8 March 2010

Telecom

Pick winners amid concerns

Outperform	Underperform
Bharti Airtel	Reliance Communications
Idea Cellular	TTML

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India
Telecom

We initiate coverage with 'Outperform' on Bharti/Idea & 'Underperform' on RCOM/TTML. We believe valuation multiples for Bharti/Idea would expand as industry concerns wane over next 3-6 months & these companies strengthen their position despite competitive headwinds. This is driven by Minutes/EBITDA/EPS CAGR of 19%/ 8%/ 10% for Bharti and 26%/ 16%/ 29% for Idea over FY10-12E. Top pick is Idea.

Recommendation summary

Company	Reco	TP	Upside (%)
Bharti	OP	359	20
Idea	OP	79	27
RCOM	UP	158	(4)
TTML	UP	22	(10)

Source: Indiabulls research.

Performance (%)

	1m	3m	1yr
Bharti	(0.5)	(3.8)	1.2
Idea	9.5	13.2	39.4
RCOM	0.9	(7.9)	21.5
TTML	4.3	(7.7)	4.3
Nifty	7.8	(0.4)	97.5

Source: Bloomberg, Capitaline.

Pricing concerns to wane

We believe tariffs are likely to stabilize after sharp step down (~15-20% decline in H2CY09). We believe (a) No value is left on table for new operators below 50p/min, (b) New entrants require 10%-12% incremental minute market share (MinMS) for value creation which is a tall task (Idea captures ~11% incremental MinMS with scale of 66k BTS), and (c) Rural battleground is even more challenging for new entrants.

Spectrum policy risks overplayed

We are cognizant that spectrum policy changes have potential risks. We believe spectrum policy would clear the dust and provide much needed stability in the sector with likely exit of marginal players. Considering risk associated with policy changes, we factor worst case valuation impact for Bharti/Idea/RCOM at Rs1.3/ 8.5/ 7.5 per sh.

MNP unlikely to displace market - post-paid MinMS dwindles

MNP is unlikely to displace the market since post-paid MinMS for GSM itself has fallen to a meagre 13% vs. 22% two years back. In addition, tariff differences between pre-paid & post-paid could primarily be attributed to higher proportion of ILD minutes on post-paid segment. Hence, the chance of a further round of price war in the post-paid segment looks bleak.

Has the telecom market matured? We don't think so…

India's MOU/capita is a meagre one-fifth of USA which underpins growth prospects. We believe that India's MOU/capita is likely to reach 50% of USA's MOU/capita which implies mobile minute CAGR of 21% over FY09-14e to 4500bn minutes.

…we introduce for the first time 'minute market share' model for telcos

Subs market share model & metrics (like ARPU, MOU) lose relevance in dual SIM environment. Focus on minutes and RPM. We believe 'minutes market share' better demonstrates operating performance of companies over 'subs market share'. Hence, we shift to MinMS model for our coverage companies. Our MinMS analysis reveals Bharti & Idea have gained MinMS amidst competitive pressure in last two quarters.

Valuation multiple to expand – pick potential winners

Indian telecoms corrected by ~30%-50% amid tariff cuts (~15-20% in H2CY09); which implies current valuation factors potential price cuts. We expect re-rating to happen as tariffs stabilize & minutes growth exceed expectations. We expect Bharti/Idea will outperform peers as these demonstrate Minutes/EBITDA CAGR of 19%/8% for Bharti and 26%/16% for Idea over FY10-12E. **Top pick is Idea.**

Valuation summary

Company	Mkt.cap (Rs bn)	EV (Rsbn) FY10E	EV/EBITDA (x) FY09	FY10E	FY11E	FY12E
Bharti Airtel	1,132	1,162	8.0	7.2	6.4	5.2
Idea	205	275	8.7	7.9	7.2	5.5
RCOM	341	615	6.8	7.7	6.7	6.2
TTML	46	83	13.2	14.9	12.3	10.8

Source: Company, Indiabulls research.

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Investment thesis

Pricing concerns to wane

We believe tariffs are likely to stabilize after recent sharp step down (~15-20% decline in H2CY09). We believe (a) No value is left on table for new operators below 50p/min; realization is likely to become prevalent - early signs visible from reduced rollout plans. (b) New entrants require 10%-12% incremental minute market share (MinMS) for value creation which is a tall ask. To put it in perspective, Idea garners ~11%-12% incremental MinMS with scale of 66000 cell sites, and (c) Rural battleground is even more challenging. New operators won't create value in rural area at current tariffs.

No value left on table for new operators below 50p/min

Our analysis reveals that new operators won't be able to derive any value below 50p/min (Refer figure 1), even if they achieve scale of 4mn minutes/cell site per year (equivalent to Idea's network utilization with scale of 66000 cell sites and 64bn minutes on its network per quarter).

We expect realization is likely to become prevalent among new operators and would bring in price stability in the sector. Early signs are visible from the reduction of network rollout of Uninor (Unitech-Telenor JV), which has reduced its capex guidance by 30% (~Rs30-35bn) for first five years. This is primarily attributable to its focused network rollout. Uninor in its Dec-2009 investor presentation stated strategy of *"focused rollout in 15 circles, fulfilling rollout obligations in all 22 circles."*

Figure 1: RPM essential to recover cost of capital is 51p/min

Units as shown

Items		Remarks
Fixed cost/min (Rs)	0.27	Includes network, personnel, selling (partly) and admin expense
Interest exp/min (Rs)	0.02	
Variable cost/min (as % of sales)	25%	Includes license, roaming, access, spectrum and other selling expense (like recharge fees)
Capex + Tax (as % of sales)	14%	Maintenance capex
Cost of equity/ min (Rs)	0.02	Cost of equity - 12%
Implied RPM to cover COE (Rs)	0.51	
Key assumptions		
Capex/min (Rs)	0.38	
Equity contribution	50%	

Source: Indiabulls research.

New entrants require 12% incremental MinMS for value creation- tall task

We have built a business model for new operators with the underlying assumption that it would adopt an asset light model (i.e. passive infrastructure sharing and capex on active components). Based on our analysis, new operators with pan-India operations wouldn't be NPV neutral even in a scenario of 7% incremental MinMS. It would require minimum 8% incremental MinMS for neutral NPV and 10%-12% incremental MinMS for value creation (Refer figure 2 & 4). ***We would like to emphasise that we mean "incremental minute market share (MinMS)" and not "incremental subscriber market share".*** **We have introduced the MinMS model in the following section.**

We view such a scenario of positive NPV for new entrants (i.e. 11-12% incremental MinMS) highly unlikely in a 12-13 operator market with 5-7 incumbent pan-India operators. Just to put it in perspective, Idea with a scale of 66k cell sites (900MHz spectrum in nine circles/wide distribution reach/ national brand) is able to garner 11%-12% incremental minute share in the current environment.

This scenario enhances our belief that new operators wouldn't incrementally resort to price based acquisition strategy.

Figure 2: NPV for new operator with pan-India rollout

Rs mn

Sum of PV of FCFE	(57,271)
PV of terminal value	38,025
Value of equity	(19,246)
Cost of equity	12.5%
Perpetual growth (FY17E+)	3.0%

Source: Indiabulls research.

Figure 3: Key assumptions in our analysis

Units as shown

		Remarks
Incremental minutes market share	7%	Extremely difficult for new GSM operators given 12-13 operator mkt and 5-7 incumbent operators
Implied minute market share among 'other operators"	17%	Other operators (8-9) include Tata Docomo, Aircel, BSNL/MTNL, BPL, MTS, Uninor, Etisalat, STel
RPM -FY11E	0.45	
Subs (mn) FY17E	80.8	
Implied subs mkt share (%) FY17E	6.9	
Cell sites by FY17E	47,000	
Average subs/BTS (-FY17E)	1,719	
Minutes/average cell site (FY17E) - mn	5.9	Scale of Bharti's cap.utilization as of FY10
Sustainable FCFE (% of revenue)	10.0%	
EBITDA break-even	4 years	
Cash break-even	7 years	
Total investment (Rs mn)	96,000	
Equity (Rs mn)	48,000	
Debt (Rs mn)	48,000	

Source: Indiabulls research

We expect Bharti/Vodafone/Idea/RCOM to corner ~57% of incremental MinMS. Balance 43% is likely to be fought out amongst the other 8-9 operators. Details for MinMS can be found in the following section.

Figure 4: NPV for new operator at various prices (RPM) and incremental MinMS

Rs mn

RPM (Rs)	Incremental minutes market share (%) 12	10	8	7	6
0.55	127,542	92,100	54,003	28,059	163
0.50	90,768	61,041	28,167	5,010	(21,015)
0.45	53,744	29,611	2,013	(19,246)	(44,287)
0.40	16,234	(2,750)	(26,117)	(46,231)	(69,373)
0.35	(25,652)	(39,427)	(58,426)	(75,438)	(94,867)

Source: Indiabulls research

Rural battleground is even more challenging; incumbents least affected in rural areas

In India, each circle/district is a unique market with different market characteristics – consumer preference, value added service preference, traffic dynamics, network, distribution model, customer service mode, opex and capex structure. In our view, opex and capex is starkly different between urban and rural areas (Refer figure 5). We believe that cost differential makes the business case unviable for new operators in rural/ far flung areas at current tariffs – they cannot generate positive NPV in rural areas (Refer figure 6). However, new operators could sustain their operations by having focused rollout in urban centres.

Figure 5: Opex differential between urban and rural areas for new operators

%

Items (as % of revenue)	Rural	Urban
Interconnect and roaming charges	13	21
License and spectrum fees	9	11
Network cost	43	20
Marketing exp	3	3
Employee cost	4	6
Subs acquisition cost/ sim cost/ cust. Verification/ retention etc	7	10
Admin exp	4	5
EBITDA margin	17	25
FCFE (as % of revenue)	3	12

Source: Indiabulls research.

Figure 6: NPV for new operator in rural rollout

Units as shown

Sum of PV of FCFE	(4,944)
PV of terminal value	2,599
Value of equity (Rs mn)	(2,345)
Equity investment (Rs mn)	3,784
Cost of equity	12.5%
Perpetual growth	4.0%
Key assumptions (rural area)	
MOU	250
RPM (outgoing charges)- FY12E	0.60
Implied RPM -FY12E	0.43
Subs (mn) FY17E	9.7
Cell sites by FY17E	6,500
Average subs/BTS (-FY17E)	1,495
Minutes/average cell site (FY17E) mn	4.4
Sustainable FCFE (% of revenue)	6.0%
Debt: Equity	1
Total investment (Rs mn)	8,000
Equity (Rs mn)	4,000
Debt (Rs mn)	4,000

Source: Indiabulls research

Figure 7: NPV for new entrant in rural area at various prices (RPM) and MoU

Rs mn

		MOU				
		200	225	250	275	300
RPM (Rs)	0.48	(4,043)	(2,014)	(114)	1,215	1,853
	0.46	(5,204)	(3,059)	(1,225)	(7)	520
	0.43	(6,466)	(4,173)	(2,345)	(1,229)	(813)
	0.41	(7,728)	(5,525)	(3,524)	(2,451)	(2,146)
	0.38	(8,990)	(6,944)	(4,899)	(3,731)	(3,498)

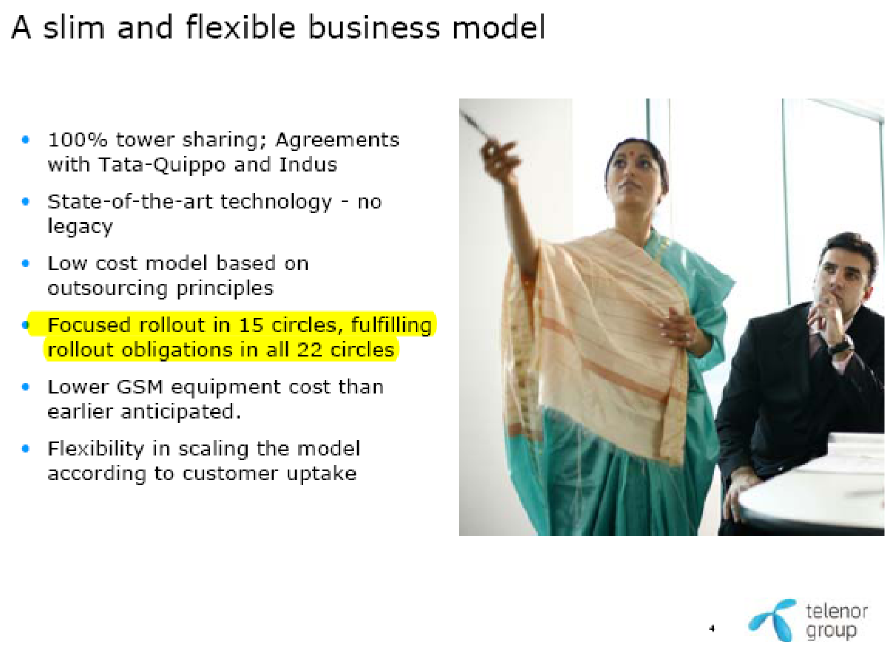
Source: Indiabulls research

This underpins our belief that incumbent operators would have limited impact in rural areas and price stability is likely to emerge.

Case Study- Uninor scaled down its initial network rollout plan

Uninor, in Dec 09 scaled down its network rollout plans and reduced capex guidance by ~30%. Initially (in Feb, 2009), the company's strategy was to rollout with ~20,000 cell sites and enhance network to ~40,000 cell sites by CY2010. In Dec, 2009 Uninor launched its operations with 12,000 cell sites (in 7 circles) and has reduced its capex guidance. The company stated its strategy to adopt a slim and flexible business model with *"focused rollout in 15 circles, fulfilling minimum rollout obligations in other 7 circles" (Refer figure 8).* It clearly indicates that current tariffs (~15-20% decline in H2CY09) led to a shift in their strategy and are likely to have a limited impact in rural/far flung areas.

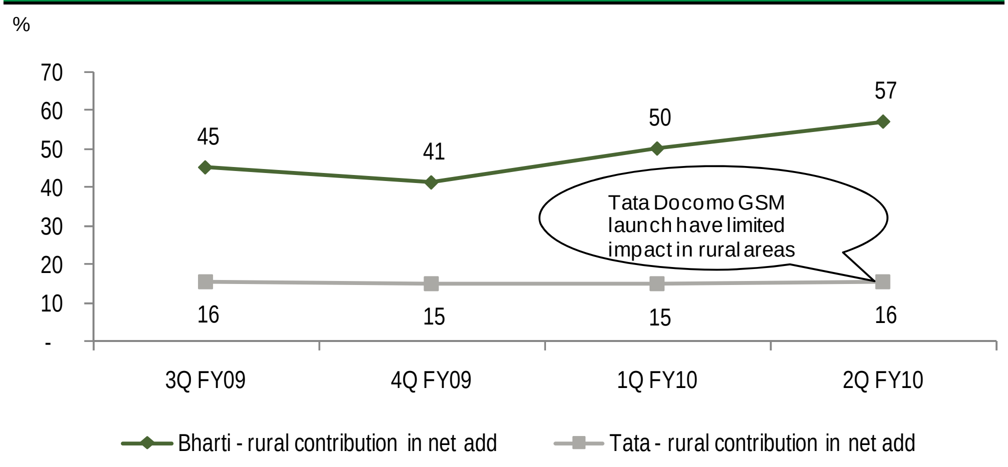
Figure 8: Uninor scaled down its rollout plan – focused rollout in 15 circles



Source: Company, Indiabulls research

There is also evidence from Tata Docomo's GSM launch in 2Q FY10 that it had limited impact on the rural side. Tata Teleservices rural subs contribution is meagre ~15-16%, implying majority subs are urban centric. On the other side, Bharti continues to add rural subs at a blistering pace. Rural subs now account for ~57% of Bharti's net subs addition.

Figure 9: Tata Docomo launch had limited impact on rural (majority urban subs)



Source: TRAI, Indiabulls research

Spectrum policy risks overplayed. Policy changes to drive consolidation

We are cognizant that spectrum policy changes have potential risks. However, we believe spectrum/M&A policy would clear the dust and provide much needed stability in sector with likely exit of marginal players. Considering risks associated with policy changes, we derive and factor the worst case impact on valuation (DCF based) for Bharti/Idea/RCOM at Rs1.3 /Rs8.5 /Rs7.5 per share respectively.

Impact of likely changes in spectrum policy is limited

There are two areas where our coverage companies could broadly get affected: (a) Telcos could be charged one-time spectrum charge for spectrum allocation above 6.2MHz, and (b) Likely spectrum renewal charges to be paid post the expiry of license period based on price administratively determined (like recent auction price or escalation based on some formula).

However, if these policies are implemented then the rationale of having escalating spectrum fees fades away. This would reduce the recurring spectrum fees for the operators and potentially benefit operators. Hence, we have analyzed the net impact of potential cost and savings of the above on our coverage companies and found that these policy changes would have net valuation (DCF based) impact on Bharti/Idea/RCOM to the tune of Rs1.3/ Rs8.5/ Rs7.5 per share respectively (Refer figure 10).

Figure 10: Net impact of various spectrum policy changes proposed

Rs mn

Operators -->	Bharti	Idea	RCOM
One-time spectrum charge for allocation above 6.2Mhz	(10,306)	(5,080)	(218)
PV of Spectrum renewal charges to be paid post-expiry of license period based on 3G auction price	(50,300)	(40,930)	(15,646)
PV of recurring spectrum fees saved on payment of one-time spectrum fees	55,674	18,086	426
Net Impact (Rs mn)	(4,932)	(27,924)	(15,438)
Impact per share (Rs)	(1.3)	(8.5)	(7.5)

Source: DoT, WPC, Indiabulls research

3G spectrum is value – accretive even if it comes at Rs.90bn

There is a potential risk that limited 3G spectrum slots (most circles have 3 slots) could bid up the auction prices. However, in our view 3G spectrum would be value-accretive for incumbent operators even if pan-India 3G spectrum comes at a price of Rs.90bn (~USD2bn). We believe base case scenario for pan-India 3G spectrum would be Rs.58bn (~USD1.3bn). 3G spectrum auction prices would vary for each circle depending on available spectrum blocks which would define the operator market share assumption, 3G subs penetration, incremental data ARPU assumptions, etc.

In our opinion, 3G would be the key catalyst for boosting Internet penetration in India. The benefits of 3G would be multi-fold since 3G spectrum would ease network congestion on 2G networks and improve overall network quality. Our base case for 3G spectrum auction price is Rs.58bn (Refer figure 11). We estimate 24% of total subs base would be 3G subs (~136mn subs) as of FY13E and contribute Rs.100 as incremental data ARPU. This would translate into incremental NPV of Rs.14bn for incumbent operators. Incremental capex for incumbent operators would be limited since operators have already invested in passive infrastructure and will now need to invest only in active electronics. These investments would also substitute their capacity expansion investments in 2G networks since partial voice traffic on 2G would be transferred to 3G. However, we have not factored lower 2G capex in our calculation and that provides further upside to our NPV.

Figure 11: Base case expectation for 3G spectrum auction price is Rs58bn

Units as shown

Key assumptions for 3G	
Incremental 3G ARPU/ month (Rs)	100
Sustainable free cash flow to firm (%)	34
Subs (mn) - FY10E	571
3G subs as % of total subs - FY13E	24
3G subs (mn)- FY13E	136
3G operator market share (%)	20
WACC (%)	11
Perpetual growth (%)	3
Incremental 3G capex (Rs bn) by FY13E	58
3G auction price - base case (Rs bn)	58
NPV for 3G operator (Rs bn) - FY10E	14

Source: Indiabulls research

We expect pan-India 3G spectrum auction price to be in the range of Rs.37bn-Rs.90bn. This is based on sensitivity of 3G subs market share assumption for an operator and percentage of 3G business NPV paid as auction price (Refer figure 12).

