

Telecoms, Media & Technology
 Wireless Telecoms
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Indian Telecoms

BWA auctions end; Tier 2 players steal the show

- ▶ **BWA auctions ends; Infotel broadband emerges as pan-India winner and Reliance Industries enters telecoms via Infotel**
- ▶ **Launch of BWA services could initiate price competition in broadband segment; downside risk for Bharti**
- ▶ **Maintain UW(V) on Bharti and INR250 TP; we rate Reliance Communications (RCOM) N(V), with a TP of INR158**

The Broadband Wireless Access (BWA) spectrum auctions finally concluded at a price of USD8.5bn (c7x reserve price, c4.5x our fair value). Unlike 3G, which had no pan-India winners, Infotel broadband emerged as the pan-India winner of the BWA spectrum. Immediately following the BWA auctions, Reliance Industries announced its acquisition of a 95% stake in Infotel. Other winners were Bharti in four services areas, Aircel in eight service areas, Tikona in five service areas, and Qualcomm in four services. Key Tier 1 players RCOM, Vodafone and Idea Cellular chose not to be aggressive and bagged no BWA spectrum, driven by their balance sheet limitations and unclear business case.

The business case for BWA services: Though not very clear, winners of the BWA spectrum would use Wimax to provide basic ADSL2+-like services, in our view. Given broadband penetration at c0.8%, and structural limitations to scale up wireline infrastructure, there is a clear demand for wireless broadband solutions. We estimate total Wimax market size over a six-year period at c45m households, with revenue potential of cUSD5bn and pan-India capex of roughly USD6bn. However, development of TD-LTE solutions, allowing operators to develop seamless 3G and BWA services, could change business dynamics.

Impact on Bharti: Aggressive bids for BWA spectrum suggest that costs of providing wireless broadband would be at par with fixed-line services. Given this, we believe there is no strong case for BWA winners to be aggressive in areas well served by fixed-line players, and believe that instead, they should focus on centres with poor fixed-line infrastructure. Nevertheless, BWA winners will launch in all markets and this would mean pricing pressure for incumbents in the medium term if all goes well with BWA winners. We maintain our UW (V) rating and INR250 TP on Bharti. Our cautious view is driven by weak earnings growth; upside risks include the ability to monetise tower assets.

Impact on RCOM: We believe RCOM is not particularly impacted by not obtaining BWA spectrum given its flexibility in spectrum. RCOM has an average of c5MHz of CDMA spectrum on a pan-India basis, leaving it with an option to roll out wireless broadband using the CDMA spectrum. We maintain our N (V) rating and INR158 TP on RCOM. The key downside risk we see is balance sheet constraints, while upside risks include a faster-than-estimated pickup of data services on CDMA.

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Figure 1: BWA spectrum winners

Circles	Category	Reserve price (USDm)	Final bid price (USDm)	Actual multiple to final price	Final pan-India (USDm)	Winning operator	
						Operator 1	Operator 2
Andhra Pradesh	A	36	235	6.6x	706	Aircel	Infotel
Gujarat	A	36	136	3.8x	409	Infotel	Tikona
Karnataka	A	36	343	9.6x	1029	Infotel	Bharti
Maharashtra	A	36	203	5.7x	610	Bharti	Infotel
Tamil Nadu	A	36	460	12.9x	1380	Infotel	Aircel
Haryana	B	13	27	2.0x	80	Infotel	Qualcomm
Kerala	B	13	57	4.3x	172	Infotel	Qualcomm
Madhya Pradesh	B	13	28	2.1x	83	Augere	Infotel
Punjab	B	13	74	5.5x	222	Bharti	Infotel
Rajasthan	B	13	22	1.6x	65	Tikona	Infotel
U.P. (East)	B	13	32	2.4x	95	Tikona	Infotel
U.P. (West)	B	13	41	3.1x	123	Tikona	Infotel
West Bengal	B	13	16	1.2x	47	Infotel	Aircel
Assam	C	3	7	2.2x	22	Aircel	Infotel
Bihar	C	3	22	6.6x	66	Infotel	Aircel
Himachal Pradesh	C	3	5	1.4x	14	Tikona	Infotel
J&K	C	3	5	1.4x	14	Aircel	Infotel
North East	C	3	5	1.4x	14	Infotel	Aircel
Orissa	C	3	14	4.2x	42	Aircel	Infotel
Delhi	Metro	36	498	14.0x	1494	Infotel	Qualcomm
Kolkata	Metro	13	116	8.7x	349	Infotel	Bharti
Mumbai	Metro	36	510	14.3x	1529	Infotel	Qualcomm
Total		389	2,855	7.3x	8,565		

Source: DoT, HSBC

Qualcomm plans – an upside for BWA players

At present, there are regulatory and technological limitations to provide voice services on BWA spectrum. Given this, BWA winners will provide wireless broadband services to capture the data market in the near to medium term. That Tier 1 telcos did not go overboard in bidding for BWA spectrum, in our view, was driven by the fact that providing broadband services using Wimax does not allow them a seamless 3G and BWA experience, which means that the services provided would have been more about 3G or BWA as individual offerings, and not an integration of the two. However, Bharti tried to cover its strategic losses in the 3G spectrum auctions by selectively bidding for BWA spectrum in four markets.

