Equity | India

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Telco Services

Overweight

Ripe for profitable growth

Telecom revenue in India contracted to only 2.4% of GDP in FY11 (17% below the OECD country average). We believe sector revenue will double in the next five years led by relative price stability, growing minute penetration and broadband usage. Top pick Bharti, closely followed by Idea.

Table 1 : Valuation snapshot of our coverage universe

Company	Recom	Price	Target price	Upside	EV/EBITDA (x)			PE (x)		
		(Rs)	(Rs)	(%)	FY12F	FY13F	FY14F	FY12F	FY13F	FY14F
Bharti	Buy	378	475	25.7	8.0	6.5	5.6	23.9	16.8	14.6
Idea	Buy	99	121	22.8	8.8	6.1	5.0	36.8	18.4	13.0
RCom	Hold	72	67	(6.6)	7.1	6.0	5.1	21.9	19.6	17.7

Note: Priced at COB 30 September 2011.
Source: RBS forecasts

India's telecom revenue looks set to double over the next five years

India's telecom revenue contracted to 2.4% of GDP in FY11 (17% below the OECD country average) from 2.9% in FY09, primarily led by significant price erosion (30%) over the past two years. Sector revenue is significantly below that of other developed and developing markets, underpinning growth prospects, in our view. India's MoU/capita (205) is one-third that of the US (602) and lower than China's (221 as of Dec-09), showing significant under-penetration. We believe India's telecom sector revenue will double over the next five years, led by: 1) increased minute penetration to 336 MoU/capita (about 50% of US MoU/capita); 2) relative price stability in the voice business (versus a 30% decline over the past two years); and 3) increased wireless broadband penetration to 5.4% by FY14 and 16% by FY16.

Structural improvement – price stability and consolidation

Pricing power is returning to operators as a result of: 1) lower competitive intensity due to limited capacity additions by new operators; 2) new operators' realisation that expansion is not viable because of continuous high EBITDA losses at current tariffs (Uninor's EBITDA loss has been Rs8bn/quarter for the past six quarters); and 3) revenue market share (RMS) consolidation among the top three operators in India. However, we expect blended revenue per minute to increase marginally (1-2%) in FY13 and remain stable in FY14.

Who will benefit from structural improvement? Idea should be biggest beneficiary

We expect Bharti to maintain its leadership position in India, and Idea and Vodafone India to gain market share. We believe Idea is likely to be the biggest beneficiary among listed peers owing to higher minute market share gains and a reduction in its churn rate. A 1% reduction in its churn rate is likely to have a 44bp positive impact on its EBITDA margin. We forecast FY11-14 EBITDA CAGRs of 29.6% and 17.1% for Idea and Bharti, respectively.

Regulatory overhang remains; National Telecom Policy 2011 should provide stability

We estimate the regulator's recommendations on spectrum pricing, if implemented, would have a Rs29/share negative impact on Bharti (5% of fair value), a Rs23/share negative impact on Idea (15% of FV), and a Rs14/share negative impact on RCom (14% of FV). We don't believe the recommendations will be implemented in their current form, as it would create an uneven playing field. Our target prices factor in the negative impacts, providing a margin of safety against the stocks' fair values. Although regulatory uncertainty remains, the NTP'11 (expected by Oct/Nov) should provide a stable regulatory outlook as it addresses known concerns (spectrum renewal charges) and offers guidelines for consolidation.

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Telecom revenue contracts to 2.4% of GDP

Telecom revenue contracted to 2.4% of GDP in FY11 (17% below OECD country average) led by 30% price erosion over the past two years. We expect telecom revenue to double in the next five years led by price stability and a rise in minute and broadband penetration.

Industry revenue to double over next five years

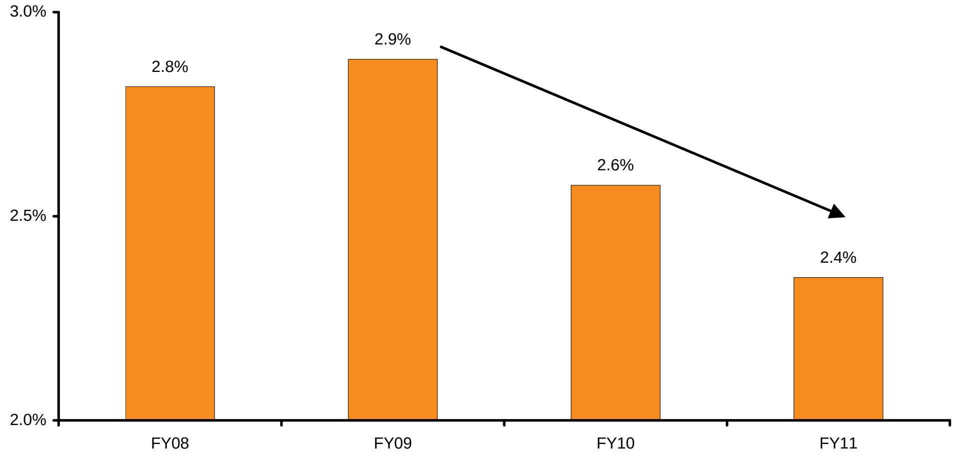
India's telecom industry remains under-penetrated, which is reflected by various parameters: India's telecom revenue as a percentage of GDP contracted to about 2.4% in FY11, subscriber penetration was 48%, voice penetration was 205 MoU/capita, and fixed broadband penetration was 1%. We believe telecom sector revenue is likely to double (we project a 15% CAGR) over the next five years, led by 1) increased minute penetration to 335 MoU/capita (12% minute CAGR); 2) relative price stability in voice business (versus 30% price erosion over FY09-11); and 3) increased wireless broadband penetration to 5.4% by FY14 (67m subs) and 16% by FY16. India's telecom industry revenue was Rs1,717bn in FY11 (representing 2.4% of GDP). If telecom revenue remains stable at 2.4% of GDP, we believe industry revenue will double to Rs3.435bn (implying a 15% CAGR) by FY16. However, industry revenue (in a best-case scenario) could expand into a Rs4,000bn industry (2.8% of GDP and implies an 18.5% CAGR for FY11-16).

India's telecom revenue is 17% below OECD country avg

India's telecom revenue as a percentage of GDP contracted over the past two years to 2.4% of GDP in FY11, primarily led by significant price erosion (30%).

Telecom revenue is low despite only 48% active subs penetration in India

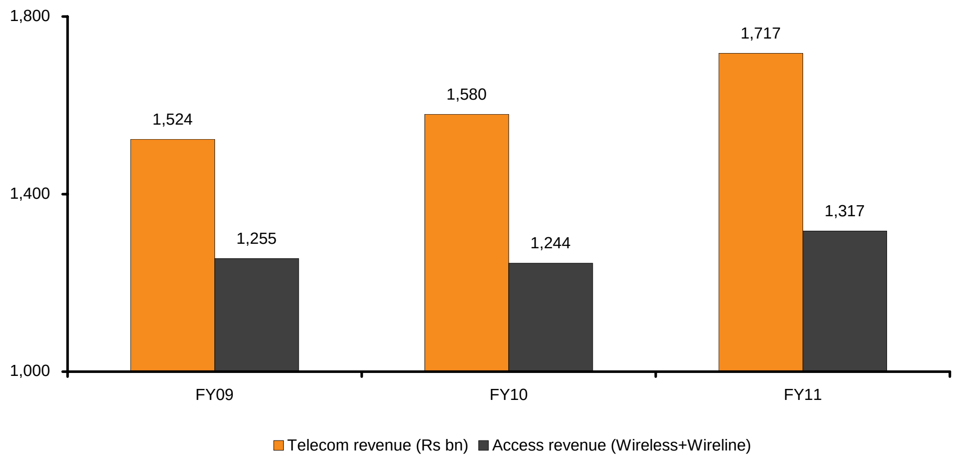
Chart 1 : India's telecom revenue as a percentage of GDP contracted over past two years



Source: TRAI, Business Beacon

In India, gross telecom revenue grew at a 6.2% CAGR over FY09-11, while access revenue (wireless plus wireline) grew a meagre 2.4% over the same period.