Figure 12:Possible 3G auction price range

Rs bn

		NPV of 3G business paid as 3G spectrum auction price (%)				
		100	90	80	50	20
3G subs market share (%) of an operator	10	45	42	40	35	34
	15	57	51	46	37	34
	20	71	64	58	40	34
	30	102	92	81	51	34
	35	117	105	94	59	34

Source: Indiabulls research.

Policy changes would potentially enable consolidation

Current spectrum/M&A policy limits potential M&A in the sector since (a) it limits merger if merged entities subs/revenue market share crosses 40%, (b) excess spectrum need to be surrendered, and (c) permission for merger to be accorded only after completion of three years from effective date of license. The comprehensive spectrum and merger/acquisition policy is likely to be implemented very soon and would potentially enable consolidation in the sector.

We believe that new entrants who aim for some reasonable scale of operations would require additional spectrum to maximize spectrum efficiency and that (in case auction is chosen as preferred way of future spectrum allotment) would provide exit option to marginal players and would reduce overcapacity building in the sector.

MNP unlikely to displace market

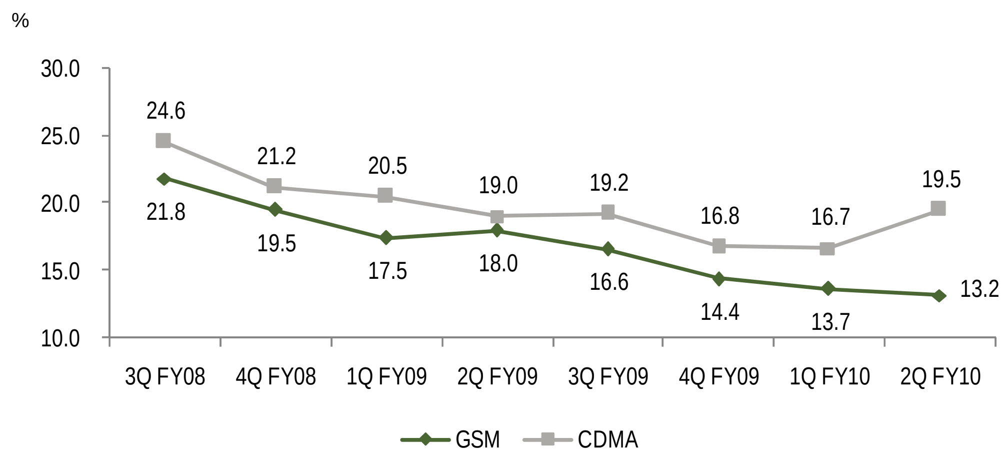
We believe mobile number portability (MNP) implementation is unlikely to displace market since post-paid MinMS for GSM operators itself has fallen to a meagre 13% (as of 2Q FY10) vs. 22% (as of 3Q FY08). In addition, tariff (RPM) difference between pre-paid and post-paid subs could primarily be attributed to higher proportion of ILD minutes on post-paid segment. Hence, further round of price war in post-paid segment looks bleak.

Post-paid MinMS fallen considerably – minimizes likely impact of MNP

Our analysis indicate that post-paid minutes contribution (to total minutes) for industry has fallen considerably in last two years minimizing the possible impact of MNP implementation. This is driven by a slower growth in post paid minutes at CAGR 8% over last 2 years, while pre-paid minutes grew at CAGR 47% over the same period (Refer figure 13).

On the contrary MNP poses potentially higher risk to CDMA operators since their concentration of post-paid minutes is to the tune of 20%. We highlight the risk given that handsets prices have fallen dramatically and may not act as a deterrent for CDMA subs to potentially shift.

Figure 13: Post-paid minute contribution fallen considerably for GSM operators



Source: TRAI, Indiabulls research

In addition, we believe the chance of a further round of price war in post-paid segment looks bleak as tariffs have fallen considerably in all segments (Local, STD, SMS and roaming) in the last few months. The tariff (RPM) difference between pre-paid and post-paid sub now could primarily be attributed to higher proportion of ILD minutes on post-paid segment. We don't believe that MNP could potentially displace the market.

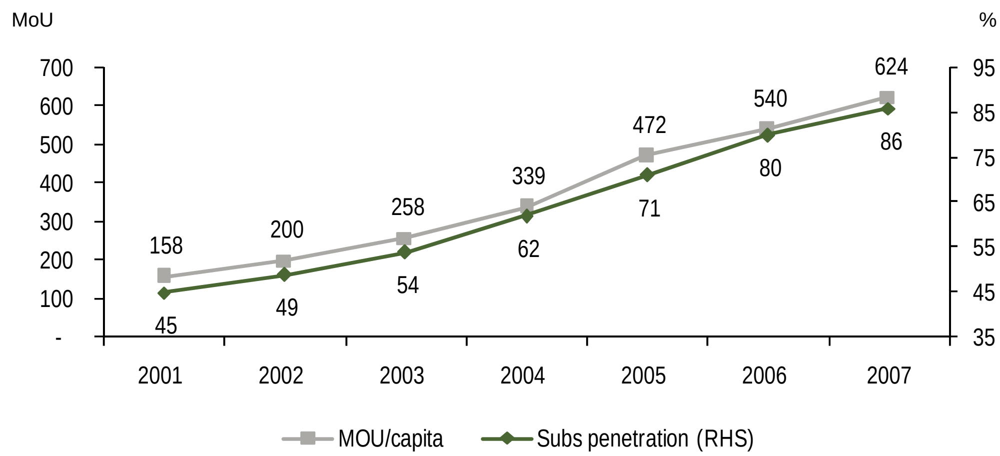
Has the telecom market matured? We don't think so...

India's MOU/capita is meagre one-fifth of USA which underpins growth prospects. We believe that India's MOU/capita is likely to reach 50% of USA's MOU/capita which implies mobile minute CAGR of 21% over FY09-14E to 4500bn minutes. The growth is likely to be driven by increase in per capita income, enhanced mobile ecosystem (community), deeper network coverage of telcos (into hinterlands) and affordable tariffs/handsets. We believe incumbent operators with 900MHz spectrum are better equipped to benefit from this opportunity as they are best positioned to expand in rural areas.

Indian telecom is under-penetrated - MOU/capita is meagre 20% of USA

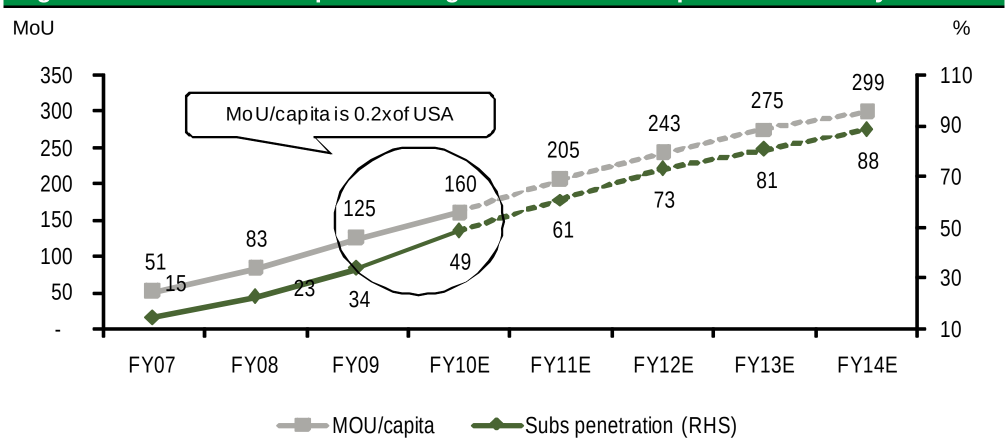
India's MoU per capita is meagre 20% of USA's MoU per capita. India's MoU per capita per month has reached meagre 125 as of FY09 while USA's MoU/capita is 624 as of CY07. We expect India's MOU/capita to reach 50% of USA by FY14E (i.e. ~300 minutes); implies minutes CAGR of 21% to 4500bn minutes by FY14E. In a blue sky scenario, if India's MOU/capita equals US (i.e. 600 minutes) it would imply a minutes CAGR of 40% to 9000bn minutes by FY14E.

Figure 14: MOU/ capita in USA increased to 624 (CAGR 27% over CY01-07)



Source: FCC, Indiabulls research

Figure 15: India's MoU/capita is meagre 20% of USA. Expect to be 50% by FY14E



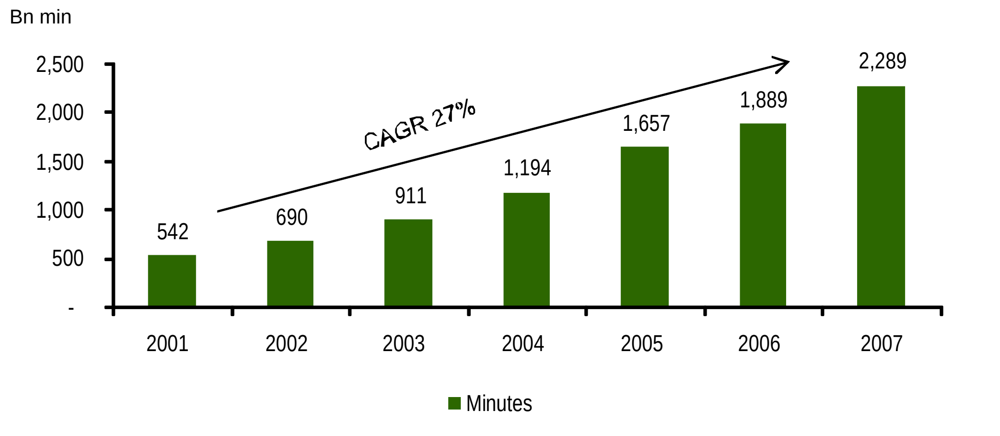
Source: TRAI, Indiabulls research

One could argue that per capita income of India is much lower than USA making the comparison unrealistic. However, we believe voice tariff (RPM) difference between the two countries captures the difference in per capita income and MoU/capita are best comparable. We note that tariffs in India are already 80%-85% lower than USA.

Put it differently, India's total mobile minutes consumption (~2100bn) has just equalled US mobile minutes consumption (~2200bn as of CY07) despite India's population base being 3.5x than USA (India's population is ~1.1bn vs. USA population at ~305mn) and tariffs being 80-85% lower than US (in India RPM is 1.2cents vs. US RPM at 6.0cents).

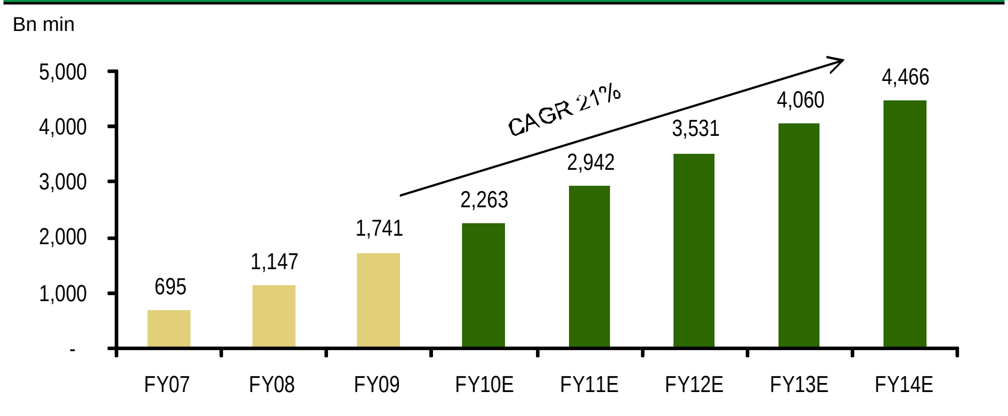
Indian voice minutes expected CAGR 21% over FY09-14E

Figure 16: USA mobile voice minutes grew at CAGR 27% (CY01-07)



Source: FCC, Indiabulls research

Figure 17: India's mobile voice minutes expected to grow at CAGR 21% (FY09-14E)

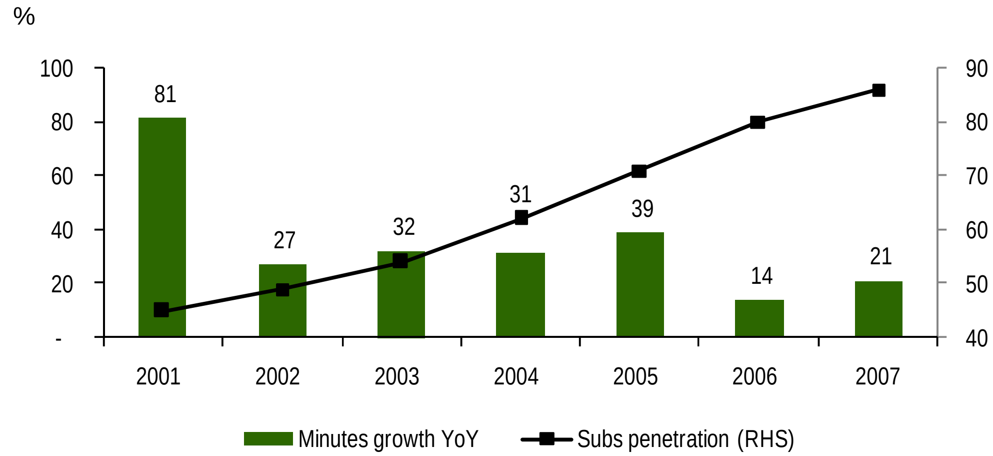


Source: TRAI, Indiabulls research.

Minutes growth in several counties support our theory

In USA, minutes grew at CAGR 27.1% over CY01-07 with subs penetration inching up from 45% in CY01 to 86% in CY07 (Refer figure 18). However voice RPM decline was restricted to 13.6% over the same period.

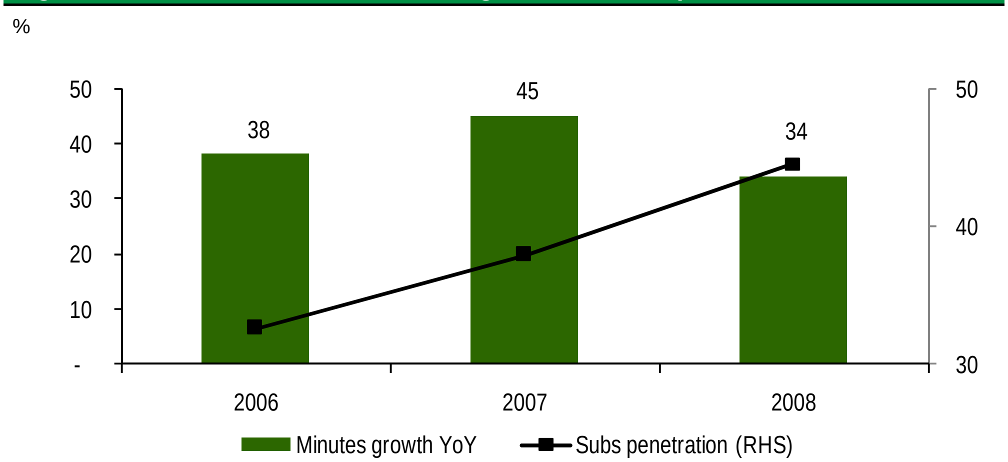
Figure 18: USA voice minutes growth vs. subs penetration trend



Source: FCC, Indiabulls research

In China, China Mobile (largest operator) minute growth was north of 30% despite industry subs penetration reaching 45% (Refer figure 19).

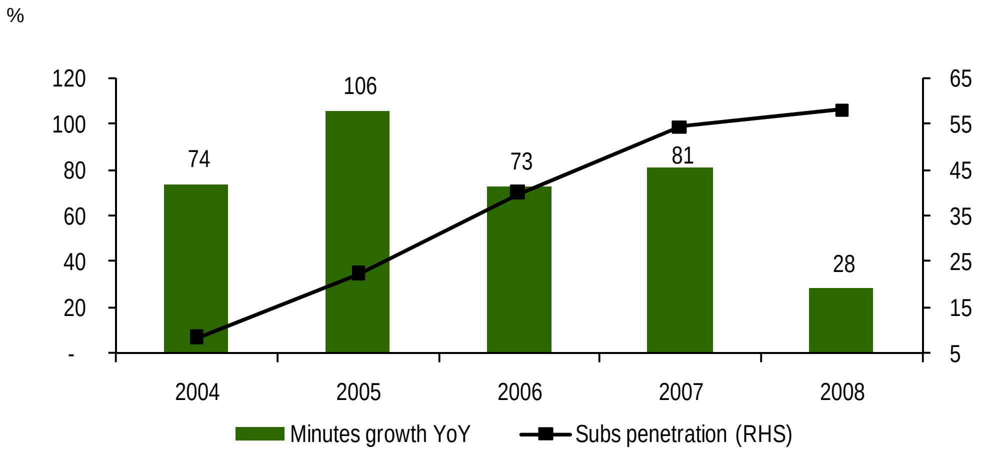
Figure 19: China mobile voice minutes growth vs. subs penetration trend



Source: Company, CNNIC, Indiabulls research

Similarly in Pakistan, we observe that Mobilink (largest operator) minutes growth has been robust despite industry subs penetration inching towards ~60% by 2008.

Figure 20: Mobilink operator minutes growth vs. Pakistan subs penetration trend



Source: Company, PTA, Indiabulls research

Taking cues from international experiences, we are comfortable with our minute growth assumptions for India mobile industry at ~25% over FY10-12E and ~21% over FY09-14E to 4500bn minutes.

We introduce minute market share model – relevant in current dual SIM environment

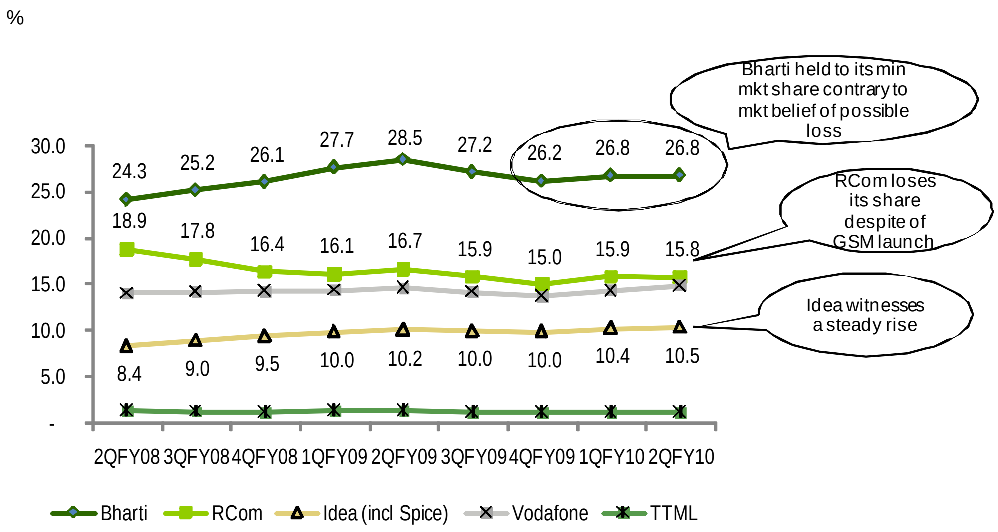
We introduce for first time "minute market share model (MinMS)" for telcos since subs based market share model loses its significance in a dual SIM environment. In the current industry environment in India, subs based traditional metrics (like ARPU, MoU) are losing its relevance and we would like to focus incrementally on total voice minutes and RPM. We believe that "minute market share (MinMS)" for telcos better demonstrates the competitive performance of the company over "subs market share". Hence, we shift to MinMS model from subs market share model for our coverage companies.

