	**561,202**	**630,011**	**648,394**
Total Assets	**326,131**	**434,661**	**550,432**	**651,790**	**719,400**
LIABILITIES AND SHAREHOLDERS' EQUITY					
Borrowings					
Unsecured Debt	95,435	120,435	131,267	127,613	100,925
Non-Convertible Preference Shares	-	-	-	-	-
Secured Debt	583	583	583	583	-
Total Borrowings	**96,017**	**121,017**	**131,849**	**128,196**	**100,925**
Share Capital					
Paid up Equity Share Capital	19,555	19,555	19,555	19,555	19,555
Common shares	18,979	18,979	18,979	18,979	18,979
Others	576	576	576	576	576
No. of Shares outstanding (mn)	*1,898*	*1,898*	*1,898*	*1,898*	*1,898*
Face Value per share (Rs)	*10*	*10*	*10*	*10*	*10*
Reserves & Surplus	**197,686**	**282,476**	**385,678**	**488,674**	**581,159**
Share Premium	39,890	39,890	39,890	39,890	39,890
General & Other Reserve	37,627	37,627	37,627	37,627	37,627
Profit & Loss	120,150	204,939	308,142	411,137	503,623
Revaluation Reserve	21	21	21	21	21
Less: Misc. Exp. not written off	2	2	2	2	2
Networth	**217,242**	**302,031**	**405,234**	**508,229**	**600,715**
Deferred tax liability	2,729	(300)	(300)	(300)	(300)
Minority Interest	10,142	11,912	13,649	15,664	18,060
Total Liabilities & Shareholders' Equity	**326,131**	**434,661**	**550,432**	**651,790**	**719,400**

Source: Company data, I-Sec Research

Table 20: Cashflow statement

(Rs mn, year ending March 31)

	FY08	FY09E	FY10E	FY11E	FY12E
Cashflow from Operating Activities					
Reported Net Income	64,954	86,559	104,939	126,934	144,900
Add:					
Depreciation & Amortisation	21,574	48,051	53,959	62,786	74,105
Provisions	-	-	-	-	-
Deferred Taxes	(1,196)	(3,029)	-	-	-
Minority Interest	-	-	-	-	-
Less:					
Other Income	2,796	1,348	5,675	7,425	9,961
Net Extra-ordinary income	(317)	(167)	-	-	-
Unrealised forex (gain)/loss					
Operating Cashflow before Working Capital change (a)	**82,853**	**130,401**	**153,223**	**182,296**	**209,044**
	18,523	*47,547*	*22,822*	*29,073*	*26,749*
Changes in Working Capital					
(Increase) / Decrease in Inventories	(230)	(133)	(179)	(231)	(265)
(Increase) / Decrease in Sundry Debtors	(9,686)	(4,085)	(8,120)	(7,266)	(7,048)
(Increase) / Decrease in Operational Loans & Adv.	(11,146)	(2,214)	(7,654)	(6,848)	(6,643)
(Increase) / Decrease in Other Current Assets	-	-	-	-	-
Increase / (Decrease) in Sundry Creditors	30,590	23,199	45,285	29,971	29,339
Increase / (Decrease) in Other Current Liabilities	10,515	-	-	-	-
Increase / (Decrease) in Provisions	2,458	1,318	2,264	1,499	1,467
Working Capital Inflow / (Outflow) (b)	**22,501**	**18,085**	**31,596**	**17,125**	**16,850**
Net Cashflow from Operating Activities (a) + (b)	**105,355**	**148,486**	**184,820**	**199,420**	**225,894**
as a % of Operating Cash Flow	*17,559*	*43,131*	*36,334*	*14,601*	*26,474*
Cashflow from Capital commitments					
Purchase of Fixed Assets	(153,016)	(164,212)	(137,806)	(131,595)	(92,488)
Purchase of Investments	-	-	-	-	-
Consideration paid for acquisition of undertaking					
Cost of Intangibles					
Cash Inflow/(outflow) from capital commitments (c)	**(153,016)**	**(164,212)**	**(137,806)**	**(131,595)**	**(92,488)**
Free Cashflow after capital commitments (a) + (b) + (c)	**(47,661)**	**(15,726)**	**47,013**	**67,825**	**133,406**
Cashflow from Investing Activities					
Purchase of Marketable Investments	(46,626)	4,229	-	-	-
(Increase)/Decrease in Other Loans & Advances	-	-	-	-	-
Other Income	2,796	1,348	5,675	7,425	9,961
Net Cashflow from Investing Activities (d)	**(43,830)**	**5,577**	**5,675**	**7,425**	**9,961**
Cashflow from Financing Activities					
Issue of Share Capital during the year	927	-	-	-	-
Proceeds from fresh borrowings	43,159	25,000	10,832	(3,653)	(27,271)
Repayment of Borrowings	-	-	-	-	-
Buyback of Shares	-	-	-	-	-
Dividend paid including tax	-	-	-	(21,923)	(50,019)
Others	46,236	(0)	0	(0)	0
Net Cashflow from Financing Activities (e)	**90,321**	**25,000**	**10,832**	**(25,577)**	**(77,290)**
Net Extra-ordinary Income (f)	**(317)**	**(167)**	**-**	**-**	**-**
Total Increase / (Decrease) in Cash (a) + (b) + (c) + (d) + (e) + (f)	**(1,487)**	**14,684**	**63,520**	**49,673**	**66,078**
Opening Cash and Bank balance	**8,521**	**7,034**	**21,718**	**85,238**	**134,912**
Closing Cash and Bank balance	**7,034**	**21,718**	**85,238**	**134,912**	**200,989**
Increase/(Decrease) in Cash and Bank balance	**(1,487)**	**14,684**	**63,520**	**49,673**	**66,078**

Source: Company data, I-Sec Research

Table 21: Key ratios

(Year ending March 31)

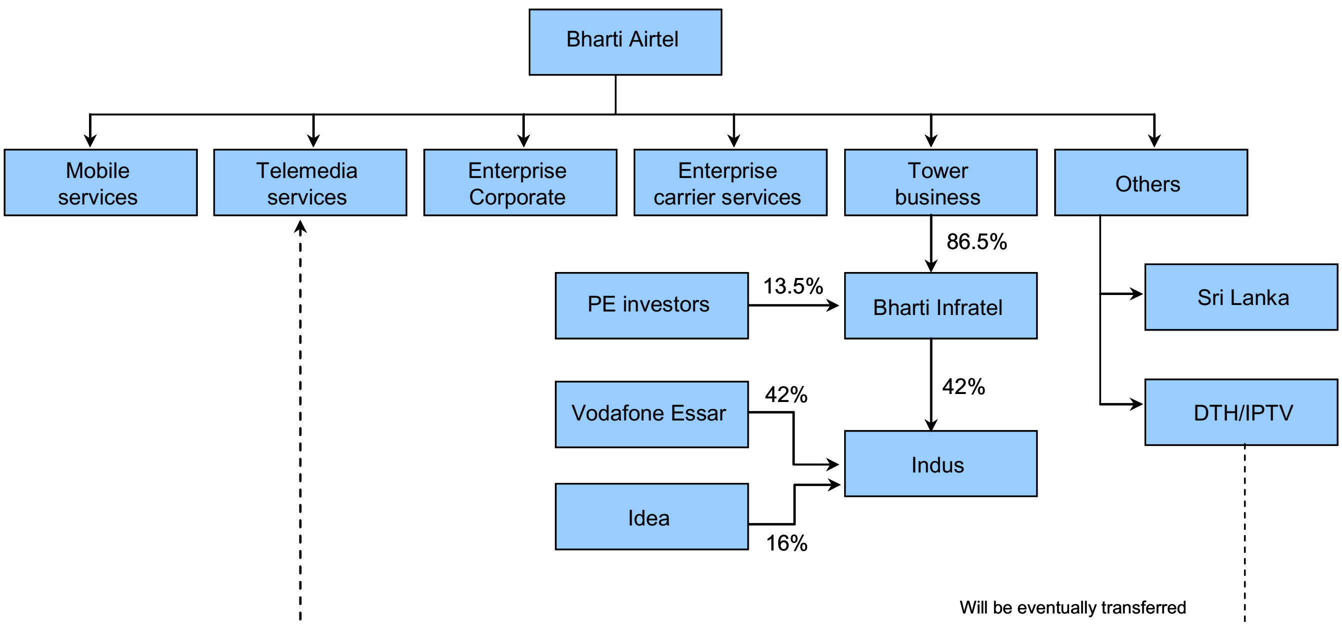
	FY08	FY09E	FY10E	FY11E	FY12E
Per-share data (Rs)					
Diluted Recurring Earning per share (DEPS)	33.8	44.8	54.4	65.8	75.1
Diluted Earnings per share	33.7	44.7	54.4	65.8	75.1
Recurring Cash Earnings per share (CEPS)	53.9	70.1	82.8	98.9	114.1
Free Cashflow per share (FCPS-post capex)	(25.1)	(8.3)	24.8	35.7	70.3
Reported Book Value (BV)	114.5	159.1	213.5	267.8	316.5
Adjusted Book Value (ABV)	114.5	159.1	213.5	267.8	316.5
Dividend per share	-	-	-	9.9	22.5
Valuation ratios (x)					
Diluted Price Earning Ratio	18.2	13.7	11.3	9.3	8.2
Price to Recurring Cash Earnings per share	11.4	8.8	7.4	6.2	5.4
Price to Book Value	5.4	3.9	2.9	2.3	1.9
Price to Adjusted Book Value	5.4	3.9	2.9	2.3	1.9
Price to Sales Ratio	4.3	3.1	2.5	2.1	1.9
EV / EBITDA	10.6	7.9	6.9	5.7	5.0
EV / Total Operating Income	4.5	3.2	2.6	2.2	1.9
EV / Operating Free Cash Flow (Pre-Capex)	11.5	8.1	6.5	6.1	5.3
EV / Net Operating Free Cash Flow (Post-Capex)	(25.3)	(76.8)	25.7	17.8	9.1
Dividend Yield (%)	-	-	-	0.0	0.0
Growth ratios (% YoY)					
Diluted Recurring EPS Growth	57.8	32.2	21.5	21.0	14.1
Diluted Recurring CEPS Growth	52.9	30.0	18.2	19.4	15.4
Total Operating Income Growth	46.6	37.9	25.0	17.9	14.7
EBITDA Growth	53.3	33.6	15.7	19.7	15.7
Recurring Net Income Growth	57.9	32.2	21.5	21.0	14.1
Operating ratios (%)					
EBITDA Margins	42.2	40.9	37.8	38.4	38.7
EBIT Margins	29.1	28.4	27.5	28.3	28.6
Recurring Pre-tax Income Margins	26.9	25.2	25.2	26.4	26.7
Recurring Net Income Margins	23.5	22.7	21.9	22.5	22.3
Network costs/Sales	12.0	16.1	22.0	23.0	23.8
SGA Expenses / Sales	14.8	13.6	12.4	12.0	11.6
Other Income / Pre-tax Income	3.8	1.4	4.8	5.1	5.8
Other Operating Income / EBITDA	0.0	0.0	0.0	0.0	0.0
Effective Tax Rate	11.1	7.9	11.8	13.6	15.2
Return/Profitability Ratios (%)					
Return on Capital Employed (RoCE)-Overall	27.7	25.1	22.6	22.0	21.9
Return on Invested Capital (RoIC)	47.2	41.6	40.1	43.0	47.1
Return on Net Worth (RoNW)	38.7	32.7	29.2	27.4	25.7
Dividend Payout Ratio	0.0	0.0	0.0	15.0	30.0
Solvency ratios/Liquidity ratios (%)					
Net Debt/Equity	18.8	18.4	0.7	(10.0)	(24.0)
Net Debt/EBITDA	35.9	36.4	1.6	(24.0)	(59.0)
Long-term Debt/Total Debt	0.6	0.5	0.4	0.5	-
Net Working Capital/Total Assets	(27.7)	(24.9)	(25.4)	(24.1)	(24.2)
Interest Coverage Ratio - based on EBIT	1,491	920	1,433	1,781	1,982
Debt Servicing Capacity Ratio (DSCR)	115.4	115.8	129.0	159.3	229.6
Current ratio	15.02	18.93	36.22	48.63	67.25
Cash & cash equivalents/Total Assets	2.2	5.0	15.5	20.7	27.9
Turnover ratios					
Inventory Turnover Ratio (x)	134.9	164.7	193.6	197.5	197.4
Assets Turnover Ratio (x)	1.1	1.0	1.0	0.9	0.9
Working Capital Cycle (days)	(127.0)	(112.1)	(82.3)	(53.2)	(26.6)
Average Collection Period (days)	31.8	29.8	28.6	29.4	29.8
Average Payment Period (days)	205.6	190.3	188.0	201.6	204.7

Source: Company data, I-Sec Research

Annexure 2: Bharti Enterprises Group – Background

Bharti Enterprises is one of India's leading business groups with interests in telecom, retail, manufacturing, agri-business and financial services. Besides BAL, other businesses in the group are Bharti AXA (JV with AXA of France offering life insurance, general insurance and asset management), Beetel (communication and media devices), Bharti Retail, (operating multiple format consumer friendly stores), Bharti Wal-Mart, (a B2B JV with Wal-Mart for wholesale cash-and-carry and back-end supply chain management operations) and Bharti Del Monte India (JV with Del Monte to offer fresh and processed fruits & vegetables in India as well as international markets).

Chart 18: BAL – Corporate structure



Source: Company data

BAL – Stockholding information

Bharti Telecom, an Indian company, holds 45.31% equity & voting interest and exercises managerial control in BAL. Pastel, a Mauritius-based wholly-owned subsidiary of SingTel, holds 15.58% equity in BAL. BAL's remaining shares are held publicly.

In addition to its direct holdings in BAL, Pastel also has an indirect interest via its 32.81% stake in Bharti Telecom. SingTel, thus, has a 30.45% equity stake (15.58% through Pastel's direct stake in BAL and 14.87% indirectly through Pastel's stake in Bharti Telecom). Vodafone, the UK-based international telecom operator, owns 5.6% minority interest in BAL.

Annexure 3: Index of Tables and Charts

Tables

Charts

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Equity Research

April 2, 2009

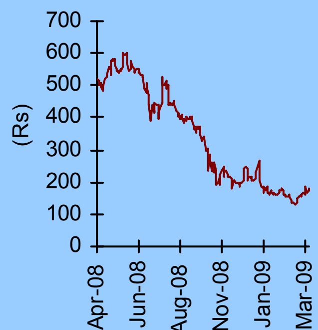
BSE Sensex: 9902

Telecom

Shareholding pattern

	Jun '08	Sep '08	Dec '08
Promoters	67.9	67.7	67.7
Institutional investors	19.4	19.0	17.9
MFs and UTI	2.9	2.6	2.7
Insurance Cos.	6.3	6.7	7.0
FIIs	10.2	9.7	8.2
Others	12.7	13.3	14.4

Price chart



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Reliance Communications

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Rs180

Reason for report: Initiating coverage

Reliance Communications (RCom) has launched its GSM network across India in December '08 with aggressive promotional packages, thereby gleaning impressive share of net adds through January-February '09. But, we do not expect the higher subscriber share to translate into increased revenue share. Reliance Infratel (RITL), RCom's telecom infrastructure subsidiary, has so far failed to garner any external tenants. We believe the company's balance sheet is stretched and 3G auction spend will further increase cashflow concerns. Based on DCF, RCom's core telecom business is valued at Rs105/share and the tower business at Rs64/share, implying a target price of Rs169/share, which suggests 6% downside from current levels. Stock valuations have declined to FY10E P/E of 7.9x & EV/EBITDA of 4.7x, owing to concerns over dual network strategy, discrepancy in reporting accounts and high leverage. Initiate coverage on RCom with HOLD.

- **RCom in Catch-22 situation** as we believe that GSM launch is a compulsion given the stagnation in CDMA. And even then, most of RCom's new GSM subscribers may just be dual SIM owners with usage restricted to free minutes. We expect higher share of net adds, but mitigated revenue growth on declining ARPMs. However, the GSM launch has long-term potential though costs will remain high.
- **RITL – Solitary reaper.** RITL has so far failed to garner any external tenants, with its internal tenancy at 1.7x owing to dual network. We expect RITL to garner a tenancy of 2.3x by FY15E, of which 0.3x will be driven by RCom's 3G foray and only 0.4x by external tenants. Higher rental charges & capex of RITL will likely be counter productive as towers are standardised with not much differentiation.
- **Balance sheet concerns loom large.** Though RCom is through with the peak of its capex cycle, we believe its balance sheet is well stretched with FY09E net debt/equity of 0.8x and net debt/EBITDA of 2.7x. While unwinding of current liabilities and 3G auction spend will further increase cashflow concerns, RCom's aggressive accounting and reporting policies increase apprehensions on valuations.
- **Valuations – Muted expectations.** RCom's stock has severely underperformed the market and has been subject to high volatility due to continuous negative newsflow. While valuations look relatively cheap, they reflect the uncertainties surrounding the company. We ascribe sum-of-the-parts (SOTP) based target price of Rs169/share, which implies 6% downside from the current levels. Our target price implies FY10E P/E of 7.4x & EV/E of 4.4x. We initiate coverage on RCom with HOLD.

Market Cap	Rs371.5bn/US$7.4bn
Reuters/Bloomberg	RLCM.BO/RCOM IN
Shares Outstanding (mn)	2,064
52-week Range (Rs)	604/132
Free Float (%)	32.3
FII (%)	8.2
Daily Volume (US$'000)	32,000
Absolute Return 3m (%)	(28.3)
Absolute Return 12m (%)	(65.3)
Sensex Return 3m (%)	(0.6)
Sensex Return 12m (%)	(37.1)

Year to March	FY08	FY09E	FY10E	FY11E
Revenue (Rs mn)	188,274	230,614	282,946	328,005
Net Income (Rs mn)	41,183	58,782	47,478	47,563
EPS (Rs)	19.7	28.1	22.7	22.7
% Chg YoY	13.1	42.7	(19.2)	0.2
P/E (x)	9.1	6.4	7.9	7.9
CEPS (Rs)	33.5	47.3	49.0	55.7
EV/E (x)	6.4	5.5	4.7	3.9
Dividend Yield (%)	0.4	0.4	-	-
RoCE (%)	7.6	8.7	7.3	6.8
RoE (%)	15.9	19.5	14.2	12.4

TABLE OF CONTENT

Investment argument

RCom in Catch-22 situation

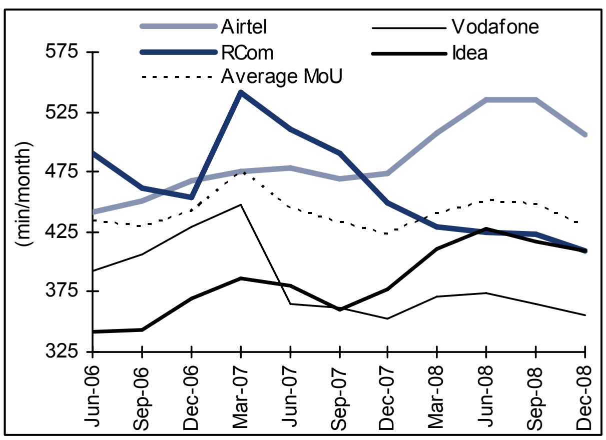
GSM a compulsion as CDMA stagnates

Recently, RCom launched its GSM network across India riding high on its aggressive promotional packages, thereby gleaning impressive share of net adds in January-February ’09. The nationwide GSM launch, in our view, was a compulsion for RCom as its growth was stagnating with its earlier offerings of CDMA and limited-area GSM services.

RCom’s CDMA network was yielding low capital productivity vis-à-vis GSM operators on lower viability of international roaming, both inwards and outwards. Further, RCom slipped as regards revenue share though it maintained momentum on subscriber share and net adds share; the company’s revenue share was 13% in Q3FY09 – estimates based on Telecom Regulatory Authority of India (TRAI) data – compared with subscriber share of 17.7% as of Q3FY09-end. RCom’s MoU & ARPU gap with Bharti Airtel (BAL) has widened in the past six quarters and Idea too has performed better than RCom recently.

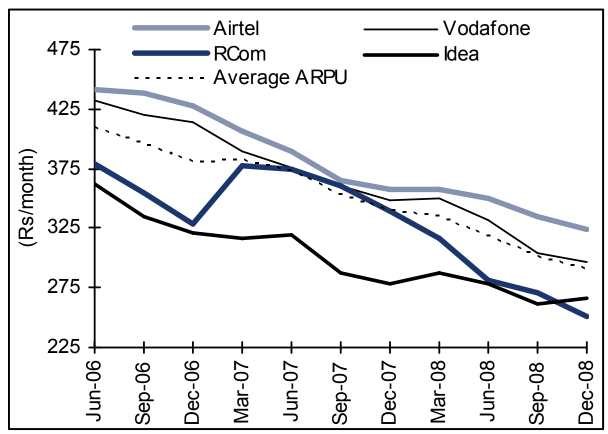
Chart 1: CDMA stagnates

MoUs – Widening gap with BAL



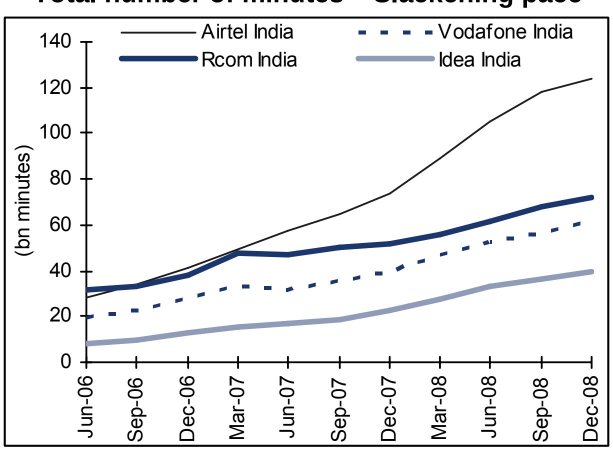
Source: Company data, I-Sec Research

ARPUs – Lagging behind Idea too



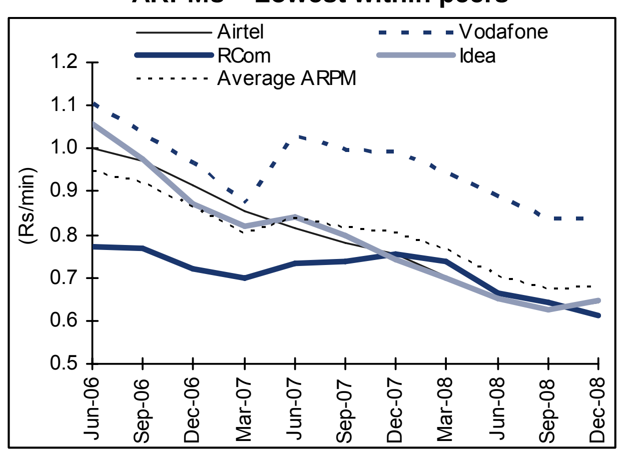
Source: Company data, I-Sec Research

Total number of minutes – Slackening pace



Source: Company data, I-Sec Research

ARPMs – Lowest within peers



Source: Company data, I-Sec Research

GSM has evolved as the dominant technology globally because of the flexibility to change handsets, and availability of more feature-rich handsets & advanced VAS applications. Costs of GSM network equipment and handsets are lower as opposed to CDMA owing to economies of scale. Further, CDMA operators have been forced to subsidise handsets, thereby pressurising margins. Hence, many operators globally have migrated to GSM from CDMA, especially in LatAm and South Korea (refer Annexure II: GSM to CDMA transition). Globally, GSM enjoys more than 82% of the total mobile subscriber base. In India too, the net add share for GSM was at 76% through December ’07-09.