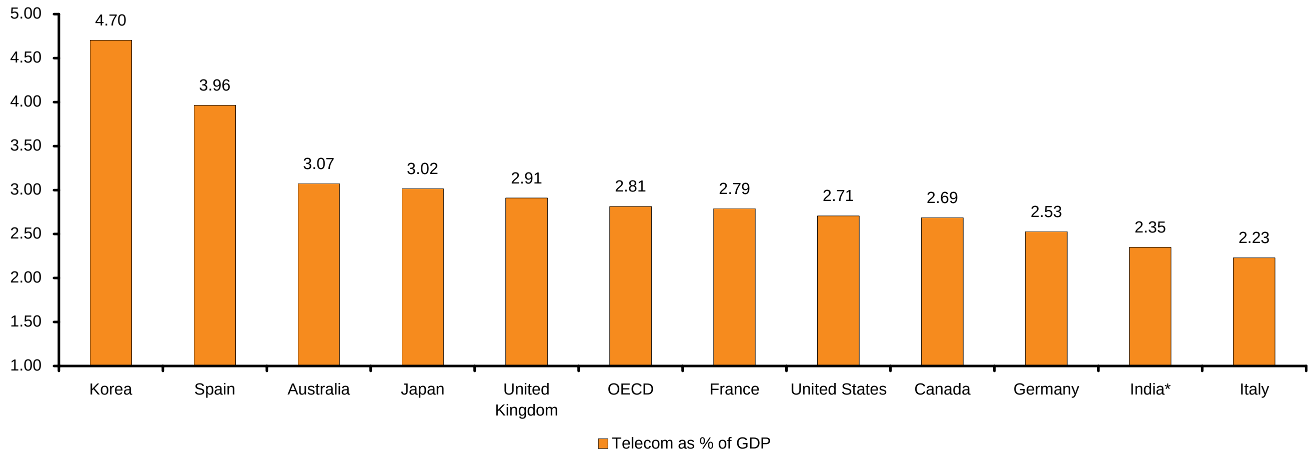
Chart 2 : Telecom revenue (6.2% CAGR) vs access revenue (2.4% CAGR) over FY09-11



Source: TRAI

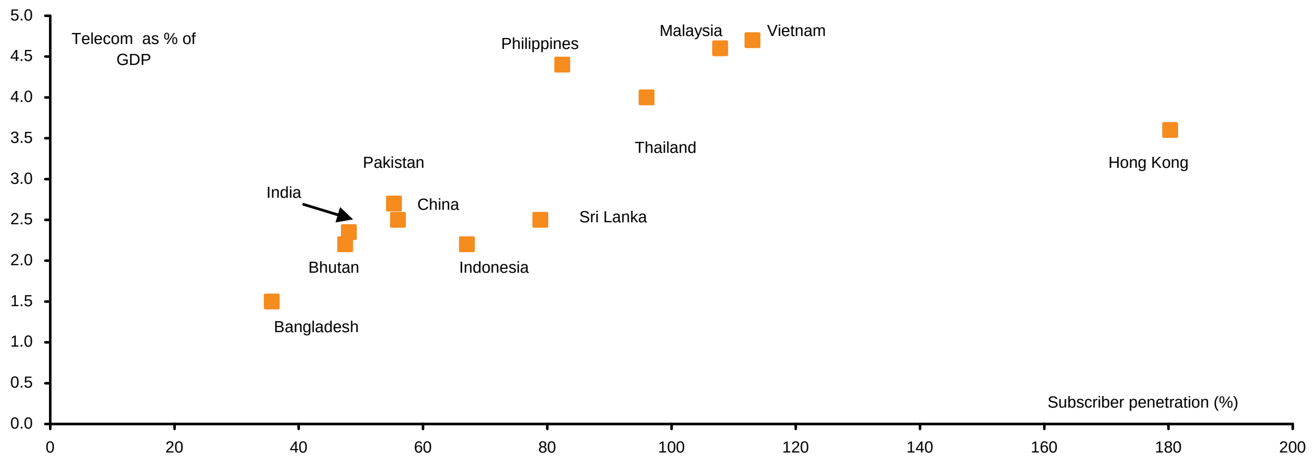
Our study of developed and developing economies indicates India's telecom revenue (as a percentage of GDP) is significantly behind that of other geographies (see Chart 3). India's telecom revenue lags that of other geographies despite its low subs penetration (48% based on an active subs base) and is below that of developed and other developing economies (see Chart 4).

Chart 3 : India's telecom spend lags that of developed markets



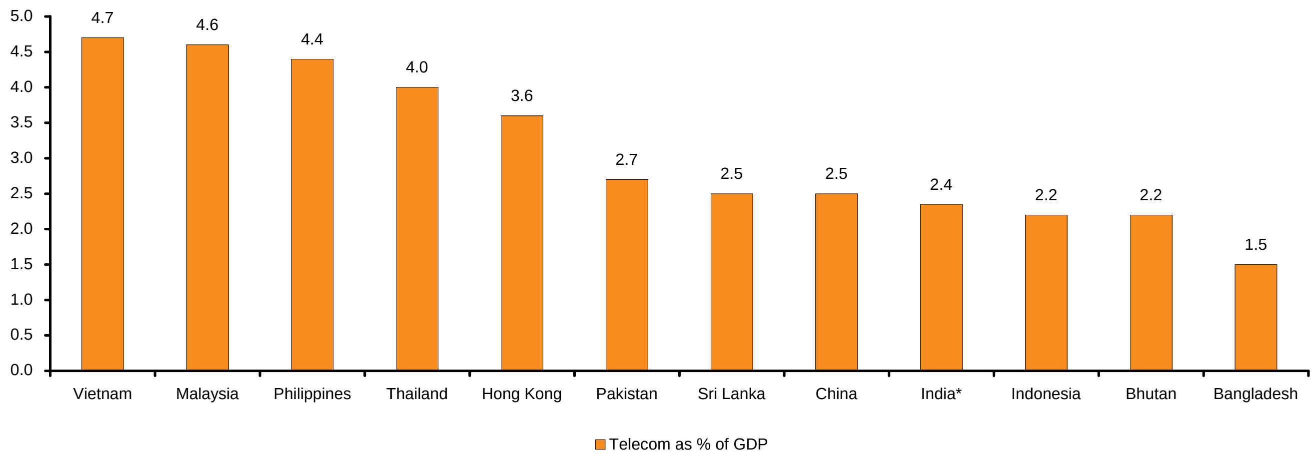
*India FY11 and other countries 2009.
Source: OECD Communications Outlook 2011, TRAI

Chart 4 : Comparison of sub penetration versus telecom spend in Asia Pacific region – India lags other economies



*India sub penetration is based on active subs; GDP numbers are for FY11; other countries 2009.
Source: TRAI, World Bank, ITU

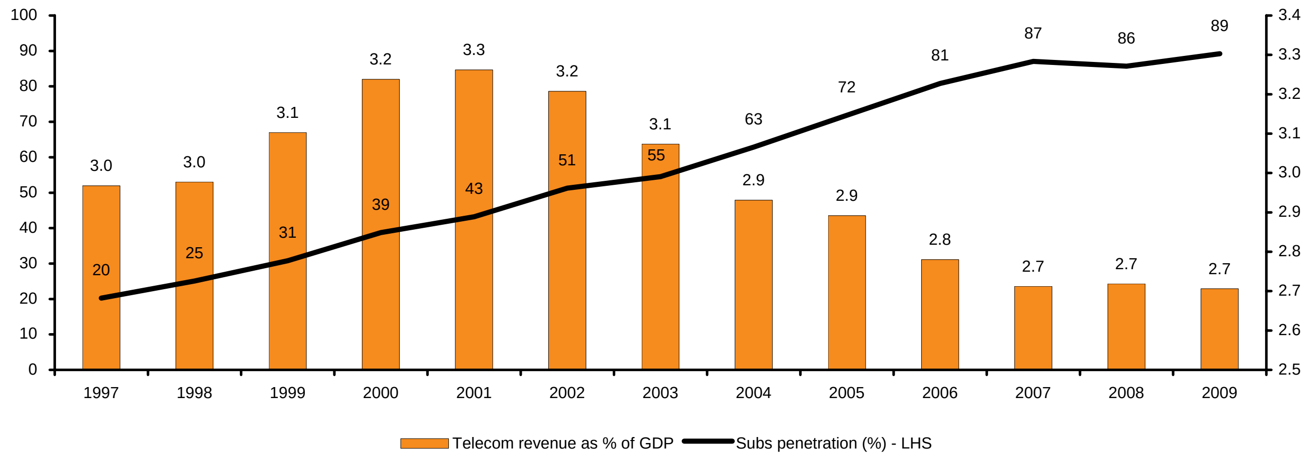
Chart 5 : India's telecom spend lags that of other Asia Pacific economies