MinMS better demonstrate true performance of companies…

Our MinMS analysis reveals that Bharti and Idea have gained MinMS amidst the competitive pressure in last two quarters (Refer figure 21). This is contrary to what industry watchers may believe that Bharti has been losing its market share due to entry of new GSM operators.

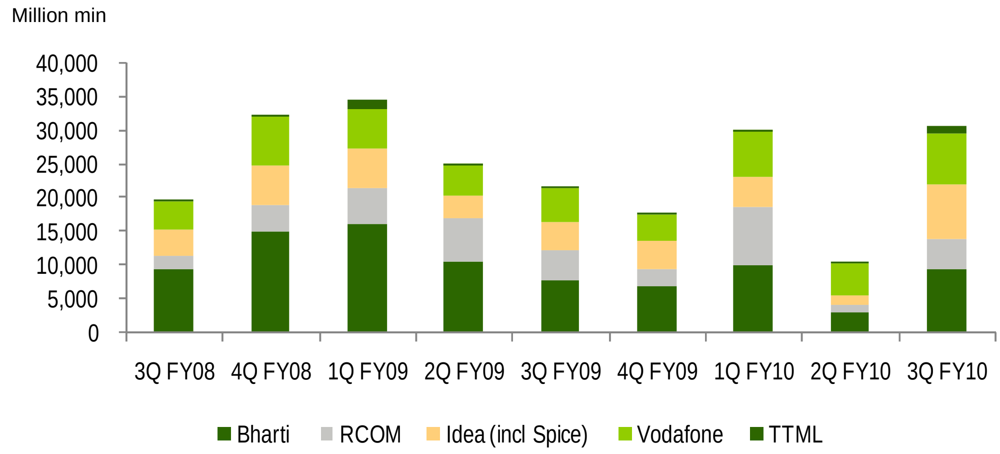
In 2Q FY10 Bharti minutes grew by meagre 2.1% which drove a view that Bharti lost its market share. However, MinMS of telcos reveal that Bharti held on its market share demonstrating its true performance. It indicates that operators (like RCOM and other unlisted players) have lost MinMS due to launch of new GSM operators (Refer figure 21).

Figure 21: MinMS performance of operators over past few quarters provide clarity



Source: TRAI, Company, Indiabulls research

Figure 22: Incremental minutes added by operators over last few quarters



Source: Company, Indiabulls research

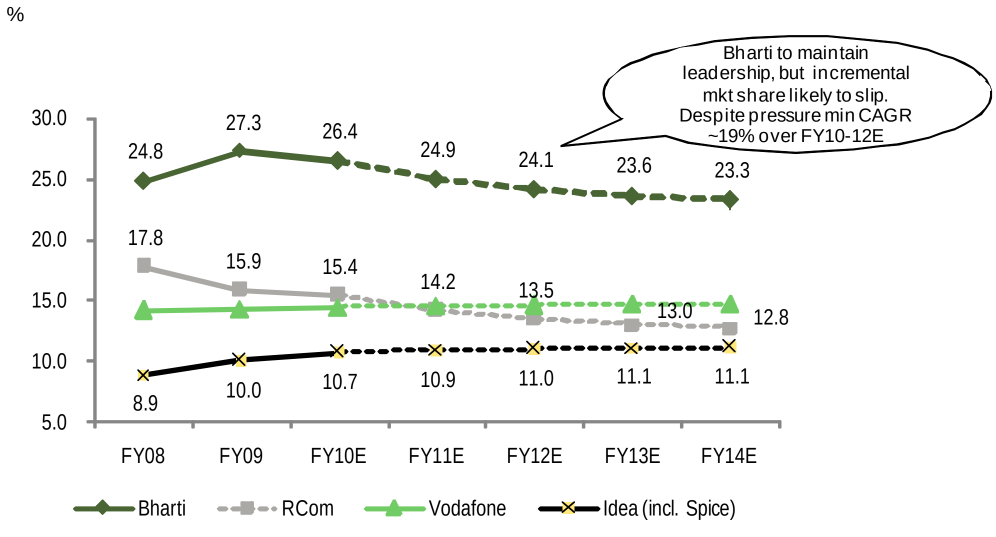
...hence we shift to MinMS model from subs based model

In current scenario where industry experts suggest incidence of dual SIMs has increased to ~25%, we believe that analyzing subs based traditional metrics (like ARPU, MOU) is losing its relevance. We would like to focus incrementally on total voice minutes and RPM.

We have discussed in previous section that voice minutes in India are expected to grow at CAGR 21% over FY09-14e to 4500bn minutes. We believe that Bharti would conservatively capture incremental MinMS of ~20%; hence maintaining its leadership position with ~23.3% MinMS by FY14e (Refer figure 23).

We have factored lower incremental MinMS for Bharti driven by two factors (a) expansion of known brands into pan-India (like Vodafone/Idea/Aircel expansion into several new circles in last year) and (b) entry of new GSM operators (like Tata Docomo, RCOM-GSM, Uninor, Etisalat, STel among others). We expect Vodafone and Idea to gain higher incremental MinMS with pan-India reach. However, we expect RCOM to lose MinMS since its traffic is more prone to shift due to new launches and it has lost its MinMS in last few quarters despite GSM launch.

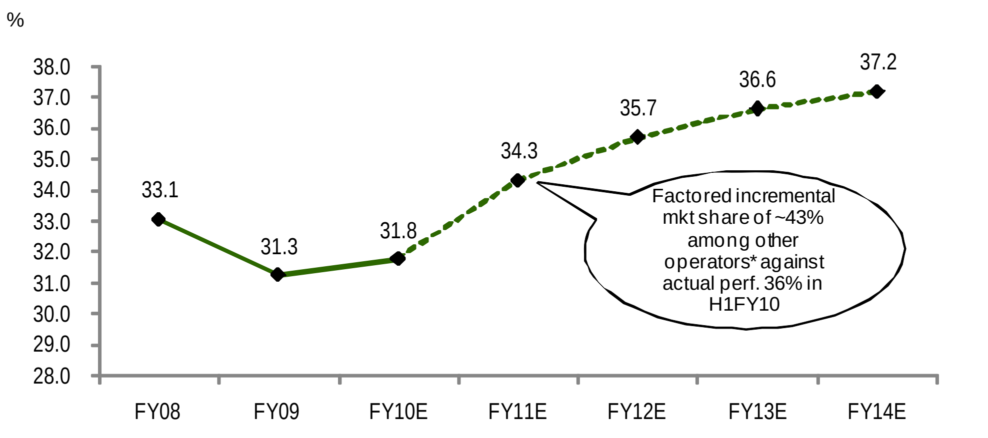
Figure 23: Idea and Vodafone gains; Bharti & RCOM likely to lose MinMS



Source: Indiabulls research

We have factored ~43% of incremental MinMS among other operators (which includes Tata Docomo, Aircel, BSNL/MTNL, BPL, MTS, Uninor, Etisalat, and STel). We have factored a higher proportion of incremental minutes among "other operators" as against their actual performance of ~36% incremental MinMS in H1FY10 considering that Uninor/STel launched selectively in 3Q FY10 and Etisalat is likely to launch in 4Q FY10/1Q FY11E.

Figure 24: MinMS for 'other operators' to improve with more new entrants



Source: TRAI, Indiabulls research
Note: "Other operators" include Tata Docomo, Aircel, BSNL/MTNL, BPL, MTS, Uninor, Etisalat, STel

Based on MinMS model, we expect Idea and Bharti will outperform peers with 26% and 19% minute CAGR over FY10-12E respectively amid hyper-competition.

Valuation multiple to expand – pick potential winners

We initiate coverage with "Outperform" rating on Bharti/Idea and "Underperform" rating on RCOM/TTML. Our top pick is Idea.

Valuation for Indian telecoms corrected by ~30%-50% amid tariff cuts (~15-20% in H2CY09); which implies current valuation factors potential price cuts. We expect sector re-rating to happen as tariffs stabilize and minutes growth exceed expectations. We believe time is ripe to pick potential winners. We believe valuation multiples for Bharti & Idea would expand as these companies strengthen their position despite competitive headwinds. This is likely to be driven by Minutes/EBITDA/EPS CAGR of 19%/8%/10% for Bharti and 26%/16%/29% for Idea over FY10-12E.

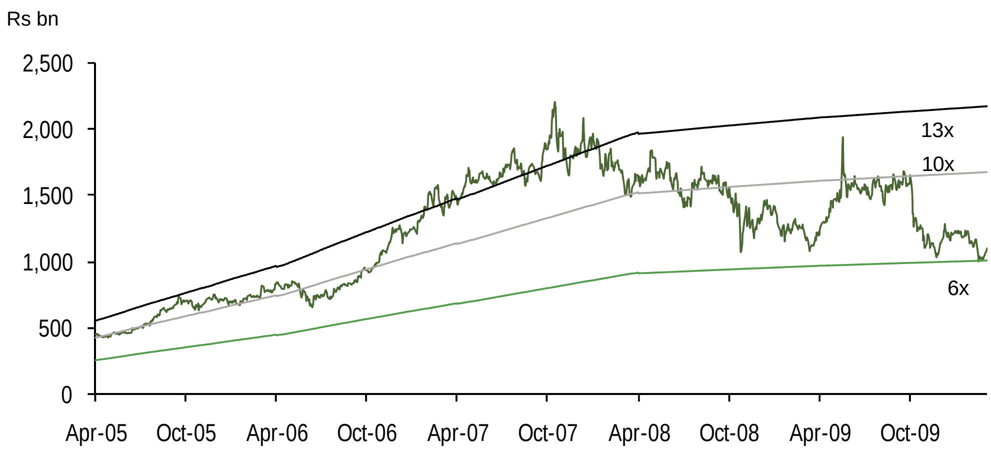
Figure 25: Valuation summary

Units as shown

						EV (Rsbn)	EV/EBITDA (x)				P/E (X)			
Company	CMP	Rating	TP	Upside (%)	Mkt cap (Rs bn)	FY10E	FY09	FY10E	FY11E	FY12E	FY09	FY10E	FY11E	FY12E
Bharti Airtel	298	OP	359	20	1,132	1,162	8.0	7.2	6.4	5.2	12.2	12.7	12.0	10.4
Idea	62	OP	79	27	205	275	8.7	7.9	7.2	5.5	23.2	27.6	27.5	16.6
RCom	165	UP	158	(4)	341	615	6.8	7.7	6.7	6.2	5.6	12.9	12.5	12.8
TTML	24	UP	22	(10)	46	83	13.2	14.9	12.3	10.8	NM	NM	NM	NM

Source: Company, Bloomberg, Indiabulls research

Figure 26: Bharti: One year forward EV/EBITDA band

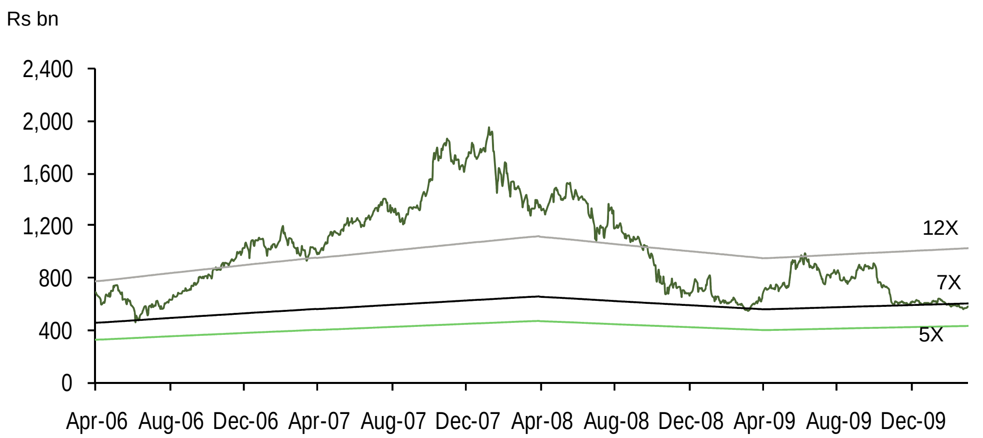


Source: Bloomberg, Indiabulls research

Figure 27: Idea: One year forward EV/EBITDA band

Source: Bloomberg, Indiabulls research

Figure 28: RCOM: One year forward EV/EBITDA band



Source: Bloomberg, Indiabulls research

Risk to Investment Case

- **Downside risk to investment case:** Higher than expected tariff cuts, overbidding for 3G spectrum, unfavorable policy changes (2G spectrum/ spectrum/license fees) and higher than expected impact of MNP.
- **Upside to investment case:** Reduction in license/spectrum fees. DoT had earlier cleared a proposal of reduction in USOF from 5% to 3% if operator covers more than 95% of development blocks. However the same was withdrawn by DoT. Such reduction in license/spectrum fees could stem upside to investment case.

Companies

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Indiabulls
Institutional Equities

8 March 2010

India
Telecom

Price: Rs 298
Target price: Rs 359

Initiating coverage

Bharti Airtel

Outperform

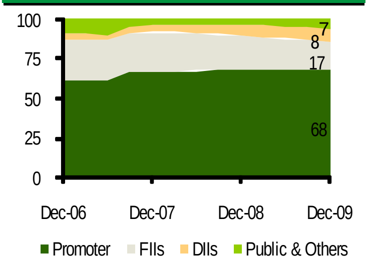
Favorable risk-reward ratio

We initiate coverage on Bharti with an 'Outperform' rating & TP of Rs.359; implying FY12E EV/EBITDA of 6.4x. Bharti has multiple catalysts for re-rating. Market concerns over domestic industry should recede (short-term catalyst) as company demonstrates Minutes/EBITDA CAGR of 19%/8% over FY10-12E. Potential Zain Africa acquisition would act as long-term catalyst as clarity emerges; however we factor worst case valuation impact of negative Rs.60/sh from the acquisition in our TP.

Stock details

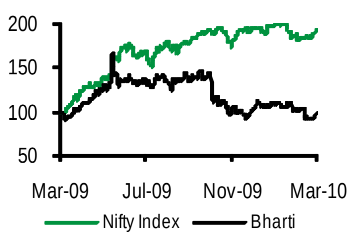
Bloomberg code	BHARTI IN
MCap Rs/US$ mn	1133291/24826
Outstanding shares (mn)	3,797
52-wk H/L (Rs)	518/230
3m avg. trading vol (US$ mn)	55.3
Nifty / Sensex	5089/16994

Shareholding pattern (%)



Stock performance (%)

	1m	3m	1yr
Absolute	(0.5)	(3.8)	1.2
Nifty	7.8	(0.4)	97.5



Source: Bloomberg, Capitaline.

Sustain leadership position with 24% minute market share; CAGR 19%

Bharti is expected to maintain leadership position with 24% minute market share (MinMS) by FY12E; implying minutes CAGR 19% (FY10-12E). MinMS analysis reveals Bharti held on its MinMS in last few quarters amid hyper-competition demonstrating its true operating strength. Minutes growth would be driven by its rural reach which has grown significantly. Bharti's rural subs grew at a CAGR 100% to 38.5mn over past 2.5 yrs.

FCFF improves…. driven by lower capex and opex leverage

Bharti's capex fell to ~23% of sales in 9MFY10; which led to FCFF generation of ~Rs.63bn in 9MFY10 (~20% of revenue). We expect FCFF trend to improve (Rs.109bn FY12E) as capex intensity (ex-3G/Wimax) is likely to reduce further & network utilization improves from 6mn min FY10E to 6.6mn min/cell site by FY12E.

Zain Africa acquisition could be a game-changer?

Zain Africa could be a game-changer.but comes with high risk. This makes it uncertain to prescribe DCF valuation currently with limited understanding of African markets. We believe Zain Africa valuation in near-term would be driven by its financials and comparable regional valuations. We value Zain Africa at FY12E EV/EBITDA of 5.0x; which implies Bharti is potentially paying a premium of USD5bn (worst case valuation impact of Rs.60/sh).

Favorable risk-reward ratio: TP of Rs.359 in worst case scenario

We initiate coverage on Bharti with an 'Outperform' rating and TP of Rs.359. Bharti's valuation multiple got de-rated amid (a) competitive pressures in domestic market, and (b) potential Zain Africa acquisition. There are multiple catalysts (short-term and long-term) for re-rating of stock. We believe that current valuations offer an opportunity with favorable risk-reward ratio since it trades at a significant discount to its fair value of Rs.419/sh & provide an upside of 20% (with target price of Rs.359) even considering worst case valuation scenario from potential Zain Africa acquisition.

Key financials

Rs million, year-end March

	FY08	FY09	FY10E	FY11E	FY12E
Revenue	270,250	369,616	392,004	426,982	479,516
EBITDA	113,715	151,678	161,205	168,219	188,742
PAT	66,212	92,571	89,320	94,404	108,709
EPS (Rs)	17.4	24.4	23.5	24.8	28.6
EPS (consensus) (44)			23.8	22.4	25.5
EPS growth (%)	55	40	(4)	6	15
ROE (%)	37.2	35.5	25.6	21.4	20.1
PE (x)	17.1	12.2	12.7	12.0	10.4
EV/EBITDA (x)	10.4	8.0	7.2	6.4	5.2
P/BV (x)	5.2	3.7	2.9	2.3	1.9

Source: Company, Indiabulls research.

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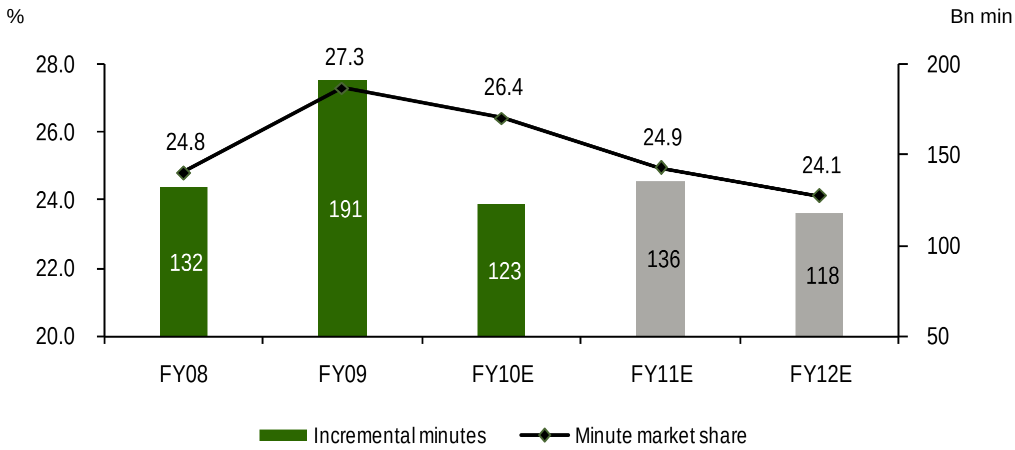
Investment thesis

Sustain leadership position with 24% minute market share

Bharti with its deepest network coverage (100k+ cell sites), 84% population coverage and trusted brand would continue to benefit in the long-run amid entry of new operators and tariff pressures. Bharti is expected to maintain its leadership position with 24% minute market share (MinMS) by FY12E (Refer figure 29); implies minutes CAGR 19% over FY10-12E to 850bn minutes.