However, Qualcomm claims that TD-LTE solutions would allow backward compatibility with 3G, both HSPA and EVDO, which are further compatible with 2G GSM and CDMA2000 1X. If such solutions evolved, this would increase the scope for BWA players and may drive consolidation between the BWA players and Tier 1 telecom operators.

Qualcomm could attract a partner – Tier 1 telcos could make up for lost metros

Qualcomm reiterated after the close of the auctions that it would seek an operating partner at the appropriate time for construction of a TD-LTE network in compliance with the Indian government's rollout requirement for the BWA spectrum, and then exit the venture. Apart from winning BWA spectrum in Kerala and Haryana, Qualcomm won BWA spectrum in metro circles. Its intended exit from such venture could provide an opportunity for Tier 1 players to make up for their loss in the metro circles.

Pricing competition in broadband segment

Figure 2: Comparing fixed line and BWA costs per household

Particulars (figures in INR)	Fixed line	BWA player
CPE	2,000	3,000
Copper	8,000	
Fibre	5,000	4,000
BWA spectrum (average pan India price)		6,000
Others	1,500	2,500
Cost per household/subscriber	16,500	15,500

Source: HSBC

Aggressive bidding for BWA spectrum has narrowed the cost structure difference for fixed-line broadband services versus wireless broadband services. However, despite this, price competition in the broadband segment is possible in the medium term, assuming a timely and successful rollout is done by Wimax players over the next 12-18 months. If all goes as planned for the BWA winners, residential broadband tariffs could decline 15% in the next 18-24 months, we believe. Price competition would be driven by the BWA winners' attempts to gain market share. We note that our estimates for wireless broadband are optimistic, driven by poor fixed-line infrastructure in India. We highlight that scalability is a big challenge for Wimax players as global scale is not in favour of the technology so far. However, given its backhaul efficiency, Wimax would allow BWA winners to get a foothold in the corporate broadband markets as well, in particular, the SMEs.

In our view, players like Bharti, which currently provide fixed-line broadband, are likely to get aggressive in their existing markets, and they have an advantage over wireless broadband players with quality and speed offerings. However, they could be reluctant to expand further in new markets, depending on how BWA deployments fare. That said, it is possible that the BWA winners enter into tie-ups with Tier 1 operators, possibly at a later stage.

Valuation and risks

Bharti Airtel

We maintain our UW(V) rating and INR250 target price on Bharti Airtel shares. We value the core business at INR190 per share on a mix of PE and DCF, and the tower business at INR60 per share. Our cautious view is driven by weak earnings growth, sector overcapacity, and the challenges Bharti faces in replicating its minute factory model at Zain. An ability to monetise tower assets and earlier-than-expected sector consolidation are the key upside risks. The possibility of equity dilution supports our view, though we believe near-term equity dilution is unlikely, as Bharti has several other options, including (1) the monetisation of tower assets and (2) issuance of long-term convertibles.

Our target price represents c12x FY11e earnings (FY11 EPS at INR20.8), and the stock is now trading at c13x on FY11e earnings. Our FY11 earnings estimate is c5% lower than consensus. We note that our numbers do not include Zain – regulatory approvals are pending – but we believe such inclusion would be EPS dilutive. For our DCF analysis of the core business, we assume a WACC of 12%, cost of equity of 12% (cost of debt of 11%), a terminal growth rate of 1%, and a beta of 1. We value Bharti's tower business (Bharti Infratel and the 42% stake in the Indus Tower JV) at INR60 on DCF, assuming a sliding WACC of 12% and a terminal growth rate of 4%.

Under our research model, for stocks with a volatility indicator, the Neutral band is 10 percentage points above and below the hurdle rate for Indian stocks of 10.5%. Our target price of INR250 provides a potential downside of 9%, below the Neutral band of our model; therefore, we reiterate our UW(V) rating.

Reliance Communications

We value RCOM at INR158, which is our 12-month target price, based on a blended approach of PE and DCF. For our DCF valuation, we assume a cost of equity of 13% (HSBC's strategy team has computed a baseline COE of 10.5% for India, and we assume a rate 250bp above that to factor in competitive intensity, accounting issues, and risks associated with a stretched balance sheet) and cost of debt of 10%. Our target debt-to-equity ratio is 15%; our WACC is 13%, and the terminal growth rate is c3%. This produces a fair value of INR157 per share. For our PE methodology, we use c10x based on our 12-month forward earnings estimate to arrive at a fair value of the core business at INR160 per share. Blending these two approaches, we arrive at a fair value of INR158 per share for the core business.