RCom’s new GSM subscribers may just be dual SIM owners

RCom launched GSM services with a customer experience programme, in which subscribers can buy a lifetime prepaid service for Rs25 initial payment and can receive up to 900 minutes of free talk time, which resulted in impressive subscriber net adds of 5mn and 3.4mn in January and February ’09 respectively (CDMA + GSM). RCom, within two months of its nation-wide GSM launch, has seen a spurt in subscriber share to 18.5% from 17.7%.

A high proportion of RCom’s new GSM subscribers may just be dual SIM owners as industry net adds were at 15.3mn & 13.4mn in January ’09 & February ’09 respectively compared with monthly net add run rate of 9-10mn in ’08 and the plan did not offer any subsidies on handsets. In case of dual-SIM users, usage will mostly be restricted to free minutes and RCom may have to give more freebies and better deals to retain subscribers.

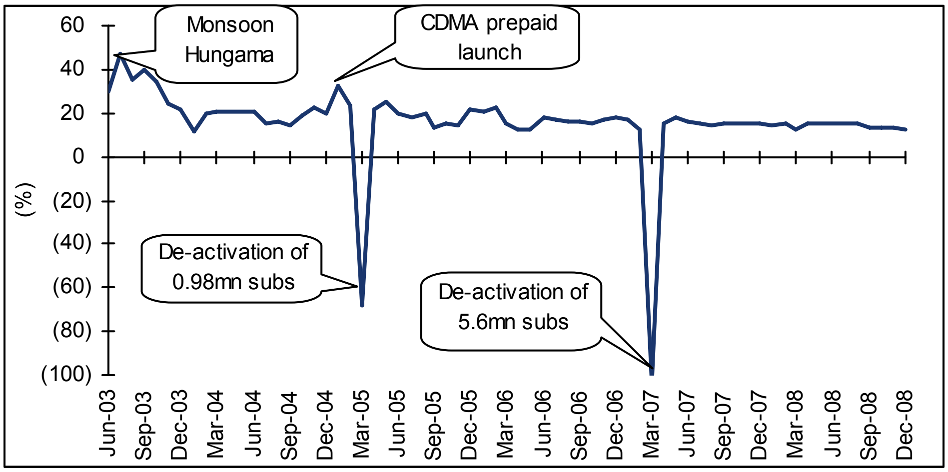
Disruptive plans have left a bad aftertaste previously

In July ’03, RCom (then Reliance Infocomm) redefined the pricing and tariff structure in the mobile industry by launching the ‘Monsoon Hungama’ offer – it offered a mobile phone for Rs501, including Rs100 free talk time. About 1mn applications were received for the service within the first 10 days of the launch with RCom gleaning a high share of net adds. RCom again changed the rules of the game by launching its CDMA prepaid services in February ’04, offering a bundle of Rs3,240-6,480 free talk-time over six months and CDMA handsets, due to which the company gained significant share of net adds. However, in both the instances, RCom was unable to maintain the momentum. Also, RCom has twice in the past deactivated many subscribers – 0.98mn (~9% of subscriber base) in March ’05 on account of subscriber verification & credit worthiness and 5.58mn (~20% of subscriber base) in March ’07 due to stricter verification norms. Hence, we are circumspect on RCom’s impressive GSM adds in the past two months.

Further, RCom had to write off Rs4.3bn as bad debts to clean up its balance sheet in FY04, which the company also attributed to the ‘Monsoon Hungama’ offer. The write-off amounted to 16% of Rs27bn revenues for FY04.

Impressive net adds share whenever new offers were launched but they eventually fizzled out

Chart 2: RCom's CDMA net adds share over the years



Source: Company data, I-Sec Research

Promotional blitz for spectrum gain?

RCom's strategy of adding subscribers quickly through its aggressive promotional schemes may be a tactic to gain additional spectrum, which is getting increasingly scarce. In the metros, RCom will be eligible for additional 1.8MHz spectrum if it crosses 0.5-0.7mn GSM subscribers.

For instance in Mumbai, if RCom's GSM subs do not use the service beyond the free minutes, the cost over three months for RCom for 0.7mn subscribers will be limited to Rs0.3/min termination charge for 900 minutes talk time, which translates into only Rs189mn even if we assume that all calls will be off-net. In effect, RCom will be able to gain additional 1.8MHz spectrum for Rs189mn, while the actual cost of spectrum is estimated to be much higher.

We expect higher share of net adds…

We expect RCom to gain high net adds share given the advantage of having a relatively vacant GSM network and the freedom to offer free MoUs. Also, the impending MNP implementation will likely trigger the shift of GSM customers to RCom from incumbents as RCom will be able to offer better network quality.

We estimate RCom's GSM subscriber base to increase 5x and its share of RCom's total subscriber base to rise to 45% from 24% by FY15E. We have modelled in 18%, 15% and 12% share of net adds in FY10E, FY11E and FY12E estimates respectively in the new GSM circles and expect RCom's GSM subscriber share in new GSM circles to reach 8.2% by FY15E.

Table 1: Expect 8.2% subscriber share in new GSM circles by FY15E

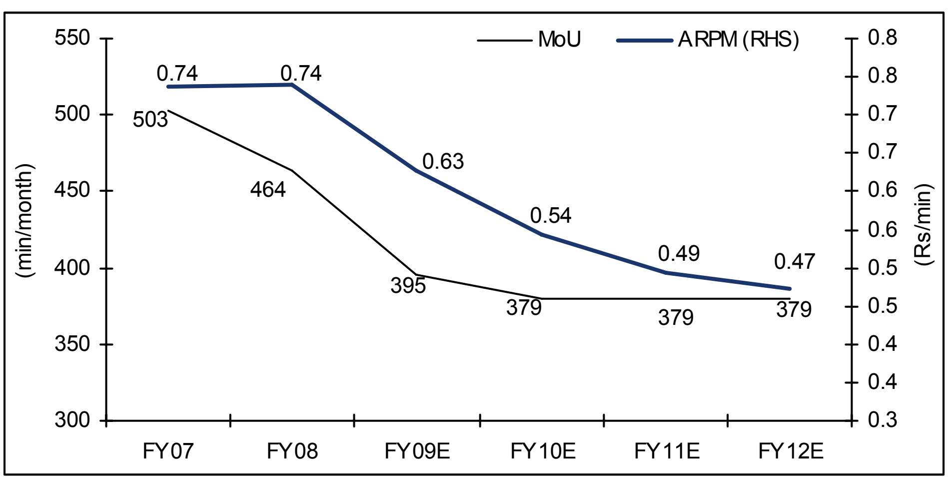
	FY08	FY09E	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E
Subscribers (mn)								
Reliance CDMA	38.8	54.0	63.5	70.0	75.0	78.8	81.7	83.6
Reliance GSM phase 1	7.0	11.5	15.1	18.3	20.9	22.9	24.5	25.6
Reliance GSM phase 2	-	7.1	22.6	32.0	37.7	42.0	45.1	46.8
Total	**45.8**	**72.7**	**101.2**	**120.4**	**133.6**	**143.8**	**151.3**	**156.0**
Net adds (mn)								
Reliance CDMA	14.2	15.2	9.5	6.5	5.0	3.8	2.9	1.8
Reliance GSM phase 1	2.7	4.5	3.5	3.3	2.6	2.0	1.6	1.1
Reliance GSM phase 2	-	7.1	15.5	9.4	5.7	4.3	3.1	1.8
Total	**16.8**	**26.9**	**28.5**	**19.2**	**13.2**	**10.2**	**7.5**	**4.7**
Subscriber share (%)								
Reliance CDMA	*14.9*	*13.9*	*12.5*	*11.5*	*11.0*	*10.6*	*10.4*	*10.3*
Reliance GSM phase 1	*2.7*	*3.0*	*3.0*	*3.0*	*3.1*	*3.1*	*3.1*	*3.2*
Reliance GSM phase 2	-	*1.8*	*4.4*	*5.3*	*5.5*	*5.7*	*5.7*	*5.8*
Total	**17.5**	**18.7**	**19.9**	**19.8**	**19.5**	**19.4**	**19.2**	**19.2**
Net adds share (%)								
Reliance CDMA	*14.9*	*12.0*	*7.9*	*6.6*	*6.5*	*6.5*	*6.5*	*6.7*
Reliance GSM phase 1	*2.8*	*3.5*	*3.0*	*3.3*	*3.4*	*3.4*	*3.6*	*4.1*
Reliance GSM phase 2	-	*5.6*	*12.9*	*9.5*	*7.4*	*7.3*	*7.1*	*6.4*
Total	**17.7**	**21.1**	**23.8**	**19.4**	**17.3**	**17.3**	**17.2**	**17.1**
Industry subs in 15 circles	206	299	385	448	495	531	556	571
RCOM GSM subs share in 15 circles (%)		*2.4*	*5.9*	*7.2*	*7.6*	*7.9*	*8.1*	*8.2*
Industry net adds in 15 circles	72	93	86	63	47	36	26	15
RCOM GSM net adds share in 15 circles (%)		*7.6*	*18.0*	*15.0*	*12.0*	*12.0*	*12.0*	*12.0*

Source: TRAI, I-Sec Research
Phase 1 refers to GSM services in Assam, Bihar, HP, Kolkata, MP, North East, Orissa and WB.
Phase 2 refers to the 15 circles where RCOM launched GSM services in December '08

….but mitigated revenue growth on declining ARPMs

We do not expect the higher subscriber share to translate into increased revenue share. RCom's APRM will trend downwards more than peers as the company's GSM services is likely to mainly attract deal-seeking customers initially, prior to the implementation of MNP. Even after MNP implementation, RCom's GSM services may find it difficult to snare high ARPU GSM subscribers from other operators since incumbent GSM operators offer better coverage especially in B and C circles and better quality network may not be a good enough reason.

Chart 3: ARPMs likely to dip 24% through FY09-12E without MoU elasticity



Source: Company data, I-Sec Research

Long-term revenue potential though on high costs

Due to RCom's pan-India GSM network, the company can now save on high access charges that it was paying owing to a partial GSM network earlier. In the long term, RCom will benefit from global roaming revenues and higher ARPU of GSM subscribers, and better VAS applications & handset features in GSM. Also, with dual networks, RCoM can have differentiated products, especially for corporate customers by targetting high-ARPU executives using GSM and low-ARPU field force using CDMA subscribers.

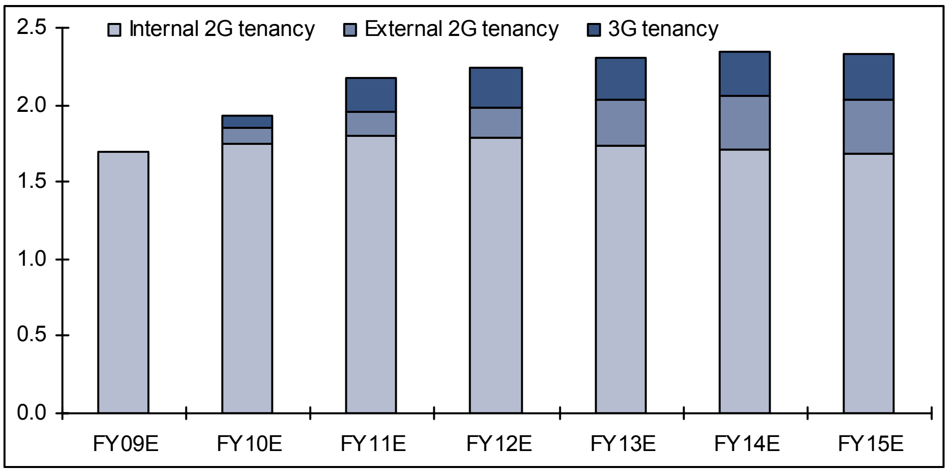
However, dual networks will continue to keep network operating costs high. RCom has 1,800MHz spectrum in all the circles, which will make it difficult for the company to get similar traction for capex deployed as compared with incumbents since RCom will need higher cell sites to gain similar coverage.

Reliance Infratel – Solitary reaper

No external tenants so far

Reliance Infratel (RITL) has so far failed to garner any external tenants, catering only to internal cell sites for its CDMA and GSM networks. The company owing to its dual network has 1.7x internal tenancy already and the roll-out of 3G network will likely boost internal tenancy. However, as the GSM network on 1,800MHz spectrum needs higher number of cell sites than CDMA to achieve the same coverage, RCom may have to build towers for just GSM cell sites, which will lead to a decline in internal tenancy as the GSM network expands. We expect RITL to garner a tenancy of 2.3x by FY15E, of which 0.3x will be driven by RCom's 3G foray and only 0.4x by external tenants.

Chart 4: Expect only 0.4x external tenancy by FY15E



Source: Company data, I-Sec Research

RITL not the partner of choice

RITL has to actively scout for tenants since the new players are finalising their roll-out plans and tying up with tower companies for tower renting. All the existing big players are already in tower-sharing agreements – BAL, Vodafone & Idea are sharing towers through Indus Towers; Tata Teleservices (TTSL) has recently merged its tower infrastructure subsidiary, Wireless Tata-Tele Info-Services (WTTIL) with Quippo and BSNL & MTNL have plans to share towers. WTTIL-Quippo has managed to add Unitech Wireless, one of the new entrants, as a tenant for its pan-India roll out.

Key upside for RITL depends on pan-India sharing with one or many of the new entrants. Reportedly, RITL is in talks with many new entrants such as Swan Telecom and Shyam-Sistema for passive and active infrastructure sharing, but so far no deal has fructified.

Higher rental charges & capex to be counter productive

RITL is betting on being a one-stop shop for telecom infrastructure by providing active infrastructure sharing and fibre backhaul connectivity along with tower sharing. The company has invested more capital per tower so as to support 4-5x tenancy and provide shareable fibre backhaul facility. We factor in RITL capex per tower at 15%

premium to other tower companies owing to higher investment in slots and backhaul. The high capex may, however, not be able to translate into higher rentals for tenants, given that towers are standardised with not much differentiation, thus reducing RITL's rental yield.

We factor in rental yields of 13.5% for RITL versus 14% for Bharti Infratel (BITL) and Indus Towers, leading to just 10.9% higher rental charges for RITL versus peers in spite of 15% higher capex.

Table 2: FY09E tariff and capex – RITL, Indus and BITL

	RITL	Indus	BITL	% difference RITL vs. Indus
Capex per tower (Rs mn)				
GBT	3.5	3.0	3.0	*15.0*
RTT	2.1	1.8	1.8	*15.0*
Additional capex per tenant (Rs mn)				
GBT	0.15	0.15	0.15	
RTT	0.15	0.15	0.15	
Rental per anchor tenant per month (Rs)				
GBT	38,813	35,000	35,000	*10.9*
RTT	23,288	21,000	21,000	*10.9*
Rental yield (%)	**13.5**	**14.0**	**14.0**	***(0.5)***

Source: Company data, I-Sec Research

Private placement of RITL– Highest valuation among all tower deals

RCom holds 95% stake in RITL though various subsidiaries and trusts, and the remaining is held by institutional investors. In July '07, RCom placed 5% stake of RITL with a group of foreign institutional investors at US$337.5mn (Rs14bn). The deal valued RITL at US$6.75bn (Rs280bn), when it had ~14,000 towers, implying a valuation of ~Rs20mn/tower. The investors included Fortress Capital, HSBC Principal Investments, Galleon Group, New Silk Route, GLG Partners, Quantum Fund (George Soros) and DA Capital.

We value RITL at Rs4.2mn EV per tower

Since RITL has only internal tenants at present, there is little rationale to separately value the company. However, as we expect RITL to be subsequently hived off, we have factored in this valuation separately by considering that RCom's wireless business will pay rentals to RITL. We note that without external tenancy there is little value add from RITL to RCom's valuation.

We value the tower company at an enterprise value of Rs205bn or Rs4.2mn/tower, which is not significantly higher than the capex per tower. We, however, believe that significant value creation can happen for RCom in the tower business if RITL is able to attract higher external tenancy. A 10% increase in our base case tenancy estimate by FY15 E can increase the value 21%.

Table 3: RITL contributes Rs64/share to RCom's value based on DCF

(Rs mn)

Reliance Infratel	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E	FY16E	FY17E	FY18E	FY19E
Towers	**62,000**	**69,000**	**76,000**	**83,000**	**88,000**	**91,000**	**93,000**	**94,000**	**94,500**	**95,001**
GBT (Ground-based towers)	49,235	54,975	60,785	66,665	70,915	73,495	75,235	76,115	76,560	77,011
RTT (Roof-top towers)	12,765	14,025	15,215	16,335	17,085	17,505	17,765	17,885	17,940	17,990
GBT % of towers	*0.79*	*0.80*	*0.80*	*0.80*	*0.81*	*0.81*	*0.81*	*0.81*	*0.81*	*0.81*
Tenants	**119,715**	**150,248**	**169,945**	**191,223**	**206,330**	**212,012**	**217,136**	**219,941**	**221,584**	**223,233**
Internal tenants	108,296	124,374	135,679	143,890	149,986	153,799	156,611	159,472	160,507	161,536
External tenants	6,200	10,350	15,200	24,900	30,800	31,851	33,371	32,501	32,270	32,025
3G tenants	5,219	15,524	19,066	22,433	25,544	26,363	27,154	27,968	28,807	29,672
Tenancy	**1.93**	**2.18**	**2.24**	**2.30**	**2.34**	**2.33**	**2.33**	**2.34**	**2.34**	**2.35**
Rental revenues	**44,609**	**58,623**	**69,282**	**77,879**	**85,421**	**89,542**	**91,481**	**92,774**	**93,304**	**93,580**
Avg rental/tenant/month (Rs)	*36,318*	*36,192*	*36,063*	*35,939*	*35,811*	*35,673*	*35,528*	*35,377*	*35,220*	*35,063*
Pass-through costs	28,533	38,004	45,526	51,865	57,661	61,283	63,494	65,314	66,639	67,807
Avg pass-through /tenant/month (Rs)	*23,230*	*23,462*	*23,697*	*23,934*	*24,173*	*24,415*	*24,659*	*24,906*	*25,155*	*25,406*
Total revenues incl. pass-through	**73,142**	**96,627**	**114,807**	**129,744**	**143,081**	**150,825**	**154,975**	**158,088**	**159,943**	**161,387**
Growth (%)		*32.1*	*18.8*	*13.0*	*10.3*	*5.4*	*2.8*	*2.0*	*1.2*	*0.9*
Semi-fixed costs	16,940	20,812	23,683	26,212	28,387	29,676	30,367	30,781	30,949	31,038
Total opex incl. pass-through	**45,473**	**58,816**	**69,208**	**78,077**	**86,048**	**90,959**	**93,862**	**96,096**	**97,588**	**98,845**
EBITDA	**27,670**	**37,811**	**45,599**	**51,667**	**57,034**	**59,866**	**61,114**	**61,993**	**62,355**	**62,542**
EBITDA margin incl. pass-through (%)	*37.8*	*39.1*	*39.7*	*39.8*	*39.9*	*39.7*	*39.4*	*39.2*	*39.0*	*38.8*
EBITDA margin ex pass-through (%)	*62.0*	*64.5*	*65.8*	*66.3*	*66.8*	*66.9*	*66.8*	*66.8*	*66.8*	*66.8*
Valuations										
EBIT	13,703	21,905	27,649	31,200	34,702	36,604	37,258	37,774	37,957	38,016
NOPAT	9,044	14,458	18,249	20,592	22,903	24,159	24,590	24,931	25,052	25,091
Depreciation	13,967	15,906	17,950	20,467	22,332	23,262	23,856	24,219	24,398	24,526
Capex	41,661	25,941	24,412	24,746	17,731	10,173	7,010	3,555	1,820	1,832
Net change in working capital	(15,036)	(5,141)	(3,973)	142	2,440	2,685	4,559	4,977	5,345	5,308
FCFF	**(3,614)**	**9,563**	**15,759**	**16,171**	**25,064**	**34,563**	**36,877**	**40,618**	**42,284**	**42,477**
Terminal value	312,712									
Enterprise value (Rs mn)	207,868									
Net debt	61,740		**Assumptions**							
Equity value (Rs mn)	138,440		WACC		12.8%					
Value per RCom share	67		Exit EV/EBITDA		5.0x					
% holding by RCom	95									
Effective value per RCom share (Rs)	64									
Implied EV/tower (Rs mn)	**4.2**									

Source: Company data, I-Sec Research

Table 4: Upside of 21% if FY15E tenancy is 10% higher than our base estimates

		Rent yield (%)				
		11.5	**12.5**	**13.5**	**14.5**	**15.5**
Tenancy Variation (%)	**(10)**	21	36	51	65	80
	(5)	27	42	57	73	88
	0	32	48	**64**	80	96
	5	38	54	71	87	104
	10	43	61	78	94	111

Source: Company data, I-Sec Research

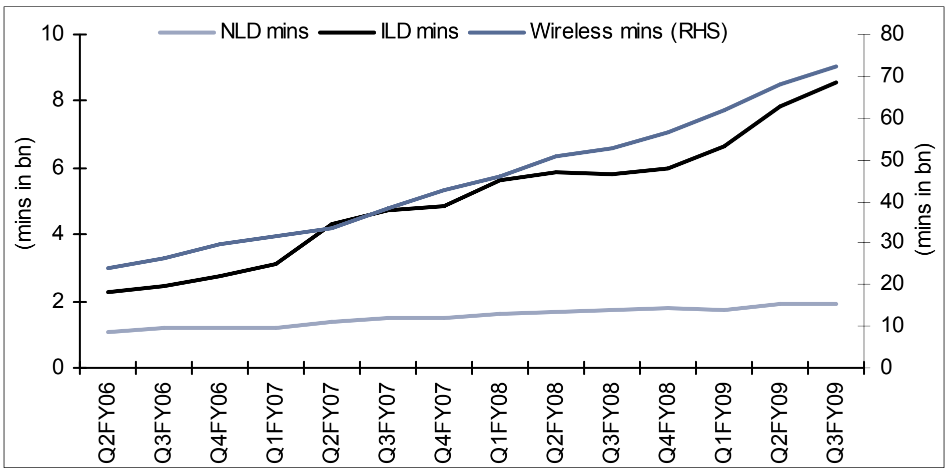
Non-wireless – Of strategic importance

Reliance Globalcom – Moving up the value chain

Reliance Globalcom consists of national long distance (NLD) operations, international voice & data businesses and WiMAX operations, with wholesale, enterprise and retail offerings in each business segment.