We expect Bharti to capture +20% incremental MinMS (lower than its current share) due to enhanced competition. This is led by two factors (a) expansion of known brands into pan-India (like Vodafone/Idea/Aircel expansion into several new circles last year), and (b) entry of new GSM operators (like Tata Docomo, RCOM-GSM, Uninor, Etisalat, STel).

Figure 29: Bharti to sustain minute leadership position; CAGR 19% (FY10-12E)

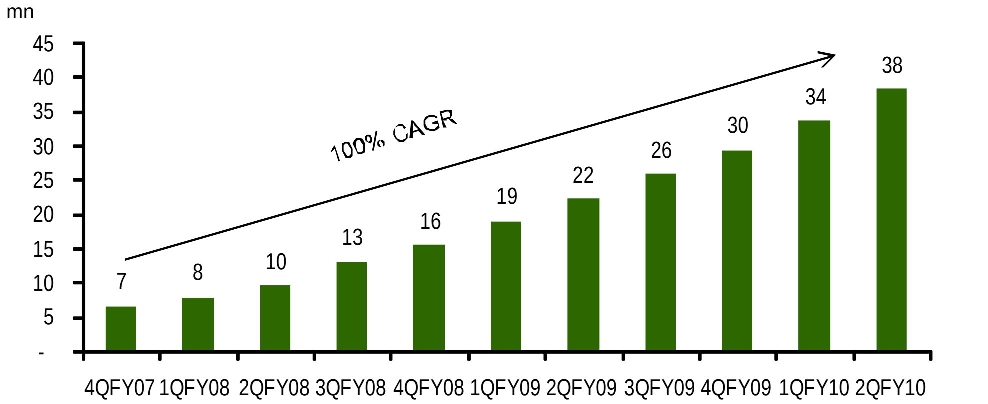


Source: Company, TRAI, Indiabulls research

Bharti's minute growth would be led by its rural reach which has grown significantly in last few years. Bharti's rural subs base has increased at CAGR 100% from 6.8mn to 38.5mn over past 2.5 years. It implies rural subs concentration increased from 18.2% in FY07 to 34.8% in 2Q FY10.

We expect rural minute growth to be superior over urban minute growth in the long-run led by (a) rise in per capita rural income, and (b) expansion of rural mobile community. As the address book of the rural subs increases, the minute usage delta in rural subs is likely to be higher than urban subs. We expect Bharti to be the highest beneficiary as the rural mobile community expands.

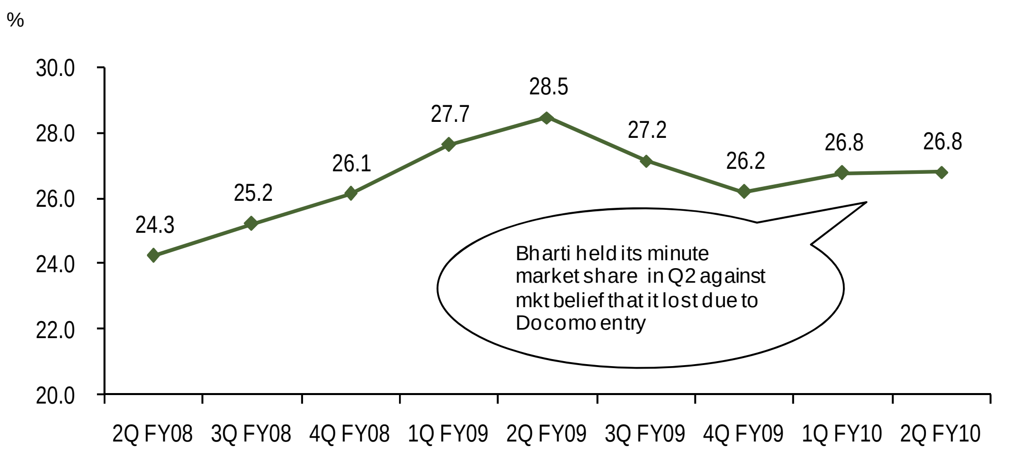
Figure 30: Bharti's rural subs grew at CAGR 100% over last 2.5 years



Source: TRAI, Indiabulls research

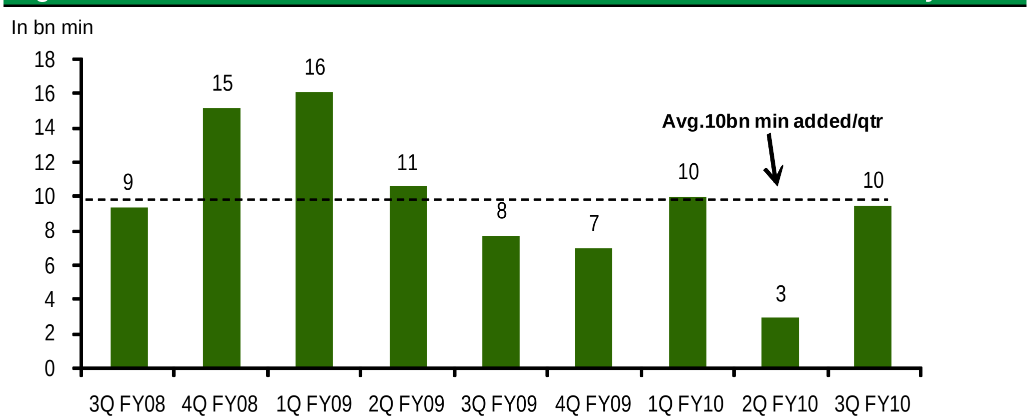
We want to highlight that Bharti held its MinMS in last few quarters (Refer figure 31). In 2Q FY10 Bharti minutes grew by meagre 2.1% which drove a view that Bharti lost its market share. However, minutes market share of telcos reveal that Bharti held on its market share demonstrating its true performance.

Figure 31:Bharti held its MinMS in last few quarters amid hyper-competition



Source: Company, TRAI, Indiabulls research.

Figure 32:Bharti's incremental minute addition remains robust over last two years

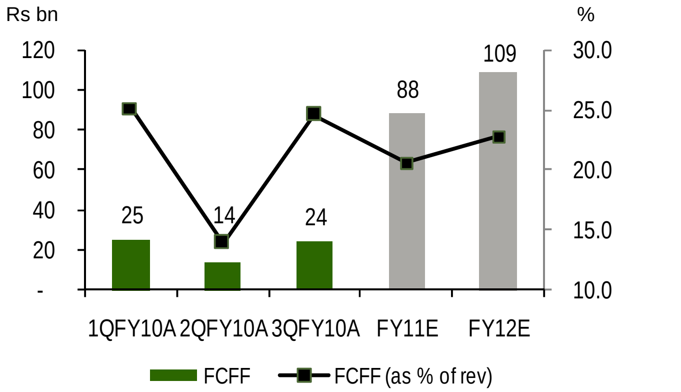


Source: Company, Indiabulls research.

FCFF improves…. driven by lower capex and opex leverage

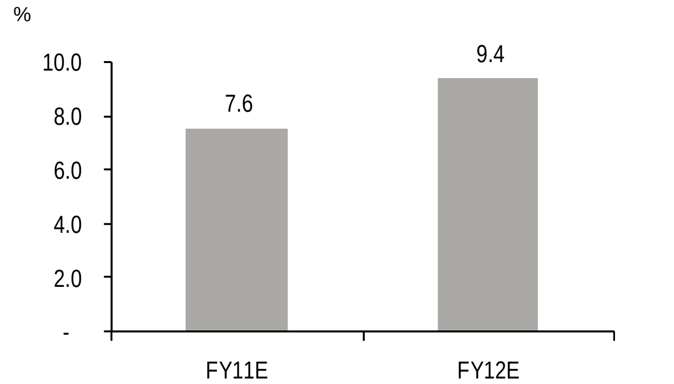
Bharti's capex has fallen considerably to ~23% of sales in 9MFY10; which led to healthy FCFF generation of ~Rs63bn in 9MFY10 (Refer figure 33). We expect FCFF trend to improve since capex intensity (ex-3G/Wimax spectrum) is likely to reduce further. We expect FCFF of Rs88bn and Rs109bn in FY11E and FY12E respectively. This implies a robust FCFF yield of 9.4% for FY12E (Refer figure 34).

Figure 33: Bharti's FCFF improves…



Source: Company, Indiabulls research

Figure 34: Bharti's FCFF Yield (%)

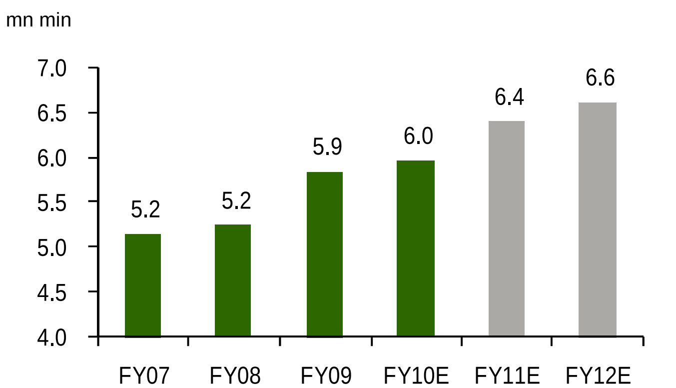


Source: Indiabulls research

Network utilization to improve…. further room for opex leverage

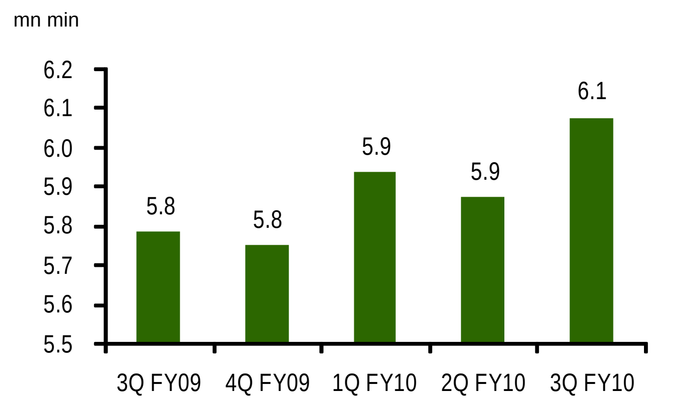
We expect robust minute growth (CAGR 19%) would improve network utilization. The company is likely to benefit from opex leverage (driven by increase in rural network utilisation) since fixed cost constitutes majority of total operating costs. . The company has stated that incremental capex was primarily driven by capacity requirement over geographical expansion plans as it crossed 84% population coverage in 3Q FY10.

Figure 35: Bharti's network utilization to improve…



Source: Company, Indiabulls research

Figure 36: … it continues to improve in last few quarters



Source: Company, Indiabulls research
Note: Quarterly minutes are annualized to reflect network utilization in mn minutes/cell site per annum.

Zain Africa acquisition could be a game-changer?

Zain Africa acquisition could potentially be game-changer for Bharti, since domestic operations would generate significant FCFF (~USD2bn in FY11E) which could be leveraged. However, entry into African markets comes with higher risk profile. Value creation for Zain Africa is back-ended in nature and comes with on-ground execution risks This makes it uncertain to prescribe a DCF based enterprise value at this point of time with limited understanding of African countries (particularly regulatory framework, cost structure in each country, potential sources of opex efficiencies etc). We believe Zain Africa valuation in near-term (next 3-6 months) would be driven by its financial performance and comparable regional valuations. Hence, from Bharti's valuation perspective we value Zain Africa on FY12E EV/EBITDA of 5.0x; which implies Bharti is potentially paying a deal premium of USD5bn (worst case valuation impact of Rs.60/sh).

Entry into African market is a long-term strategic move - value appears to be back-ended

We believe Bharti's view to enter into African continent is a potential game-changer from a longer-term perspective. Zain Africa's countries under coverage are high growth markets. GDP doubled (in Zain Africa's 15 covered countries) in last 5 years to USD327bn (Source: WEO) and is expected to grow at CAGR 9.0%+ to USD508bn (FY09-14E). These countries have low SIM penetration (~36%) and unique subs penetration is even lower since multi-SIM phenomenon is prevalent in African countries.

DCF-based enterprise valuation for Zain Africa appears to be in the range of USD9.4bn-14.4bn (Refer figure 39). Key assumptions in our analysis: (a) Revenue CAGR 10% (FY10-17E), (b) EBITDA margin at 35%, (c) FCFF ~20% of revenue in FY17E, and (d) Cumulative capex ~USD10bn (FY10-17E).

Figure 37:What Bharti is potentially looking at? Zain Africa DCF based valuation

US$ mn	
PV of terminal value	11,014
Sum of PV of FCFF	2,454
ZAIN Africa EV	13,468
Less: Minority interest (~20%)	2,694
ZAIN EV (attributable to Bharti)	10,774
Key assumptions	
WACC	11%
Perpetual growth (FY17E+)	3%

Source: Indiabulls research

Figure 38: Zain Africa—financial snapshot

US$ mn

	FY08	FY09	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E	FY16E	FY17E	CAGR (FY10-17E)
Revenue	3,164	4,160	3,643	4,189	4,817	5,299	5,829	6,412	6,864	7,207	10
YoY growth		*31*	*(12)*	*15*	*15*	*10*	*10*	*10*	*7*	*5*	
EBITDA	1,129	1,397	1,159	1,466	1,686	1,855	2,040	2,244	2,402	2,523	12
YoY growth			*(17)*	*26*	*15*	*10*	*10*	*10*	*7*	*5*	
EBITDA margin	*36*	*34*	*32*	*35*	*35*	*35*	*35*	*35*	*35*	*35*	
FCFF				(607)	(392)	85	961	1,144	1,373	1,441	
FCFF as % of revenue				*(14)*	*(8)*	*2*	*16*	*18*	*20*	*20*	
Capex				2,000	2,000	1,700	1,000	1,000	1,030	1,081	
Capex as % of revenue				*48*	*42*	*32*	*17*	*16*	*15*	*15*	

Source: Company, Indiabulls research.

Figure 39:DCF valuation sensitivity of Zain Africa (Bharti's proportionate stake)

US$ mn

Perpetual growth rate	WACC	9%	10%	11%	12%	13%
	6%	28,627	21,027	16,472	13,438	11,275
	5%	21,819	17,089	13,939	11,693	10,012
	4%	17,734	14,463	12,131	10,385	9,029
	3%	15,011	12,588	10,774	9,367	8,244
	2%	13,066	11,181	9,719	8,552	7,601
	1%	11,607	10,087	8,875	7,886	7,065

Source: Indiabulls research

However, it would be difficult to assign DCF based enterprise value at this point of time with limited understanding of African countries (particularly regulatory framework, ground level execution risks, cost structure in each country and potential sources of opex efficiencies etc). We believe that Zain Africa valuation in near-term (next 6-12 months) would be driven by its near term financial performance and comparable regional valuations.

Worst case valuation implies a deal premium of USD5bn (Rs60/sh)

Worst case enterprise valuation for Bharti's proportionate stake of Zain Africa appears to be USD5.3bn based on FY12E EV/EBITDA of 5.0x; which implies a deal premium of USD5bn (Rs60/sh). This scenario comes with an underlying assumption that Bharti will be unable to bring in synergy benefits in the near-term and Zain Africa revenue grows at 15% and EBITDA margin remains stable at 35%. We prescribe FY12E EV/EBITDA multiple of 5.0x which is similar to African regional telcos valuation.

Figure 40: Zain Africa worst case valuation (no synergy benefits)

US$ mn

FY12E	
EBITDA (FY12E)	1,686
EV/EBITDA (x)	5.0
Value of operations (US$ mn)	8,430
Less: Increase in net debt (FY10-12E)	1,800
Enterprise value (US$ mn) -current	6,630
Less: Minority interest (20%)	1,326
Bharti's (proportionate value)	5,304
Less: Potential deal price	10,360
Deal premium	(5,056)
Valuation impact/ share (Rs)	(60)

Source: Indiabulls research

Valuation scenarios for Zain Africa based on potential synergy benefits

We see various sources of synergy benefits for Zain Africa and believe the best way to assess the potential is to build several scenarios given the limited understanding of the African markets. The three main sources of synergies are: (a) Revenue enhancement, (b) Opex efficiency, and (c) Capex-related synergies (each discussed in detail below). Based on three potential scenarios (Refer figure 42 for assumptions), valuation impact on Bharti could swing from a negative impact of Rs60/sh to a positive impact of Rs49/sh.

Figure 41: Valuation impact on Bharti under possible scenarios

US$ mn

	Worst case	Base case	Best case
PV of synergy benefits	0	5,153	9,161
Less: Deal premium	5,056	5,056	5,056
Zain Africa contribution to Bharti	(5,056)	98	4,106
Zain Africa contribution/share (Rs)	(60)	1	49

Source: Indiabulls research

Figure 42: Key assumptions under various scenarios

Units as shown

	Worst case	Base case	Best case
Revenue enhancement (in FY12E) %	-	5.0	30.0
Cost benefits (% of revenue)	-	5.0	5.0
Capex savings (% of revenue)	-	3.0	5.0
Key financials Zain (FY12E) US$	Worst case	Base case	Best case
Revenue	4,817	5,027	6,074
EBITDA	1,686	2,011	2,430
EBITDA margin (%)	35	40	40

Source: Indiabulls research

Revenue enhancement sources

Revenue-related synergy benefits could come if Bharti is able to successfully export its low tariff-high usage model overseas where penetration is low and there is consumer appetite to talk. We note that RPM in Zain's markets is 10x higher than Bharti's RPM in India; while MoU is low at meagre ~100 vs. MoU of ~450 in India. In addition, VAS services could be potentially enlarged and their combined experiences in 16 countries would help in improving revenue opportunities.

In addition, the enlarged balance sheet of combined Bharti-Zain Africa would help it to pursue high growth opportunities and grow at a rapid pace in emerging markets. We expect FCFF of the Bharti-Zain Africa combined to increase from US$1.4bn (FY11E) to US$4.2bn (FY15E).

Figure 43: Zain 5 markets (pop. ~60%) contribute meagre 39% EBITDA – potential key growth markets

Units as shown

Countries	Population ('000)	Penetration (%)	Zain Subs ('000)	Subs mkt share (%)	Rank	ARPU (US$)	Revenue (US$ mn)	EBITDA (US$ mn)	Biggest competitor (sub mkt share)
Nigeria	155,770	45	14,936	25	2	7	986	331	MTN (45)
Kenya	39,888	48	2,191	17	2	4	118	14	Safaricom (78)
Ghana	24,537	61	1,208	9	4	3	35	(29)	MTN (54)
Uganda	33276	35	2243	37	2	4	76	9	MTN (50)
Madagascar	20901	23	1425	38	2	5	57	12	Orange (40)
Total (5 mkts)	274,372		22,003				1,272	337	
Contribution (of above 5 mkts) %	59		53				47	39	
Zain Africa (total)	468,928	36	41,897				2,732	871	

Source: Company, Indiabulls research.

Opex efficiencies

Bharti could potentially achieve opex reduction by adopting best practices through several sources such as network cost, selling and distribution cost, subs acquisition cost, subs service cost and cost of handsets/ other accessories. For instance, we gather that Zain Africa is pursuing savings on network costs by sharing passive infrastructure. In addition, potential opex efficiencies could be brought in by outsourcing IT and call centres. We believe Bharti can derive opex related efficiencies; however there would be on-ground challenges in each of the markets.