*India FY11 and other countries 2009.
Source: TRAI, World Bank, ITU

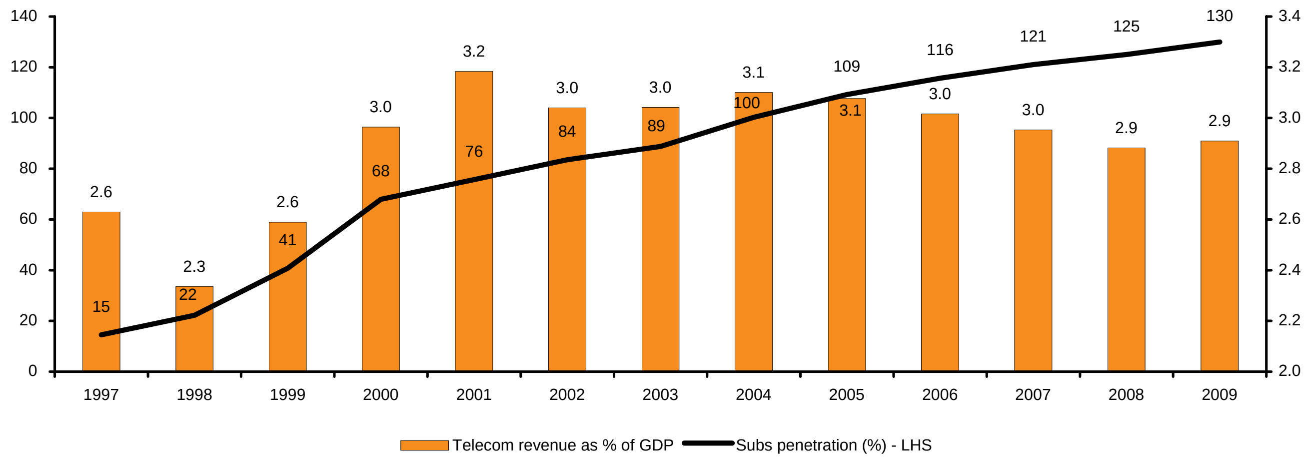
Our study of various developed markets indicates telecom spend (as a percentage of GDP) rises with subs penetration before it peaks. We analysed trends for various geographies and they seem to support this theory (see Charts 6-9). Based on this data, we believe India's telecom spend (as a percentage of GDP) is likely to rise with an increase in subs penetration, the latter of which was a meagre 48% as of FY11.

Chart 6 : US: telecom revenue (as a percentage of GDP) versus subs penetration



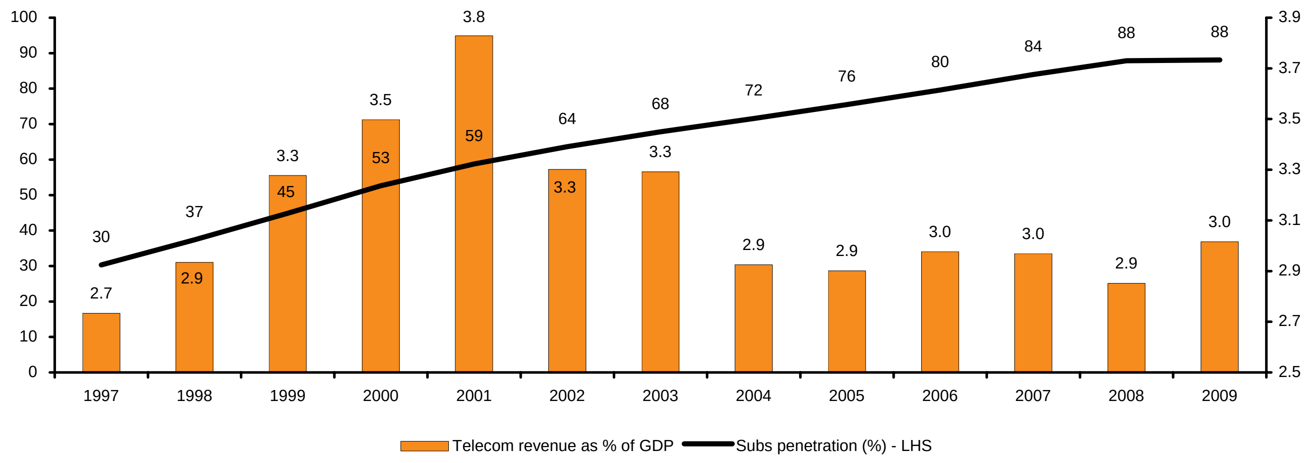
Source: OECD Communications Outlook 2011

Chart 7 : UK: telecom revenue (as a percentage of GDP) versus subs penetration



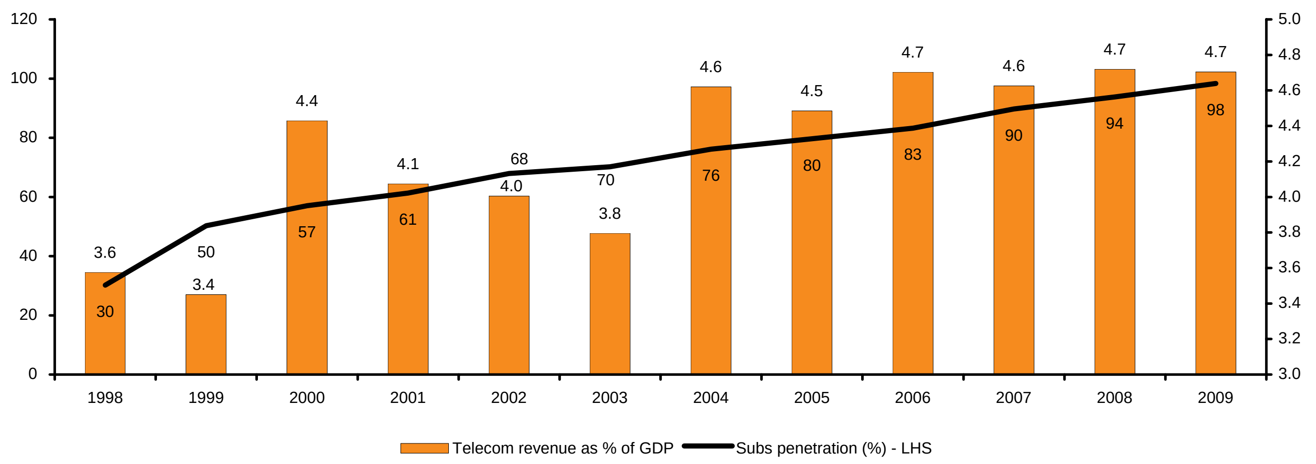
Source: OECD Communications Outlook 2011

Chart 8 : Japan: telecom revenue (as a percentage of GDP) versus subs penetration



Source: OECD Communications Outlook 2011

Chart 9 : Korea: telecom revenue (as a percentage of GDP) versus subs penetration



Source: OECD Communications Outlook 2011

Our study of various OECD countries indicates mobile revenue growth has far exceeded nominal GDP growth during periods of rising subs penetration (see Table 2). The study covered a period after the countries reached subs penetration of about 40-50%. We believe this supports our belief that India's telecom spend is likely to double over the next five years, as the active sub penetration in India based on visitor location register (VLR) is 48% as of FY11.

Mobile revenue growth exceeded nominal GDP in developed markets

Table 2 : Comparison of telecom/mobile revenue CAGR versus nominal GDP growth after countries reached about 40-50% sub penetration

Country	Penetration (about 40-50%)	Year	Penetration in 2009 (%)	Telecom revenue CAGR (%)	Mobile revenue CAGR (%)	GDP CAGR (%)
United States	43.2	2001	89.2	1.6%	9.5%	4.0%
Japan	44.9	1999	88.1	0.7%	6.6%	1.5%
Germany	58.6	2000	132.2	5.6%	7.3%	6.5%
France	48.9	2000	95.3	9.0%	15.7%	8.0%
United Kingdom	40.8	1999	129.9	5.0%	7.7%	3.8%
Italy	52.8	1999	146.1	5.9%	10.8%	5.8%
Spain	37.3	1999	111.2	10.0%	18.6%	9.0%
Canada	47.0	2004	70.6	6.9%	15.2%	6.2%
Australia	41.6	2000	109.6	7.4%	NA	10.3%
Korea	50.3	1999	98.4	9.4%	8.6%	6.1%