In the NLD segment, RCom's traffic has grown 1.8x from 4.7bn minutes in Q3FY07 to 8.6bn minutes in Q3FY09. In Q2FY09, RCom signed agreements with three private service providers, Idea, TTSL and Aircel, for NLD carriage of 1,100mn minutes per quarter, which is likely to result in 15-20% increase in NLD traffic and incremental revenue of Rs1bn per quarter with ~50% EBITDA margin. As of Q3FY09, RCom hosted 40% of NLD traffic from external customers such as Vodafone, Idea, Spice, Aircel, TTSL, BPL, Shyam and HFCL. RCom is targetting to achieve revenue share of ~Rs20bn in the next two years out of an addressable NLD market of Rs50bn.

Chart 5: Growth in NLD minutes linked to RCom's wireless minutes growth



Source: Company data, I-Sec Research

The voice segment consists of international long distance (ILD) carriage and international virtual calling service, *Reliance Global Call*. Globalcom enjoys 30% share of incoming wholesale voice traffic and *Reliance Global Call* is the market leader in the international calling card services market in India with 75% share and more than 2mn customers as of December '08. In the wholesale international voice carriage segment, removal of the access deficit charges (ADC) from September '08 is likely to lead to some tariff pressure in the short term as operators are likely to pass on the benefits to customers.

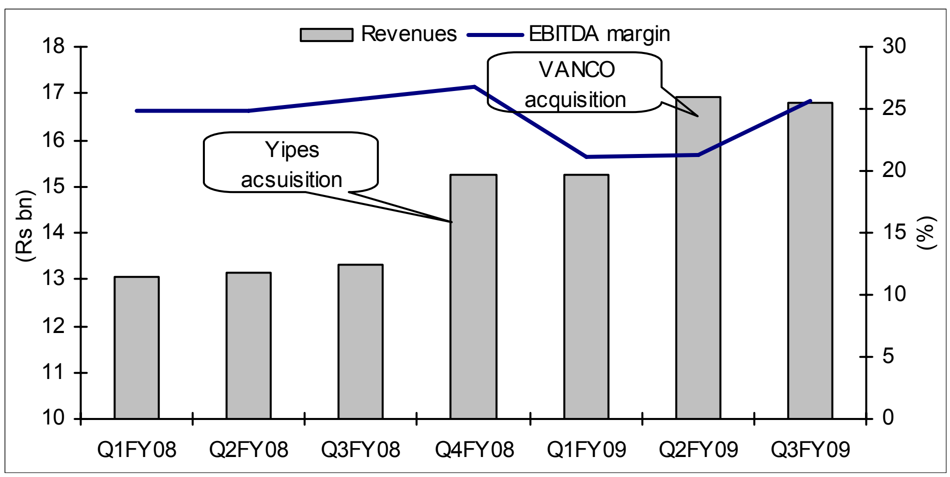
The international data business comprises sales to carriers in the wholesale segment and to corporates in the enterprise segment, including managed network services. Reliance Globalcom has made many acquisitions in the international enterprise services and WiMAX spaces in the past 2-3 years and is moving up the value chain from selling capacity wholesale to providing managed network services to enterprises.

Table 5: Recent acquisitions – Increasing bouquet of services

Acquired company	Deal details	Date	Details of the acquired company
Flag Telecom	100% for US$207mn (Rs10bn)	October '03	Flag owns and operates the largest private submarine cable system in the world spanning 65,000kms, directly connecting more than 40 countries
Yipes Enterprises	100% for US$300mn	December '07	Yipes owned over 22,000km of fibre across 14 metros in US, which covers ~40% of the total US datacom market
Anupam Globalsoft Uganda	90%	February '08	Holds infrastructure provider and service provider licences in Uganda. Plans to offer mobile, fixed-line, internet, NLD, ILD, WiMAX and Wi-Fi services.
eWave World	90%	April '08	Holds WiMAX licenses and has received spectrum to commence WiMAX services in several countries
VANCO	100% for US$76.9mn (Rs3.27bn)	May '08	Managed global services player with over 220 MNC customers. 90% of VANCO's revenue is from developed markets of UK, US, France and Germany.

Source: Company data, I-Sec Research

Chart 6: Reliance Globalcom – Revenue and EBITDA margin



Source: Company data, I-Sec Research

Revenue growth in Globalcom has been lumpy with most of it coming inorganically from acquisitions. EBITDA margin declined 570bps in Q1FY09 due to the VANCO acquisition but improved 440bps in Q3FY09. Going forward, we expect NLD and ILD traffic to post 14.9% and 6% CAGR respectively through FY09E-12E. We expect revenue CAGR to be 13.8% through FY09E-12E, though there may be short-term pressure in the international enterprise services space due to the ensuing slowdown as companies may cut down on their spend on IT & telecom to control costs.

Table 6: Reliance Globalcom – Key metrics

(Rs mn)

	FY07	FY08	FY09E	FY10E	FY11E	FY12E
NLD mins	**5,550**	**6,794**	**7,445**	**7,966**	**8,444**	**8,866**
Growth (%)	*25.1*	*22.4*	*9.6*	*7.0*	*6.0*	*5.0*
ILD mins	**17,012**	**23,251**	**32,435**	**38,922**	**44,760**	**49,236**
Growth (%)	*81.3*	*36.7*	*39.5*	*20.0*	*15.0*	*10.0*
Revenues	**51,771**	**54,750**	**65,687**	**76,718**	**87,347**	**96,894**
Growth (%)	*(12.3)*	*5.8*	*20.0*	*16.8*	*13.9*	*10.9*
Operating expenses	39,057	40,718	50,191	57,085	63,247	68,222
EBITDA	**12,714**	**14,032**	**15,496**	**19,633**	**24,100**	**28,672**
EBITDA margin (%)	*24.6*	*25.6*	*23.6*	*25.6*	*27.6*	*29.6*

Source: Company data, I-Sec Research

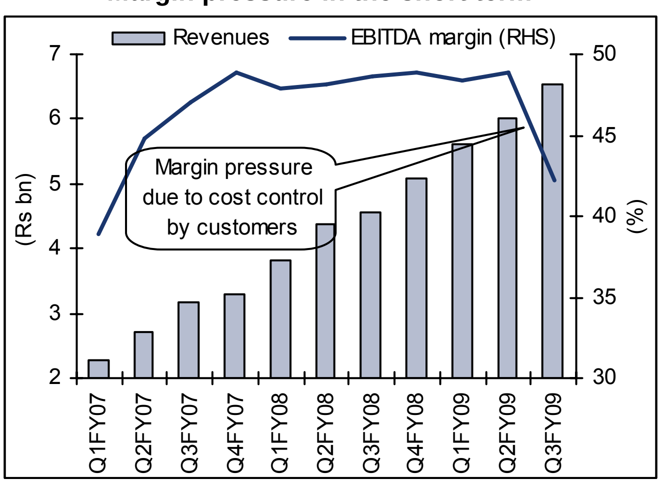
Broadband – Short-term pressure due to rough macro conditions

The broadband segment is RCom's domestic enterprise services segment, in which the company offers voice, data, video, internet and IT infrastructure services to large corporates and small & medium enterprises (SMEs). RCom's domestic WiMAX business is also housed in the broadband segment. The company has launched WiMAX broadband services in top 10 cities in India and has received necessary Government approvals for the deployment of WiMAX in 184 more cities.

The broadband segment is a high EBITDA margin business and has been posting healthy revenue growth so far. The segment witnessed EBITDA margin pressure in Q3FY09 owing to cost control by RCom's customers in a slowing economic scenario. We expect short-term pressure on growth and margins due to declining macro conditions.

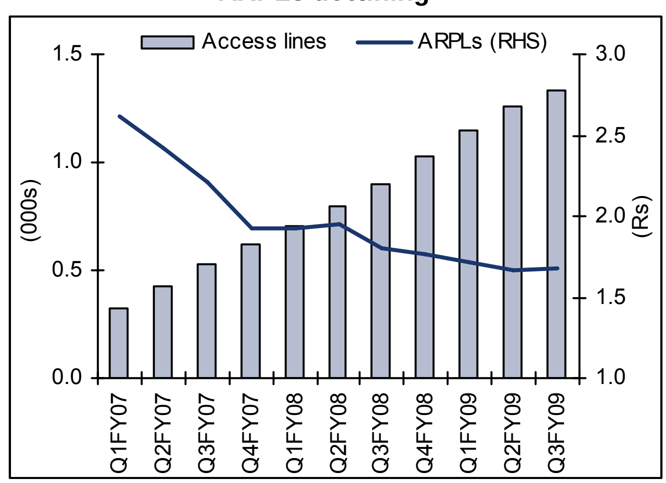
Chart 7: Broadband segment

Margin pressure in the short term



Source: Company data, I-Sec Research

ARPLs declining



Source: Company data, I-Sec Research

We expect access lines in the broadband segment to grow at 19% CAGR through FY09E-12E, while the average revenue per line is expected to decline at 6% CAGR, leading to revenue CAGR of 15.5% through FY09E-12E.

Table 7: Broadband – Key metrics

(Rs mn)

	FY07	FY08	FY09E	FY10E	FY11E	FY12E
Access lines ('000s)	620	1,031	1,461	1,811	2,161	2,461
Net adds ('000s)	90	411	430	350	350	300
ARPL (Rs/mth)	1,932	1,804	1,682	1,547	1,454	1,396
Growth (%)	*(17.5)*	*(6.6)*	*(6.8)*	*(8.0)*	*(6.0)*	*(4.0)*
Revenues	**11,441**	**17,868**	**25,145**	**30,374**	**34,660**	**38,719**
Growth (%)	*77.8*	*56.2*	*40.7*	*20.8*	*14.1*	*11.7*
Operating expenses	6,247	9,216	13,786	16,759	19,245	21,634
EBITDA	**5,194**	**8,652**	**11,359**	**13,615**	**15,415**	**17,085**
EBITDA margin (%)	*45.4*	*48.4*	*45.2*	*44.8*	*44.5*	*44.1*

Source: Company data, I-Sec Research

DTH/IPTV services – Triple play

RCom has ventured into the TV distribution segment through its 100% owned subsidiary, Reliance Big TV, which launched DTH services in August '08 and is currently available in 6,500 towns. Big TV had an impressive debut, gathering 1mn subscribers within 90 days of the launch and gleaning 30% of the gross adds in Q3FY09.

Competitive intensity in the DTH space has increased with four other players in the market at present – DISH TV, Tata Sky, Sun Direct and Airtel Digital TV. RCom has plans to launch its IPTV services commercially.

RCom follows the accounting policy of considering the set top boxes (STBs) as being provided on a rental basis; the cost of STBs are not expensed but capitalised. At present, revenues and costs of the DTH business are reported under 'others' segment.

Stretched financials

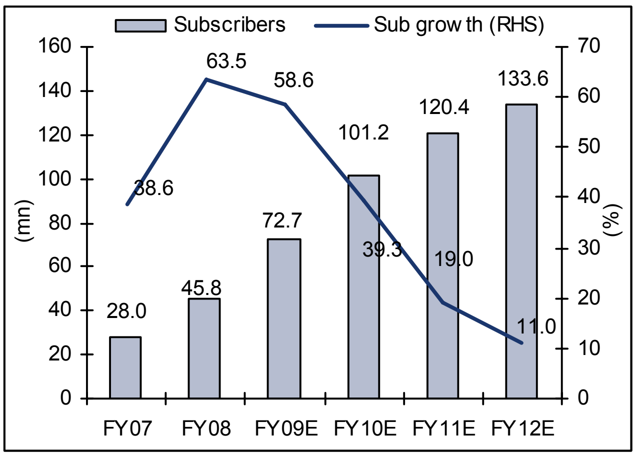
Wireless revenues to lag sub adds; dual network to strain margins

We expect RCom's subscriber CAGR at 23% in FY09E-12E with market share increasing from 17.7% as of end December to 19.5% in FY12E-end. However, the high subscriber growth will come at the cost of tariffs declining more than that for other incumbents, since we expect RCom to establish itself as a discount brand.

We expect ARPMs to decline 24% for RCom versus 19-20% for BAL and Idea through FY09E-12E. MoUs are also expected to decline 4% as a result of low MoU elasticity of existing subscribers and low MoUs of incremental subscribers, leading to 27% decline in ARPUs through FY09E-12E. As a result, wireless revenue CAGR is expected to be 23% through FY09E-12E.

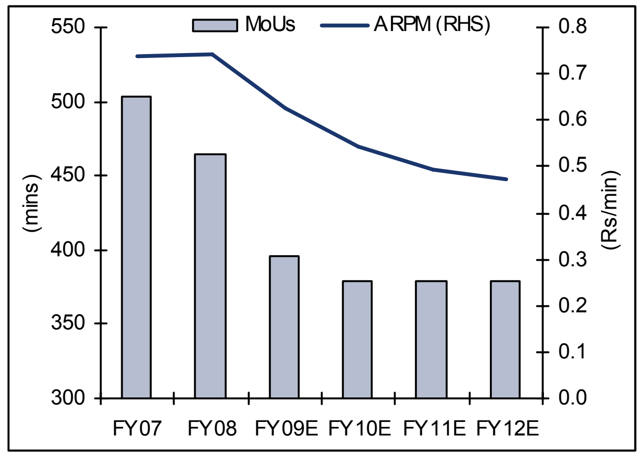
Chart 8: Wireless revenue CAGR of 16% versus subscriber CAGR of 23% through FY09E-12E

Subscriber growth of 84% through FY09E-12E…



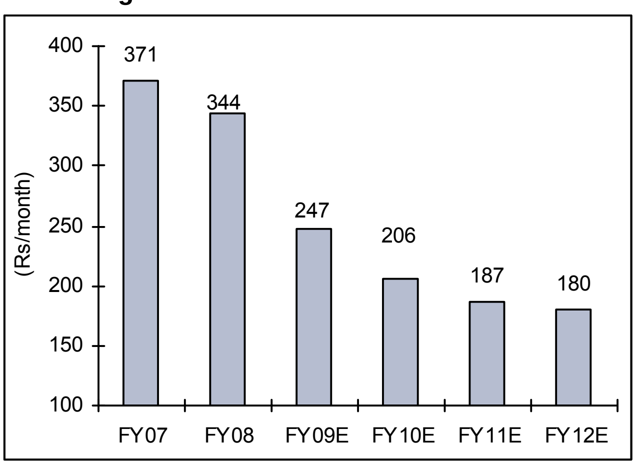
Source: Company data, I-Sec Research

…but ARPMs to decline without MoU increase



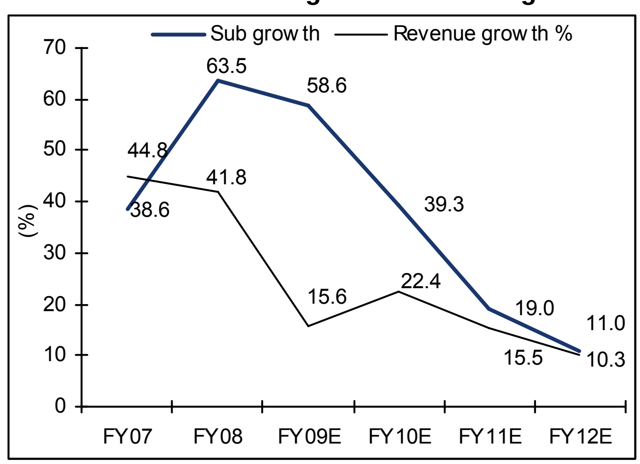
Source: Company data, I-Sec Research

….leading to 27% decline in ARPUs in FY09E-12E



Source: Company data, I-Sec Research

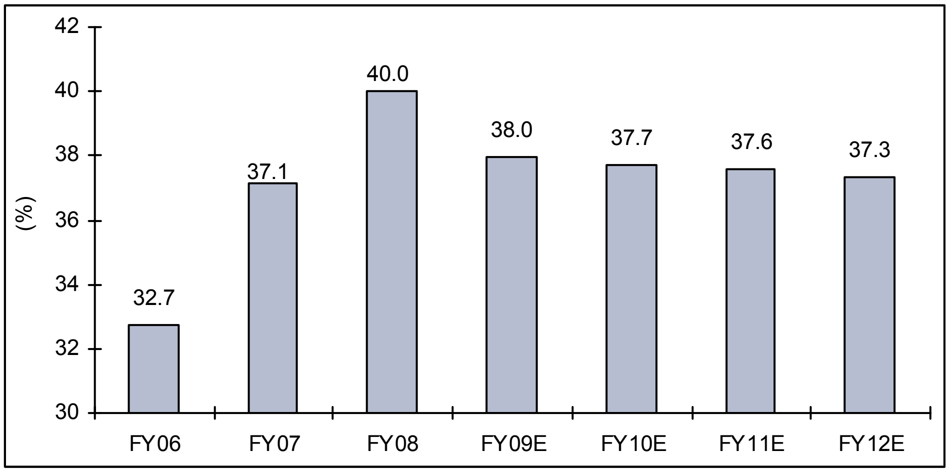
…and lower revenue growth than sub growth



Source: Company data, I-Sec Research

We expect wireless EBITDA margin to be under pressure due to high network operating costs driven by GSM roll-out and the cost of maintaining dual networks. Excluding the tower rentals that will be paid to RITL, EBITDA margin is expected to decline 30bps in FY10E, mostly driven by higher network operating costs and partly due to increased administrative & other costs. If we include the tower rentals paid to RITL, wireless EBITDA margin would decline further to 21-22%.

Chart 9: Wireless EBITDA margin under strain on high network operating costs



Source: Company data, I-Sec Research
Note: Wireless EBITDA margin excluding rentals paid to RITL

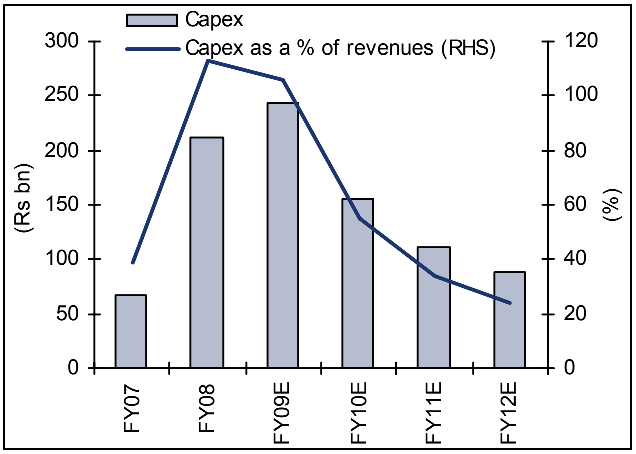
High capex but low capital productivity

RCom has embarked on an aggressive capex plan for the past six quarters with ~Rs355bn capex through Q2FY08-Q3FY09, mostly because it was building the GSM network and partly due to its investments in the submarine cable network. The company was at the peak of its capex cycle in FY08-09, with capex as a percentage of revenues at more than 100% over the two years. The company is almost through with the peak of its capex cycle and we expect capex to reduce substantially FY10 onwards. RCom has guided for Rs250bn (US$5bn) capex in FY09E and Rs150bn (US$3bn) in FY10E.

The capital productivity of RCom has been very poor compared with that of BAL. We expect RCom's RoCE and RoE to decline further due to lower revenue growth profile expected for RCom's GSM network.