In addition, Zain Africa's 5 markets (which contribute 18% sub/12% revenue) have sub 20% EBITDA margin which puts pressure on the average EBITDA margin (~33%). If we find average EBITDA margin across other 10 markets, it is ~36%. This stems an opportunity that overall EBITDA margin of Zain Africa could potentially be improved significantly from these five markets itself.

Figure 44: Zain 5 mkts contribute 18%/12% to Sub/Revenue but meagre 1% to EBITDA - potential for opex efficiency

Units as shown

Countries	Population ('000)	Penetration (%)	Zain subs ('000)	Subs mkt share (%)	Rank	ARPU (US$)	Revenue (US$ mn)	EBITDA (US$ mn)	EBITDA margin
Kenya	39,888	48	2,191	17	2	4	118	14	11.9
Ghana	24,537	61	1,208	9	4	3	35	(29)	(15.0)
Uganda	33276	35	2243	37	2	4	76	9	11.8
Sierre Leone	6095	39	555	46	1	7	33	2	6.1
Madagascar	20901	23	1425	38	2	5	57	12	21.1
Total (5 mkts)	124,697		7,622				319	8	2
Contribution (of above 5 mkts) %	27		18				12	1	
Zain Africa (total)	468,928	36	41,897				2,732	871	33
Zain Africa (ex-above 5 mkts)							2,413	863	36

Source: Company, Indiabulls research

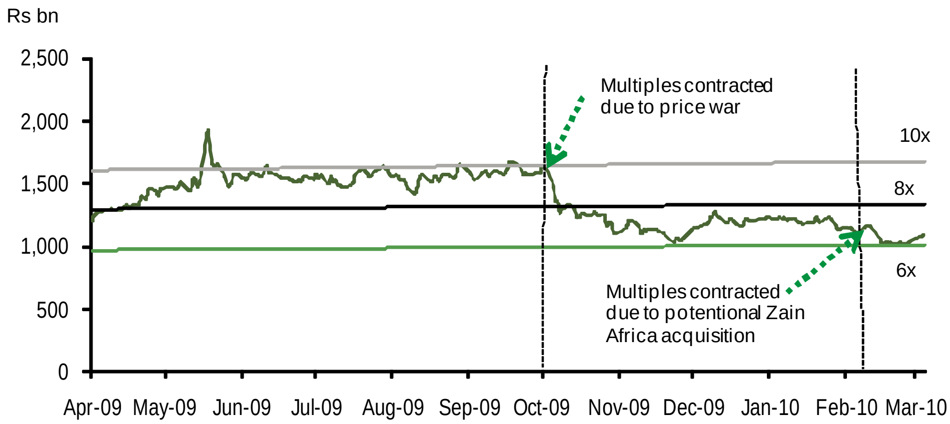
Capex-related synergies

We believe the combined entity would have significant bargaining power with suppliers (estimated capex of ~USD4.0bn for FY11E), and even a small saving could lead to a huge gains for shareholders. This could be driven by centralized sourcing of network supplies or applying business model of India internationally (In India, network deployment and management is outsourced and pricing is linked to capacity).

Favorable risk-reward ratio: TP of Rs359 in worst case scenario. Multiple catalysts for re-rating

We initiate coverage on Bharti with an "outperform" rating and target price of Rs.359. Our target price implies FY12E EV/EBITDA of ~6.4x and FCFF yield of 9.0%. Bharti valuation multiple contracted amid (a) competitive pressures in domestic market and (b) potential Zain Africa acquisition (Refer figure 45). There are multiple catalysts (short-term and long-term) for re-rating of stock. We believe that current valuations offer an opportunity with favorable risk-reward ratio since it trades at a significant discount to its fair value of Rs.419/sh and provide an upside potential of 20% (with target price of Rs.359) even considering the worst case scenario.

Figure 45: Bharti's valuation multiple contracted (forward EV/EBITDA)



Source: Bloomberg, Indiabulls research.

Multiple catalysts for re-rating of Bharti's valuation:-

- **Concerns over price pressure in domestic market recede** and company demonstrates Revenue/EBITDA/EPS growth. We expect Bharti's Revenue/EBITDA/EPS to grow at CAGR 10.6%/8.2%/10.2% over FY10-12E respectively. This is primarily driven by voice minutes CAGR of 19% over FY10-12E, while tariff decline is likely to be restricted at CAGR 7.3% to 46p/min by FY12E. We expect the domestic industry environment to become favorable in next 3-6 months; which would be near-term catalyst for the stock.

- **Concerns over Zain Africa acquisition recede:** We believe that further understanding of African markets, potential growth prospects and sources of synergy benefits would act as key catalysts towards receding concerns over Zain Africa acquisition price. However, we believe this catalyst would take at least 9-12 months to evolve.

Fair value for Bharti's Asia business is Rs.419/sh…

We derive a fair value of Rs419/sh for Bharti's business segments in Asia (Refer figure 46). We believe SOTP valuation would best capture value of Bharti's several business segments. Bharti's valuation should get re-rated (over next 3-6 months) as pricing concerns in domestic market recede and 3G spectrum auction concludes. However, we expect more clarity on potential Zain Africa acquisition to take at least 9-12 months.

Figure 46: SOTP valuation for Bharti provides a fair value of Rs.419/sh

Units as shown

Items	Methodology	Rs mn	Rs/share	Remarks
Core business	EV/EBITDA	1,028,995	270	6x EV/EBITDA
Infratel (incl Indus)	EV/Tower	370,100	97	EV/tower of Rs5mn
DTH	EV/sub	16,000	4	EV/sub = Rs4000; 3QFY10-2mn subs; FY12E sub-4mn
Sri Lanka	P/BV	9,000	2	1.0x P/B (Investment of $200mn until FY12)
Bangladesh	P/BV	13,500	4	1.0x P/B (Investment of $300mn)
Total enterprise value		1,437,595	378	
Less: Net debt/minority int (FY12E)		(155,347)	(41)	
Equity value		1,592,942	419	

Source: Indiabulls research.

.. we factor worst-case scenario from Zain Africa acquisition in our TP of Rs359

We believe concerns over Zain acquisition price would take a longer time to recede and hence factor worst case scenario from Zain Africa acquisition in our TP. We have discussed possible valuation scenarios for Zain Africa in our previous section. We arrive at target price of Rs.359 considering worst case scenario; which implies FY12E EV/EBITDA of 6.4x for Bharti. Our target price implies FY12E EV/EBITDA of 7.1x on consolidated financial (Bharti + Zain Africa).

Figure 47:Bharti's various scenarios - TP of Rs359 considers worst case scenario

US$ mn unless specified

Scenarios	Worst	Base	Best
Bharti fair value of Asia (Rs/ sh)	419	419	419
Zain Africa contribution/sh			
Zain Africa EBITDA (FY12E)	1,686	1,686	1,686
EV/EBITDA (x)	5.0	5.0	5.0
Value of operations (US$ mn)	8,430	8,430	8,430
Less: Increase in Net debt (FY10-12E)	1,800	1,800	1,800
Enterprise value (US$ mn) -current	6,630	6,630	6,630
Less: Minority interest (20%)	1,326	1,326	1,326
Bharti's (proportionate value)	5,304	5,304	5,304
Add: PV of synergy benefits	-	5,153	9,161
Zain Africa EV (Bharti's stake)	5,304	10,458	14,466
Less: Potential acquisition price	10,360	10,360	10,360
Zain Africa contribution to Bharti	(5,056)	98	4,106
Zain Africa contribution/share (Rs)	(60)	1	49
Bharti's combined value/share (Rs)	359	420	467

Source: Indiabulls research.

Figure 48:Implied EV/EBITDA multiple and PE on our target price

Units as shown

Items	Bharti	Bharti + Zain Africa
Value per share (Rs)	359	359
Equity value (Rs mn)	1,365,440	1,365,440
Net debt (Rs mn)	(155,347)	398,425
Enterprise value (Rs mn)	1,210,093	1,763,865
EBITDA (FY12E) -Rs mn	188,742	249,492
Implied EV/EBITDA (x)	6.4	7.1
EPS (FY12E)	29	28
Implied PE (x)	12.6	13.0

Source: Indiabulls research.

Risk to investment case

- **Downside risk to investment case:** Higher than expected tariff cuts, overbidding for 3G spectrum, unfavorable policy changes (2G spectrum/ spectrum & license fees), over-bidding for international acquisition and higher than expected impact of MNP.
- **Upside risk to investment case:** Higher than expected minutes growth, ROE expansion with free cash flow utilization, higher tenancy in Bharti Infratel & Indus Tower.

Figure 49:Summary financials

Rs million, year-end March

Profit and loss	FY08	FY09	FY10E	FY11E	FY12E
Revenues	270,250	369,616	392,004	426,982	479,516
Expenses	156,535	217,937	230,800	258,763	290,774
EBITDA	113,715	151,678	161,205	168,219	188,742
Other income	2,526	327	5,695	12,438	18,235
Depreciation	37,261	47,581	60,091	61,112	69,130
Interest	3,240	3,479	2,905	4,173	3,495
PBT	75,740	100,945	103,903	115,372	134,352
Taxes	8,378	6,615	12,764	18,636	23,055
Minority interest	1,150	1,759	1,819	2,331	2,588
Net profit	66,212	92,571	89,320	94,404	108,709
Extra ordinary items	795	(7,872)	-	-	-
Reported PAT	67,007	84,699	89,320	94,404	108,709
EPS	17.4	24.4	23.5	24.8	28.6
Dividend per share	-	1	-	-	-
Dividend payout ratio	-	4	-	-	-

Balance sheet					
Total liabilities	*325,192*	*432,195*	*520,209*	*607,603*	*701,138*
Net worth	217,042	303,945	393,273	487,692	596,423
Equity (A)	18,979	18,982	18,990	19,005	19,027
Reserves (B)	198,063	284,963	374,283	468,687	577,396
Debt	97,063	118,800	115,668	106,312	88,528
Deferred tax liability	2,531	(1,254)	(1,254)	(1,254)	(1,254)
Minority interest	8,556	10,704	12,523	14,854	17,442
Others					
Total asset	*325,192*	*432,195*	*520,209*	*607,603*	*701,138*
Net fixed asset	290,608	387,307	410,054	355,384	355,154
CWIP	36,003	35,138	18,860	15,591	12,993
Investments	108	128	818	78,228	83,058
Working capital (excl cash)	(78,723)	(66,263)	(33,205)	(40,796)	(38,539)
Cash & cash equiv.	55,006	49,166	96,363	171,415	260,062
Others	22,190	26,720	27,320	27,781	28,410

Source: Company, Indiabulls research.

Summary financials (*cont'd*)

Rs million, year-end March

Cash flow	FY08	FY09	FY10E	FY11E	FY12E
Sources	*178,485*	*146,258*	*148,105*	*148,506*	*162,665*
Retained earnings (PAT-div.)	67,007	84,699	89,320	94,404	108,709
Non cash items (incl. dep.)	45,639	42,898	60,091	61,112	69,130
Equity issuance	21,237	198	7	15	22
Increase in borrowings	45,437	7,007	(3,133)	(9,356)	(17,784)
Others	(835)	11,455	1,819	2,331	2,588
Application	*178,485*	*146,258*	*148,105*	*148,506*	*162,665*
Capital expenditure	138,352	143,294	98,872	83,380	75,973
Investments	45,582	(12,835)	30,000	60,000	90,000
Change in working capital (excl cash)	(4,763)	11,431	2,036	(9,926)	(1,955)
Change in cash	(686)	4,368	17,197	15,052	(1,353)
Ratios					
Revenue growth (%)	45.9	36.8	6.1	8.9	12.3
EBIDTA growth (%)	52.6	33.4	6.3	4.4	12.2
EPS growth (%)	55.4	39.8	(3.5)	5.6	15.0
EBITDA margin (%)	42.1	41.0	41.1	39.4	39.4
PAT margin (%)	24.5	25.0	22.8	22.1	22.7
Asset turnover					
Sales/net block	1.1	1.1	1.0	1.1	1.3
ROCE	27.2	25.8	19.7	17.8	17.4
Debt/equity	0.46	0.39	0.29	0.22	0.15
Tax rate	10.9	7.1	12.4	16.8	17.8
ROE (%)	37.2	35.5	25.6	21.4	20.1
Valuation					
P/E	17.1	12.2	12.7	12.0	10.4
EV/EBIDTA	10.4	8.0	7.2	6.4	5.2
P/BV	5.2	3.7	2.9	2.3	1.9
EV/sales	4.4	3.3	3.0	2.5	2.0
Dividend yield	-	0.3	-	-	-

Source: Company, Indiabulls research.

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![Indiabulls Institutional Equities]

Initiating coverage

8 March 2010

Idea Cellular

Outperform

Discount unwarranted - Ripe for re-rating

India

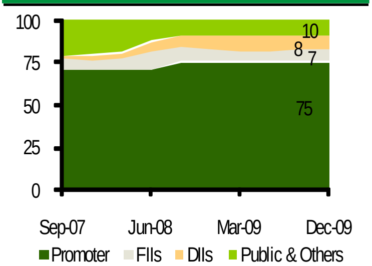
Telecom

Price: Rs 62

Target price: Rs 79

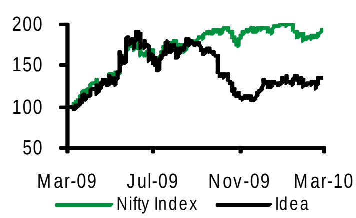
Stock details	
Bloomberg code	IDEA IN
MCap Rs/US$ mn	192051/4207
Outstanding shares (mn)	3100
52-wk H/L (Rs)	92/42
3m avg. trading vol (US$ mn)	7.14
Nifty / Sensex	5089/16994

Shareholding pattern (%)



Stock performance (%)

	1m	3m	1yr
Absolute	9.5	13.2	39.4
Nifty	7.8	(0.4)	97.5



Source: Bloomberg, Capitaline.

We initiate coverage on Idea with an "Outperform" rating and target price of Rs.79, implying a potential upside of 27%. We believe the valuation discount of 20% to Bharti's mobile EV/min of Rs.0.78 is unwarranted. We expect Idea to re-rate as it continues to demonstrate superior performance with higher incremental minute market share (minutes CAGR 26.3% over FY10-12E) & EBITDA CAGR of 16.2% over FY10-12E led by increase in network utilization.

Idea's minute factory is under-valued; discount (20%) unwarranted

Idea carried 64bn minutes in 3Q FY10 equivalent to ~42% of Bharti's minutes on network; while Idea's EV (Rs.275bn) is a meagre 24% of Bharti's EV. On comparing mobile business EV, we find Idea trades at a 20% discount to Bharti's EV/min of Rs.0.78 despite similar RPM profile. We believe such discount is unwarranted as Idea gains higher minute market share (MinMS), network utilization and margins improve as new circle launches are completed. This underpins our argument that valuation discount to Bharti should incrementally reduce. We value Idea at EV/min of Rs.0.70 (10% discount to Bharti) implying a target price of Rs79.

Minute market share continues to improve…expect 11% by FY12E

We expect Idea to capture 11% MinMS by FY12E implying minutes CAGR of 26.3% over FY10-12E to 388bn minutes. Idea's MinMS improved to 10.5% as of 2Q FY10 as the company invested heavily in network (6x expansion), brand and distribution over last three years. We expect Idea to gain higher incremental MinMS (~11.5%) led by improvement in its market share in new circles & deeper rollout in established circles

Capacity utilization to improve as new circles rollout is now behind

We expect Idea's network utilization to enhance to 4.6mn minutes by FY12E (albeit lower than Bharti's 6.6mn minutes) as new circles rollout was completed in 3Q FY10. Idea's massive network rollout led to a drop in utilization from 4.8mn minutes in 2Q FY09 to 4.0mn minutes in 2Q FY10. We expect higher network utilization would help Idea absorb tariff pressure (opex leverage) and hold its EBITDA margin at ~27% by FY12E. This would lead to EBITDA/EPS CAGR of 16.3%/28.8% over FY10-12E. We expect Idea to re-rate as tariff concerns recede. Initiate with 'Outperform' and TP of Rs.79.

Key financials

Rs million, year-end March

	FY08	FY09	FY10E	FY11E	FY12E
Revenue	67,200	101,313	131,606	150,758	175,604
EBITDA	22,518	28,134	34,801	37,991	47,020
PAT	10,423	8,816	7,424	7,475	12,366
EPS (Rs)	4.0	2.7	2.2	2.3	3.7
EPS (consensus) (41)			2.6	2.0	2.8
EPS growth (%)	104	(32)	(16)	0	65
ROE (%)	36.5	12.1	6.3	6.1	9.9
PE (x)	15.7	23.2	27.6	27.5	16.6
EV/EBITDA (x)	9.7	8.2	7.9	7.2	5.5
P/BV (x)	4.6	1.4	1.4	1.5	1.3

Source: Company, Indiabulls research.

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Investment thesis

Idea's minute factory is under-valued. Discount unwarranted

We initiate coverage on Idea with an "Outperform" rating and target price of Rs.79, implying a potential upside of 27%. We believe that current valuation discount of 20% to Bharti's mobile EV/min of Rs.0.78 is unwarranted; we value Idea's mobile business at Rs.66/sh, ABTL (tower stake) at Rs.21/sh and factor in worst case impact of possible spectrum policy related changes at Rs.8.5/sh. (Refer figure 50)

Figure 50:Idea - SOTP Valuation at Rs79/sh

Units as shown

Business units	Value per share (Rs)	Remarks
IDEA (incl Spice)	66	Refer figure 51
Tower value - ABTL	21	Refer figure 52
Total	87	
Less: Possible impact of spectrum policy changes	9	Refer figure 56
Value per share (Rs)	79	

Source: Indiabulls research.

Figure 51:Idea mobile business value

Units as shown

Minutes on network (FY12E)- mn	388,197
EV/min (Rs)	0.70
Enterprise value (Rs mn)	271,738
Less: Net debt - FY12E (Rs mn)	53,331
Equity value (Rs mn)	218,406
Value per share (Rs)	66

Source: Indiabulls research.

Figure 52:Idea tower value (ABTL stake)

Units as shown

	Towers	EV/tower (Rs mn)	Rs mn
Indus Towers -FY12E	122,831	5	614,156
Less: Debt			90,000
Equity value			524,156
ABTL's stake in Indus			16%
ABTL (Equity value)			83,865
Less: Providence equity stake -16.14%			13,536
Equity value attributable to IDEA			70,329
Value per share (Rs)			21

Source: Indiabulls research.

Idea trades at EV/min of Rs.0.63; implies 20% discount to Bharti's

Idea carries 64bn minutes on its network in 3Q FY10 which is equivalent to ~42% of Bharti's minutes on network; while Idea's EV (Rs275bn) is meagre 24% of Bharti's EV. On comparing mobile business EV, we find that Idea trades at ~20% discount to Bharti. Idea's FY11E EV/min stands at Rs.0.63 vs. Bharti's EV/min of Rs.0.78 despite similar RPM profile. (Refer figure 53).

