

Telecom sector continued its momentum with a robust 35% yoy and 5.4% qoq rise in Q2 revenues underpinned by impressive subscriber additions by Bharti and Rcom. ARPUs maintained their downward trend but Rcom managed to limit the decline the most amongst the three companies under our coverage. Operating margins declined yoy on higher network operations related expenses. Use of different accounting principles makes inter-company profit comparison difficult albeit aggregate profits rose 5.5% yoy but declined 15.2% qoq dragged down by Idea PAT (down 35% yoy). Despite a slowdown in GDP, companies remain optimistic about the sector outlook. We largely concur with this view. However, margins could decline going forward as operators sign up low income consumers in rural areas. We maintain our positive view on the sector with Bharti Airtel as the top pick.

Q2 FY09 highlights

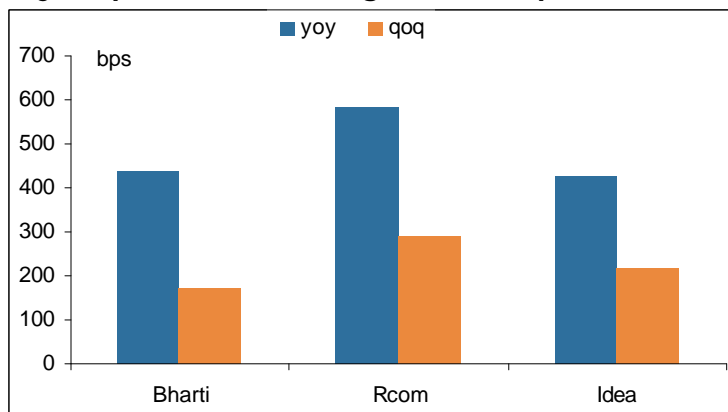
Rs mn	Q2 FY09	Q2 FY08	% yoy	Q1 FY09	% qoq	Comments
Revenues	168,719	124,678	35.3	160,017	5.4	Robust revenue growth; Bharti, Rcom subscriber net adds up 9.4% and 5.9% qoq while for Idea marginal decline of 0.2% qoq
Operating profit	65,033	51,319	26.7	64,344	1.1	
Adj. PAT	33,431	31,687	5.5	39,421	(15.2)	Bharti, Rcom use different accounting policies which makes inter-company PAT comparisons difficult; steep rise yoy in interest cost depresses Idea PAT
			Inc/(Dec)		Inc/(Dec)	
OPM (%)	38.5	41.2	(262)	40.2	(167)	Network roll out costs dent margins yoy

Source: Companies, India Infoline Research

Network operation costs jump yoy

As companies expand coverage in to rural areas, it takes time to get an electricity connection from grids to the cell sites. This has increasingly forced operators to rely on diesel pushing up energy costs causing higher network operations expenses. For instance, Rcom saw its network operation costs increase 580bps yoy.

Major operators incur higher N/W opex

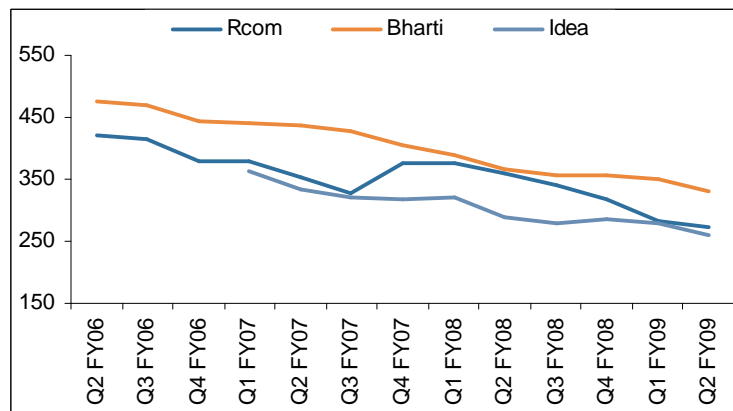


Source: Companies, India Infoline Research

Idea drags down aggregate PAT

Higher interest cost weighed on Idea Cellular Q2 PAT, which fell 34.6% yoy thereby dragging down aggregate PAT by 15.2% qoq. Both Bharti and Rcom use different accounting policies to adjust FX fluctuation on loans taken to acquire fixed assets which renders inter-company PAT comparisons difficult. For instance, if Bharti had followed Schedule VI of Companies Act instead of AS-11 as it does wef April 1, 2008, its group net profit would have been higher by Rs4.2bn. Rcom Q2 PAT rose 17.3% yoy but remained virtually flat qoq; however, use of AS-11 would have reduced its net profit by Rs2.8bn for realized FX fluctuations in the quarter.

ARPUs maintain their downward trend



Source: Companies, India Infoline Research

Remain positive on the sector; Bharti top pick

Telecom subscriber additions have remained healthy with September 2008 net adds at about 10mn amidst a moderation in GDP growth in current year. We believe companies would witness healthy revenue growth but margins could come under pressure as operators increasingly sign up low income subscribers. Even so, we forecast earnings CAGR of 33.9% and 14.9% for Bharti and Rcom respectively over FY08-10E and retain Bharti as our top pick in the sector.

Valuations summary

Company	EPS		P/E		EV/EBIDTA		P/BV	
	FY09E	FY10E	FY09E	FY10E	FY09E	FY10E	FY09E	FY10E
Bharti Airtel	46.0	58.7	15.6	12.2	10.0	7.9	4.6	3.3
Reliance Comm.	27.2	34.5	9.2	7.3	8.2	6.5	1.5	1.3

Source: India Infoline Research

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