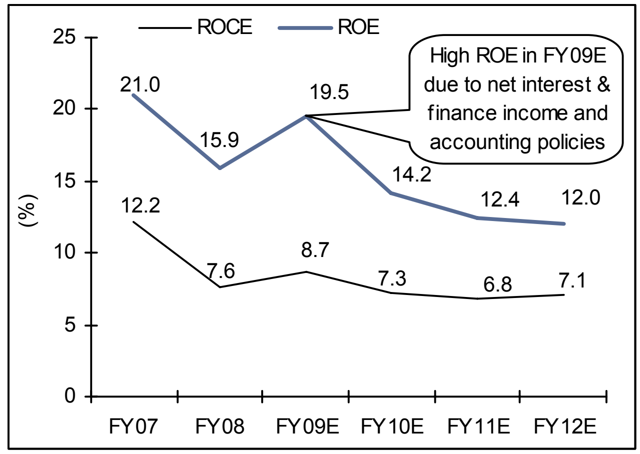
Chart 10: Capex & capital productivity

Through with peak of the capex cycle…



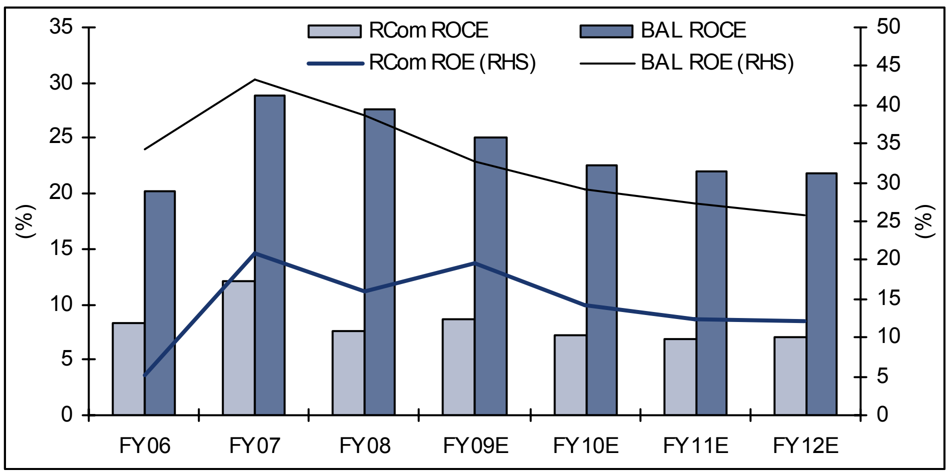
Source: Company data, I-Sec Research

…but RoCE and RoE to decline further



Source: Company data, I-Sec Research

Chart 11: Capital productivity – RCom versus BAL

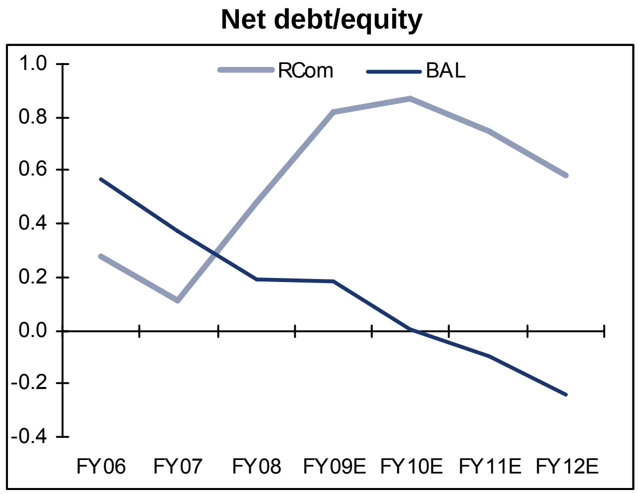


Source: Company data, I-Sec Research

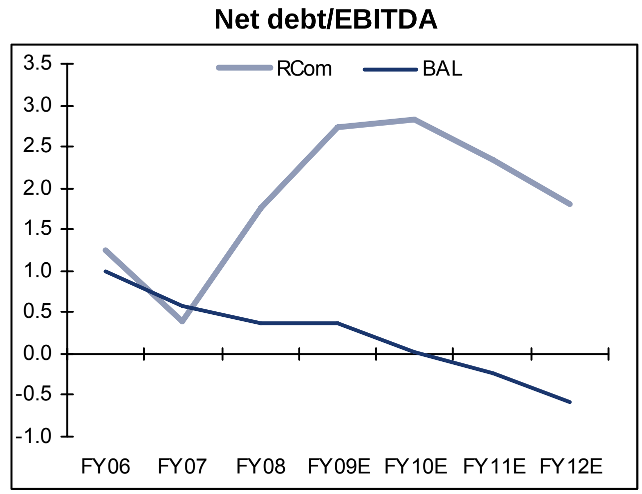
Balance sheet concerns loom large

- **High leverage with net debt/EBITDA of 2.7x in FY09E.** Though RCom is through with the peak of its capex cycle, we believe the company's balance sheet is well-stretched due to high debt gearing with FY09E net debt/equity of 0.8x and net debt/EBITDA of 2.7x. The company had net debt of Rs185bn as of December '08, with Rs83bn capex expected in Q4FY09E and Rs155bn in FY10E; this is excluding the capex on 3G auctions & roll-out. We expect RCom's leverage to increase further in FY10 as it takes more debt to fund capex; we expect the company to start paying debt FY12 onwards.

Chart 12: High leverage versus BAL



Source: Company data, I-Sec Research



Source: Company data, I-Sec Research

- **Unwinding of current liabilities to lead to significant cash outflows.** Current liabilities have surged from Rs156.2bn as of end-FY08 to Rs272.9bn as of end-Q3FY09, increasing ~75%. As per the management, a significant portion of this increase is due to vendor financing to fund the GSM network expansion. Unwinding of current liabilities could lead to significant cash outflows in the near future, for which the company will have to arrange for funds.

- **Capitalisation of CWIP to increase depreciation.** Capital-work-in-progress (CWIP) as a percentage of gross block has increased from ~10% as of end-Q4FY07 to ~25% of gross block as of end-Q3FY09 owing to GSM network expansion. As and when the network gets completed and the CWIP is moved to gross block, which we expect to happen in FY10, depreciation would increase significantly leading to lower net profit after taxes.

- **3G will further accentuate gearing.** Our capex expectations of Rs155bn and management capex guidance of Rs150bn for FY10E do not include the spend on 3G auctions and roll-out. RCom will have to opt for more leverage if it decides to bid aggressively in the 3G auctions, which would further stretch the balance sheet.

- **We expect FCCBs to be redeemed rather than converted.** RCom had issued two FCCBs worth US$1.5bn together, which have to be converted or redeemed before end of FY12. As of March '08, the company had FCCBs worth US$1.29 pending. Post the buy-back of US$35mn FCCBs in FY09, we estimate RCom to have Rs62.6bn FCCBs pending conversion and failure to convert may result in potential cash outflow of US$1.5bn or Rs79.4bn at maturity. The severe 68% price correction in RCom's share since January '08 has decreased the chances of conversion. We have factored in redemption of FCCBs rather than conversion. If RCom is able to buy back a significant part of FCCBs at a large discount before maturity, it would lead to an upside to our estimates.

Table 8: Non conversion of FCCB could lead to up to Rs79bn outflow by FY12E

	Issue 1	Issue 2	Total
Number of FCCBs	500,000	10,000	
Value per FCCB (US$)	1,000	100,000	
Total value (US$ mn)	**500**	**1,000**	**1,500**
Conversion price (Rs)	480.68	661.23	
Yield to maturity (%)	4.65	4.95	
To be converted by	01-May-11	18-Feb-12	
Converted	203,051	100	
Repurchased		350	
Pending	296,949	9,550	
Pending (US$ mn)	**297**	**955**	**1,252**
Pending (Rs mn)	14,847	47,750	62,597
Pending dilution in shares (mn)	**27.4**	**63.7**	**91.1**
Potential payout (US$ mn)	**373**	**1,216**	**1,589**
Potential payout (Rs mn)	**18,636**	**60,797**	**79,433**

Source: Company data, I-Sec Research

Aggressive accounting & reporting policies increase risk

Reported net interest charges misleading

RCom has consistently reported net financing income for the past four quarters in spite of being a net debt company. We attribute this to the use of aggressive accounting policy and active treasury & hedging operations. We estimate that the company has earned ~Rs11bn though forex and derivative gains through 9MFY09, including Rs637.5mn due to buy-back of FCCBs worth US$25mn in Q3FY09. These gains cannot be estimated and hence increase the uncertainty in RCom's financials.

Table 9: Net financing income in spite of net debt

	Q4FY08	Q1FY09	Q2FY09	Q3FY09
Net interest & financing charges	**(81)**	**(2,340)**	**(2,353)**	**(1,496)**
Term loans	9,500	2,375	-	-
Interest rate (%)	*12.0*	*12.0*	*12.0*	*12.0*
Interest on term loans	**677**	**178**	**36**	**-**
Unsecured loans	206,181	205,167	240,735	266,722
FCCBs (estimate)	54,932	58,856	62,780	64,146
Unsecured loans excluding FCCBs	151,249	146,311	177,955	202,576
Interest rate (%)	*6.0*	*7.0*	*7.0*	*7.0*
Interest on other loans	**1,803**	**2,604**	**2,837**	**3,330**
Total interest expense	**2,479**	**2,782**	**2,873**	**3,330**
Cash & cash equivalents	115,981	77,654	88,478	80,747
Interest rate (%)	*8.0*	*6.0*	*6.0*	*6.0*
Interest income	**2,285**	**1,452**	**1,246**	**1,269**
Other financing income	**276**	**3,670**	**3,980**	**3,556**

Source: Company data, I-Sec Research

In Q1FY09, RCom had changed the accounting policy for accounting short-term fluctuations in forex rates related to foreign currency debt (term loans & FCCBs) taken to fund acquisition of fixed assets from AS-11 to AS-6. These are now adjusted in the carrying cost of fixed assets instead of the profit & loss statement. Had the AS-11 accounting standard been followed, as per the management, RCom would have reported net interest & financing charges in 9MFY09, instead of the net interest & financing income of Rs6.2bn. 9MFY09 PAT would have been lower Rs35,699mn to Rs8,836mn instead of Rs46,179mn reported.

Table 10: 9MFY09 PAT Rs35.7bn lower if forex fluctuations in foreign currency debt is adjusted in the P&L

	Q1FY09	Q2FY09	Q3FY09	9MFY09
Realised	1,088	2,842	8,240	12,170
Unrealised	9,545	14,519	(536)	23,528
Total	10,633	17,361	7,705	35,699
Reported PAT if AS-11 used	**4,490**	**(2,052)**	**6,398**	**8,836**
FCCBs (not accounted for)	3,991	5,371	2,105	11,467
PAT including losses on FCCBs	**499**	**(7,423)**	**4,293**	**(2,632)**

Source: Company data, I-Sec Research

Though RCom does not adjust forex gains & losses in the value of foreign currency debt in P&L, it continues to make adjustments in the P&L for: i) gains or losses in the buy-back of FCCBs and ii) interest earned on 'cash on books' remaining from the unused portion of the foreign currency debt. In Q3FY09, RCom made a one-time gain of Rs637.5mn due to buy-back of FCCBs worth US$25mn, which was included in the net interest & financing charges.

Increasing variation between revenues reported to TRAI and markets

The percentage difference between the revenues in the financial statements and that reported to TRAI by RCom has been increasing steadily, while for other operators such as BAL and Idea, the percentage difference has remained more or less the same. This has led to the Central Vigilance Commission (CVC) asking for an investigation into RCom's revenue reporting. The management attributes this to the accounting of certain revenues such as non-SMS VAS revenues in its subsidiaries that do not hold UAS licence. So according to the management, the company reports consolidated revenues in its financial statements, but only the relevant licence-related revenues to TRAI resulting in a large difference. We note that RCom's non-voice revenues would include revenues on data cards, internet access from cell phones, and downloads.

Table 11: Variation between revenues reported to TRAI and markets

(Rs mn)

	Q1FY08	Q2FY08	Q3FY08	Q4FY08	Q1FY09	Q2FY09	Q3FY09
RCom							
UASL + Mobile revenues TRAI	31,382	29,063	32,883	33,146	31,608	34,182	32,984
Wireless revenues reported	33,730	37,230	39,567	41,608	41,187	43,356	44,119
Difference (%)	***7.5***	***28.1***	***20.3***	***25.5***	***30.3***	***26.8***	***33.8***
BAL							
UASL + Mobile revenues TRAI	53,376	59,377	63,282	69,240	76,493	80,093	86,841
Wireless + Telemedia revenues	53,489	57,602	63,412	71,842	77,138	81,329	87,850
Difference (%)	***0.2***	***(3.0)***	***0.2***	***3.8***	***0.8***	***1.5***	***1.2***
Idea*							
UASL + Mobile revenues TRAI	15,808	16,049	17,639	20,371	22,029	23,281	26,611
Wireless revenues reported	14,775	15,622	17,081	19,724	21,732	23,003	26,204
Difference (%)	***(6.5)***	***(2.7)***	***(3.2)***	***(3.2)***	***(1.3)***	***(1.2)***	***(1.5)***

* Idea standalone excluding Spice & Indus
Source: TRAI, Company data, I-Sec Research

Valuations – Muted expectations

We expect subdued results from RCom's dual network strategy, which is more of a compulsion for the company in our view. We prefer to value the stock based on DCF – the core telecom business is valued at Rs105/share and the tower business at Rs64/share, implying a target price of Rs169/share. Our target price implies FY10E P/E of 7.4x and EV/EBITDA of 4.4x, yielding 6% downside from current levels. We initiate coverage on RCom with HOLD. However, a scenario analysis of the GSM launch gives us a broader range of Rs123-235/share value for the company.

Our valuation for the company implies FY09E P/E of 6.4x, which is at 47% discount to BAL (13.7x) and 40% to the Sensex (10.7x). The low P/E multiple attributed to RCom is due to the high uncertainty of the performance of the dual network, stretched balance sheet and questions over its accounting practices by the regulator/CVC. We believe the company has far more challenges ahead and an uphill task of performing in a highly competitive market.

Table 12: Core business valued at Rs105/share based on DCF valuation

(Rs mn)

	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E	FY16E	FY17E	FY18E	FY19E
EBIT	42,594	40,918	44,654	53,472	63,416	72,647	81,920	91,978	102,760	114,439
NOPAT	40,033	37,939	39,826	46,976	55,143	62,535	70,598	79,340	88,710	98,855
Depreciation	39,620	51,400	58,188	62,306	65,747	69,446	73,253	77,248	81,578	86,161
Capex	113,960	84,431	63,110	43,832	47,430	50,918	54,515	58,529	62,965	67,835
Net change in WC	3,257	14,237	2,443	2,485	1,231	2,366	2,315	1,872	3,216	4,705
FCFF	**(37,565)**	**(9,331)**	**32,462**	**62,965**	**72,228**	**78,697**	**87,021**	**96,187**	**104,106**	**112,476**
Terminal value										802,399
Enterprise value	**482,880**									
Net debt	265,503									
Equity value	217,377			**Assumptions**						
Number of shares	2,064			WACC		12.8%				
Core business value/share (Rs)	**105**			Exit EV/EBITDA		4.0x				
Towers value/share (Rs)	64									
Total value/share (Rs)	**169**									
% upside	**(6)**									
Implied FY10E P/E	7.4x									
Implied FY10E EV/EBITDA	4.4x									

Source: Company data, I-Sec Research

Table 13: Sensitivity analysis – Core business valuations

		WACC (%)				
		11.8	12.3	12.8	13.3	13.8
Exit EV/EBITDA	**5.0x**	134	134	134	134	134
	5.5x	120	120	120	120	120
	6.0x	105	105	**105**	105	105
	6.5x	91	91	91	91	91
	7.0x	76	76	76	76	76

Source: Company data, I-Sec Research

Execution of GSM launch, key variable

RCom's performance is extensively hinged on: i) the performance of its GSM services in terms of gaining subscriber share and capping too much decline in ARPMs and ii) RITL's ability to get high tenancy on its tower business. We have factored in 18%, 15% and 12% net adds share for RCom's GSM service in new circles through FY10E-12E and 14% and 10% decline in voice ARPMs in FY10E and FY11E respectively. We have also factored in a tenancy of 2.3x for RITL by FY15E.

We have considered optimistic and pessimistic case scenarios based on the above factors. Our scenario analysis suggests 38% upside in the best-case scenario and 27% downside in the worst-case scenario, indicating the high risk of investing in the stock.

Table 14: Downside of 31% in pessimistic scenario

(Rs)

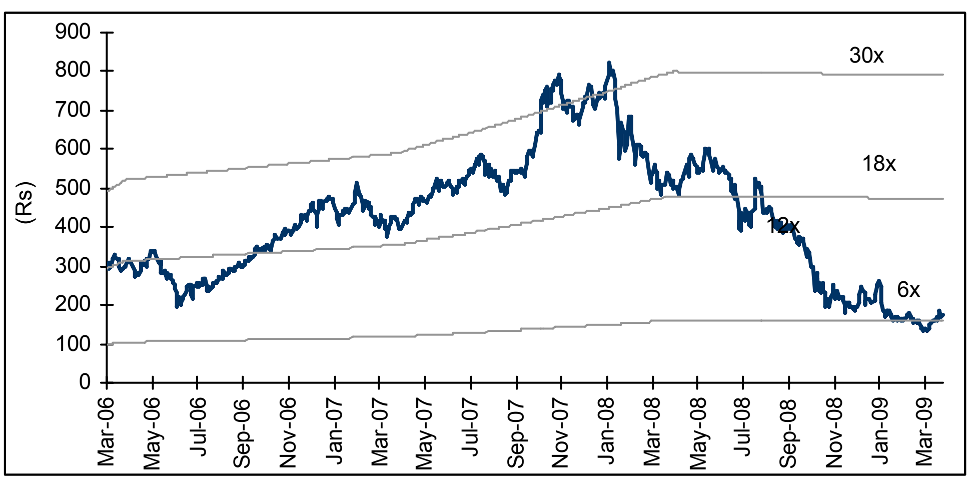
	Scenarios	Core business value/share	RITL value/ share	Total value/ share	% upside
Optimistic Case	i) 5% higher net adds share in FY10E-12E ii) 2% lower decline in voice ARPMs in FY10E-11E iii) 10% higher tenancy FY12E onwards	157	78	235	31
Base case	i) 18%, 15% and 12% net adds share in FY10E, FY11E & FY12E respectively ii) 14% and 10% decline in voice ARPMs in FY10E & FY11E respectively iii) 2.3x tenancy for RITL by FY15E	105	64	169	(6)
Pessimistic Case	i) 2% lower net adds share in FY10E-12E ii) 2% higher decline in voice ARPMs in FY10E-11E iii) 10% lower tenancy FY12E onwards	74	50	123	(31)

Source: Company data, I-Sec Research

Key risks to our recommendation

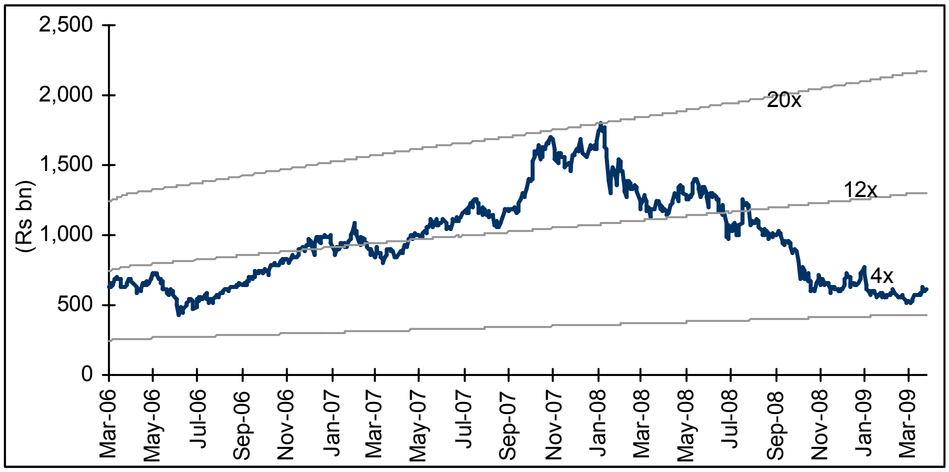
- **Better-than-expected performance from the GSM launch in terms of subscribers and revenues**. High growth in subscribers after the RCom freebie scheme will lead to an upside. Faster implementation of MNP will be an upside as it is likely to lead to churn of high-ARPU subscribers from existing GSM players.
- **Tie-ups for external tenancy in RITL with other telecom operators,** especially new entrants. Reportedly, Swan is likely to tie up with RITL for its 13 circle roll-out, which could lead to an upside.
- **More spectrum allocation in GSM circles** based on subscriber criteria will reduce capex requirements for RCom. Also, a delay in 3G auctions is positive for RCom as the company will be able to complete its 2G GSM roll-out.
- **Value unlocking in RITL or Reliance Globalcom** through IPOs or stake sales.