Figure 53:Idea's implied mobile EV/min and Bharti's implied mobile EV/min

Rs mn

Idea's Implied mobile EV/min	FY11E	Remarks
Enterprise valuation	265,565	At Rs60
Less: ABTL value (attributable to Idea)	64,619	EV/tower of Rs5mn
Implied mobile business value (Rs mn)	200,946	
Minutes on network (mn)	320,357	FY11E minutes
Implied EV/min (Rs)	0.63	

Bharti's Implied mobile EV/min	FY11E	Remarks
Enterprise value	1,153,663	At price of Rs314 before announcement of potential Zain acquisition
Less: Bharti Infratel EV	334,865	EV/tower of Rs5mn
Implied EV of non-tower business	818,798	
Less: EV (non-mobile business)	245,639	Assuming 30% value since ~30% of EBITDA comes from non-mobile
Implied EV (attributable to mobile business)	573,158	
Minutes on network (mn)	733,458	FY11E minutes
Implied EV/min (Rs)	0.78	

Source: Indiabulls research.

We believe the 20% discount is unwarranted considering Idea continues to gain minute market share (MinMS) and minutes are expected to grow at CAGR 26.3% over FY10-12E. We expect that Idea's network utilization and margin profile should improve as pan-India rollout is behind the company. We note that Bharti's mobile segment EBITDA margin stood at 30.4% and Idea's EBITDA margin in its old 11 circles is similar at 30.1% as of 3Q FY10. As new circles and Spice Telecom's circles benefit from opex leverage, the margin profile for consolidated mobile business should improve significantly.

This underpins our argument that valuation discount to Bharti should reduce incrementally. Conservatively, we provide 10% valuation discount against Bharti and value Idea's mobile business at EV/min of Rs.0.70 (Refer figure 54). We believe that there is potential upside risk to our estimate if Idea turns in higher-than-expected improvement in network utilization.

Figure 54:Idea mobile business fair value at Rs66/sh (EV/min methodology)

Units as shown

Minutes on network (FY12E) mn	388,197
EV/min (Rs)	0.70
Enterprise value (Rs mn)	271,738
Less: Net debt - FY12E	53,331
Equity value (Rs mn)	218,406
Value per share (Rs)	66

Source: Indiabulls research.

Alternatively, we could use EV/EBITDA valuation methodology to value Idea's mobile business. We derive a fair value of Rs.68/sh for mobile business at FY12E EV/EBITDA of 7.0x (Refer figure 55)

Figure 55: Idea's mobile business value (EV/EBITDA valuation methodology)

Rs mn	
Mobile EBITDA - IDEA (incl Spice)	39,504
EV/EBITDA multiple	7.0
EV (Rs mn)	276,525
Less: Net debt (FY12E)	53,331
Equity value (Rs mn)	223,193
Value per share (Rs)	68

Source: Indiabulls research.

TP builds in probable impact due to potential spectrum policy changes

We note that our valuation factors in probable impact of potential risks associated with spectrum policy changes. There are two areas where Idea could broadly get affected: (a) one-time spectrum charge for spectrum allocation above 6.2MHz, and (b) spectrum renewal charges to be paid post the expiry of license period based on administratively determined price (like recent auction price or escalation based on some formula). However, if these policies are implemented then the rationale for having an escalating spectrum fees fades away. This would reduce the recurring spectrum fees and potentially stem savings for Idea. Hence, we analyze and factor the net impact of potential cost and savings of the above on Idea. Our analysis reveals that these policy changes could have negative impact of Rs. 8.5/sh on Idea (Refer figure 56).

Figure 56: Probable impact due to potential spectrum policy changes

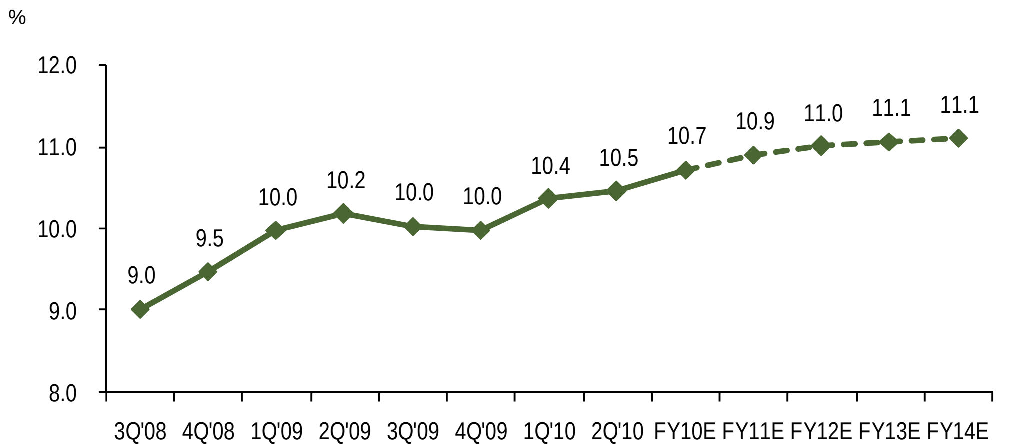
Rs mn	
One-time spectrum charge for allocation above 6.2Mhz	(5,080)
PV of Spectrum renewal charges to be paid post-expiry of license period based on 3G auction price	(40,930)
PV of recurring spectrum fees saved on payment of one-time spectrum fees	18,086
Net impact (Rs mn)	(27,924)
Impact per share (Rs)	(8.5)

Source: DoT, WPC, TRAI, Indiabulls research

Minute market share continues to improve…expect 11% by FY12E

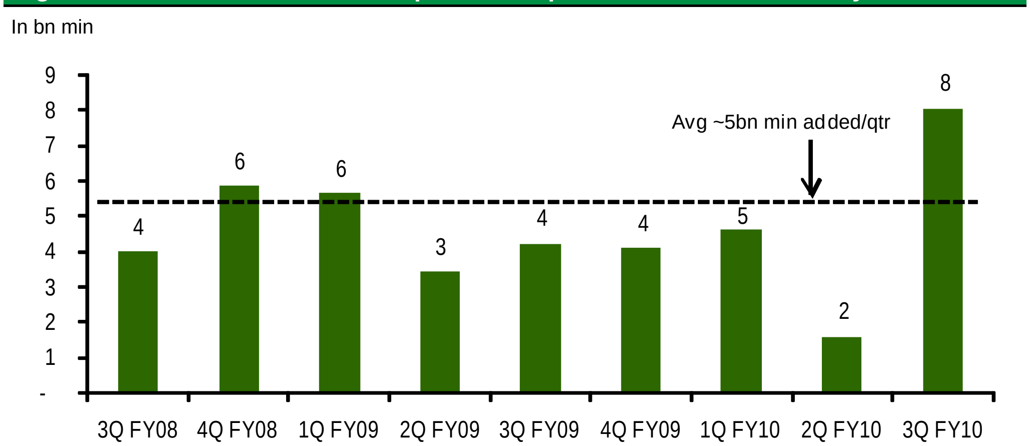
We expect Idea to capture 11% MinMS by FY12E (Refer figure 57); which implies minutes CAGR of 26.3% over FY10-12E to 388bn minutes. Idea is expected to gain higher incremental MinMS (~11.5%) led by improvement in its market share in the new circles and deeper rollout in its established circles. Idea's MinMS improved from 9% in 3Q FY08 to 10.5% as of 2Q FY10 as company invested heavily in network, brand and distribution over last three years.

Figure 57: Idea's minute market share continues to improve amid hyper-competition



Source: Company, Indiabulls research.

Figure 58:Idea's minute addition quarter-on-quarter has been extremely robust



Source: Company, Indiabulls research.

Minute growth for Idea (ex-Spice) is driven primarily by its stupendous network expansion which grew by 6.0x over last 3 years to over 56k cell sites (Refer figure 59). This led to surge in its minutes which grew over 4.0x over the same period to 58bn minutes as of 3Q FY10 (Refer figure 60).

Figure 59: Network expanded over 6x in last 3 years…

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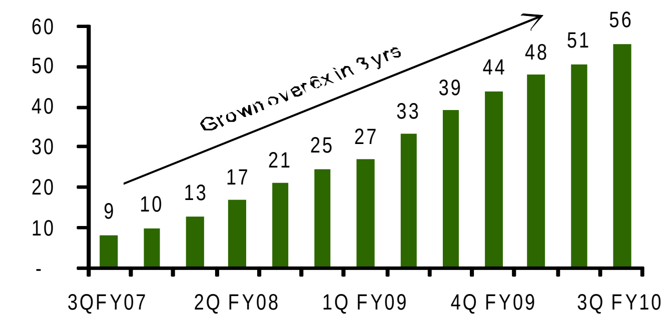
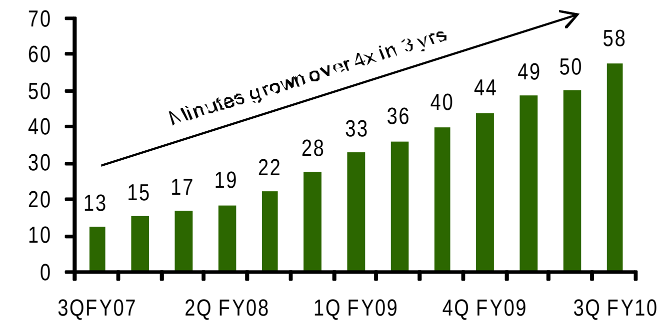


Source: Company, Indiabulls research.

Figure 60: …which led to surge in minute on network

In bn min

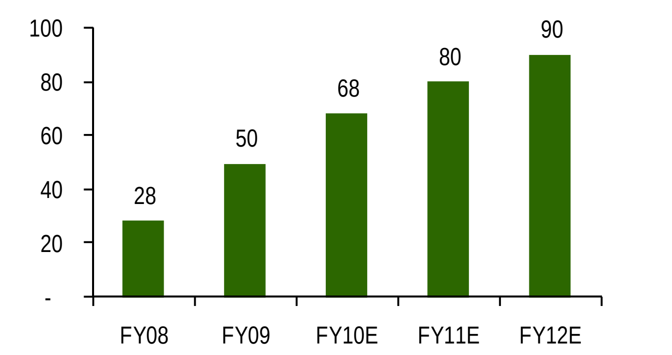


Source: Company, Indiabulls research.

We expect Idea to continuously invest in its established circles and maintain its leadership position. Idea (incl. Spice) network is expected to expand to 90k cell sites by FY12E (similar to Bharti's network as of FY09). We expect Idea (incl. Spice) to capture 11.5% incremental MinMS which would imply minutes CAGR of 26.3% over FY10-12E to 388bn minutes (Figure 62).

Figure 61: Idea's network to expand to 90k cell sites

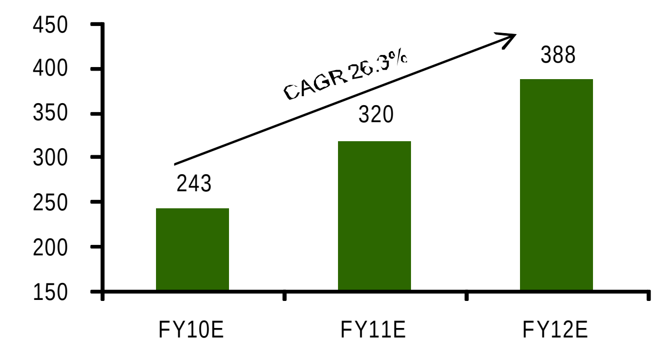
'000



Source: Company, Indiabulls research.

Figure 62: Minutes expected to grow at CAGR 26.3%

In bn min



Source: Indiabulls research.

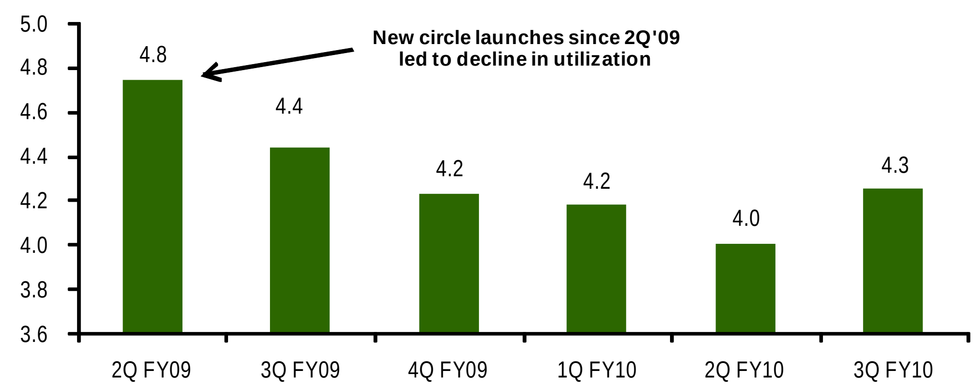
Capacity utilization to improve as new circles rollout is behind

We expect Idea's network utilization to enhance to 4.6mn minutes by FY12E (albeit lower than Bharti's network usage of 6.6mn minutes) (Refer figure 64). Load factor is likely to improve going forward as new circle rollout is complete in 3Q FY10 and fill factor improves on its cell sites. Idea's massive network rollout led to a drop in its network utilization from 4.8mn minutes/cell site in 2Q FY09 to 4.0mn minutes in 2Q FY10 (Refer figure 63). Idea's network utilization is much lower than Bharti which stood at 6.1mn minutes per cell site as of 3Q FY10.

We expect higher network utilization would help Idea absorb tariff pressure (opex leverage) and it is expected to hold its EBITDA margin at ~27% by FY12E. This would lead to EBITDA CAGR of 16.3% over FY10-12E and EPS CAGR 28.8% over FY10-12E. We expect Idea to re-rate as tariff concerns recede. We initiate with 'Outperform' rating and TP of Rs.79/sh.

Figure 63: Network utilization dips post new circle launches…improves in 3Q FY10

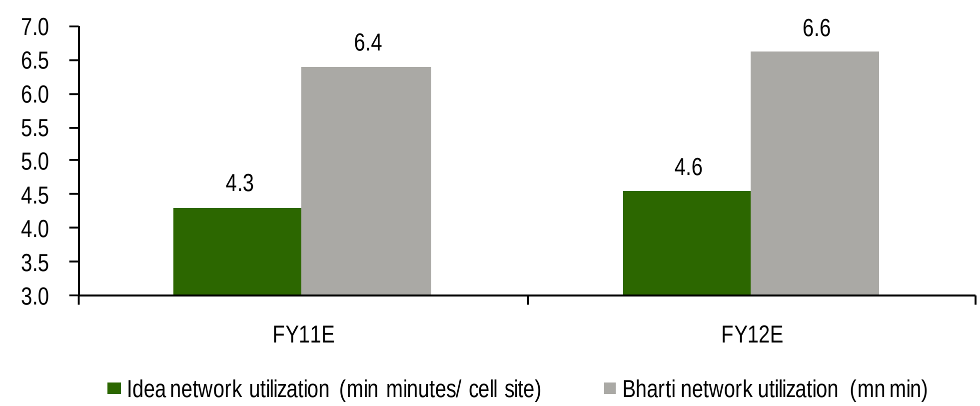
In mn minutes



Source: Company, Indiabulls research.

Figure 64:…expect network utilization to improve as expansion pace slows down

In mn minutes



Source: Indiabulls research.

Established circles performance remain robust exhibit brand resilience

Idea's brand resilience is exhibited by its performance in established circles where it continues to gain revenue market share amid hyper-competition (Refer figure 65). Idea's revenue market share in new circles (Bihar 6.8% and Mumbai 3.2%) has improved remarkably within a year of launch (Refer figure66). The revenue market share performance clearly demonstrates that Idea's investment in network, brand and distribution is paying off.

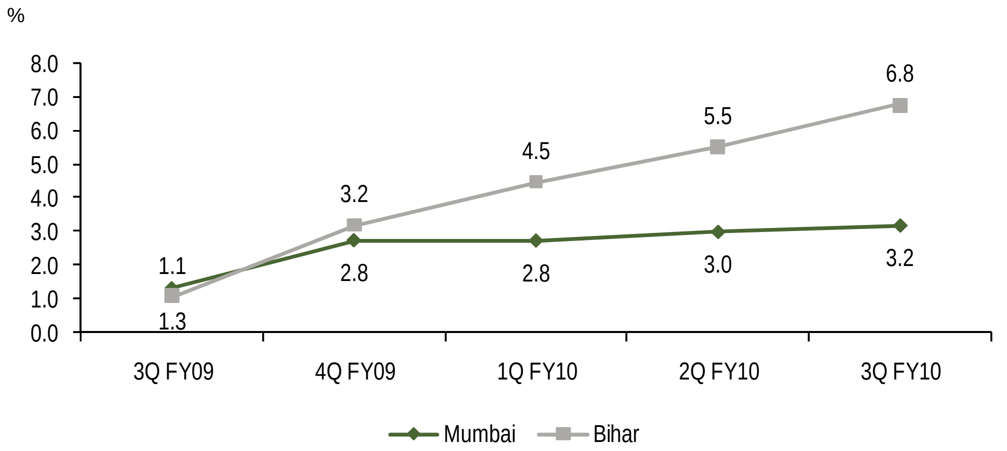
Figure 65: Revenue market share performance in its 7 established circles with 900MHz spectrum

%

	3Q FY08	4Q FY08	1Q FY09	2Q FY09	3Q FY09	4Q FY09	1Q FY10	2Q FY10	3Q FY10	Rank
Maharashtra	24.8	25.7	28.0	28.6	28.2	29.6	30.4	30.4	31.6	1
Gujarat	14.1	13.6	15.4	16.3	16.5	17.2	17.8	17.9	18.7	2
A.P.	14.6	15.0	16.6	17.4	17.1	18.0	18.0	16.8	18.0	2
Kerala	21.1	21.3	25.7	31.2	29.0	31.3	31.0	31.5	34.6	1
Haryana	16.6	18.5	19.4	19.5	18.8	19.7	20.6	19.9	19.3	3
U.P.(W)	20.9	21.7	25.0	25.9	26.0	27.4	27.9	28.6	29.9	1
M.P.	25.5	26.7	29.4	29.9	27.7	27.7	29.9	30.8	30.2	2

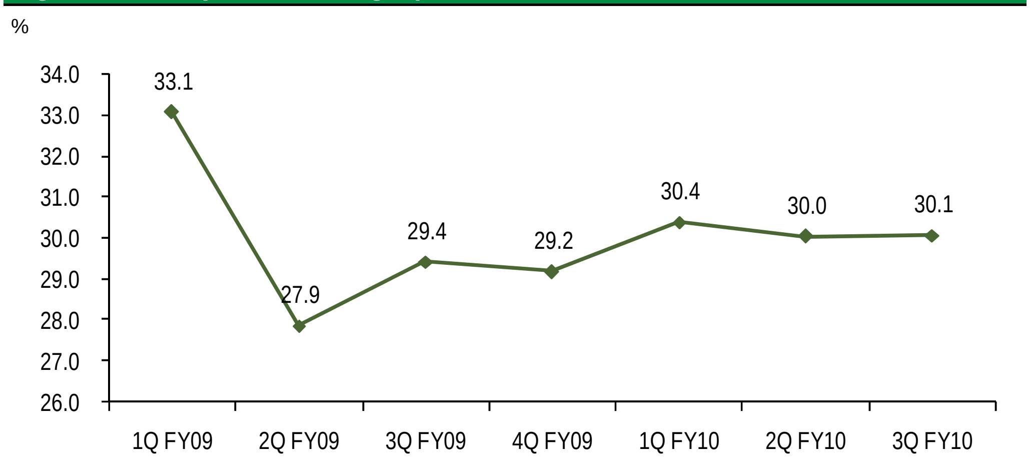
Source: TRAI, Indiabulls research.
Note: Market share performance relates to adjusted gross revenue (%) net of interconnection fees.