Source: OECD Communications Outlook 2011

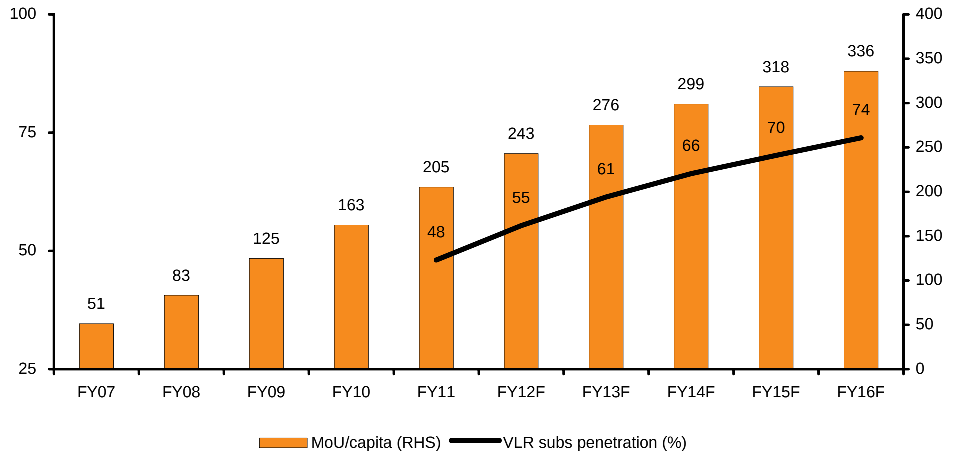
India's voice minute penetration is one-third that of US; we expect minute CAGR of 14.9% for FY11-14

India's MoU/capita is a meagre one-third that of the US's, underpinning growth prospects, in our view. India's MoU/capita reached about 205 as of March 2011, versus the US's MoU/capita of 602 as of December 2010). It lags behind China's MoU/capita, which was 221 as of December 2009.

We believe India's MoU/capita is likely to expand to 336 by FY16 (about 50% of the US's MoU/capita), implying minute growth of 11.9% over the period to 5.1trn minutes. We believe the growth is likely to be driven by an increase in active subs penetration from 48% in FY11 to 74% by FY16, an increase in per capita income, an enhanced mobile ecosystem (community), and deeper network coverage of telcos (into the hinterlands). We believe incumbent operators with 900MHz spectrum are better equipped to benefit from this opportunity because, in our view, they are best positioned to expand into rural areas.

India's MoU/capita is significantly lower than that of the US

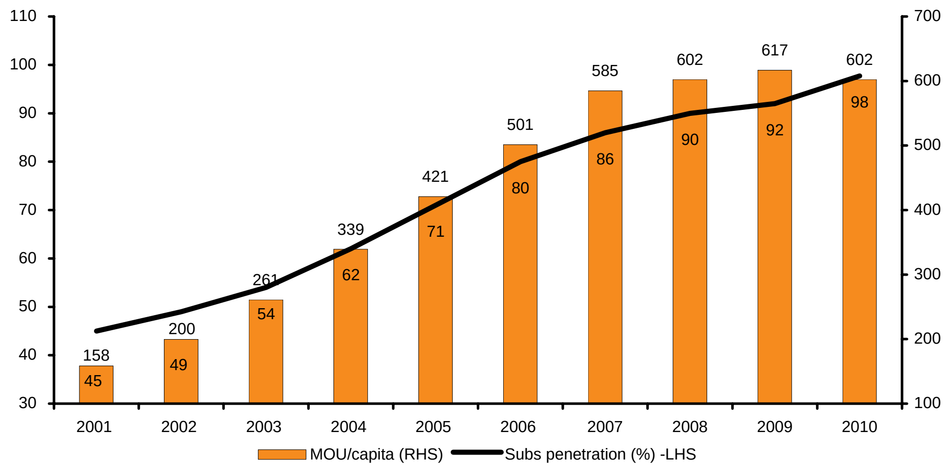
Chart 10 : India's MoU/capita lags that of peers and we expect it to reach 336 by FY16



Source: TRAI, RBS forecasts

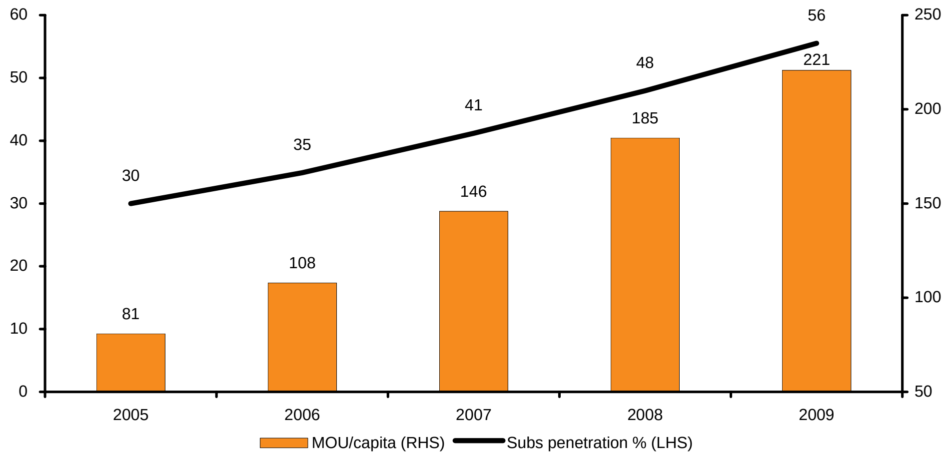
Our study indicates US minutes increased at a 17.1% CAGR over 2001-10 and US subs penetration expanded from 45% to 98% in 2010. China experienced minutes growth of 29.7% over 2005-09, led by an increase in subscriber penetration from 30% in 2005 to 56% in 2009.

Chart 11 : US MoU/capita expanded to 600 in 2010 from 158 in 2001



Source: FCC

Chart 12 : China MoU/capita expanded with increase in subs penetration



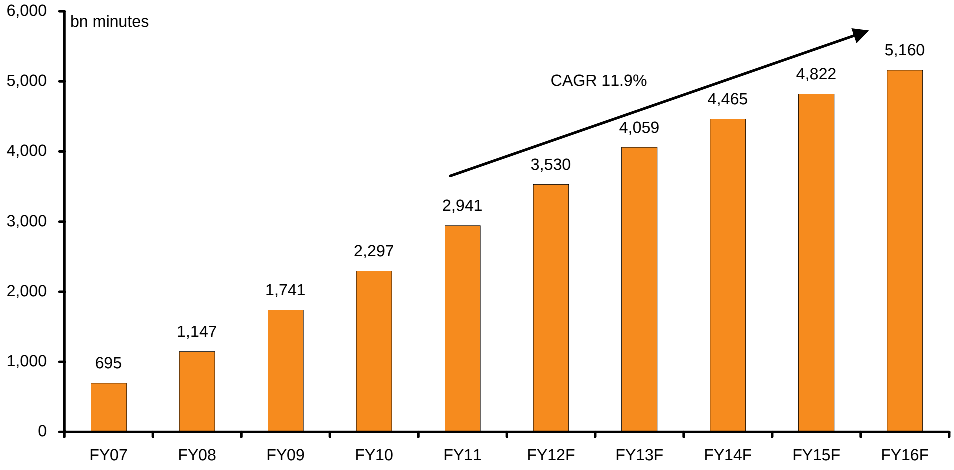
Source: ITU, National Bureau of Statistics of China

MoU/capita is comparable as India's RPM is significantly lower than that of the US, which captures a difference between per capita incomes

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

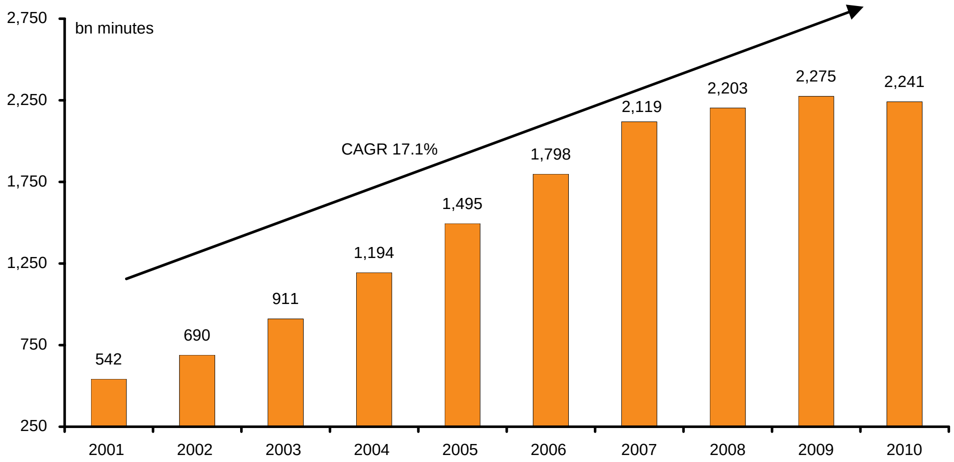
Put differently, India's total mobile minutes consumption (2.9trn) was about 30% higher than US mobile minutes consumption (2.2trn as of CY10), despite India's population base being about 3.8 times that of the US (India's population is 1.2bn, compared with the US population at 310m) and its tariffs being 85% lower than those in the US (in India, RPM is less than US$0.01 versus US RPM at about US$0.07).