Chart 13: P/E bands



Source: Company data, Bloomberg, I-Sec Research

Chart 14: EV/EBITDA



Source: Company data, Bloomberg, I-Sec Research

Table 15: RCom – Detailed business model

(Rs mn)

	FY07	FY08	FY09E	FY10E	FY11E	FY12E
Wireless						
Wireless subs (mn)	**28.0**	**45.8**	**72.7**	**101.2**	**120.4**	**133.6**
CDMA subs	24.6	38.8	54.0	63.5	70.0	75.0
GSM phase 1 subs	3.4	7.0	11.5	15.1	18.3	20.9
GSM phase 2 subs	-	-	7.1	22.6	32.0	37.7
Growth (%)	*38.6*	*63.5*	*58.6*	*39.3*	*19.0*	*11.0*
Net adds (mn)	7.8	17.8	26.9	28.5	19.2	13.2
Growth (%)		*128.2*	*51.0*	*6.3*	*(32.8)*	*(31.1)*
ARPU (Rs/mth)	371	344	247	206	187	180
Growth (%)		*(7.3)*	*(28.0)*	*(16.6)*	*(9.4)*	*(3.8)*
MoU (min/mth)	503	464	395	379	379	379
Growth (%)		*(7.7)*	*(14.8)*	*(4.0)*	*0.0*	*0.0*
ARPM (Rs/min)	0.74	0.74	0.63	0.54	0.49	0.47
Growth (%)		*0.4*	*(15.5)*	*(13.1)*	*(9.4)*	*(3.8)*
Voice ARPU (Rs/mth)	358	320	229	189	170	163
Growth (%)		*(10.6)*	*(28.5)*	*(17.4)*	*(10.0)*	*(4.0)*
VAS ARPU (Rs/mth)	24	22	18	17	17	17
Growth (%)		*(9.8)*	*(15.1)*	*(5.0)*	*(3.0)*	*(2.0)*
Wireless revenues	**107,276**	**152,135**	**175,815**	**215,192**	**248,469**	**273,938**
Growth (%)		*41.8*	*15.6*	*22.4*	*15.5*	*10.3*
Operating expenses	67,432	91,288	109,052	166,746	195,505	217,266
Wireless EBITDA	**39,844**	**60,847**	**66,763**	**48,446**	**52,964**	**56,672**
EBITDA margin (%)	*37.1*	*40.0*	*38.0*	*22.5*	*21.3*	*20.7*
EBITDA margin excl. rentals (%)	*37.1*	*40.0*	*38.0*	*37.7*	*37.6*	*37.3*
Globalcom						
NLD mins (mn)	**17,012**	**23,251**	**32,435**	**38,922**	**44,760**	**49,236**
Growth (%)	*81.3*	*36.7*	*39.5*	*20.0*	*15.0*	*10.0*
ILD mins (mn)	**5,550**	**6,794**	**7,445**	**7,966**	**8,444**	**8,866**
Growth (%)	*25.1*	*22.4*	*9.6*	*7.0*	*6.0*	*5.0*
Revenues	**51,771**	**54,750**	**65,687**	**76,718**	**87,347**	**96,894**
Growth (%)	*(12.3)*	*5.8*	*20.0*	*16.8*	*13.9*	*10.9*
Operating expenses	39,057	40,718	50,191	57,085	63,247	68,222
EBITDA	**12,714**	**14,032**	**15,496**	**19,633**	**24,100**	**28,672**
EBITDA margin (%)	*24.6*	*25.6*	*23.6*	*25.6*	*27.6*	*29.6*
Broadband						
Access lines (000s)	620	1,031	1,461	1,811	2,161	2,461
Net adds	90	411	430	350	350	300
ARPL (Rs/mth)	1,932	1,804	1,682	1,547	1,454	1,396
% growth	*(17.5)*	*(6.6)*	*(6.8)*	*(8.0)*	*(6.0)*	*(4.0)*
Revenues	**11,441**	**17,868**	**25,145**	**30,374**	**34,660**	**38,719**
Growth (%)	*77.8*	*56.2*	*40.7*	*20.8*	*14.1*	*11.7*
Operating expenses	6,247	9,216	13,786	16,759	19,245	21,634
EBITDA	**5,194**	**8,652**	**11,359**	**13,615**	**15,415**	**17,085**
EBITDA margin (%)	*45.4*	*48.4*	*45.2*	*44.8*	*44.5*	*44.1*

Source: Company data, I-Sec Research

Annexure 1: Financials

Table 16: Profit & Loss statement

(Rs mn, year ending March 31)

	FY08	FY09E	FY10E	FY11E	FY12E
Gross Sales	**188,274**	**230,614**	**282,946**	**328,005**	**365,707**
Less: Excise Duty					
Net Sales	**188,274**	**230,614**	**282,946**	**328,005**	**365,707**
of which Export Sales	-	-	-	-	-
of which Domestic Sales	*188,274*	*230,614*	*282,946*	*328,005*	*365,707*
Total Operating Income	**188,274**	**230,614**	**282,946**	**328,005**	**365,707**
Less:					
License fees & Access Charges	40,583	35,366	41,465	46,701	51,352
Network Operating Exp	22,008	43,567	60,314	69,469	76,150
Personnel Exp	12,037	17,189	19,850	22,592	24,609
Administration & other Exp	34,059	41,301	51,434	59,114	65,155
Total Operating Expenses	**108,687**	**137,422**	**173,063**	**197,876**	**217,265**
EBITDA	**79,587**	**93,192**	**109,883**	**130,128**	**148,442**
Depreciation & Amortisation	28,053	38,871	53,586	67,305	76,138
Other Income	2,404	-	-	-	-
EBIT	**53,938**	**54,321**	**56,296**	**62,823**	**72,304**
Less: Net Interest	(3,997)	(6,163)	3,221	6,291	7,557
Recurring Pre-tax Income	**57,935**	**60,484**	**53,076**	**56,532**	**64,747**
Less: Extraordinary Expenses	(12,828)	-	-	-	-
Less: Taxation	2,836	(411)	5,349	8,443	12,143
--Current Tax	1,835	2,330	5,349	8,443	12,143
--Deferred Tax	1,002	(2,741)	-	-	-
Tax rate (%)	4.9	(0.7)	10.1	14.9	18.8
Earnings from Associate Companies	-	-	-	-	-
Minority Interest	13,915	2,113	248	526	722
Net Income (Reported)	**54,011**	**58,782**	**47,478**	**47,563**	**51,882**
Less: Preference dividend					
Recurring Net Income	**41,183**	**58,782**	**47,478**	**47,563**	**51,882**

Source: Company data, I-Sec Research

Table 17: Balance sheet

(Rs mn, year ending March 31)

	FY08	FY09E	FY10E	FY11E	FY12E
ASSETS					
Current Assets, Loans & Advances					
Cash & Bank balance	8,782	29,688	52,080	60,150	67,331
Inventory	4,059	5,055	6,100	7,071	7,884
Sundry Debtors	27,224	44,227	30,344	32,480	34,209
Loans and Advances	42,695	31,591	41,696	43,842	43,872
Other Current Assets	23,058	31,128	37,354	43,331	48,530
Total Current Assets	**105,817**	**141,689**	**167,573**	**186,874**	**201,827**
Current Liabilities & Provisions					
Current Liabilities	156,213	244,724	237,073	243,957	241,075
Provisions	44,564	35,651	43,494	50,888	57,504
Total Current Liabilities and Provisions	**200,776**	**280,375**	**280,567**	**294,845**	**298,579**
Net Current Assets	**(94,959)**	**(138,686)**	**(112,994)**	**(107,972)**	**(96,752)**
Investments					
Strategic & Group Investments					
Other Marketable Investments	109,996	2,818	2,818	2,818	2,818
Total Investments	**109,996**	**2,818**	**2,818**	**2,818**	**2,818**
Deferred Tax Asset	**-**	**-**	**-**	**-**	**-**
Goodwill	**35,654**	**35,654**	**35,654**	**35,654**	**35,654**
Fixed Assets					
Gross Block	463,388	642,821	888,218	1,034,789	1,140,592
Less Accumulated Depreciation	89,561	128,432	182,018	249,324	325,462
Net Block	373,826	514,389	706,200	785,466	815,130
Add: Capital Work in Progress	149,299	214,274	124,497	88,298	70,018
Total Fixed Assets	**523,126**	**728,662**	**830,697**	**873,764**	**885,148**
Total Assets	**573,817**	**628,448**	**756,175**	**804,265**	**826,868**
LIABILITIES AND SHAREHOLDERS' EQUITY					
Borrowings					
Short Term Debt	9,500	-	-	-	-
Non-Convertible Preference Shares	-	-	-	-	-
Long Term Debt	248,717	286,722	366,722	366,722	336,722
Total Borrowings	**258,217**	**286,722**	**366,722**	**366,722**	**336,722**
Deferred Tax Liability	**1,028**	**3,769**	**3,769**	**3,769**	**3,769**
Share Capital					
Paid up Equity Share Capital	10,320	10,320	10,320	10,320	10,320
No. of Shares outstanding (mn)	*2,064*	*2,064*	*2,064*	*2,064*	*2,064*
Face Value per share (Rs)	*5*	*5*	*5*	*5*	*5*
Diluted no of shares	*2,091*	*2,091*	*2,091*	*2,091*	*2,091*
Reserves & Surplus					
Share Premium	-	-	-	-	-
General & Other Reserve	198,078	198,078	198,078	198,078	198,078
Profit & Loss	81,866	103,138	150,615	198,179	250,061
Less: Misc. Exp. not written off	-	-	-	-	-
Net Worth	**290,263**	**311,535**	**359,013**	**406,577**	**458,459**
Minority Interest	**24,309**	**26,422**	**26,671**	**27,197**	**27,919**
Total Liabilities & Shareholders' Equity	**573,817**	**628,448**	**756,175**	**804,265**	**826,868**

Source: Company data, I-Sec Research

Table 18: Cashflow statement

(Rs mn, year ending March 31)

	FY08	FY09E	FY10E	FY11E	FY12E
Cash Flow from Operating Activities					
Reported Net Income	67,926	60,895	47,726	48,090	52,604
Add:					
Depreciation & Amortisation	33,635	38,871	53,586	67,305	76,138
Provisions					
Deferred Taxes	1,002	(2,741)	-	-	-
Less:					
Other Income	2,404	-	-	-	-
Net Extra-ordinary income	12,828	-	-	-	-
Operating Cash Flow before Working Capital change (a)	**87,332**	**97,025**	**101,313**	**115,395**	**128,742**
Changes in Working Capital					
(Increase) / Decrease in Inventories	762	(996)	(1,045)	(971)	(813)
(Increase) / Decrease in Sundry Debtors	(8,908)	(17,004)	13,884	(2,136)	(1,730)
(Increase) / Decrease in Operational Loans & Adv.	(20,592)	11,104	(10,105)	(2,147)	(30)
(Increase) / Decrease in Other Current Assets	(9,175)	(8,070)	(6,226)	(5,977)	(5,200)
Increase / (Decrease) in Sundry Creditors	41,879	88,512	(7,651)	6,884	(2,882)
Increase / (Decrease) in Other Current Liabilities/provisions	(2,585)	(8,913)	7,843	7,394	6,615
Working Capital Inflow / (Outflow) (b)	**1,382**	**64,633**	**(3,300)**	**3,047**	**(4,038)**
Net Cash flow from Operating Activities (a) + (b)	**88,714**	**161,658**	**98,013**	**118,442**	**124,704**
Cash Flow from Capital commitments					
Purchase of Fixed Assets	(226,338)	(244,407)	(155,621)	(110,373)	(87,522)
Purchase of Investments	-	-	-	-	-
Consideration paid for acquisition of undertaking	-	-	-	-	-
Cost of Intangibles	-	-	-	-	-
Cash Inflow/(outflow) from capital commitments (c)	**(226,338)**	**(244,407)**	**(155,621)**	**(110,373)**	**(87,522)**
Free Cash flow after capital commitments (a) + (b) + (c)	**(137,624)**	**(82,749)**	**(57,608)**	**8,069**	**37,182**
Cash Flow from Investing Activities					
Purchase of Marketable Investments	(32,882)	107,178	-	-	-
Other Income	2,404	-	-	-	-
Net Cash flow from Investing Activities (d)	**(30,479)**	**107,178**	**-**	**-**	**-**
Cash Flow from Financing Activities					
Issue of Share Capital during the year	97	-	-	-	-
Proceeds from fresh borrowings	83,834	28,505	80,000	-	(30,000)
Repayment of Borrowings	-	-	-	-	-
Buyback of Shares	-	-	-	-	-
Dividend paid including tax	(1,811)	(1,811)	-	-	-
Others	9,931	(30,216)	-	-	-
Net Cash flow from Financing Activities (e)	**92,051**	**(3,523)**	**80,000**	**-**	**(30,000)**
Net Extra-ordinary Income (f)	**12,828**	**-**	**-**	**-**	**-**
Total Increase / (Decrease) in Cash (a) + (b) + (c) + (d)+ (e) + (f)	**(63,225)**	**20,906**	**22,392**	**8,069**	**7,182**
Opening Cash and Bank balance	**72,006**	**8,782**	**29,688**	**52,080**	**60,150**
Closing Cash and Bank balance	**8,782**	**29,688**	**52,080**	**60,150**	**67,331**
Increase/(Decrease) in Cash and Bank balance	**(63,225)**	**20,906**	**22,392**	**8,069**	**7,182**

Source: Company data, I-Sec Research

Table 19: Key ratios

(Year ending March 31)

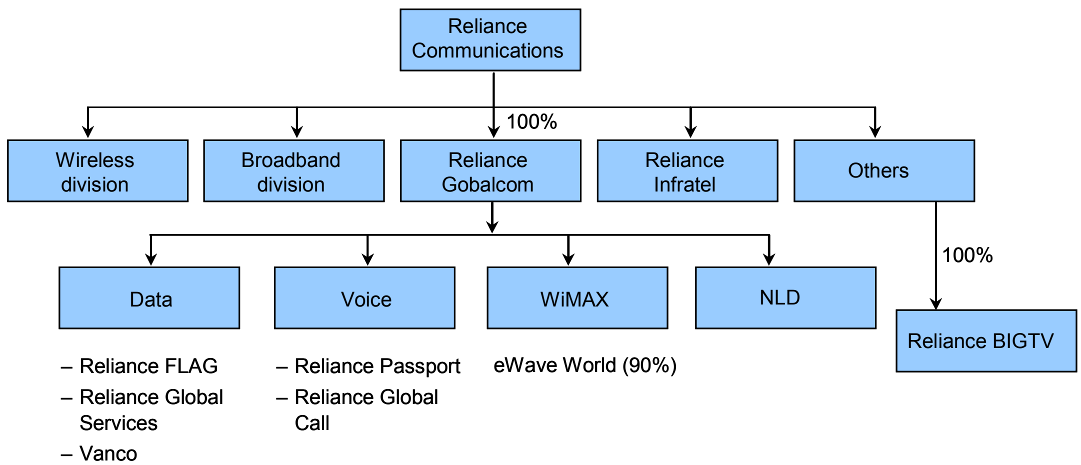
	FY08	FY09E	FY10E	FY11E	FY12E
Per Share Data (Rs)					
Diluted Recurring Earning per share (DEPS)	19.7	28.1	22.7	22.7	24.8
Diluted Earnings per share	26.2	28.5	23.0	23.0	25.1
Recurring Cash Earnings per share (CEPS)	33.5	47.3	49.0	55.7	62.0
Free Cashflow per share (FCPS-post capex)	(66.7)	(40.1)	(27.9)	3.9	18.0
Reported Book Value (BV)	140.6	150.9	173.9	197.0	222.1
Adjusted Book Value (ABV) **	140.6	150.9	173.9	197.0	222.1
Dividend per share	0.8	0.8	-	-	-
Valuation Ratios (x)					
Diluted Price Earning Ratio	9.1	6.4	7.9	7.9	7.3
Price to Recurring Cash Earnings per share	5.4	3.8	3.7	3.2	2.9
Price to Book Value	1.3	1.2	1.0	0.9	0.8
Price to Adjusted Book Value	1.3	1.2	1.0	0.9	0.8
Price to Sales Ratio	2.0	1.6	1.3	1.1	1.0
EV / EBITDA	6.4	5.5	4.7	3.9	3.4
EV / Total Operating Income	2.7	2.2	1.8	1.6	1.4
EV / Operating Free Cash Flow (Pre-Capex)	5.8	3.2	5.2	4.3	4.1
EV / Net Operating Free Cash Flow (Post-Capex)	(3.7)	(6.2)	(8.9)	63.3	13.7
Dividend Yield (%)	0.4	0.4	-	-	-
Growth Ratios (% YoY)					
Diluted Recurring EPS Growth	13.1	42.7	(19.2)	0.2	9.1
Diluted Recurring CEPS Growth	4.6	41.0	3.5	13.7	11.4
Total Operating Income Growth	9.5	22.5	22.7	15.9	11.5
EBITDA Growth	22.9	17.1	17.9	18.4	14.1
Recurring Net Income Growth	13.1	42.7	(19.2)	0.2	9.1
Operating Ratios (%)					
EBITDA Margins	42.3	40.4	38.8	39.7	40.6
EBIT Margins	28.6	23.6	19.9	19.2	19.8
Recurring Pre-tax Income Margins	30.4	26.2	18.8	17.2	17.7
Recurring Net Income Margins	21.6	25.5	16.8	14.5	14.2
Raw Material Consumed / Sales	11.7	18.9	21.3	21.2	20.8
SGA Expenses / Sales	21.6	15.3	14.7	14.2	14.0
Other Income / Pre-tax Income	4.1	-	-	-	-
Other Operating Income / EBITDA	-	-	-	-	-
Effective Tax Rate	4.9	(0.7)	10.1	14.9	18.8
Return / Profitability Ratios (%)					
Return on Capital Employed (RoCE)-Overall	7.6	8.7	7.3	6.8	7.1
Return on Invested Capital (RoIC)	17.7	16.0	16.9	18.0	19.7
Return on Net Worth (RoNW)	15.9	19.5	14.2	12.4	12.0
Dividend Payout Ratio	3.8	2.7	-	-	-
Solvency Ratios / Liquidity Ratios (%)					
Debt Equity Ratio (D/E)	0.89	0.92	1.02	0.90	0.73
Long Term Debt / Total Debt	0.96	1.00	1.00	1.00	1.00
Net Working Capital / Total Assets	(0.18)	(0.27)	(0.22)	(0.21)	(0.20)
Interest Coverage Ratio-based on EBIT	(13.49)	-	-	-	-
Debt Servicing Capacity Ratio (DSCR)	14.93	(15.11)	34.02	20.54	19.46
Current Ratio	0.30	0.39	0.45	0.49	0.53
Cash and cash equivalents / Total Assets	0.02	0.05	0.07	0.07	0.08
Net D/E	0.48	0.82	0.87	0.75	0.58
Turnover Ratios					
Inventory Turnover Ratio (x)	46.4	45.6	46.4	46.4	46.4
Assets Turnover Ratio (x)	0.4	0.4	0.4	0.4	0.5
Working Capital Cycle (days)	(184.3)	(243.7)	(209.6)	(170.5)	(145.9)
Average Collection Period (days)	44.1	56.5	48.1	34.9	33.3
Average Payment Period (days)	454.3	532.5	508.1	443.7	407.4

Source: Company data, I-Sec Research

Annexure 2: Reliance ADAG – Group background

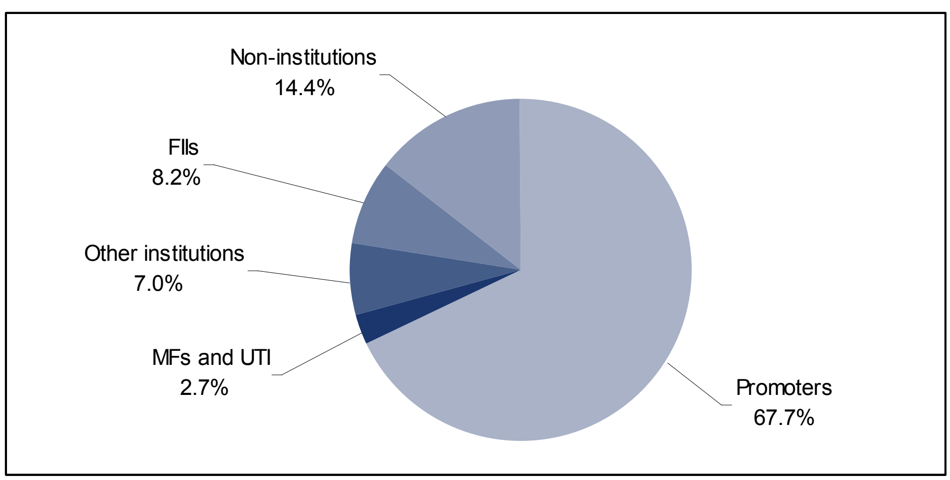
Reliance-Anil Dhirubhai Ambani Group, an offshoot of the Reliance Group founded by Dhirubhai Ambani, has business interests that range from telecommunications (RCom), financial services (Reliance Capital), power generation & distribution (Reliance Energy), infrastructure (Reliance Infrastructure) to entertainment (BIG entertainment) and natural resources (Reliance Natural Resources). Across different companies, the group has a customer base of over 100mn and a shareholder base of over 12mn. It has a business presence that extends to over 20,000 towns, 0.45mn villages in India and in five continents.

Chart 15: RCom – Corporate structure



Source: Company data

Chart 16: RCom – Shareholding structure

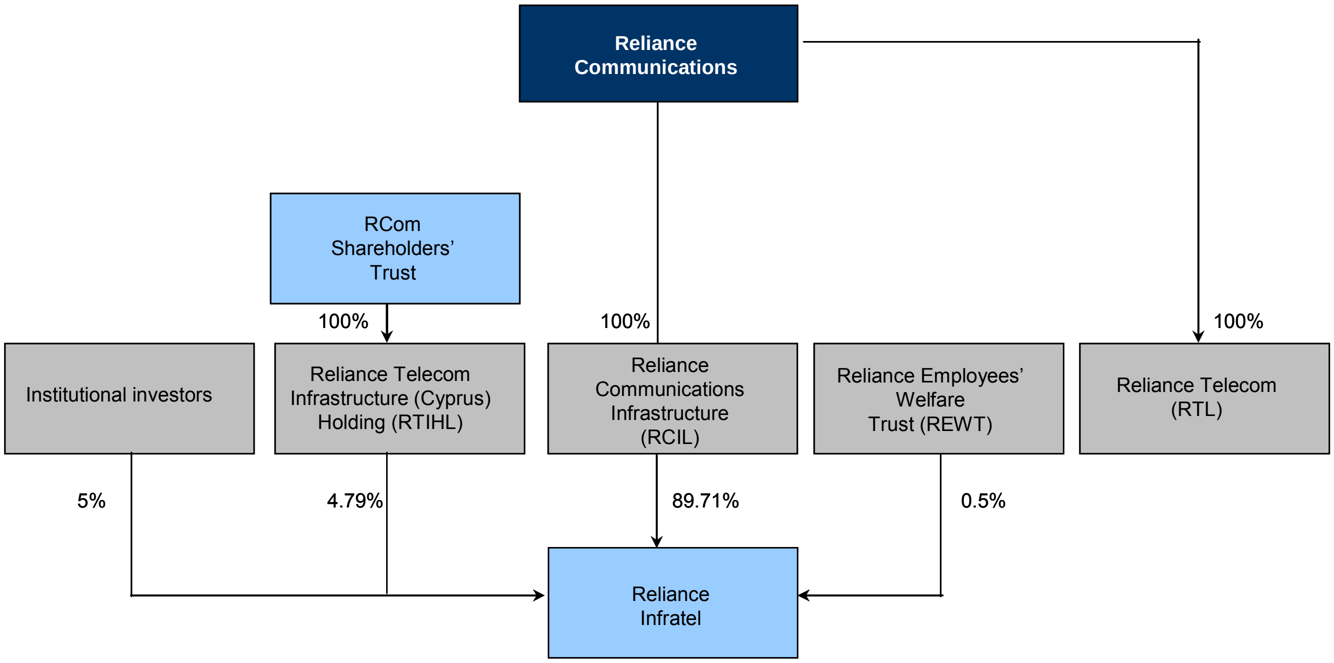


Source: Company data

RITL – Shareholding structure

Of the 95% held by RCom in RITL, 89.71% is held by Reliance Communications Infrastructure (RCIL), 4.79% by Reliance Telecom Infrastructure (Cyprus) Holdings (RTIHL) and 0.5% by Reliance Employees' Welfare Trust (REWT). RCIL and RTIHL are wholly-owned subsidiaries of RCom.

Chart 17: RITL – Shareholding structure



Source: Company data

Annexure 3: GSM to CDMA transition

South Korea

SK Telecom and KT Freetel exclusively used the CDMA technology earlier (including EV-DO for 3G) but moved to W-CDMA standards (an evolution of GSM) in ’07. W-CDMA subscribers in South Korea reached 9.2mn by Q1CY08-end within a year of commercial launch by SK Telecom and KT Freetel.