Figure 66: Idea's revenue market share has remarkably improved in new circles



Source: TRAI, Indiabulls research.
Note: Note: Market share performance relates to adjusted gross revenue (%) net of interconnection fees.

Figure 67:Steady EBITDA margin performance in old circles



Source: Company, Indiabulls research.
Note: This performance relate to 11 circles which incl. HP, Raj and UP(E) which are relatively new circles.

Risk to investment case

- **Downside risk to investment case:** Higher than expected tariff cuts, overbidding for 3G spectrum, unfavorable policy changes (2G spectrum/ spectrum & license fees).
- **Upside risk to investment case:** Higher than expected minutes growth, higher tenancy in Indus Tower.

Figure 68:Summary financials

Rs million, year-end March

Profit and loss	FY08	FY09	FY10E	FY11E	FY12E
Revenues	67,200	101,313	131,606	150,758	175,604
Expenses	44,682	73,179	96,805	112,766	128,584
EBITDA	22,518	28,134	34,801	37,991	47,020
Other income	1,991	4,498	3,223	2,850	3,600
Depreciation	8,768	14,028	21,210	22,487	25,264
Interest	4,592	9,212	8,167	8,905	9,004
PBT	11,148	9,391	8,647	9,450	16,352
Taxes	725	576	1,222	1,975	3,689
Minority interest	-	-	-	-	297
Net profit	10,423	8,816	7,424	7,475	12,366
Extra ordinary items	-	-	-	-	-
Reported PAT	10,423	8,816	7,424	7,475	12,366
EPS	4.0	2.8	2.2	2.3	3.7
Dividend per share	-	-	-	-	-
Dividend payout ratio	-	-	-	-	-
Balance sheet					
Total liabilities	*101,261*	*222,905*	*251,984*	*248,728*	*262,231*
Net worth	35,446	132,653	147,941	141,488	154,055
Equity (A)	26,354	31,001	33,016	33,117	33,174
Reserves (B)	9,092	101,633	114,906	108,352	120,861
Debt	65,154	89,122	102,913	106,110	106,749
Deferred tax liability	661	1,130	1,130	1,130	1,130
Minority interest	-	-	-	-	297
Others	-	19	19	19	19
Total asset	*101,261*	*222,905*	*251,984*	*248,728*	*262,231*
Net fixed asset	96,791	145,263	207,456	208,384	217,398
CWIP	10,372	21,409	13,854	11,371	5,875
Investments	-	0	1	1	1
Working capital (excl cash)	(16,497)	(17,540)	(25,969)	(33,862)	(38,047)
Cash & cash equiv.	10,535	51,316	34,185	40,377	54,548
Others	61	22,457	22,457	22,457	22,457

Source: Company, Indiabulls research.

Summary financials (*cont'd*)

Rs million, year-end March

Cash flow	FY08	FY09	FY10E	FY11E	FY12E
Sources	*45,245*	*130,312*	*13,088*	*33,511*	*38,767*
Retained earnings (PAT-div.)	10,423	8,816	7,424	7,475	12,366
Non cash items (incl. dep.)	12,779	24,305	21,210	22,487	25,264
Equity issuance	3,188	93,927	50	352	201
Increase in borrowings	22,649	15,974	(15,595)	3,197	639
Others	(3,793)	(12,710)	-	-	297
Application	*45,245*	*130,312*	*13,088*	*33,511*	*38,767*
Capital expenditure	55,576	101,745	46,620	34,767	28,806
Investments	5,116	-	(452)	5,000	10,000
Change in working capital (excl cash)	(2,221)	4,133	(4,376)	(7,449)	(4,209)
Change in cash	(13,225)	24,434	(28,705)	1,193	4,170
Ratios					
Revenue growth (%)	53.9	50.8	29.9	14.6	16.5
EBIDTA growth (%)	53.7	24.9	23.7	9.2	23.8
EPS growth (%)	104.2	(28.1)	(20.9)	0.4	65.2
EBITDA margin (%)	33.5	27.8	26.4	25.2	26.8
PAT margin (%)	15.5	8.7	5.6	5.0	7.0
Asset turnover					
Sales/net block	1.09	0.96	0.80	0.76	0.86
ROCE	17.8	10.8	6.1	5.8	7.7
Debt/equity	1.9	0.8	0.8	0.9	0.8
Tax rate	6.5	6.1	14.1	20.9	22.6
ROE (%)	36.5	12.1	6.3	6.1	9.9
Valuation					
P/E	15.7	21.8	27.6	27.5	16.6
EV/EBIDTA	9.7	8.2	7.9	7.2	5.5
P/BV	4.6	1.4	1.4	1.5	1.3
EV/sales	3.3	2.3	2.1	1.8	1.5
Dividend yield	-	-	-	-	-

Source: Company, Indiabulls research.

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Indiabulls
Institutional Equities

8 March 2010

India
Telecom

Price: Rs 165

Target price: Rs 158

Reliance Communication

Underperform

No need to rush in

We initiate coverage with an 'Underperform' rating and fair value of Rs.158/sh based on 6x FY12E EV/EBITDA (20% discount to Bharti). RCOM is expected to underperform its peers due to (a) intense competition in core CDMA segment, (b) intense competition in GSM and (c) RDEL income would possibly discontinue. RCom financial leverage is high (Net Debt/EBITDA at 3.5x FY10E) which pose risk amid high competitive scenario & 3G auction event risk.

Minute market share loss expected to continue despite GSM foray

RCOM to lose incremental minute market share (MinMS) due to intense competition in GSM segment where it is a challenger & competitive pressure in core CDMA voice segment from Tata Indicom & MTS. RCOM is likely to command MinMS of 13.5% by FY12E; which implies minute CAGR is restricted to 16.8% over FY10-12E to 476bn.

Competition intensifies in all segments…tower co. is the only savior

RCOM's EBITDA CAGR would be restricted to 6.3% over FY10-12E. We expect the company to underperform peers due to (a) intense competition in core CDMA voice/data segment, (b) intense competition in GSM, (c) potential pressure on internet data card revenue post 3G launch & (d) RDEL income would possibly discontinue. The only savior is its tower subsidiary (Rel Infratel) which signed contracts with Etisalat & STel among others. We expect 30% of incremental revenue & 75% of incremental EBITDA to be driven by its tower subsidiary over FY10-12E.

Financial leverage is high - little comfort to bid aggressively for 3G

RCOM's debt repayment obligation (~USD2bn) leaves little comfort for the company to bid aggressively for 3G spectrum. Its financial leverage is high- net debt Rs.274bn (FY10E) and Net debt/EBITDA 3.5x (FY10E). We believe 3G spectrum is critical for RCOM (MNP in backdrop) to retain its voice & data revenue and drive future growth. Failure to get 3G (coupled with launch of MNP) could potentially lead to loss of current subs base.

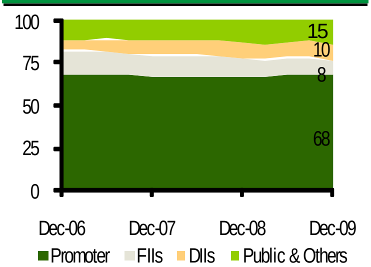
Valuations have come down. No need to rush in. Underperform

We initiate coverage on RCOM with 'Underperform' rating and fair value of Rs.158/sh based on 6.0x FY12E EV/EBITDA. We believe the 20% discount to Bharti is justified due to RCOM's loss of MinMS, inherent risk of dual network and weaker financial performance (EBITDA CAGR 6% over FY10-12E). The high financial leverage also poses a risk amid high competitive scenario as also the ensuing 3G spectrum auction.

Stock details

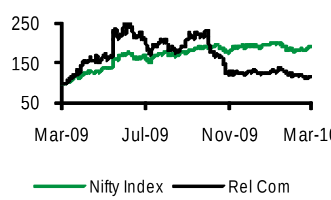
Bloomberg code	RCOM IN
MCap Rs/US$ mn	340565/7460
Outstanding shares (mn)	2064
52-wk H/L (Rs)	362/131
3m avg. trading vol (US$ mn)	21.39
Nifty / Sensex	5089/16994

Shareholding pattern (%)



Stock performance (%)

	1m	3m	1yr
Absolute	0.9	(7.9)	21.5
Nifty	7.8	(0.4)	97.5



Source: Bloomberg, Capitaline.

Key financials

Rs million, year-end March

	FY08	FY09	FY10E	FY11E	FY12E
Revenue	188,274	229,485	224,223	259,025	284,159
EBITDA	79,587	93,049	79,382	86,279	89,712
PAT	54,011	60,524	26,300	27,306	26,658
EPS (Rs)	26.2	29.3	12.7	13.2	12.9
EPS (consensus) (44)			18.5	15.7	19.2
EPS growth (%)	47	12	(57)	4	(2)
ROE (%)	24.3	20.2	7.1	6.9	6.4
PE (x)	6.3	5.6	12.9	12.5	12.8
EV/EBITDA (x)	6.4	6.8	7.7	6.7	6.2
P/BV (x)	1.4	1.0	0.9	0.8	0.8

Source: Company, Indiabulls research.

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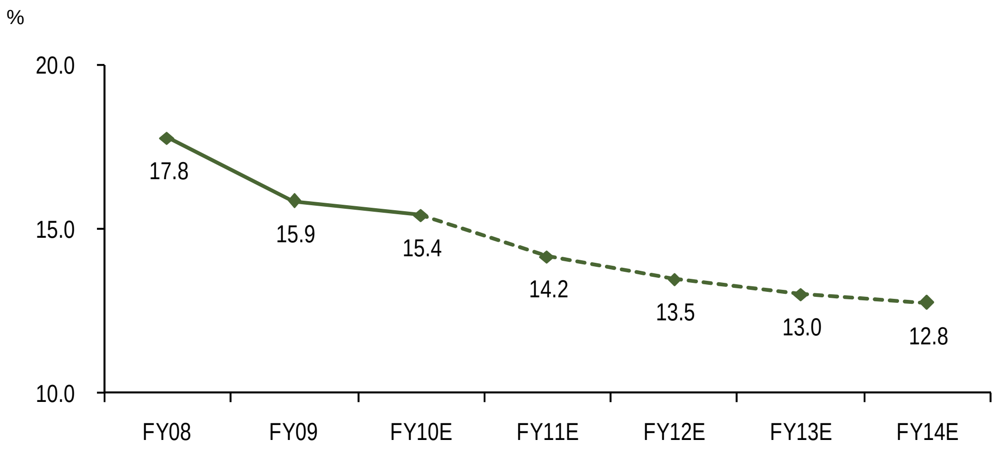
Investment thesis

Minute market share loss to continue despite GSM foray

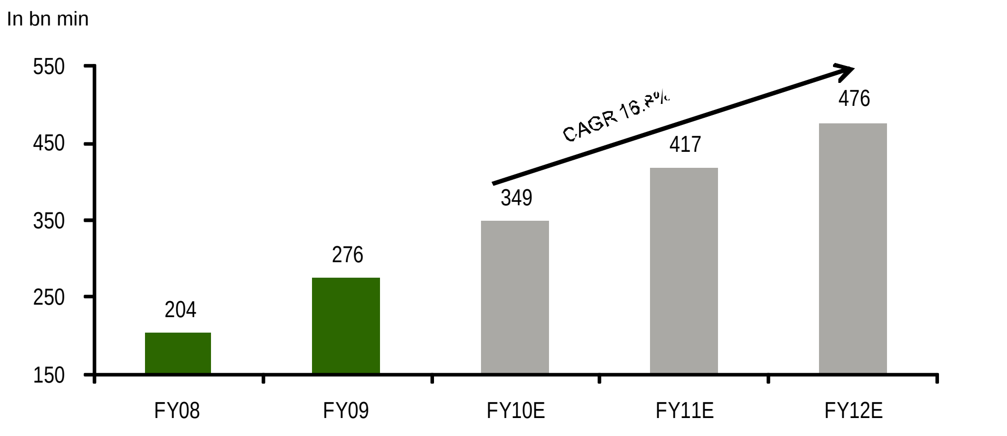
We expect RCOM to lose incremental minute market share (MinMS) due to intense competition in the GSM segment where RCOM is a challenger and competitive pressure in its core CDMA voice segment from Tata Indicom and MTS. RCOM is likely to command MinMS of 13.5% by FY12E; which implies minute CAGR is restricted to 16.8% over FY10-12E to 476bn (Refer figure 70).

Figure 69: RCOM expected to lose minute market share



Source: TRAI, Company, Indiabulls research.

Figure 70: RCOM's minute CAGR restricted to 16.8% over FY10-12E

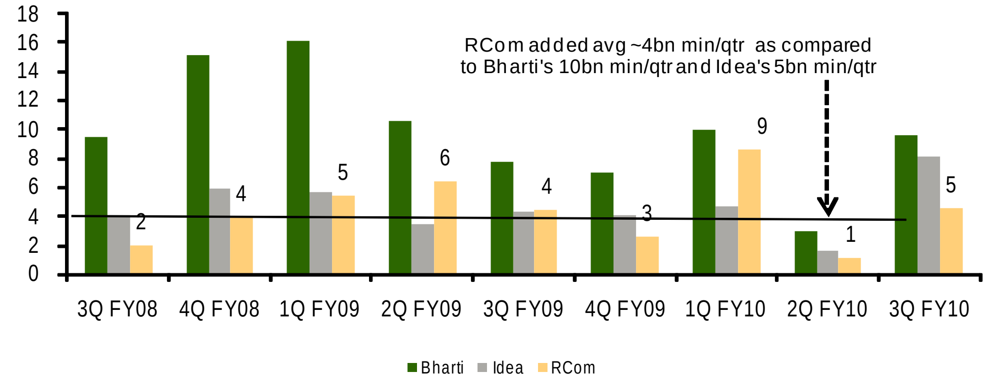


Source: Company, Indiabulls research.

RCOM minute addition lags competitors despite GSM foray in 4Q FY09 and most aggressive pricing. It added ~4bn minutes/ quarter over last two years (Refer figure 71), which lags Bharti (~10bn min) and Idea (~5bn min).

Figure 71:RCOM minute addition lags competitors despite GSM & aggressive pricing

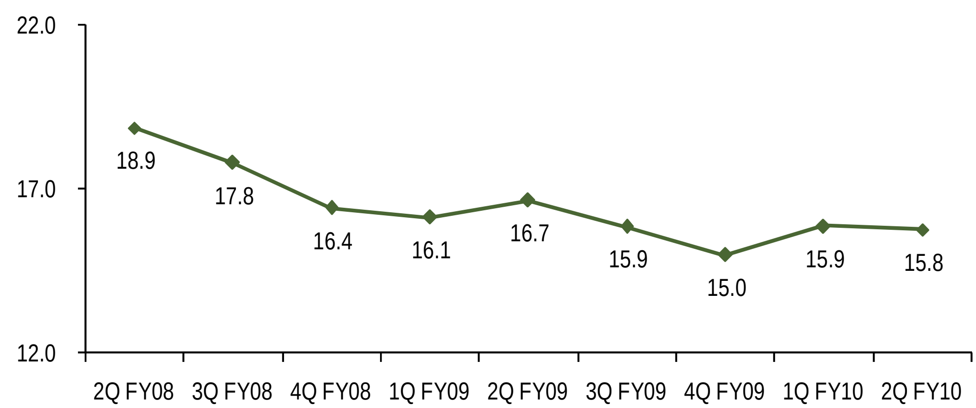
In bn min



Source: Company, Indiabulls research.

Figure 72:RCOM loses minute market share

%



Source: TRAI, Indiabulls research.

Figure 73:RCOM's wireless and voice revenue (as per TRAI) has been flat for last 2 years

Rs bn

	3Q FY08	4Q FY08	1Q FY09	2Q FY09	3Q FY09	4Q FY09	1Q FY10	2Q FY10	3Q FY10
Wireless revenue	40	42	41	43	44	45	48	40	40
Voice revenue - TRAI	33	33	32	34	33	31	30	32	32

Source: Company, TRAI, Indiabulls research.

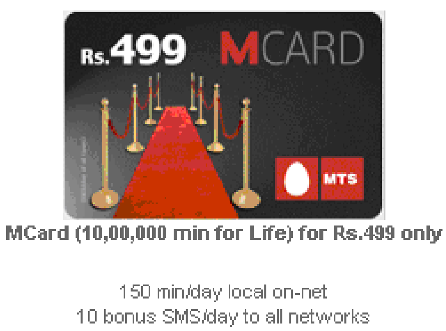
Competition intensifies in all segments…tower company is only savior

RCOM growth is likely to be constrained with revenue/EBITDA/EPS to register CAGR 12.6%/6.3%/0.7% over FY10-12E. Growth is expected to be weak as compared to its peers due to (a) intense competition in its core CDMA voice and data segment from Tata Indicom and MTS, (b) intense competition in GSM segment, (b) potential pressure on internet data card revenue post 3G launch, and (d) RDEL income (government grants) would possibly discontinue. Considering the above, it would be a challenge for company to grow its wireless revenue. The only savior is tower subsidiary (Reliance Infratel) which has signed multi-year tenancy arrangements with Etisalat & STel among other operators. We expect ~30% of incremental revenue and ~75% of incremental EBITDA is to be driven by its tower subsidiary over FY10-12E.

CDMA voice and data segment faces renewed competition

In India, the CDMA segment was duopoly with RCOM and Tata Indicom until FY09. The entry of MTS and new plans by Tata Indicom has changed the scenario. MTS started operations in 12 circles in the past two quarters with pan-India plans and gained 3.0mn subs as of Dec-09. MTS's pricing is more competitive than other CDMA participants (Refer figure 74). In addition, Tata Indicom has introduced new plans like "pay per call" which intensifies tariff pressure in the CDMA segment (Refer figure 76). This would stem pressure on RCOM's CDMA revenue.

Figure 74: MTS offers free on-net minutes (150min/day)



Source: Company.

Figure 75: MTS offers bonus card (call rate 1p/2sec)

Source: Company.

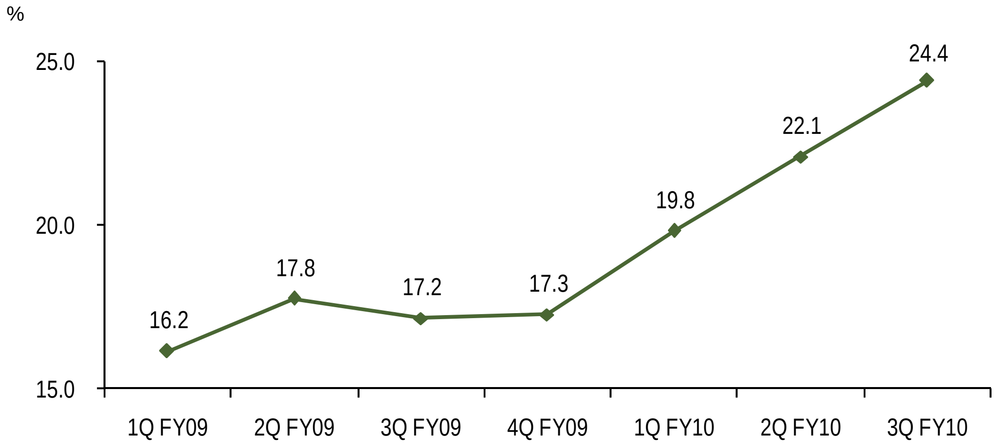
Figure 76: Tata Indicom introduces pay per call plan

Source: Company.

