

# Telcos pain is government's gain

*"We learn from history that we learn nothing from history"*

The European telecom operators, particularly UK and Germany, bid aggressively for the 3G spectrum auction during early 2000. The UK government raised US\$35bn whereas Germany, US\$46bn from the auction. Post auction, most of the companies witnessed a significant increase in their debt levels, which resulted in pressure on stock price performance.

After 10 years, we are witnessing the same story in India. The pan-India auction amount reached Rs167.5bn (US\$3.7bn), up 379% over the base price of Rs35bn. With this, the Indian government will raise Rs677bn (US\$15bn). Apart from the payment for spectrum, operators would also need to pay for 3G capex, which will increase the debt burden. We expect RCom's debt burden to go up by about 26% whereas Idea's debt burden would go up by 57%.

The Metro areas — Mumbai and Delhi — clearly stole the show with the auction amount crossing Rs30bn. Delhi emerged a leader in the entire auction process, with the winning price reaching Rs33bn versus Rs3.2bn, a rise of over 936%. Mumbai came in second with the winning amount at Rs32.5bn, up 915% over base price.

**Key 3G spectrum wins:** Bharti won 3G spectrum in 13 circles, indicating total cash outflow of Rs123bn. Vodafone grabbed it in 9 circles, leading to cash outflow of Rs116bn. RCom managed to get the spectrum in 13 circles, with cash outflow of Rs86bn. Idea, on the other hand, won 3G spectrum in 11 circles, which would cost the company Rs57.7bn.

**Our View:** We believe that incremental opex incurred towards running a 3G network in terms of NOC and selling and marketing expense would not be commensurate with the incremental revenues from 3G services. Earnings will be further impacted due to increase in amortization and interest expenses after the deployment of 3G network. We remain negative on the telecom sector and maintain SELL on Bharti Airtel, RCom and Idea Cellular.

## Exhibit 1: Snapshot of winning operators

Rsmn	No. of Winning Circles	Cash Outflow
BSNL/ MTNL	22	167,506
Bharti	13	122,955
Vodafone	9	116,179
RCom	13	85,850
Aircel	13	64,995
Tata Tele	9	58,643
Idea	11	57,686
S Tel	3	3,377
<b>Total</b>	<b>93</b>	<b>677,190</b>

Source: DoT, Ambit Capital research

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**What lies ahead:** Operators must pay the amounts within the next 10 days. The spectrum, however, would be available in the month of September 2010. In our view, operators would require 4-6 months to launch the service after allotment of spectrum. Therefore, we expect 3G services to be launched in the last quarter of FY11. Some media reports suggested, 3G spectrum would be available only at the end of year 2010, which in our view, will only serve to delay deployment of 3G services further.

## Playerwise analysis

### Bharti Airtel

Bharti won 3G spectrum in 13 circles, leading to cash outflow of Rs123bn. The circles wherein Bharti has won this spectrum accounts for 68% of its total mobile revenue and 65% of its total subscriber base. This augurs well for the company. As of March 2010, Bharti had a cash balance of Rs77bn. Although this amount would be adequate for part of the funding, for incremental amount and for upcoming BWA auction, Bharti would need additional funding. Hence we expect the company to raise debt of Rs80bn. The company has indicated that the capex for 3G services would be marginally above the announced capex of US\$1.8bn for FY11.

**Key positives:** In our view, getting spectrum in most of the key circles where Bharti has higher revenue and subscriber market share is positive.

**Key negatives:** In our view, the price paid for the 3G spectrum is much higher and it will be difficult to monetise the 3G services in the short term. Also, not getting 3G spectrum in Gujarat and Maharashtra is negative for Bharti, in our view, as Bharti has more than 20% revenue market share in each of these circles.

#### Exhibit 2:Company snapshot: Bharti Airtel

Winning Circles	Bid Amount	Subs Base (mn)	% Share	Qtrly Revenue (Rsmn)	% Share	Subs Mkt Share (%)	Revenue Mkt Share (%)
Delhi	33,169	5.7	4.8	8,639	10.1	21.4	38.0
Mumbai	32,471	3.0	2.5	4,053	4.7	12.2	19.9
Andhra Pradesh	13,731	12.1	10.2	8,532	9.9	29.3	40.2
Karnataka	15,799	11.8	9.9	9,846	11.5	36.1	51.4
Tamil Nadu	14,649	10.5	8.8	8,093	9.4	21.1	35.1
Uttar Pradesh (West)	5,140	3.6	3.0	2,054	2.4	13.3	18.5
Rajasthan	3,210	9.6	8.1	5,597	6.5	31.3	44.5
West Bengal	1,236	4.9	4.1	2,176	2.5	22.4	27.9
Himachal Pradesh	372	1.3	1.1	906	1.1	28.1	43.8
Bihar	2,035	10.1	8.5	5,382	6.3	31.6	46.2
Assam	415	2.1	1.8	1,416	1.7	27.5	33.1
North East	423	1.3	1.1	1,030	1.2	28.3	36.5
Jammu and Kashmir	303	1.7	1.5	957	1.1	34.6	42.5
Total	122,955	77.7	65.4	58,683	68.4		

Note: Subscriber base and gross revenue for Oct-Dec2009 qtr

Source: TRAI, DoT, Company, Ambit Capital research

## Reliance Communications

RCom managed to get the 3G spectrum in 13 circles., leading to a cash outflow of Rs86bn. The circles wherein RCom has won 3G spectrum accounts for 55% of its total mobile revenue and 49% of its total subscriber base. As of March 2010, RCom had a cash balance of Rs48bn, and gross debt of Rs247bn. The cash in hand would be insufficient to fund the acquisition of 3G spectrum. Also, BWA auction is lined up after two days. In order to fund this, RCom will need to raise further debt of Rs65bn, in our view. This will result in gross debt going up to Rs317bn, which will further put a strain on the balance sheet.