The success of W-CDMA has had a direct impact on EV-DO subscriber growth, which initially levelled out, only to go into reverse July ’07 onwards. In Q1CY08 itself, more than 0.8mn EV-DO active connections were terminated on a net basis in South Korea.

LG Telecom, the third and the smallest mobile player in South Korea, is still using the CDMA technology and finally launched 3G EV-DO services late in ’07, but this is unlikely to do much to mitigate the effects of the migration process of its two rivals.

South America

The number of CDMA mobile subscribers in Caribbean and Latin America (CALA) plummeted ~13mn in the year-ended March ’08, ending at 50.6mn after the seventh successive quarter of decline in Q1CY08. The loss of subscribers widened to 3.72mn in Q1CY08 from 1.61mn in Q1CY07 and 2.73mn in Q4CY07, although this was still below the loss of over 4mn in Q3CY07. As a result, the share of the total for the technology fell from 19.8% to 12.7%, just half the share seen less than three years ago. The loss of CDMA customers is being driven by the operators, who are actively migrating customers to their newer GSM networks.

The CDMA networks will not necessarily disappear since they may be used to provide fixed-wireless services. Also, the roaming customers from North America, where CDMA is prevalent, can not to be ignored. For these reasons and because the assets are unlikely to be fully depreciated, CDMA will not be totally removed, but its marginalisation is inevitable.

The GSM ranks have been boosted by the fact that subscribers of AMPS and TDMA networks are also being migrated – the total number using these legacy technologies has dipped more than two-thirds from 23.7mn to just 7.2mn in the year. The migration process is now at its end. As a result, the number of GSM connections has been boosted 45% in the year, almost double the growth of the continent at 24%, leaving the base at 336mn as of end of March ’08 or 84.4% of the total.

CANTV in Venezuela is the last remaining major CDMA operator in the Caribbean and Latin America. Vivo, the Brazilian operator, was one of the last Latin American operators to announce a shift to the GSM platform. In August ’06, Vivo announced the construction of its 3G-oriented GSM network that would comprise more than 3,000 cell sites. It had 30mn subscribers then. In January ’07, it commercially launched a GSM network. At present the GSM network operates well with the current CDMA network covering all Vivo service areas in Brazil. As of December ’08, the GSM operation had achieved more than 30.4mn subscribers, representing ~68% of the total subscriber base of 44.945mn.

Annexure 4: Index of Tables and Charts

Tables

Charts

Equity Research
April 2, 2009
BSE Sensex: 9902

INDIA

Idea Cellular

HOLD

An Idea whose time has not come

Rs50

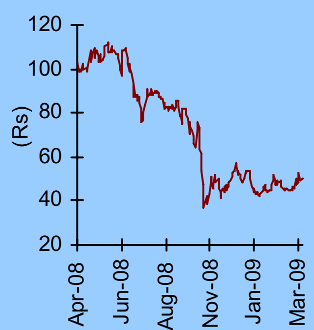
Reason for report: Initiating coverage

Telecom

Shareholding pattern

	Jun '08	Sep '08	Dec '08
Promoters	57.7	49.1	49.1
Institutional investors	16.7	15.2	15.1
MFs and UTI	4.7	4.9	5.5
Insurance Cos.	0.6	0.9	1.2
FIIs	11.3	9.4	8.4
Others	25.6	35.8	35.8

Price chart



Idea Cellular has demonstrated leadership in its legacy circles and is geared up for a pan-India roll-out through entry into 10 new circles and via consolidation of two Spice circles. However, Idea is likely to face many challenges in new circles in an increasingly competitive market space. Idea's strategic partnership with Bharti Airtel (BAL) and Vodafone to form Indus Towers will enable quick roll out of cell sites, but the company's high tower renting strategy and 1800MHz spectrum in the new circles are likely to strain profitability. Idea cellular has the strenuous task of transforming itself from a combination of niche plays to a pan-India player at the expense of short-term gains. We initiate coverage on Idea with HOLD and sum-of-the-parts (SOTP) based target price of Rs48.4/share.

- **Growing pains.** Idea has exhibited leadership in legacy circles, but we see short-term pain as it enters 10 new circles in FY09-10. In an increasingly competitive market, seizing subscriber share will be difficult, leading to tariff cuts/free minutes, while 1800MHz spectrum in new circles will curtail profitability. We believe Idea will maintain subscriber share at ~11% through FY09-12E.
- **Tower sharing – Indus partnership will help Idea accelerate its expansion** in new circles. The company's tower sharing and renting strategy will keep it asset-light, but lead to higher network operating costs and more pressure on EBITDA margin.
- **Reduced leverage owing to funds raised**, but 3G auction and roll-out will stretch the balance sheet. Idea raised a net funding of ~Rs66.6bn in FY09, reducing FY09E net debt/EBITDA to a comfortable 1.5x.
- **Valuations back-ended.** We are cautious on Idea's short-term performance. The company will be better placed if it opts for judicious expansion in new circles. We initiate coverage on Idea with HOLD and SOTP-based target price of Rs48.4/share. We value the core business at Rs32.6/share and its stake in Indus at Rs15.8/share. Idea currently trades at FY11E P/E of 14.8x and EV/EBITDA of 4.3x, which is expensive and therefore, offers limited upside from current levels. However, a quick turnaround in new business circles can lead to significant upgrade in Idea's stretched financials.

Market Cap	Rs155bn/US$3.1bn
Reuters/Bloomberg	IDEA.BO/IDEA IN
Shares Outstanding (mn)	3,102
52-week Range (Rs)	112/37
Free Float (%)	50.9
FII (%)	8.4
Daily Volume (US$'000)	2,900
Absolute Return 3m (%)	(8.1)
Absolute Return 12m (%)	(52.0)
Sensex Return 3m (%)	(0.6)
Sensex Return 12m (%)	(37.1)

Year to March	FY08	FY09E	FY10E	FY11E
Revenue (Rs mn)	67,200	102,147	163,608	197,989
Net Income (Rs mn)	10,423	9,924	9,306	11,131
EPS (Rs)	4.0	3.0	2.8	3.4
% Chg YoY	104.2	(24.0)	(6.2)	19.6
P/E (x)	12.6	16.6	17.7	14.8
CEPS (Rs)	7.3	7.1	9.3	11.2
EV/E (x)	9.3	7.7	5.5	4.3
Dividend Yield	-	-	-	-
RoCE (%)	15.7	8.0	5.5	6.5
RoE (%)	36.4	11.2	6.4	7.2

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Investment argument

Growing pains

Idea has exhibited leadership in its legacy circles, but we see short-term pain as it sets out to enter new circles. The expansion of Idea from a regional player to a pan-India operator makes business sense provided the company can exhibit similar execution in its new launches as in legacy circles. However, we believe the present market conditions are significantly different than earlier and we attach a higher degree of uncertainty as regards Idea's plans to penetrate into the bastions of incumbents in new circles.

Strong foothold in legacy circles

Idea has been able to demonstrate leadership in its eight legacy circles through superior execution. As of Q3FY09-end, Idea was the #1 player in three circles and the #2 player in two circles. Apart from strong subscriber share of ~20% in the eight circles, Idea has also been able to achieve high ARPU and strong profitability in the legacy circles due to its first mover advantage and through holding 900MHz spectrum in seven of the eight legacy circles.

Along with strengthening its lead in the eight legacy circles, Idea has also steadily increased its market share in three relatively new circles of Uttar Pradesh (East), Himachal Pradesh and Rajasthan, where services were launched in February '06; the company has not yet managed to achieve EBITDA break-even in these three circles. Even in terms of ARPUs, as of Q3FY09, Idea's ARPUs in three relatively new circles were ~17% lower than that in the eight legacy circles, indicating difficulty in gaining revenue share in new circle roll outs.

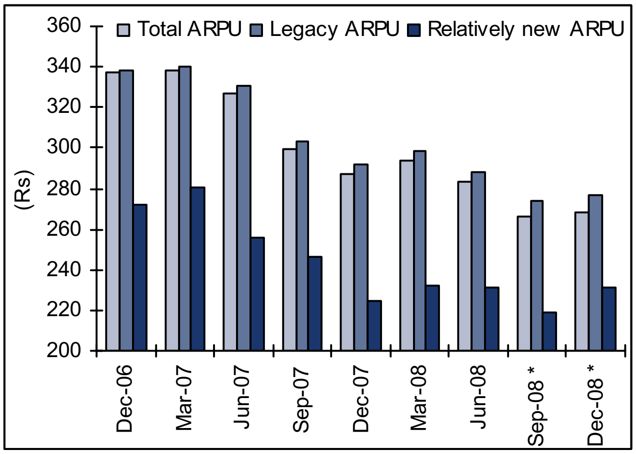
Table 1: Top notch execution in legacy circles; other circles more challenging

	FY06			FY08			Feb-09		
	Subs (mn)	Rank	Share (%)	Subs (mn)	Rank	Share (%)	Subs (mn)	Rank	Share (%)
Established circles									
AP	0.93	5	12.1	3.25	3	15.8	4.94	3	16.6
Delhi	0.87	6	9.8	1.90	5	11.7	2.40	5	11.4
Gujarat	1.03	3	15.1	2.62	3	15.5	3.80	3	16.2
Haryana	0.31	5	13.9	0.98	4	15.3	1.56	2	17.2
Kerala	0.80	3	16.0	2.70	1	23.1	4.24	1	26.8
Maharashtra	1.78	1	24.2	4.88	1	23.2	7.23	1	24.2
MP	0.73	2	21.3	3.23	1	24.5	4.83	1	24.5
UP W	0.92	2	21.2	2.57	2	19.9	3.90	2	21.2
Relatively new circles									
UP E	0.00	7	0.0	0.97	6	6.0	1.92	5	7.4
Rajasthan	0.00	8	0.0	0.82	6	6.1	1.21	6	5.5
HP	0.00	7	0.0	0.07	7	3.2	0.14	5	3.9
Spice circles									
Punjab	1.50	2	27.8	2.57	2	22.0	2.43	3	17.0
Karnataka	0.43	6	6.2	1.64	5	9.6	1.62	5	7.0
Recently launched									
Mumbai							0.69	7	3.7
Bihar							0.61	7	3.1

Source: TRAI, I-Sec Research; AP-Andhra Pradesh, UP-Uttar Pradesh, HP-Himachal Pradesh

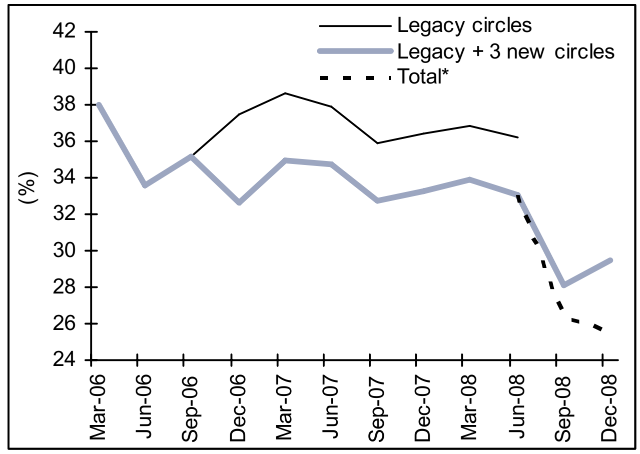
Chart 1: High ARPU and strong profitability in legacy circles; new circles yet to break even on EBITDA

ARPU in new circles ~17% lower



Source: Company data, TRAI, I-Sec Research
* ARPUs based on TRAI's financial data

EBITDA margin in legacy circles



Source: Company data, I-Sec Research

From regional to pan-India presence…

Idea launched services in Mumbai and Bihar in FY09, with plans to venture into Tamil Nadu (including Chennai), Orissa and West Bengal (including Kolkata) over the next six months; services in the remaining three circles, Assam, the North East and Jammu & Kashmir are expected to start by FY10-end. With the consolidation of the Spice circles, Punjab and Karnataka, the company would become a pan-India operator.

Chart 2: Idea's transformation from regional to national operator

1997 - Launched in Maharashtra & Gujarat

2000 - Merged with Tata Cellular (AP)

2002 - Acquired RPG Cellcom (MP) & launched in Delhi

2005 – 8 circles

Acquired Escotel (Haryana, UP (W), Kerala)

2006 – 11 circles

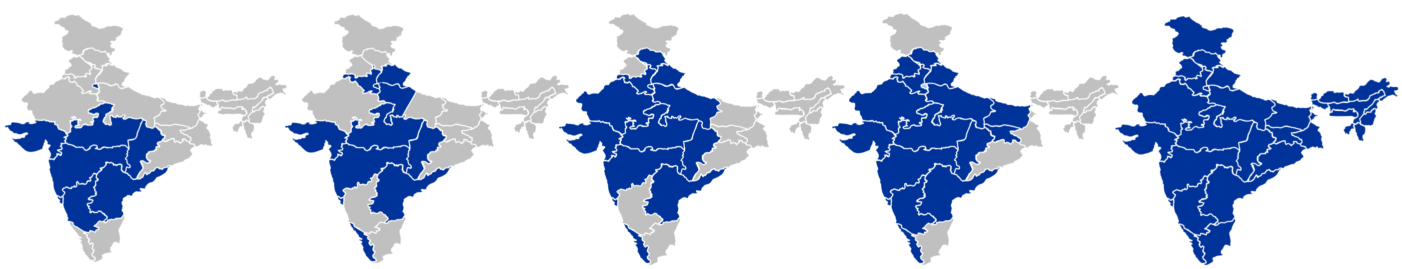
Launched Rajasthan, UP (E) and HP

2008 – 15 circles

Acquired Spice (Punjab & Karnataka) Launched Mumbai & Bihar

2009-10 – 23 circles

Plans to launch in remaining circles



Source: Company data, I-Sec Research

……but execution in new circles challenging

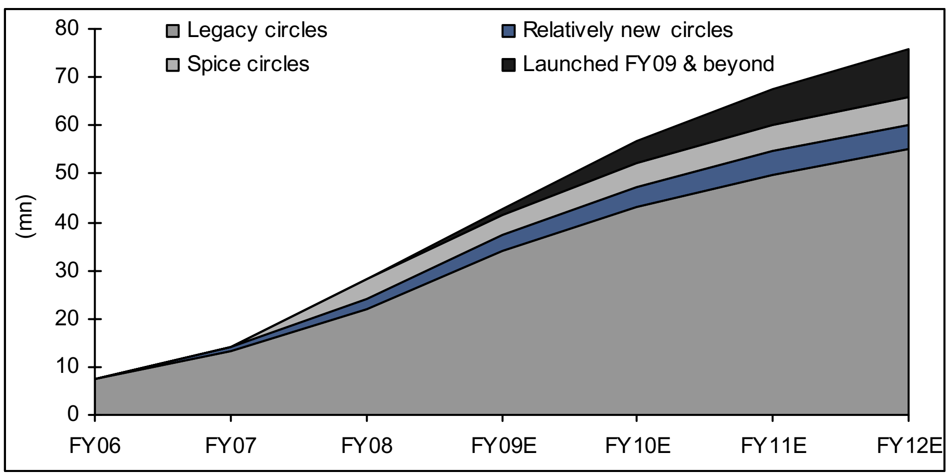
Idea's launches in FY09 have been reasonably successful in terms of subscriber acquisition, with the company reaching 3.7% market share in nine months and 3.1% market share in seven months in Mumbai and Bihar respectively.

However, Idea is likely to face multiple challenges while expanding into new circles in an increasingly competitive market space. Increasing competition will make seizing subscriber share progressively difficult and will force Idea to keep up with the competition in terms of tariff cuts or free minutes. As Idea is the seventh or eighth operator in the new circles, the profile of new subscribers will be low, implying lower incremental MoUs and ARPUs. At the same time, 1800MHz spectrum in the new circles will imply higher capex to roll out network and higher network operating expenses, which would cap profitability.

We expect Idea to maintain subscriber share at ~11%

We expect Idea's subscribers, including Spice circles, to grow at 21% CAGR through FY09E-12E. We believe Idea will maintain subscriber share at ~11%. ARPMs are expected to decline 20%, while MoUs are expected to increase 5.1%, leading to ARPU decline of 16.4% through FY09E-FY12E.

Chart 3: Non-legacy circle subscribers to increase to 28% of total Idea subs



Source: Company data, I-Sec Research

Table 2: Mobile services – Key metrics

	FY06	FY07	FY08	FY09E	FY10E	FY11E	FY12E
Subscribers (mn)	**7.4**	**14.0**	**24.0**	**42.9**	**56.6**	**67.5**	**76.0**
Legacy circles	7.4	13.4	22.1	34.3	43.7	50.4	55.6
3 relatively new circles	0.0	0.7	1.9	3.2	3.9	4.2	4.5
New circles after FY09	0.0	0.0	0.0	1.1	3.9	6.7	9.0
Spice circles	1.9	2.7	4.2	4.0	4.7	5.2	5.5
Subscriber share (%)	***7.5***	***8.4***	***9.2***	***11.0***	***11.1***	***11.1***	***11.1***
Legacy circles	*16.1*	*17.5*	*18.6*	*19.7*	*19.3*	*19.0*	*18.9*
3 relatively new circles	*0.0*	*3.3*	*5.8*	*6.3*	*5.8*	*5.2*	*4.9*
New circles after FY09	-	-	*14.6*	*10.8*	*10.3*	*9.9*	*9.7*
Spice circles				*1.2*	*2.6*	*3.8*	*4.4*
Net adds (mn)	**2.3**	**6.6**	**10.0**	**14.7**	**13.8**	**10.9**	**8.5**
Net adds share (%)	*5.3*	*9.9*	*10.5*	*11.6*	*11.5*	*11.0*	*11.1*
ARPU (Rs/mth)	**391**	**332**	**295**	**265**	**243**	**230**	**225**
% growth	*(5.6)*	*(15.1)*	*(11.3)*	*(10.1)*	*(8.4)*	*(5.4)*	*(1.8)*
MoU (min/mth)	289	358	378	406	418	426	426
Growth (%)	*3.2*	*23.9*	*5.6*	*7.3*	*3.0*	*2.0*	-
ARPM (Rs/min)	1.35	0.93	0.78	0.65	0.58	0.54	0.53
Growth (%)	*(8.5)*	*(31.5)*	*(16.0)*	*(16.2)*	*(10.2)*	*(7.3)*	*(1.8)*
Voice ARPU (Rs/mth)	359.7	301.5	271.0	240.0	217.6	204.2	200.1
Growth (%)	*(7.9)*	*(16.2)*	*(10.1)*	*(11.4)*	*(7.2)*	*(6.2)*	*(2.0)*
VAS ARPU (Rs/mth)	31.3	30.5	23.6	24.8	25.1	25.3	25.3
Growth (%)	*32.6*	*(2.4)*	*(22.7)*	*5.2*	*1.0*	*1.0*	-
VAS as a % of ARPU	*8.0*	*9.2*	*8.0*	*9.4*	*10.3*	*11.0*	*11.2*
Revenues (Rs mn)	**29,655**	**43,664**	**67,200**	**102,147**	**144,455**	**170,422**	**193,409**
Growth (%)	*31.5*	*47.2*	*53.9*	*52.0*	*41.4*	*18.0*	*13.5*
Operating expense	29,011	44,682	74,944	114,054	133,088	148,580	160,685
EBITDA (Rs mn)	**10,674**	**14,653**	**22,518**	**27,202**	**30,401**	**37,335**	**44,828**
EBITDA margin (%)	*36.0*	*33.6*	*33.5*	*26.6*	*21.0*	*21.9*	*23.2*

Source: Company data, I-Sec Research

Price based competition to squeeze margins

Competition to drive tariffs and margins down

A price war is likely as players enter new circles and try to gain subscriber share without regard to revenue share at least initially. RCom launched its nationwide GSM services by offering up to Rs900 of free talk time in the first three months. After RCom's GSM launch in Mumbai, Idea had to change its tariff plans in Mumbai to match RCom's free talk time offer. While RCom opted for the free talk time strategy in the first three months, Idea decided to adopt the low tariff strategy in the first six months. Recently, Aircel has also taken the route of low tariffs for its new launch in Delhi with tariffs as low as Rs0.4/min.

We expect similar free minutes or low tariff plans in at least circles where new launches are imminent. Both these strategies are likely to result in lower realisations and margins for all operators and higher churn for incumbents in each circle.

Table 3: Price war on the cards

	RCom GSM Free minutes strategy	Aircel in Delhi Low tariff strategy	Idea in Mumbai Low tariff strategy
Basic component			
SIM MRP	49	99	
Validity	Lifetime	Lifetime	
Talk time	10	10	
Customer experience pack			
Free talk time	10/day		
Duration	90 days		
Other offers	Night calling packs and double talk time benefit		
Tariffs (Rs/min)			
All local/intra circle calls	1.0		0.6 first 6 months, 1 afterwards
1st min		1.0	
2nd min		0.6	
3rd min		0.4	
STD calls	1.5		1first 6 months, 1.5 afterwards
Intra-operator		0.5 first 3 months 1.5 afterwards	
to other mobile/landline		1.5	
SMS (Rs)			
Local	1.0	1.0	1.0
National	1.5	2.0	1.5
International	5.0	5.0	5.0
No. of free local/national SMS	0	300	0
Other offers	Night Calling Pack		

Source: Company data, I-Sec Research

Long distance operations to provide some respite on access charges

Idea obtained national long distance (NLD) and international long distance (ILD) licences in April ’06 and started its NLD operations in April ’08, while its ILD operations are still in the nascent stage. The company currently carries 25% of its wireless traffic on its own NLD network and plans to increase this to 50%. The company has guided for US$100mn capex on its long distance operations in FY09E. As Idea’s long-distance business ramps up and gains more traction, access charges as a percentage of revenues are expected to come down marginally, providing some relief to EBITDA margin.

Expect new circles to achieve EBITDA break-even after three years

We expect new circles that start operations FY09 onwards to achieve EBITDA break-even only in FY13, thereby straining Idea’s EBITDA margin. In the short term, adding cell sites for coverage rather than capacity will squeeze margins as Idea will be paying rentals for relatively empty networks. In the long term, profitability depends on the revenue share and we believe, operators entering new circles will find it difficult to gain significant revenue share.