With respect to risks, we recognise that RCOM could benefit from 3G services, given its CDMA capabilities and fibre backhaul, but we believe it is too early to give much credit to this opportunity, and we view this an upside risk. Data cards on the CDMA platform may enable RCOM to achieve higher-than-estimated ARPU, and we view higher-than-estimated elasticity as a further upside risk. In our view, improved disclosure would be positive and address investor concerns. Downside risks include the company's strained balance sheet, non-availability of 2G spectrum in the next six to nine months, and execution risks around 3G.

Under our research model, for stocks with a volatility indicator, the Neutral band is 10 percentage points above and below the hurdle rate for Indian stocks of 10.5%. Our target price of INR158 provided a potential return that was within the Neutral band of our model at the time we set our target; therefore, we rate the stock N(V).

Disclosure appendix

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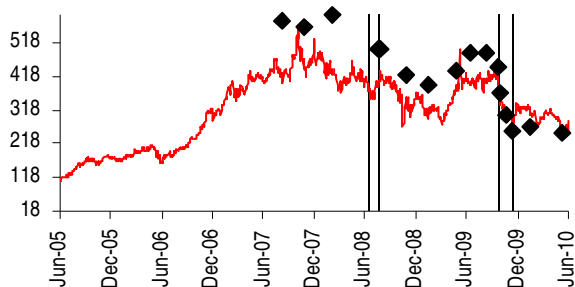
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Share price and rating changes for long-term investment opportunities

Bharti Airtel (BRTI.BO) Share Price performance INR Vs HSBC rating history



Source: HSBC

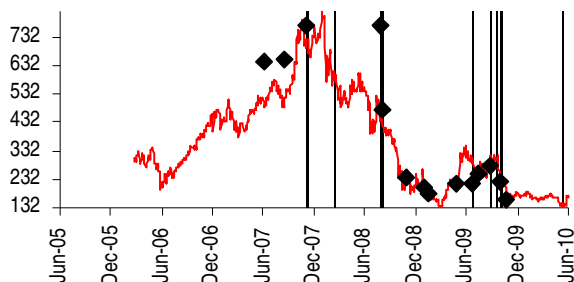
Recommendation & price target history

From	To	Date
Overweight	Overweight	20 June 2008
Overweight	Overweight (V)	30 July 2008
Overweight (V)	Neutral (V)	30 September 2009
Neutral (V)	Underweight (V)	24 November 2009
Target Price	Value	Date
Price 1	585.00	21 August 2007
Price 2	570.00	07 November 2007
Price 3	603.00	17 February 2008
Price 4	501.50	30 July 2008
Price 5	501.00	04 August 2008
Price 6	421.50	03 November 2008
Price 7	393.00	21 January 2009
Price 8	438.00	04 May 2009
Price 9	488.50	22 June 2009
Price 10	488.50	18 August 2009
Price 11	448.00	30 September 2009
Price 12	368.00	07 October 2009
Price 13	305.00	01 November 2009
Price 14	254.00	24 November 2009
Price 15	270.00	24 January 2010
Price 16	250.00	20 May 2010

Source: HSBC

Reliance Communications (RLCM.NS) Share Price performance INR Vs HSBC

rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Overweight (V)	Neutral	15 November 2007
Neutral	Restricted	22 February 2008
Restricted	Neutral	04 August 2008
Neutral	Neutral (V)	15 August 2008
Neutral (V)	Underweight (V)	29 June 2009
Underweight (V)	Neutral (V)	01 September 2009
Neutral (V)	Restricted	25 September 2009
Restricted	Underweight (V)	07 October 2009
Underweight (V)	Neutral (V)	20 May 2010
Target Price	Value	Date
Price 1	644.00	12 June 2007
Price 2	651.00	23 August 2007
Price 3	775.00	15 November 2007
Price 4	Restricted	22 February 2008
Price 5	775.00	04 August 2008
Price 6	475.00	15 August 2008
Price 7	235.00	05 November 2008
Price 8	202.00	13 January 2009
Price 9	180.00	27 January 2009
Price 10	218.00	05 May 2009
Price 11	214.00	29 June 2009
Price 12	250.00	23 July 2009
Price 13	280.00	01 September 2009
Price 14	Restricted	25 September 2009
Price 15	227.00	07 October 2009
Price 16	158.00	02 November 2009

Source: HSBC

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BHARTI AIRTEL	BRTI.NS	285.20	11-Jun-2010	2, 4, 5, 6, 7
RELIANCE COMMUNICATIONS	RLCM.NS	174.35	11-Jun-2010	2, 5, 7

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