Chart 13 : We expect India's voice minutes to grow at an 11.9% CAGR in FY11-16



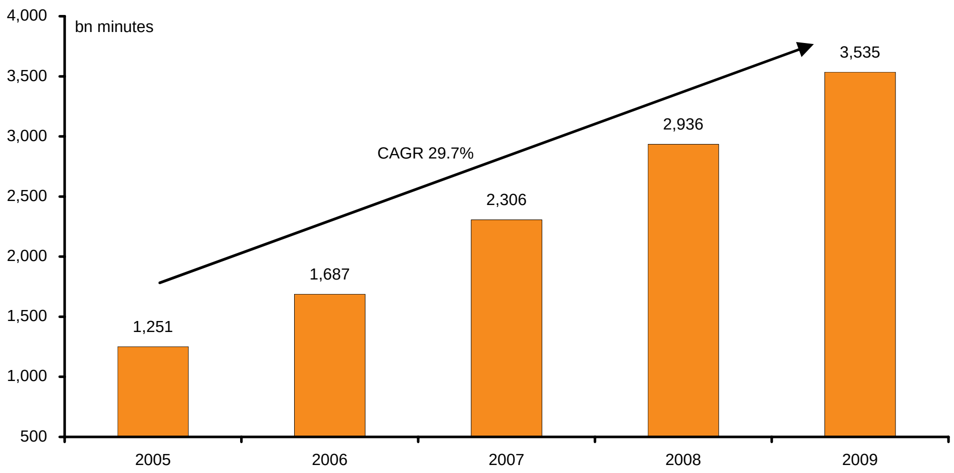
Source: TRAI, RBS forecasts

Chart 14 : US voice minutes grew at 17.1% CAGR over 2001-10



Source: FCC

Chart 15 : China minutes grew at 29.7% CAGR over 2005-09



Source: ITU, National Bureau of Statistics of China

Table 3 : Voice minutes CAGR over 2004-09 in several developed markets

Country	Penetration in 2004 (%)	Penetration in 2009 (%)	Voice minutes 5-year CAGR (%)
Japan	72	88	5.0
Germany	90	132	17.3
France	71	95	6.4
United Kingdom	100	130	13.0
Italy	109	146	13.0
Spain	90	111	13.7
Korea	76	98	6.2

Source: OECD Communications Outlook 2011

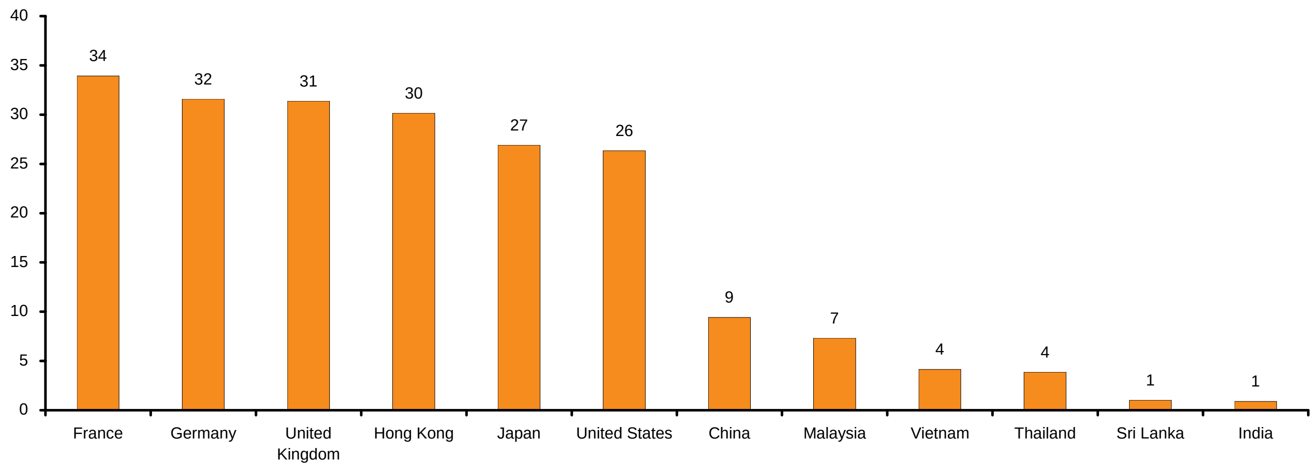
Taking a cue from international experience, we are comfortable with our voice minute growth assumption for India's mobile industry at a 14.9% CAGR over FY11-14 to 4.5trn minutes and 11.9% CAGR over FY11-16 to 5.1trn minutes.

India's broadband penetration significantly below that of developed markets; we expect J-curve growth after FY14

We expect India's broadband penetration to improve via the wireless route...

India's fixed broadband penetration is currently less than 1% and is significantly below that of developed markets (see Chart 16). In addition, India's wireless broadband penetration is in a nascent stage. India's Department of Telecommunications, part of the Ministry of Communications and Information Technology, concluded spectrum auctions (2.1GHz and 2.3GHz band) during June-10 last year, and operators have begun to roll out wireless broadband services during the past few quarters. We expect India's broadband penetration to be driven by the wireless route due to a significant investment by industry in the wireless broadband ecosystem and a lack of last-mile infrastructure for fixed broadband penetration.

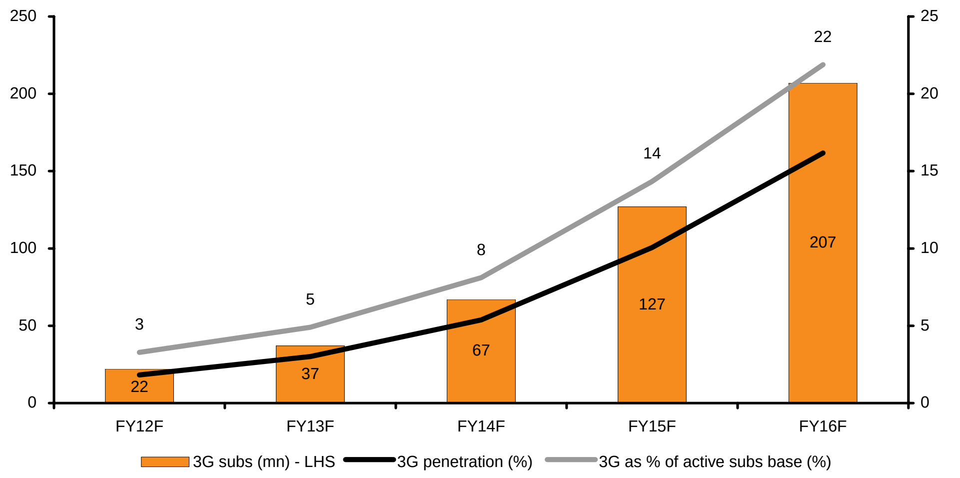
Chart 16 : India's fixed broadband penetration (%) in 2010 significantly lags that of other geographies



Source: ITU, TRAI

We expect wireless broadband (3G) penetration to rise to a meagre 5.4%; implying 67m subs (8% of the active subs base) by FY14 (see Chart 17). We believe it is likely to take a few years for the wireless broadband ecosystem to stabilise, and we expect a J-curve in broadband penetration after FY14.