Spice acquisition fills in the gaps

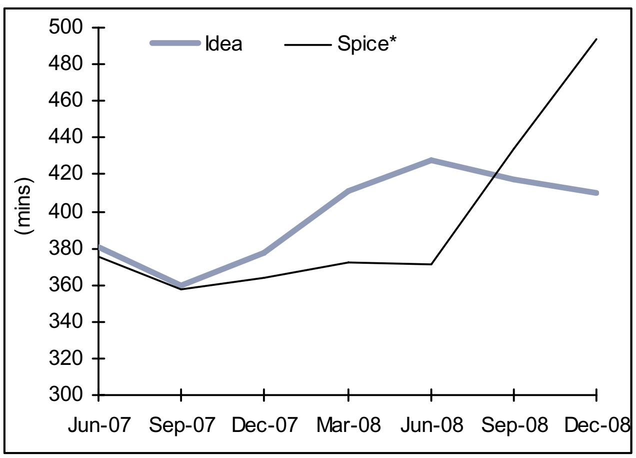
Acquisition to provide strong foothold in two circles

Idea announced the acquisition of Spice Communications in July ’09, which is expected to be completed by April 1, ’09. The acquisition gives Idea a strong foothold in the highly penetrated circles of Punjab and Karnataka where Spice is the #3 and #5 player respectively. Apart from giving Idea the scale, the inorganic route will also lead to cost savings versus setting up greenfield operations in the two circles. Spice holds 900MHz spectrum in Punjab (8MHz) and Karnataka (6MHz), which means lower network operating costs and higher efficiency. Had Idea started operations in the two circles (with 4.4MHz start-up spectrum in 1800MHz band), it would have led to much higher initial capex and higher network operating costs.

Spice subscribers in the two circles are high usage subscribers. Spice restated the subscriber numbers to match with the reporting structure of Idea in Q2FY09, which led to a decline in the number of subscribers, after which the usage profile of Spice subscribers are better than that of Idea subscribers. In Q3FY09, Spice MoUs were 20% higher than Idea MoUs and Spice ARPUs were 5% higher than Idea ARPUs.

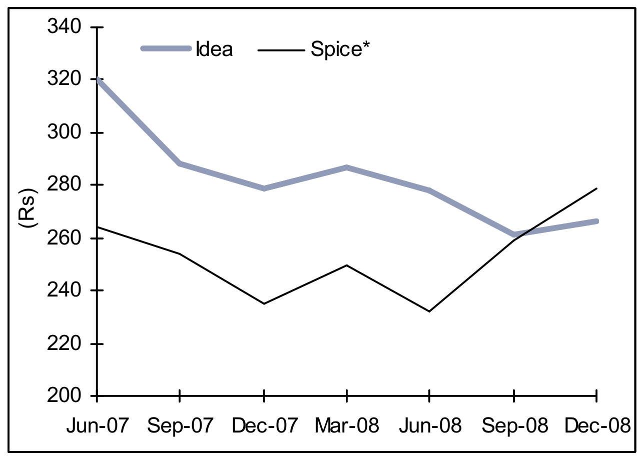
Chart 4: Idea gained high usage, high ARPU subscribers in two Spice circles

MoUs



Source: COAI, AUSPI, TRAI, I-Sec Research
* Spice restated the subscriber numbers in Q2FY09

ARPUs



Source: Company data, I-Sec Research

The Spice acquisition will be EBITDA margin dilutive for Idea in the short term due to lower EBITDA margin of Spice, but we expect margin for the Spice circles to improve FY10 onwards due to operational efficiencies and economies of scale as a result of merger with Idea circles.

Net cash inflow of Rs46bn from the deal

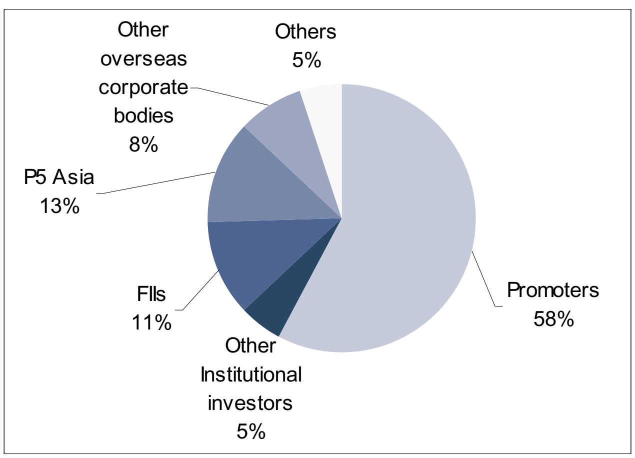
The acquisition will be completed in a three-stage deal: i) Idea will buy out Spice promoters Modis' 40.8% stake in a cash deal at Rs77.3/share and pay additional Rs5,440mn as non-compete fee, ii) Idea and Telekom Malaysia International (TMI) together will make an open offer for up to 20% of Spice shares and iii) remaining Spice shares will be swapped for Idea shares in the proportion of 100 shares of Idea for every 49 shares of Spice. As a part of the deal, Idea also issued 464.74mn shares at Rs156.96/share to TMI, implying 14.99% stake in Idea. TMI's stake in Idea will increase to ~20% after 49:100 swap of TMI's stake in Spice with Idea shares.

The first two parts of the deal and the share allotment to TMI are now complete and the swapping of Spice shares for Idea shares is expected to be completed by April 1, '09. Idea currently holds 49.9% in Spice with 41.09% directly held (40.8% bought from the Modis and 0.29% from the open offer for Spice shares) and 8.81% indirectly held through its associate company, Green Acres Agro. TMI holds 49% in Spice with the remaining 1.1% held by the public.

The acquisition of Spice resulted in Rs27.4bn cash outflow for Idea and Rs73bn inflow from the stake sale to TMI, resulting in net inflow of Rs45.6bn. The deal also led to 25.3% equity dilution, 17.6% from the issue of shares to TMI and 6.5% from the swapping of shares for Spice's shares. The cash inflow from TMI helped Idea in reducing its leverage and provided enough funding for the roll-outs in the new circles. Having a strong strategic partner such as TMI with experience in 10 other Asian markets is likely to benefit Idea in the future, especially in the impending 3G roll-out.

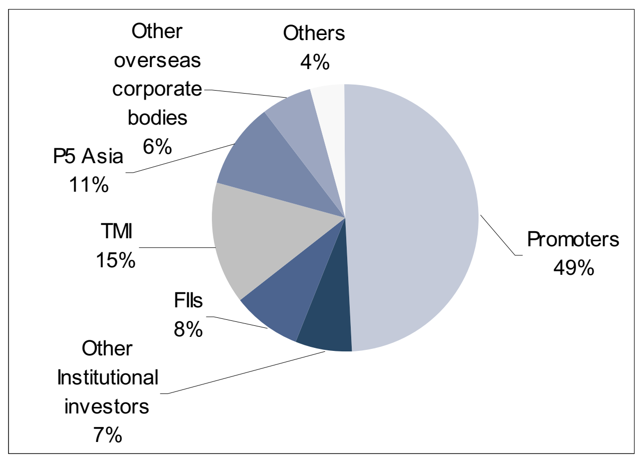
Chart 5: Idea – Shareholding

Before stake sale to TMI – June '08



Source: COAI, AUSPI, TRAI, I-Sec Research

After stake sale to TMI – December '08



Source: Company data, I-Sec Research

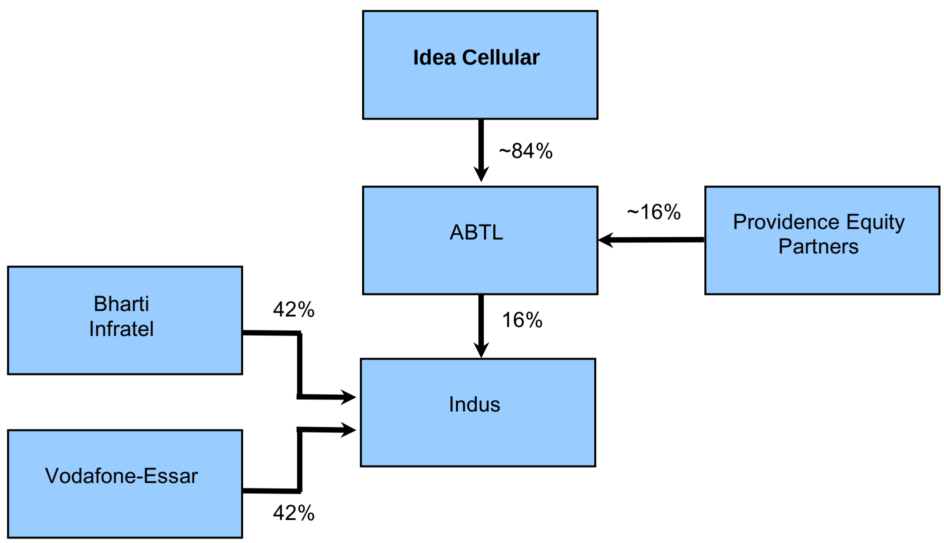
Tower sharing – Asset-light strategy

Indus Towers, a win-win partnership

Idea's tie-up with BAL and Vodafone to form Indus Towers for tower sharing is in line with the company's philosophy of rolling out network via higher tower sharing and renting. Idea will contribute ~11,100 towers to Indus for a 16% stake and the participation in Indus gives Idea access to 90,000+ towers in 16 circles. Of the 16 circles, Idea is in the process of rolling out network in five circles – Mumbai, West Bengal, Kolkata, Tamil Nadu and Chennai – which should give it considerable advantage in accelerating its network roll-outs. We expect Indus to post the highest tenancy among tower companies, which will likely translate into lower rentals per cell site for Idea. Through FY09E-12E, we expect 70% of Idea's cell site requirement to be met through Indus.

Idea's 16% stake in Indus is held through Aditya Birla Telecom (ABTL), in which Idea recently sold 16.14% stake to Providence Equity Partners for US$428mn, taking Idea's effective stake in Indus to 13.41%. ABTL also holds Idea's towers in seven non-Indus circles and its mobile operations in the Bihar circle.

Chart 6: Indus Towers – Holding structure



Source: Company data, I-Sec Research

The Indus partnership also gives Idea the opportunity to place its cell sites in five non-Indus circles, where it is launching services on towers of BAL and Vodafone. We expect Idea to build very few towers in non-Indus circles, with less than 20% of the incremental requirement being built. Most of Spice's cell sites in Punjab and Karnataka are also placed on towers rented from Quippo, since Spice sold its 875 towers in the two circles to Quippo in FY08.

Renting strategy to affect margins

Idea has accelerated the roll-out of its network over the past 12 months and has increased cell sites 85.3% from 21,197 in December '07 to 39,289 in December '08, of which 70% have been rented and only 30% built. The high tower sharing and renting strategy will help keep Idea's asset base light and increase the company's ability to reach the target market quickly. However, the strategy will lead to higher network operating costs and strain EBITDA margin.

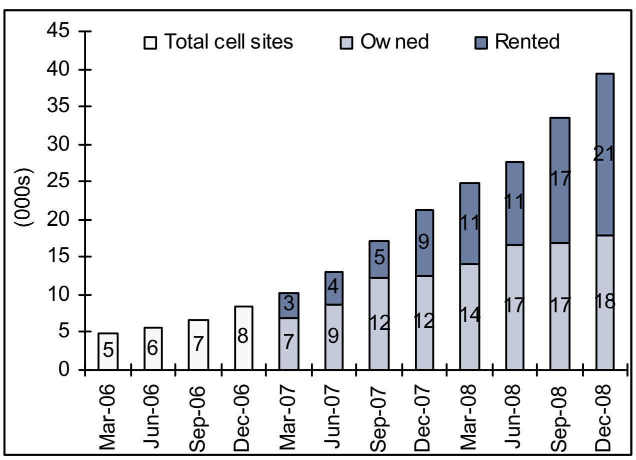
We expect Idea's FY10E capex requirement to be Rs61.5bn, excluding 3G and Indus, slightly higher than Rs60bn capex guidance. Of this, we expect ~82% to be spent on active infrastructure with the rest on passive infrastructure (to build towers in non-Indus circles through ABTL), NLD operations and backhaul equipment. We have not yet factored in the 3G auction and capex spend in our estimates.

Table 4: Idea's cell sites roll-out to be driven by renting and tower sharing

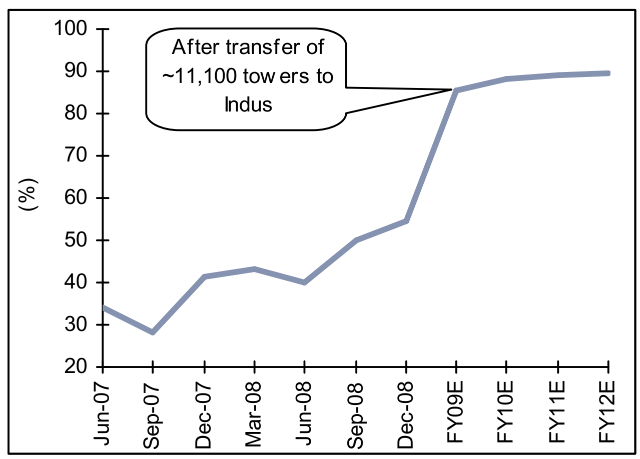
	FY06	FY07	FY08	FY09E	FY10E	FY11E	FY12E
No. of cell sites	**4,763**	**10,144**	**24,793**	**46,500**	**61,886**	**71,393**	**78,874**
Rented	**953**	**3,348**	**10,660**	**39,770**	**54,586**	**63,505**	**70,647**
--- from Indus				31,116	43,652	49,236	53,333
--- from External				8,654	10,934	14,269	17,314
% Rented	*20.0*	*33.0*	*43.0*	*85.5*	*88.2*	*89.0*	*89.6*
Owned (ABTL)	**3,810**	**6,796**	**14,133**	**6,730**	**7,300**	**7,888**	**8,227**
% Owned	-	-	-	*78.2*	*80.0*	*77.5*	*75.5*
Tenancy				1.00	1.10	1.15	1.20
Capex (Rs bn) *				**62,976**	**61,259**	**37,221**	**26,597**

Source: Company data, I-Sec Research
* Excluding 16% share of Indus capex and including Spice capex FY10 onwards

Chart 7: Rented towers to rise from ~85% to ~90% in FY09E-12E straining margins



Source: Company data, I-Sec Research



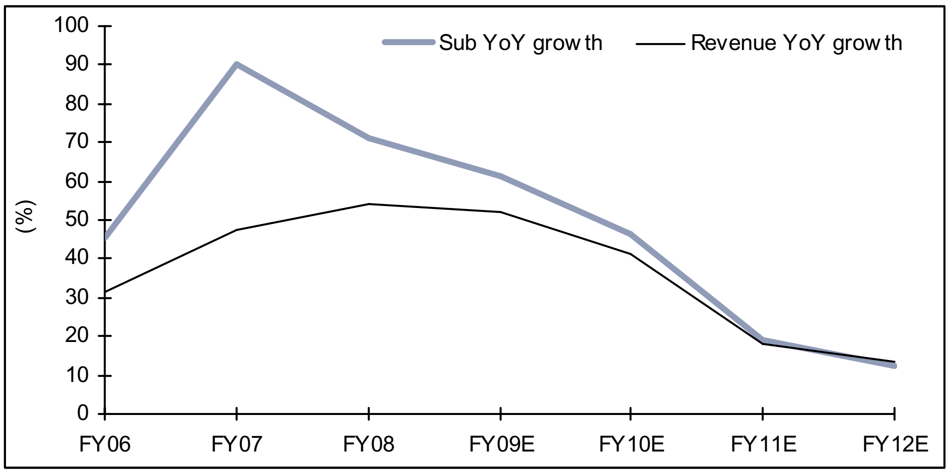
Source: Company data, I-Sec Research

Financials – Downward pressure to continue

Revenue growth to be muted vis-à-vis subscriber growth

We expect Idea's subscribers, including Spice circles, to grow at 21% CAGR through to FY09E-12E. We estimate Idea's revenues to grow 41.4% YoY in FY10E as a result of full-year Spice consolidation, while revenue growth in FY11E and FY12E is likely to be more muted at 18% and 11.4% respectively.

Chart 8: Revenue growth through FY09-12 to be lower than subscriber growth



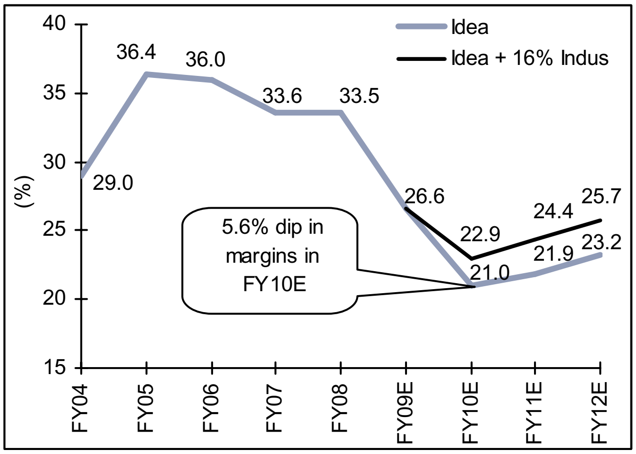
Note: FY10E revenues not exactly comparable YoY due to spice consolidation and transfer of towers to Indus
Source: Company data, I-Sec Research

EBITDA margin to be under pressure; Indus consolidation to help margin

We expect EBITDA margin, excluding Indus consolidation, to dip 5.6% to 21.1% in FY10E as a result of transfer of towers to Indus, consolidation of margin-dilutive Spice circles and expansion into eight new circles; the management has guided for 5-6% decline in FY10E margins. Access charges as a percentage of revenues are expected to decline going forward as Idea hopes to increase the share of traffic carried on its own NLD operations from 25% at present to 50%. Beyond FY10, we expect EBITDA margin to improve steadily as the subscriber acquisition costs and ad spends in new circles decline and new circle operations move closer to EBITDA break-even. On a consolidated basis, including 16% of Indus, we expect the dip in EBITDA margin to be less steep in FY10.

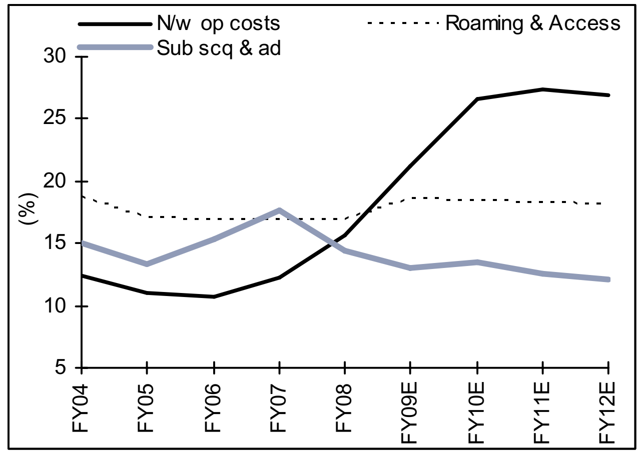
Chart 9: Margin to dip in FY10 but improve later; EBITDA margin including 16% of Indus to be better

FY10E core business EBITDA margin to dip 5.6%



Source: Company data, I-Sec Research
Note: FY09E as reported by Idea

Network op costs to drive down EBITDA margin

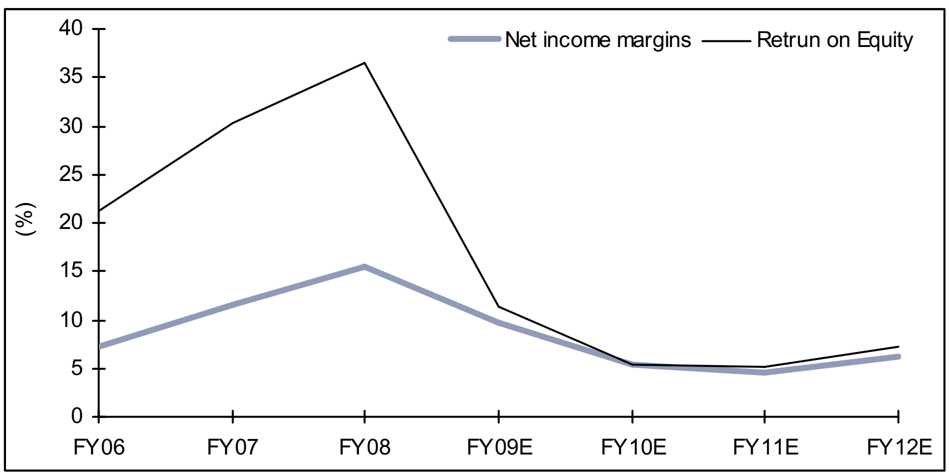


Source: Company data, I-Sec Research
Note: FY09E as reported by Idea

Short-term profitability and RoE under pressure

We expect net income margin of Idea's core business to dip to 5.4% in FY10E and 4.7% in FY11E, but it will likely start improving thereafter as new circle operations start achieving EBITDA break-even.

Chart 10: Core business net income margins & RoE to dip in FY10-11, but improve thereafter



Source: Company data, I-Sec Research

Funding raised reduces leverage, but 3G will stretch balance sheet

Idea was able to raise a total funding of ~Rs93.9mn in FY09E from TMI and Providence, while it spent ~Rs27.3bn on the acquisition of Spice, leading to a net cash inflow of Rs66.6bn in FY09E. The funding helped reduce Idea's net debt/EBITDA to 1.6x in FY09E, but we expect it to increase in FY10E to 2.8x (core business excluding Indus). Excluding the spend on 3G, Idea's balance sheet is comfortably placed. However, raising more capital for the 3G auctions will likely stretch Idea's balance sheet.