**Key positives:** Getting spectrum in Metro circles and MP where it has higher subscriber and revenue market share.

**Key negatives:** Increase in debt to fund 3G and BWA auction would put pressure on balance sheet further. Also, low usage subscribers would make it difficult to monetise the 3G services. Not getting 3G spectrum in any of the circle A areas is negative for RCom, in our view.

### Exhibit 3:Company snapshot: RCom

Winning Circles	Bid Amount	Subs Base (mn)	% Share	Qtrly Revenue (Rsmn)	% Share	Subs Mkt Share (%)	Revenue Mkt Share (%)
Delhi	33,169	5.4	5.7	3,132	9.7	20.0	13.8
Mumbai	32,471	5.4	5.8	3,335	10.4	22.2	16.3
Kolkata	5,443	3.5	3.7	1,270	3.9	23.1	17.8
Punjab	3,220	2.4	2.5	703	2.2	12.9	6.4
Rajasthan	3,210	4.3	4.6	1,078.9	3.4	14.1	8.6
Madhya Pradesh	2,584	7.8	8.3	2,535	7.9	27.5	21.7
West Bengal	1,236	4.2	4.5	1,098	3.4	19.3	14.1
Himachal Pradesh	372	1.1	1.2	405	1.3	25.2	19.6
Bihar	2,035	6.9	7.3	2,178	6.8	21.6	18.7
Orissa	970	2.5	2.7	974	3.0	19.6	18.6
Assam	415	1.6	1.7	814	2.5	20.5	19.0
North East	423	0.5	0.5	174	0.5	10.7	6.2
Jammu and Kashmir	303	0.4	0.5	94	0.3	8.5	4.2
<b>Total</b>	<b>85,850</b>	<b>46.0</b>	<b>49.0</b>	<b>17,790</b>	<b>55.3</b>		

Note: Subscriber base and gross revenue for Oct-Dec2009 qtr

Source: TRAI, DoT, Company, Ambit Capital research

## Idea Cellular

Idea managed to win 3G spectrum in 11 circles, which will result in cash outflow of Rs57.7bn. The circles wherein Idea has won 3G spectrum accounts for 80% of its total mobile revenue and 45% of its total subscriber base. As of March 2010, Idea had a cash balance of Rs14bn, which will not be sufficient to meet the 3G spectrum auction amount. The company will also need funds for the BWA auction, so we expect Idea to raise debt of Rs45bn. This will take total debt to Rs123bn.

**Key positives:** Getting spectrum in its key circles such as Maharashtra, AP, Gujarat, MP, Haryana, Kerala, MP and UP (W) circles.

**Key negatives:** Increase in debt to fund 3G and BWA auction would put pressure on the balance sheet. Also, not getting 3G spectrum in key metro markets of Delhi and Mumbai will restrict its ability to generate higher revenue from 3G services, in our view.

### Exhibit 4: Company snapshot: Idea Cellular

Winning Circles	Bid Amount	Subs Base (mn)	% Share	Qtrly Revenue (Rsmn)	% Share	Subs Mkt Share (%)	Revenue Mkt Share (%)
Maharashtra	12,578	8.9	15.5	5,877	17.4	22.3	28.5
Gujarat	10,761	4.9	8.5	2,827	8.4	16.7	18.7
Andhra Pradesh	13,731	6.0	10.5	3,648	10.8	14.5	17.2
Kerala	3,125	5.1	8.8	3,438	10.2	22.9	28.6
Punjab	3,220	3.0	5.3	1,941	5.8	16.4	17.6
Haryana	2,226	1.9	3.3	1,138	3.4	15.0	19.7
Uttar Pradesh (East)	3,646	3.3	5.7	1,527	4.5	8.7	10.0
Uttar Pradesh (West)	5,140	5.3	9.2	3,146	9.3	19.5	28.3
Madhya Pradesh	2,584	6.6	11.5	3,248	9.6	23.3	27.8
Himachal Pradesh	372	0.2	0.4	136	0.4	5.2	6.6
Jammu and Kashmir	303	0.0	0.0	6	0.0	0.2	0.3
Total	57,686	45.3	78.7	26,931	79.9		

Note: Subscriber base and gross revenue for Oct-Dec2009 qtr

Source: TRAI, DoT, Company, Ambit Capital research

## Explanation of Investment Rating

Investment Rating	Expected return (over 12-Month period from date of initial rating)
Buy	> 15%
Hold	5% to 15%
Sell	< 5%

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