Chart 17 : We estimate 3G wireless broadband penetration will remain muted until FY14

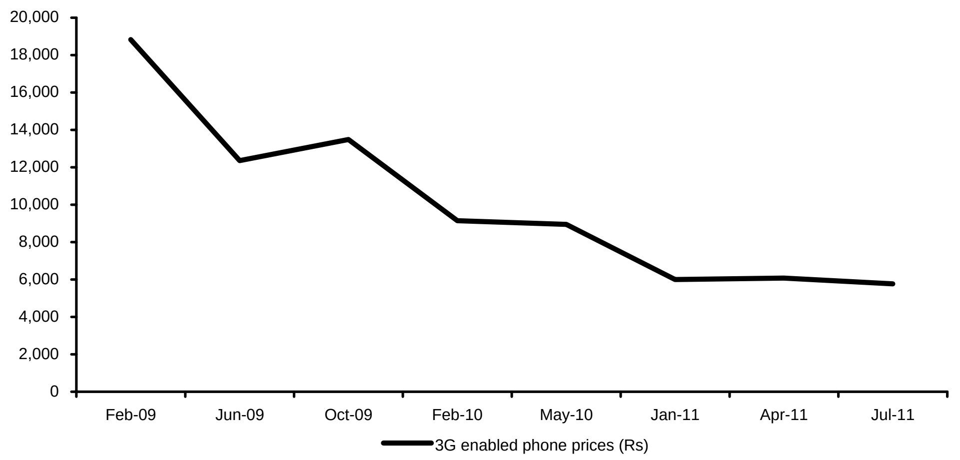


Source: RBS forecasts

… with 3G ecosystem experiencing improvement on all fronts

The key catalysts to improving the wireless broadband ecosystem and penetration in India are: 1) wider network coverage; 2) 3G handset penetration led by affordable handsets; 3) affordable access charges; and 4) mass appeal or demand for data services. We believe India's wireless broadband ecosystem is experiencing improvement on all the fronts (see Chart 18, Tables 4-6), but we believe it may take longer than the Street expects for wireless broadband penetration to rise materially. We believe it may take longer for consumer habits to change and to adapt data services. A case in point is Idea Cellular (third-largest telecom operator by revenue market share in India). A meagre 8% of its subs have 3G handsets, 10% of its subs use data services (GPRS/EDGE), and its SMS penetration was 39% among its subs as of FY11. Hence, we believe it may be a little premature to assume a very high adoption rate for 3G in FY12/FY13, and we think wireless broadband penetration could experience a J-curve after FY14.

Chart 18 : 3G handsets becoming affordable in India



Source: Industry, RBS estimates

3G network coverage improving, albeit at a slow pace

Table 4 : Comments of operators in India on 3G services coverage and ecosystem

Operators	Comments on 3G services as of 1QFY12 and thereafter
Bharti	Company expanded 3G coverage to 84 cities covering all 13 circles where it won spectrum
	Bilateral arrangements to offer 3G services in other circles (seven) except in Orissa and Punjab
	Management mentioned proliferation of 3G handsets in the Indian market is increasing
	Management mentioned that it would not worry about revenue increase at this stage, and its focus is to improve the ecosystem and provide the right customer experience
	Company reached about 2m subs as of 31 March 2011
Vodafone India	3G coverage in 147 towns and cities across 12 circles as of 30 June 2011
	Bilateral arrangements to offer 3G services in other circles
	Company has about 26m data users (18% of its subs base) as of 30 June 2011
Idea	Expanded 3G coverage over 825 towns in 15 circles and expects to reach 3,000 towns across India by FY12
	Coverage includes bilateral roaming arrangements for Mumbai, Bihar, Karnataka, Delhi, Kolkata and Tamil Nadu (including Chennai) circles
	Idea has rolled out 6,989 3G cell sites (equivalent to 9% of 2G cell sites coverage) in nine circles as of 1Q
	Management commits to build data factory that can handle many times the current daily data volume of 30 terabytes
	Company is upgrading its backhaul transmission to high capacities, DWDM (dense wavelength division multiplexing) upgrading with microwave to IP (Internet protocol) radios and building requisite number of PoPs (points of presence) – ie, intracity PoPs, especially in the top 100 cities
	Company said 8% of its subs have 3G handsets, and handset ecosystem needs to improve
	Company had reached 2m subs as of 30 June 2011, but on average 22-25% of these subs are on daily VLR
	Company believes 2G data tariffs offered in the market are not sustainable and far below cost
	Company reduced 3G data tariffs by about 50% during September 2011
RCom	Coverage of 3G in 333 towns in 13 circles with about 11,000 3G sites
	Unlikely to expand 3G coverage to new towns for rest of the year
	3G coverage expansion will occur through bilateral roaming arrangements in the remaining nine circles
	Cheaper handset is key for expansion of 3G user base
	Company offered 3G tablet at Rs12,999 during quarter
	Had reached about 2m subs as of 30 June 2011, versus 1.7m in the previous quarter

Source: Company data, Industry

Table 5 : Smart devices (like 3G tablets) becoming affordable

Categories	Ipad	Samsung Galaxy	RCom 3G tab	Beetel Magiq
Price range	Rs32,000-45,000	Rs36,200	Rs12,999	Rs9,999
Manufacturer	Apple	Samsung	ZTE	Huawei
Operating system	iOS4	Android 3.1(Honeycomb)	Android 2.3 (Gingerbread).	Android 2.2 (Froyo)
Power	About 7,000 mAh	7,000 mAh	3,400 mAh	2,200mAh
Processer	1 GHz Apple Dual core	1 GHz Dual core	800 Mhz single core	1 GHz single core
Internal memory	16GB, 32GB and 64GB	16GB, 32GB and 64GB	4GB (SD card bundled)	8GB
External memory	NA	NA	32GB	32GB
RAM Memory	512 MB	1GB	512MB	512MB
Display	1024x768 px, 9.7 inch screen	1280x800 px, 10.1 inch screen	480x800 px, 7 inch screen	480x800 px, 7 inch screen
Camera	0.7MP rear and VGA (<1 MP) front	3.2 MP rear and 1.3 MP front	2 MP rear and VGA (<1 MP) front	2 MP rear and 2 MP front
Connectivity	Wi-Fi, 3G and Bluetooth	Wi-Fi, 3G and Bluetooth	Wi-Fi, 3G and Bluetooth	Wi-Fi, 3G and Bluetooth
Weight	600g	565g	389g	500g
Key input features	Multi-touch screen, light sensors, accelerometer and digital compass	Multi-touch screen, light sensors, accelerometer and digital compass	Multi-touch screen	Resistive touch screen

Source: Industry

Table 6 : Data access charges for 3G becoming more affordable…

	Vodafone				Idea				RCom			
3G data tariffs (prepaid)	Old		New		Old		New		Old		New	
Rates (Rs)	102	375	109	375	97	449	103	450	100	399	97	399
Free data (MB)	100	500	200*	1000*	100	600	200	1200	100	500	300	1500
Validity (days)	30	30	30	30	30	30	30	30	30	30	30	30
Charges over quota	10p/10kb	10p/10kb	10p/10kb	10p/10kb	10p/10kb	10p/10kb	5p/10kb	5p/10kb	2p/10kb	2p/10kb	2p/10kb	2p/10kb
Implied data price (Rs/MB)	**1.02**	**0.75**	**0.55**	**0.38**	**0.97**	**0.75**	**0.52**	**0.38**	**1.00**	**0.80**	**0.32**	**0.27**

*Applicable for selected circles only. New rates effective from September 2011.
Source: Company data

Table 7 : … but 3G data rates remain significantly higher than 2G data access rates

2G data tariff plans (prepaid)	Vodafone			Bharti			Idea			RCom		
Rates (Rs)	17	58	96	19	60	98	15	50	98-150	5	51	99
Free data (MB)	200	1000	2000	200	1000	1000-2000	200-500	1000	2000	50	1000	2500
Validity (days)	3	15	30	3	14	30	3	15	30	1	15	30
Charges over quota	10p/10kb	10p/10kb	10p/10kb	10-15p/10kb	10-15p/10kb	10-15p/10kb	2-5p/kb	2-5p/kb	10p/10kb	10p/10kb	10p/10kb	10p/10kb
Implied data price (Rs/MB)	**0.09**	**0.06**	**0.05**	**0.10**	**0.06**	**0.05-0.09**	**0.03-0.08**	**0.05**	**0.05-0.08**	**0.10**	**0.05**	**0.04**

Source: Company data

Structural improvement – price stability

Pricing power is returning to operators owing to limited capacity addition by new GSM operators who are suffering from high financial leverage and continuous high operating losses.

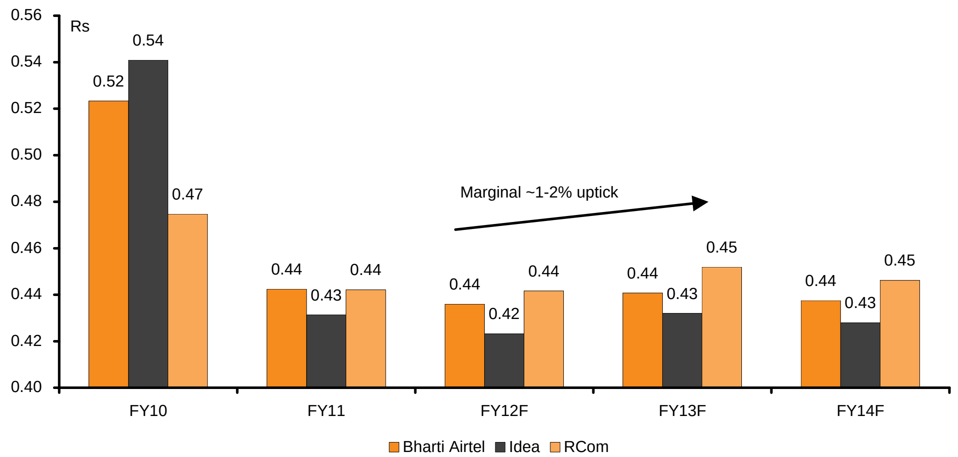
We believe pricing power is returning to operators as a result of 1) lower competitive intensity led by limited network rollouts by new GSM operators (both dual technology operators and new entrants); 2) new operators' realisation that expansion is not viable, owing to continuous high EBITDA losses at current tariffs (Uninor's EBITDA loss has been about Rs8bn/quarter over the past six quarters); and 3) revenue market share consolidation among the top three operators. However, we expect blended RPM to increase marginally (1-2%) during FY13 and remain stable in FY14.