Table 5: Idea received net funding of Rs66.6bn in FY09E

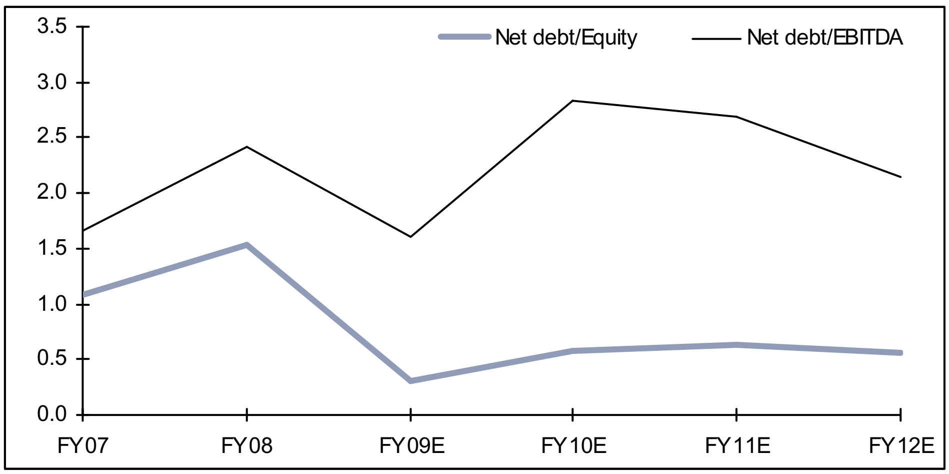
(Rs mn)

Particulars	Cash	Details
Purchase of Spice promoters' stake	(21,759)	Purchase of 40.8% for Rs77.3/share
Payment of non-compete fees	(5,440)	
Purchase of Spice shares in open offer	(155)	Purchase of 0.29% shares at Rs77.3/share, 8.89% was purchased by Green Acres Agro and
Total outflow	**(27,354)**	
Issue of shares to TM	72,944	Issue of 464.73 shares for Rs156.96/share. TM currently holds 14.99% share
Stake sale in ABTL to Providence*	21,000	Sale of 16.14% stake in ABTL to Providence for US$428mn
Total inflow	**93,944**	
Net cash flow	**66,590**	

Source: Company data, I-Sec Research

* The original deal with Providence was for 20% stake at US$640mn but the FIPB approval was received only for 16.14% stake

Chart 11: FY10E core business net/debt EBITDA at 2.7x, excluding 3G spend



Source: Company data, I-Sec Research

Valuations back-ended

We value the core business of Idea based on DCF at Rs32.6/share, assuming 12% WACC and exit EV/EBITDA of 4x. We expect Idea to achieve FCFF break-even in FY12, implying that most of the value in the DCF model is back-ended, which increases risk. We expect 13.41% effective stake in Indus to contribute Rs15.8/share, implying a total value of Rs48.4/share. Our target price implies FY10E P/E & EV/EBITDA of 17.2x & 5.5x, yielding 3% downside from current levels. We initiate coverage with HOLD.

We expect Idea to report consolidated EPS of Rs3, Rs2.8 and Rs3.5 in FY09E, FY10E and FY11E respectively at 1.9% EPS CAGR through FY08-11E. The low growth in profitability is owing to expansion in new circles. Though Idea has had a good track record in the legacy circles, we believe the entry in the new circles as the seventh or eighth player reduces earnings visibility. While pan-India presence is the key to higher profitability, Idea is currently neither a pan-India play nor a niche play, which makes the business case challenging. We are positively biased on the company but recommend a 'wait and watch' strategy as regards performance in the new circles and intensity of competition.

Table 6: SOTP valuation at Rs48.4/share

(Rs mn)

	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E	FY16E	FY17E	FY18E	FY19E
EBIT	13,040	16,384	21,505	27,820	32,634	37,716	43,035	48,557	54,237	60,025
NOPAT	11,594	14,205	18,348	23,313	27,415	31,744	36,268	40,474	45,242	50,100
Depreciation	17,361	20,951	23,324	25,032	25,783	26,557	27,354	28,174	29,020	29,890
Capex	61,259	37,221	26,597	20,996	20,227	20,834	21,459	22,103	22,766	23,449
Net working capital	6,339	5,883	4,286	2,640	2,179	2,488	2,794	3,091	3,374	3,636
FCFF	**(38,643)**	**(7,948)**	**10,788**	**24,709**	**30,793**	**34,979**	**39,369**	**43,454**	**48,122**	**52,905**
Terminal Value	370,452									
Enterprise Value	**145,523**									
Net debt	86,086									
Equity Value	**107,485**		**Assumptions**							
No. of shares	3,301		WACC		12.0%					
Core business value/share	**32.6**		Exit EV/EBITDA		4.0x					
Tower business value/share	15.8									
Total value/share	**48.4**									
% upside	**(3)**									
Implied FY10E P/E	17.2x									
Implied FY10E EV/EBITDA	5.5x									

Source: Company data, I-Sec Research

Table 7: Sensitivity of core business value to exit multiple and WACC

		WACC (%)				
		11.0	**11.5**	**12.0**	**12.5**	**13.0**
Exit EV/EBITDA	**5.0x**	47.1	43.8	40.6	37.6	34.7
	4.5x	42.7	39.5	36.6	33.8	31.1
	4.0x	38.2	35.3	**32.6**	29.9	27.4
	3.5x	33.8	31.1	28.5	26.1	23.8
	3.0x	29.3	26.9	24.5	22.3	20.1

Source: Company data, I-Sec Research

Table 8: Scenario analysis indicates 19% downside in case of higher competition

	Scenarios	Core business value/share (Rs)	Tower business/ share (Rs)	Total business/ share (Rs)	% upside
Optimistic case	10% & 6% decline in voice ARPMs in FY10E & FY11E respectively	40.6	15.8	56.4	13
Base case	12% & 8% decline in voice ARPMs in FY10E & FY11E respectively	32.6	15.8	48.4	(3)
Pessimistic case	14% & 10% decline in voice ARPMs in FY10E & FY11E respectively	24.7	15.8	40.5	(19)

Source: Company data, I-Sec Research

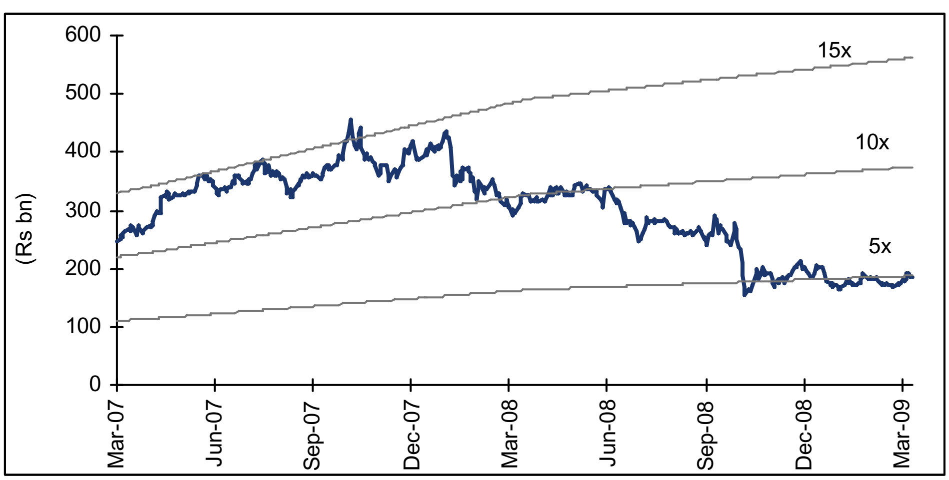
Key risks to business performance

Idea plans to transform itself into a pan-India player by venturing into ten new circles (including Chennai & Kolkata) through FY09-10, keeping the capex high at Rs61bn. Also, participation in 3G auctions will increase Idea's funding requirements significantly. Given this scenario, we believe high 3G bidding, poor execution in new circles and increased competition in new circles from RCom's GSM offering & new entrants can impact profitability. Also, execution risks exist for the merger between Spice and Idea.

Chart 12: P/E bands

Source: Company data, Bloomberg, I-Sec Research

Chart 13: EV/EBITDA



Source: Company data, Bloomberg, I-Sec Research

Annexure 1: Financials

Table 9: Profit & Loss Statement

(Rs mn, year ending March 31)

	FY08	FY09E	FY10E	FY11E	FY12E
Gross Sales	**67,200**	**102,147**	**163,608**	**197,989**	**227,166**
Less: Excise Duty					
Net Sales	**67,200**	**102,147**	**163,608**	**197,989**	**227,166**
of which Export Sales					
of which Domestic Sales	*67,200*	*102,147*	*163,608*	*197,989*	*227,166*
Total Operating Income	**67,200**	**102,147**	**163,608**	**197,989**	**227,166**
Less:					
Cost of Trading Goods	0	97	-	-	-
Personnel Exp	3,464	5,408	7,146	8,311	9,264
Network Operating Exp	10,470	21,656	49,223	61,494	69,956
License and WPC Charges	6,851	11,288	15,943	18,811	21,352
Roaming & Access Charges	11,334	18,912	26,660	31,115	34,929
Sub Acq & Servicing & Ad & Promotion Exp	6,424	8,817	13,023	14,228	15,504
Advertisement and Business Promotion Exp	3,225	4,426	6,537	7,142	7,783
Administration & other Exp	2,914	4,340	7,612	8,673	9,887
Total Operating Expenses	**44,682**	**74,944**	**126,144**	**149,775**	**168,673**
EBITDA	**22,518**	**27,202**	**37,464**	**48,214**	**58,492**
Depreciation & Amortisation	8,768	13,597	21,430	25,981	29,057
-Depreciation	7,569	11,830	19,042	23,307	26,215
-Amortisation	1,199	1,768	2,388	2,675	2,842
Other Income	175	60	66	73	80
EBIT	**13,925**	**13,665**	**16,101**	**22,306**	**29,515**
Less: Net Interest	2,776	3,574	5,008	8,289	9,037
Recurring Pre-tax Income	**11,148**	**10,092**	**11,093**	**14,016**	**20,478**
Add: Extraordinary Income	-	21,000	-	-	-
Less: Extraordinary Expenses					
Less: Taxation	725	515	1,787	2,886	4,295
Tax rate(%)	*6.5*	*1.7*	*16.1*	*20.6*	*21.0*
--Current Tax	426	109	1,607	2,677	4,063
--Deferred Tax	650	287	-	-	-
--Fringe benefit Tax	74	119	181	209	232
--MAT credit	(425)	-	-	-	-
Minority Interest	-	-	-	-	-
Net Income (Reported)	**10,423**	**30,576**	**9,306**	**11,131**	**16,183**
Less: Preference dividend	-	-	-	-	-
Recurring Net Income	**10,423**	**9,924**	**9,306**	**11,131**	**16,183**

Source: Company data, I-Sec Research

Table 10: Balance sheet

(Rs mn, year ending March 31)

	FY08	FY09E	FY10E	FY11E	FY12E
ASSETS					
Current Assets, Loans & Advances					
Cash & Bank balance	4,975	43,771	24,300	47,179	65,791
Inventory	276	304	334	368	404
Sundry Debtors	1,986	2,668	3,727	4,511	5,175
Loans and Advances	7,742	9,484	14,692	18,864	22,889
Other Current Assets	521	971	1,195	1,446	1,659
Total Current Assets	**15,500**	**57,198**	**44,248**	**72,368**	**95,919**
Current Liabilities & Provisions	**27,022**	**35,372**	**49,936**	**55,839**	**59,759**
Current Liabilities	26,203	34,528	49,050	54,908	58,782
Provisions	819	844	886	930	977
Total Current Liabilities and Provisions	**27,022**	**35,372**	**49,936**	**55,839**	**59,759**
Net Current Assets	**(11,523)**	**21,826**	**(5,688)**	**16,529**	**36,160**
Investments					
Strategic & Group Investments	-	24,420	24,420	24,420	24,420
Other Marketable Investments	5,560	5,910	5,910	5,910	5,910
Total Investments	**5,560**	**30,330**	**30,330**	**30,330**	**30,330**
Deferred Tax Asset	**-**	**-**	**-**	**-**	**-**
Goodwill	**61**	**27,962**	**27,962**	**27,962**	**27,962**
Fixed Assets					
Gross Block	110,141	161,970	224,100	248,408	269,690
Less Accumulated Depreciation	31,242	43,291	62,333	85,640	111,854
Net Block	78,899	118,680	161,767	162,768	157,835
Gross Intangibles	28,869	39,179	40,404	41,893	42,957
Less: Amortization	10,977	17,227	19,615	22,290	25,132
Net Intangibles	17,892	21,952	20,790	19,604	17,825
Add: Capital Work in Progress	10,372	14,528	24,163	27,736	30,290
Total Fixed Assets	**107,163**	**155,160**	**206,720**	**210,108**	**205,950**
Total Assets	**101,261**	**235,277**	**259,324**	**284,929**	**300,402**
LIABILITIES AND SHAREHOLDERS' EQUITY					
Borrowings					
Short Term Debt	10,605	38,681	23,681	23,681	23,681
Non-Convertible Preference Shares					
Long Term Debt	54,549	54,549	84,549	99,549	99,549
Total Borrowings	**65,154**	**93,230**	**108,230**	**123,230**	**123,230**
Deferred Tax Liability	**661**	**948**	**948**	**948**	**948**
Share Capital					
Paid up Equity Share Capital	26,354	33,012	33,012	33,012	33,012
No. of Shares outstanding (mn)	*2,635*	*3,301*	*3,301*	*3,301*	*3,301*
Face Value per share (Rs)	*10*	*10*	*10*	*10*	*10*
ESOP outstanding	38	160	160	160	160
Reserves & Surplus	**9,055**	**107,928**	**116,974**	**127,580**	**143,053**
Share Premium	21,076	89,373	89,373	89,373	89,373
General & Other Reserve	2,058	2,058	2,058	2,058	2,058
Profit & Loss	(14,079)	16,497	25,544	36,149	51,622
Less: Misc. Exp. not written off	-	-	-	-	-
Net Worth	**35,446**	**141,099**	**150,146**	**160,751**	**176,224**
Minority Interest	-	-	-	-	-
Total Liabilities & Shareholders' Equity	**101,261**	**235,277**	**259,324**	**284,929**	**300,402**

Source: Company data, I-Sec Research

Table 11: Cashflow statement

(Rs mn, year ending March 31)

	FY08	FY09E	FY10E	FY11E	FY12E
Cash Flow from Operating Activities					
Reported Net Income	10,423	30,576	9,306	11,131	16,183
Add:					
Depreciation & Amortisation	6,117	18,299	21,430	25,981	29,057
Deferred Taxes	650	287	-	-	-
Provisions	281	25	42	44	47
Net Interest	2,776	3,574	5,008	8,289	9,037
Less:					
Other Income	175	60	66	73	80
Net Extra-ordinary income	-	21,000	-	-	-
Operating Cash Flow before Working Capital change (a)	**20,073**	**31,701**	**35,719**	**45,373**	**54,244**
Changes in Working Capital					
(Increase) / Decrease in Inventories	(97)	(28)	(30)	(33)	(37)
(Increase) / Decrease in Sundry Debtors	(461)	(682)	(1,059)	(783)	(665)
(Increase) / Decrease in Operational Loans & Adv.	(3,743)	(1,741)	(5,208)	(4,172)	(4,025)
(Increase) / Decrease in Other Current Assets	237	(451)	(224)	(251)	(213)
Increase / (Decrease) in Sundry Creditors	5,221	8,325	14,521	5,859	3,873
Working Capital Inflow / (Outflow) (b)	**1,157**	**5,423**	**8,000**	**619**	**(1,066)**
Net Cash flow from Operating Activities (a) + (b)	**21,230**	**37,124**	**43,719**	**45,992**	**53,178**
Cash Flow from Capital commitments					
Purchase of Fixed Assets	(44,970)	(78,859)	(71,765)	(27,881)	(23,835)
Purchase of Investments	-	-	-	-	-
Cost of Intangibles	(7,210)	(10,310)	(1,225)	(1,489)	(1,064)
Cash Inflow/(outflow) from capital commitments (c)	**(52,180)**	**(89,170)**	**(72,990)**	**(29,370)**	**(24,899)**
Free Cash flow after capital commitments (a) + (b) + (c)	**(30,950)**	**(52,046)**	**(29,271)**	**16,622**	**28,279**
Cash Flow from Investing Activities					
Purchase of Marketable Investments	(5,548)	(350)	-	-	-
Other Income	175	60	66	73	80
Net Cash flow from Investing Activities (d)	**(5,373)**	**(290)**	**66**	**73**	**80**
Cash Flow from Financing Activities					
Issue of Share Capital during the year	3,188	72,944	-	-	-
Proceeds from fresh borrowings	22,649	28,076	15,000	15,000	-
Payment of preferential dividends	-	-	-	-	-
Buyback of Shares	-	-	-	-	-
Dividend paid including tax	-	-	-	-	-
Net interest	(2,776)	(3,574)	(5,008)	(8,289)	(9,037)
Others	38	(27,314)	(259)	(526)	(710)
Net Cash flow from Financing Activities (e)	**23,098**	**70,132**	**9,733**	**6,185**	**(9,747)**
Net Extra-ordinary Income (f)	**-**	**21,000**	**-**	**-**	**-**
Total Increase / (Decrease) in Cash (a) + (b) + (c) + (d) + (e) + (f)	**(13,225)**	**38,797**	**(19,471)**	**22,880**	**18,612**
Opening Cash and Bank balance	**18,199**	**4,975**	**43,771**	**24,300**	**47,179**
Closing Cash and Bank balance	**4,975**	**43,771**	**24,300**	**47,179**	**65,791**
Increase/(Decrease) in Cash and Bank balance	**(13,225)**	**38,797**	**(19,471)**	**22,880**	**18,612**

Source: Company data, I-Sec Research

Table 12: Key ratios

(Year ending March 31)

	FY08	FY09E	FY10E	FY11E	FY12E
Per Share Data (Rs)					
Diluted Recurring Earning per share (DEPS)	4.0	3.0	2.8	3.4	4.9
Diluted Earnings per share	4.0	9.3	2.8	3.4	4.9
Recurring Cash Earnings per share (CEPS)	7.3	7.1	9.3	11.2	13.7
Free Cashflow per share (FCPS-post capex)	(11.7)	(15.8)	(8.9)	5.0	8.6
Reported Book Value (BV)	13.5	42.7	45.5	48.7	53.4
Adjusted Book Value (ABV) **	13.5	42.7	45.5	48.7	53.4
Dividend per share	-	-	-	-	-
Valuation Ratios (x)					
Diluted Price Earning Ratio	12.6	16.6	17.7	14.8	10.2
Price to Recurring Cash Earnings per share	6.9	7.0	5.4	4.4	3.6
Price to Book Value	3.7	1.2	1.1	1.0	0.9
Price to Adjusted Book Value	3.7	1.2	1.1	1.0	0.9
Price to Sales Ratio	2.0	1.6	1.0	0.8	0.7
EV / EBITDA	9.3	7.7	5.5	4.3	3.6
EV / Total Operating Income	3.1	2.1	1.3	1.1	0.9
EV / Operating Free Cash Flow (Pre-Capex)	9.9	5.6	4.8	4.6	3.9
EV / Net Operating Free Cash Flow (Post-Capex)	(6.8)	(4.0)	(7.2)	12.6	7.4
Dividend Yield (%)	-	-	-	-	-
Growth Ratios (% YoY)					
Diluted Recurring EPS Growth	104.2	(24.0)	(6.2)	19.6	45.4
Diluted Recurring CEPS Growth	60.8	(2.2)	30.7	20.7	21.9
Total Operating Income Growth	53.9	52.0	60.2	21.0	14.7
EBITDA Growth	53.7	20.8	37.7	28.7	21.3
Recurring Net Income Growth	107.5	(4.8)	(6.2)	19.6	45.4
Operating Ratios (%)					
EBITDA Margins	33.5	26.6	22.9	24.4	25.7
EBIT Margins	20.7	13.4	9.8	11.3	13.0
Recurring Pre-tax Income Margins	16.5	9.9	6.8	7.1	9.0
Recurring Net Income Margins	15.5	9.7	5.7	5.6	7.1
Raw Material Consumed / Sales	15.6	21.2	30.1	31.1	30.8
SGA Expenses / Sales	27.1	29.6	26.0	25.2	24.8
Other Income / Pre-tax Income	1.6	0.6	0.6	0.5	0.4
Other Operating Income / EBITDA	-	-	-	-	-
Effective Tax Rate	6.5	1.7	16.1	20.6	21.0
Return / Profitability Ratios (%)					
Return on Capital Employed (RoCE)-Overall	15.7	8.0	5.5	6.5	8.0
Return on Invested Capital (RoIC)	31.6	18.9	17.6	20.4	24.8
Return on Net Worth (RoNW)	36.4	11.2	6.4	7.2	9.6
Solvency Ratios / Liquidity Ratios (%)					
Debt Equity Ratio (D/E)	184	66	72	77	70
Long Term Debt / Total Debt	84	59	78	81	81
Net Working Capital / Total Assets	(16)	(9)	(12)	(11)	(10)
Interest Coverage Ratio-based on EBIT	5.02	3.82	3.22	2.69	3.27
Debt Servicing Capacity Ratio (DSCR)	1.68	0.64	1.28	1.46	1.73
Current Ratio	0.21	0.64	0.40	0.67	0.88
Cash and cash equivalents / Total Assets	5	19	9	17	22
Net D/E	153	30	51	43	28
Turnover Ratios					
Inventory Turnover Ratio (x)	243.4	336.3	489.6	538.7	561.9
Assets Turnover Ratio (x)	0.8	0.6	0.7	0.7	0.8
Working Capital Cycle (days)	(54.7)	(12.4)	(9.0)	(20.9)	8.8
Average Collection Period (days)	9.5	8.3	7.1	7.6	7.8
Average Payment Period (days)	192.7	147.9	120.9	126.7	123.0

Source: Company data, I-Sec Research

Annexure 2: AVB group conglomerate – Background

Idea Cellular is a part of the Aditya Birla Group, a multinational group operating in 25 countries with over 125,000 employees. A US$28bn corporation, AVB Group is in the league of Fortune-500 companies with over 50% of its revenues from overseas operations.

The Group is organised into various subsidiaries that operate across different sectors. Among these are viscose staple fibre, non-ferrous metals, cement, viscose filament yarn, branded apparel, carbon black, chemicals, modern retail (under the *More* brand of supermarkets), fertilisers, sponge iron, insulators, financial services, telecom, BPO and IT services. The Group consists of five main companies, which operate in various industry sectors through subsidiaries and joint ventures – these are Hindalco, Grasim, Aditya Birla Nuvo, UltraTech Cement and Idea Cellular.

Annexure 3: Index of Tables and Charts

Tables

Charts

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ANALYST CERTIFICATION

We /I, *Vikash Mantri, PGDM, CFA and Suchitra W L, BE, MBA;* research analysts and the authors of this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report. Analysts aren't registered as research analysts by FINRA and might not be an associated person of the ICICI Securities Inc.

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