There is also potential risk that rural direct exchange line (RDEL) income (government grants) would possibly discontinue beginning FY11E. In FY09, RCOM received government grants which were included in "other operating income". Company recorded Rs15.1bn (~6.6% of total revenue) as other operating income in FY09. However, we don't know the quantum of government grant in other operating income. Considering the potential risks, it would be a challenge for company to grow its wireless revenue.

We note in last several quarters RCOM's revenue growth has been constrained due to tariff pressures and growth in inter-segment eliminations. RCOM's inter-segment elimination has grown to 24.4% of gross revenue in 3Q FY10 (Refer figure 77). We believe that RCOM's segmental revenue loses its relevance due to growing interdependence of segments which lead to higher inter-segment elimination. Eg. in 3Q FY10, company reported 0.3% QoQ growth in wireless segment, while net revenue de-grew by 6.9% QoQ (Refer figure 78).

Figure 77:Segment revenue lose relevance amid rise in inter-segmental elimination



Source: Company, Indiabulls research.

Figure 78:… like 3QFY10 wireless segment grew by 0.3% while revenue dips by 6.9%

Rs mn

	2Q FY10	3Q FY10	QoQ (%)	YoY (%)
Segmental				
Wireless	40,100	40,225	0.3	(8.8)
Global	22,643	19,818	(12.5)	18.1
Broadband	7,700	7,045	(8.5)	7.7
Others	2,760	3,160	14.5	(0.7)
Eliminations	(16,178)	(17,150)	6.0	41.5
Revenue	57,026	53,098	(6.9)	(9.2)

Source: Company, Indiabulls research.

Financial leverage is high - little comfort to bid aggressively for 3G

RCOM's debt repayment obligation leaves little comfort for the company to bid aggressively for 3G/Wimax/800Mhz spectrum. Its debt repayment obligation stands at USD2bn for FY11E and FY12E (Refer figure 79). Additional investment in 3G spectrum/ Wimax spectrum would be constrained. RCOM's financial leverage is high- net debt stands at Rs.274bn (FY10E) and Net debt/EBITDA at 3.5x (FY10E).

Figure 79: Debt repayment schedule- USD2bn during FY11E and FY12E

Units as shown

Issue date	Type	Maturity date	Amount ($mn)	Redemption premium	Amount payable ($mn)
Mar-08	ECB	Mar-11	280.0		280
May-06	FCCB	May-11	296.9	25.84%	374
Mar-08	ECB	Sep-11	116.3		116
Feb-07	FCCB	Feb-12	955.0	27.69%	1,219
Total					1,989

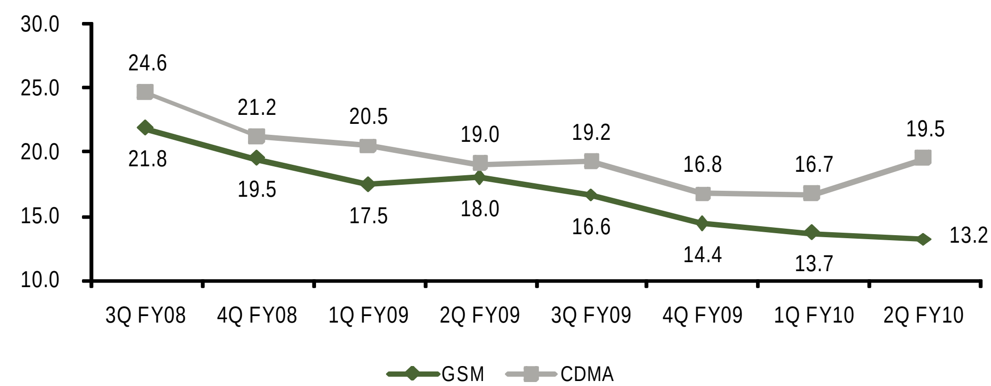
Source: RBI, Company, Indiabulls research.

3G spectrum critical to retain/attract high ARPU subs and drive growth

We believe 3G spectrum is critical for RCOM (MNP in backdrop) to retain its voice and data revenue (high ARPU subs), attract high usage subs and drive future growth. Failure to get 3G (coupled with launch of MNP) could potentially lead to loss of current subs base. Our industry minute analysis suggests that CDMA segment has higher concentration of post-paid minutes (Refer figure 80). We highlight the risk given that handsets prices have fallen considerably and may not act as a deterrent for CDMA subs to potentially shift. We perceive the 3G event as a major risk to the company, especially given high financial leverage (Net Debt/EBITDA of 3.5x FY10E).

Figure 80: CDMA post-paid minute proportion is higher. Potential to churn post MNP

%



Source: TRAI, Indiabulls research

Valuations have come down- No need to rush in. Underperform

We initiate coverage on RCOM with “underperform” rating and fair value of Rs.158/sh based on 6.0x FY12E EV/EBITDA (implying a 20% discount to Bharti). We believe discount to Bharti is justified due to RCOM’s lose its MinMS, inherent risk of dual network and weaker financial performance (EBITDA CAGR 6% over FY10-12E). In addition, RCOM has high financial leverage which poses a risk amid high competitive scenario as also the ensuing 3G auction. We believe re-rating for RCOM could happen if it is able to raise fresh equity/re-finance debt obligation and is able to successfully win 3G spectrum at a competitive price.

Figure 81: RCOM FV comes at Rs158/sh

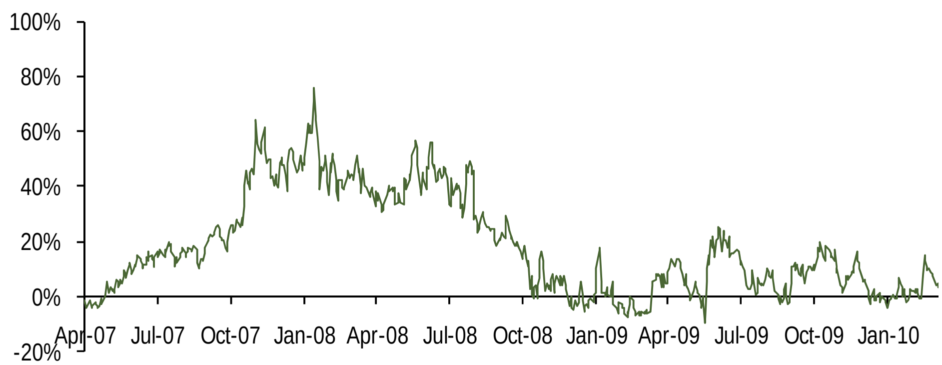
Rs mn

	FY12E	Remarks
EBITDA	89,712	
EV/EBITDA (x)	6.0	20% discount to Bharti FV multiple
Enterprise value	538,275	
Less: Net debt & minority interest	213,140	
Equity value	325,135	
Value per share (Rs)	158	

Source: Indiabulls research.

Figure 82: RCOM trades at EV/EBITDA (x) premium to Bharti

Units as shown



Source: Bloomberg, Indiabulls research.

Risk to investment case

- **Upside risk:** (a) Management had indicated its intension to raise funds through stake sale in Reliance Globalcom and Reliance Infratel. We view that such activity would be constrained given the prevailing industry scenario. However, a better-than-expected value from stake sale would pose an upside risk to our valuation, and (b) Higher than expected MinMS.

- **Downside risk:** (a) Outcome of audit report submitted to DOT, (b) overbidding for 3G spectrum, and (c) slower than expected minute growth.

Figure 83:Summary financials

Rs million, year-end March

Profit and loss	FY08	FY09	FY10E	FY11E	FY12E
Revenues	188,274	229,485	224,223	259,025	284,159
Expenses	108,687	136,435	144,841	172,746	194,446
EBITDA	79,587	93,049	79,382	86,279	89,712
Other income	29,910	17,655	8,406	7,150	4,950
Depreciation	28,053	36,077	34,989	41,117	43,325
Interest	10,681	12,585	20,355	17,730	16,884
PBT	70,763	62,042	32,444	34,582	34,453
Taxes	2,836	(518)	3,676	3,918	3,904
Minority interest	13,915	2,036	2,468	3,357	3,891
Net profit	54,011	60,524	26,300	27,306	26,658
Extra ordinary items		(75)	18,634	-	-
Reported PAT	54,011	60,449	44,934	27,306	26,658
EPS	26.2	29.3	12.7	13.2	12.9
Dividend per share	0.7	0.8	-	-	-
Dividend payout ratio	2.9	2.7	-	-	-
Balance sheet					
Total liabilities	*573,817*	*821,256*	*784,486*	*793,721*	*737,309*
Net worth	290,263	422,803	446,033	470,269	493,857
Equity (A)	10,320	10,320	10,320	10,320	10,320
Reserves (B)	279,943	412,483	435,713	459,949	483,537
Debt	258,217	391,623	331,623	316,623	236,623
Deferred tax liability	1,028	281	281	281	281
Minority interest	24,309	6,549	6,549	6,549	6,549
Others					
Total asset	*573,817*	*821,256*	*784,486*	*793,721*	*737,309*
Net fixed asset	373,826	613,957	623,851	627,435	627,737
CWIP	149,299	113,096	78,226	43,627	34,902
Investments	1,348	2,815	2,815	2,815	2,815
Working capital (excl cash)	(103,741)	(70,498)	(37,089)	(16,689)	(10,671)
Cash & cash equiv.	117,431	109,672	64,468	84,319	30,313
Others	35,654	52,215	52,215	52,215	52,215

Source: Company, Indiabulls research.

Summary financials (*cont'd*)

Rs million, year-end March

Cash flow	FY08	FY09	FY10E	FY11E	FY12E
Sources	*177,509*	*134,540*	*1,290*	*53,423*	*(19,228)*
Retained earnings (PAT-div.)	67,420	56,249	26,300	27,306	26,658
Non cash items (incl. dep.)	29,528	37,445	34,989	41,117	43,325
Equity issuance	-	-	-	-	-
Increase in borrowings	100,745	75,084	(60,000)	(15,000)	(89,212)
Others	(20,185)	(34,238)	-	-	-
Application	*177,509*	*134,540*	*1,290*	*53,423*	*(19,228)*
Capital expenditure	203,718	106,858	10,013	10,102	34,902
Investments	-	-	(32,843)	10,000	(50,000)
Change in working capital (excl cash)	35,944	20,255	36,479	23,471	(123)
Change in cash	(62,154)	7,427	(12,361)	9,851	(4,006)
Ratios					
Revenue growth (%)	9.5	21.9	(2.3)	15.5	9.7
EBIDTA growth (%)	22.9	16.9	(14.7)	8.7	4.0
EPS growth (%)	47.1	12.1	(56.5)	3.8	(2.4)
EBITDA margin (%)	42.3	40.5	35.4	33.3	31.6
PAT margin (%)	28.7	26.4	11.7	10.5	9.4
Asset turnover					
Sales/net block	0.56	0.46	0.36	0.41	0.45
ROCE	16.0	10.8	5.8	5.9	5.9
Debt/equity	1.0	1.1	0.8	0.8	0.5
Tax rate	4.9	NM	11.3	11.3	11.3
ROE (%)	24.3	20.2	7.1	6.9	6.4
Valuation					
P/E	6.3	5.6	12.9	12.5	12.8
EV/EBIDTA	6.4	6.8	7.7	6.7	6.2
P/BV	1.4	1.0	0.9	0.8	0.8
EV/sales	2.7	2.7	2.7	2.2	1.9
Dividend yield	0.5	0.5	-	-	-

Source: Company, Indiabulls research.

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Indiabulls
Institutional Equities

8 March 2010

Initiating coverage

TTML

Underperform

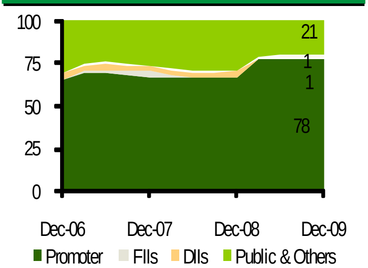
Richly valued

India
Telecom
Price: Rs 24
Target price: Rs 22

Stock details

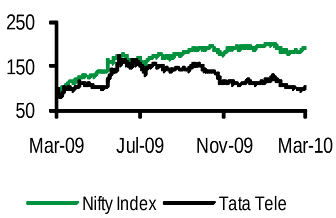
Bloomberg code	TTLS IN
MCap Rs/US$ mn	46386/1016
Outstanding shares (mn)	1897
52-wk H/L (Rs)	42/16
3m avg. trading vol (US$ mn)	2.17
Nifty / Sensex	5089/16994

Shareholding pattern (%)



Stock performance (%)

	1m	3m	1yr
Absolute	4.3	(7.7)	4.3
Nifty	7.8	(0.4)	97.5



Source: Bloomberg, Capitaline.

We initiate coverage with an 'Underperform' rating and DCF based target price of Rs.22/. Tata Teleservices Maharashtra Limited (TTML) is expected to gain minute market share and financial performance is expected to improve post its GSM foray. EBITDA is likely to improve at a CAGR of 20% over FY10-12E; however stock is richly valued among its peers at FY12E EV/EBITDA of 10.8x. 3G spectrum auction poses potential risk, especially given high financial leverage (FY10E Net Debt/EBITDA of 6.6x).

Minute growth improves considerably post GSM foray

TTML witnessed initial success with GSM launch (under the Tata Docomo brand). It's subs base increased by 3.3mn since the GSM foray in Aug-09 to 10.9mn subs by Dec-09. It added 1.6bn incremental minutes on its network since GSM launch and carried ~8bn on its network as of 3Q FY10. We expect the company to gain minute market share driven by GSM. We expect minute CAGR of 15% over FY10-12E to 37.6bn.

Peak GSM investment is behind

TTML's capex surged during FY10 with over Rs8bn investment in past 9 months driven by GSM foray. It expanded coverage from ~2700 cell sites in FY09 to ~6400 cell sites as of 3Q FY10. Majority of the GSM investment is now behind the company; network utilization is expected to improve as a result.

Financial performance to improve led by higher network utilization

We expect TTML's Revenue/EBITDA CAGR of 7.4%/20.0% over FY10-12E led by increase in EBITDA margin to 30.6% by FY12E. EBITDA margin improvement from ~25% in FY10 would be driven by scale advantage, higher network utilization and reduction in handset subsidies.

Richly valued – Underperform

We initiate with an 'Underperform' rating and DCF based fair value of Rs.22/sh. At CMP, TTML trades at FY12E EV/EBITDA of 10.8x and is most richly valued among its peers. We believe that DCF would be appropriate methodology due to back-ended nature of the investment and company coming out of significant investment mode. 3G spectrum auction poses potential risk, especially given high financial leverage – Net Debt at Rs37bn and Net Debt/EBITDA at 6.6x (FY10E).

Key financials

Rs million, year-end March

	FY08	FY09	FY10E	FY11E	FY12E
Revenue	17,896	20,581	22,839	24,579	26,337
EBITDA	4,856	6,001	5,600	6,992	8,070
PAT	(1,257)	(1,699)	(3,450)	(2,604)	(1,972)
EPS (Rs)	(0.7)	(0.9)	(1.8)	(1.4)	(1.0)
EPS (consensus) (3)			(1.4)	(1.6)	(1.6)
EPS growth (%)					
ROE (%)	NM	NM	NM	NM	NM
PE (x)	NM	NM	NM	NM	NM
EV/EBITDA (x)	14.9	13.2	14.9	12.3	10.8
P/BV (x)	NM	NM	NM	NM	NM

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Figure 84:Summary financials

Rs million, year-end March

Profit and loss	FY08	FY09	FY10E	FY11E	FY12E
Revenues	17,896	20,581	22,839	24,579	26,337
Expenses	13,041	14,580	17,239	17,587	18,267
EBITDA	4,856	6,001	5,600	6,992	8,070
Other income	13	-	100	100	100
Depreciation	4,394	4,631	5,476	5,673	5,966
Interest	1,723	3,057	3,674	4,022	4,176
PBT	(1,248)	(1,687)	(3,450)	(2,604)	(1,972)
Taxes	9	12	0	0	0
Minority interest	-	-	-	-	-
Net profit	(1,257)	(1,699)	(3,450)	(2,604)	(1,972)
Extra ordinary items	-	-	-	-	-
Reported PAT	(1,257)	(1,699)	(3,450)	(2,604)	(1,972)
EPS	(0.7)	(0.9)	(1.8)	(1.4)	(1.0)
Dividend per share	-	-	-	-	-
Dividend payout ratio	-	-	-	-	-
Balance sheet					
Total liabilities	*24,263*	*29,656*	*31,006*	*30,402*	*29,431*
Net worth	(2,006)	(3,787)	(7,237)	(9,841)	(11,812)
Equity (A)	18,936	18,972	18,972	18,972	18,972
Reserves (B)	(20,942)	(22,759)	(26,209)	(28,813)	(30,784)
Debt	26,269	33,443	38,243	40,243	41,243
Deferred tax liability	-	-	-	-	-
Minority interest	-	-	-	-	-
Others	-	-	-	-	-
Total asset	*24,263*	*29,656*	*31,006*	*30,402*	*29,431*
Net fixed asset	28,611	31,957	36,481	34,495	31,163
CWIP	1,250	2,299	922	658	658
Investments	-	-	-	-	-
Working capital (excl cash)	(5,943)	(4,974)	(7,598)	(5,199)	(2,892)
Cash & cash equiv.	345	375	1,201	448	502
Others	-	-	-	-	-

Source: Company, Indiabulls research.

Summary financials (*cont'd*)

Rs million, year-end March

Cash flow	FY08	FY09	FY10E	FY11E	FY12E
Sources	*11,601*	*10,203*	*6,826*	*5,070*	*4,994*
Retained earnings (PAT-div.)	(1,257)	(1,699)	(3,450)	(2,604)	(1,972)
Non cash items (incl. dep.)	4,394	4,631	5,476	5,673	5,966
Equity issuance	-	-	-	-	-
Increase in borrowings	8,045	7,114	4,800	2,000	1,000
Others	420	157	-	-	-
Application	*11,601*	*10,203*	*6,826*	*5,070*	*4,994*
Capital expenditure	12,045	8,157	8,623	3,424	2,634
Investments	-	-	-	-	-
Change in working capital (excl cash)	47	2,116	(2,624)	2,399	2,306
Change in cash	(491)	(70)	827	(753)	54
Ratios					
Revenue growth (%)	25.6	15.0	11.0	7.6	7.2
EBIDTA growth (%)	60.5	23.6	(6.7)	24.9	15.4
EPS growth (%)	NM	NM	NM	NM	NM
EBITDA margin (%)	27.1	29.2	24.5	28.4	30.6
PAT margin (%)	(7.0)	(8.3)	(15.1)	(10.6)	(7.5)
Asset turnover					
Sales/avg net block	0.7	0.7	0.7	0.7	0.8
ROCE	1.0	2.5	0.4	2.2	3.4
Debt/equity	NM	NM	NM	NM	NM
Tax rate	NM	NM	NM	NM	NM
ROE (%)	NM	NM	NM	NM	NM
Valuation					
P/E	NM	NM	NM	NM	NM
EV/EBIDTA	14.9	13.2	14.9	12.3	10.8
P/BV	NM	NM	NM	NM	NM
EV/sales	4.0	3.9	3.6	3.5	3.3
Dividend yield	-	-	-	-	-

Source: Company, Indiabulls research.

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Key to Indiabulls Institutional Equities recommendations:
Outperform= Expected total return is more than 15%
Neutral= Expected total return is less than 15% but more than zero.
Underperform= Expected total return is negative

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