Building a stable price outlook owing to…

We saw price stability across operators over the past few quarters (see Chart 25). In addition, we saw price hikes by operators in 2QFY12 (see Table 8). The price hikes varied from occurring in a few circles to Pan-India. We believe the price actions are structurally positive for the sector and could increase voice RPM by 1-2p/min over a period of one year. However, it is not possible to finitely quantify the impact of these price hikes. The primary reason is that there could be rate cutters and value vouchers in the market to boost usage along with these tariff plans. Directionally, we believe prices are likely to stabilise or improve. However, we have been cautious and expect only a marginal uptick in blended RPM (1-2%) during FY13, led by price stability in voice RPM and an increase in non-voice revenue. Thereafter, we expect voice RPM to decline in FY14. However, we believe blended RPM is likely to remain stable in FY14 (see Chart 19) owing to a rising contribution of non-voice revenue (see Chart 21).

We cautiously build in a marginal 1-2% uptick in RPM in FY13

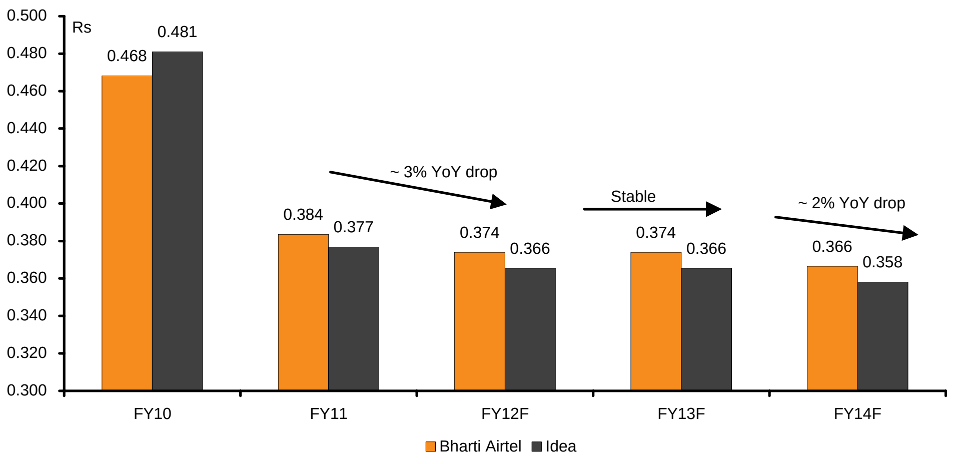
Chart 19 : We expect blended RPM to increase marginally (1-2%) in FY13…



Source: Company data, RBS forecasts

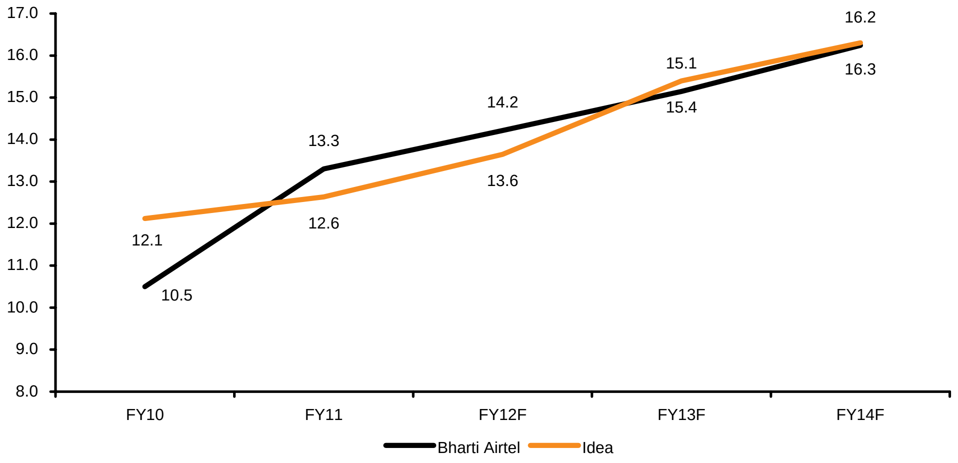
We expect voice RPM to remain stable in FY13 and to decline thereafter to induce usage and drive penetration

Chart 20 : ... led by price stability in voice RPM in FY13; we expect decline thereafter…



Source: Company data, RBS forecasts

Chart 21 : … and rising proportion (%) of non-voice revenue to support blended RPM



Source: Company data, RBS forecasts

Table 8 : Tariff hikes across operators in 2QFY12 indicate the return of pricing power

Operators	Date	Tariff correction
Tata DoCoMo	Jun-11	STD rates: After one year, rates to increase from 1p/sec to 2p/sec
		SMS: Local rates increased from Rs0.6 to Rs1 per SMS, and national rate increased from Rs1.2 to Rs2 per SMS
Bharti	Jul-11	On-net call rates (local and STD) increased from 1p/sec to 1.2p/sec
		Landline rates (local and STD) increased from 1.2p/sec to 1.5p/sec
Idea	Jul-11	On-net call rates (local and STD) increased from 1p/sec to 1.2p/sec
		Landline rates (local and STD) increased from 1.2p/sec to 1.5p/sec
Vodafone	Jul-11	On-net call rates (local and STD) increased from 1p/sec to 1.2p/sec
Aircel	Jul-11	On-net call rates (local and STD) increased from 1p/sec to 1.2p/sec
		Landline rates (local and STD) increased from 1.2p/sec to 1.5p/sec
RCom	Aug-11	GSM: Call rates increased from 1p/sec to 1.2p/sec (all networks), and on per minute plan rate increased from 50p/min to 60p/min (all networks)
		CDMA: Only off-net leg call rates increased in line with GSM
Tata DoCoMo	Aug-11	On-net roaming charges hiked from 1ps/sec to 1.5ps/sec for all incoming and outgoing calls
		Call rates hiked from 1p/sec to 1.2p/sec in its Karnataka and Tamil Nadu circles
BSNL	Aug-11	Off-net call rates hiked from 1p/sec to 1.2p/sec

STD = subscriber trunk dialling; GSM = global system for mobile telephony; CDMA = code division multiple access.
BSNL = Bharat Sanchar Nigam Ltd.
Source: Company data, industry sources

… lower competitive intensity due to limited capacity addition by new operators

Uninor and other new GSM entrants have repeatedly scaled down their network expansion plans because there isn't a viable business case for new entrants to operate at current price points. In addition, network rollouts of new operators and their impact are limited to metros and urban centres (a higher population density enables network rollouts in these areas to have a greater impact than rural rollouts). It is not viable for new entrants to operate in rural areas at current price points.

As shown next, the capex intensity of Uninor has been reduced dramatically over the last six quarters. RCom's (GSM's new entrant in India) capex fell significantly. The decline in capex is partly driven by operators' high leverage (see Table 9) and investors' lack of interest in infusing equity into the business (partly owing to concerns about the validity of new licences).

High financial leverage of dual technology operators has led to lower capex intensity and has brought rationalisation in tariffs

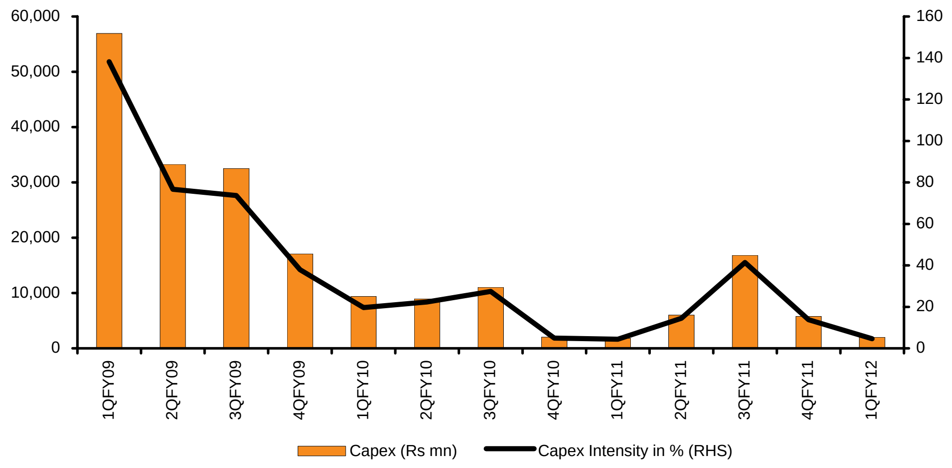
Table 9 : High financial leverage led to decline in capex intensity

FY11	Revenue (Rs bn)	EBITDA (Rs bn)	Net debt (Rs bn)	Net debt /EBITDA	Net debt /revenue
Bharti (India +SA)	464	171	147	**0.9**	0.3
Idea	156	37	109	**2.9**	0.7
Vodafone India	273	70	330	**4.7**	1.2
RCom	206	65	349	**5.3**	1.7
TTML	23	5	46	**9.0**	2.0
Uninor	10	(33)	37	**NA**	3.8

TTML = Tata Teleservices (Maharashtra) Ltd.
Source: Company data

... Capex intensity dropped for dual technology operators...

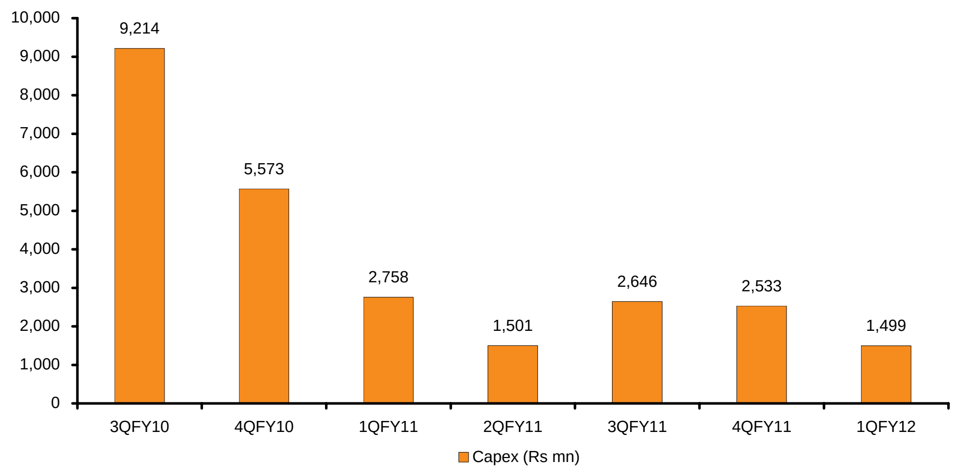
Chart 22 : RCom capex intensity dropped significantly over past two years



Source: Company data

... and new entrants such as Uninor

Chart 23 : Uninor's capex intensity dropped



Source: Company data

Uninor management stated in its recent earnings conference call that Uninor's capex is limited to areas where the company is established, and the company is not expanding into new circles. The same is visible from the circle-wise revenue momentum, which shows that expansion is restricted to a few select circles. About 80% of Uninor's revenue was concentrated in the top seven markets as of 1QFY12.

Uninor's network rollout is restricted to a few focus circles, thereby limiting its impact on incumbent operators

Table 10 : Uninor is focused on a few circles; 80% of its revenue is concentrated in seven markets

Rs m	3QFY10	4QFY10	1QFY11	2QFY11	3QFY11	4QFY11	1QFY12
Circles							
UP (E)	5	67	188	315	504	789	1,032
UP (W)	3	52	103	174	323	497	656
Maharashtra	3	12	3	86	231	391	562
Gujarat	3	12	4	135	278	389	512
A.P.	9	71	106	161	275	364	487
Bihar	4	36	63	119	197	327	470
W.B.	3	3	2	82	222	332	438
Mumbai	4	19	5	95	181	250	298
Kolkata	4	16	2	64	143	203	259
T.N.	12	44	58	88	116	164	235
Karnataka	11	57	57	90	123	176	230
Orissa	3	17	21	37	55	90	137
Kerala	7	27	30	35	44	59	73
Total	**70**	**434**	**641**	**1,481**	**2,689**	**4,030**	**5,389**

Source: TRAI

Realisation among new operators that expansion is not viable due to high EBITDA losses at current tariffs

Uninor (a new entrant) began to offer services in December 2009. Despite its significant investment (about Rs100bn) over the past two years, the company's EBITDA losses have not contracted. Its EBITDA loss has so far remained at about Rs8bn per quarter, leading the company to scale back its network rollouts. Over the past year, the company's cell sites have expanded only by about 5,000 to about 26,600 cell sites in June 2011 (see Table 11).

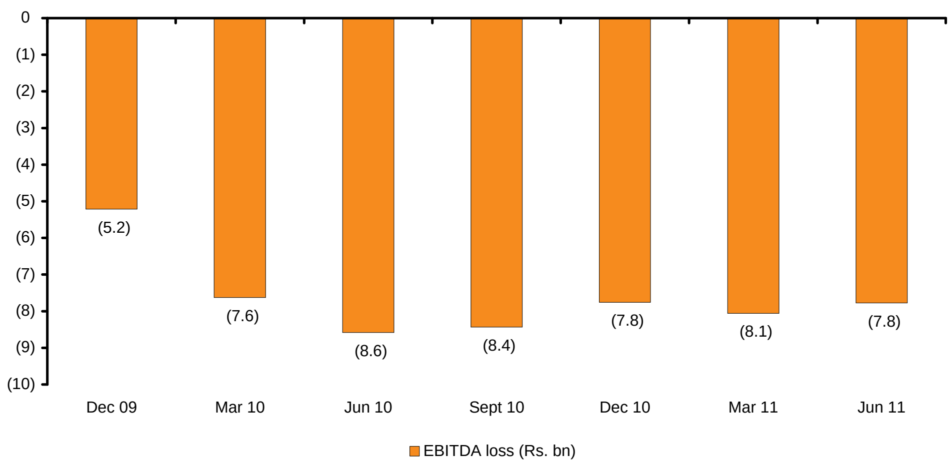
Table 11 : Uninor's financial performance: no improvement in EBITDA losses

Rs bn	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10	Mar 11	Jun 11
Revenue	0.0	0.4	0.8	1.6	3.0	4.3	5.6
Operating expense	5.2	8.1	9.4	10.1	10.8	12.4	13.4
EBITDA	**(5.2)**	**(7.6)**	**(8.6)**	**(8.4)**	**(7.8)**	**(8.1)**	**(7.8)**
Cell sites	12,000	18,000	21,500		23,200	24,300	26,623
Capex	9.2	5.6	2.8	1.5	2.6	2.5	1.5

Source: Company data

Uninor's EBITDA losses have not contracted

Chart 24 : Uninor's EBITDA losses haven't contracted despite scaled-back rollout

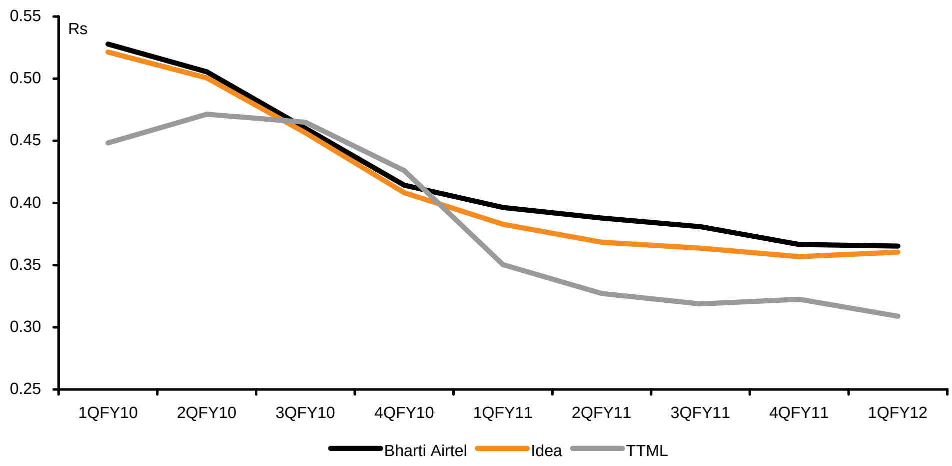


Source: Company data

This indicates that new entrants have realised it is not viable to expand at current price points as tariffs have eroded by about 30% over the past two years. Voice RPM across operators dropped 30% over the past two years (see Chart 25). Vodafone India's outgoing RPM dropped by 35% over the period.

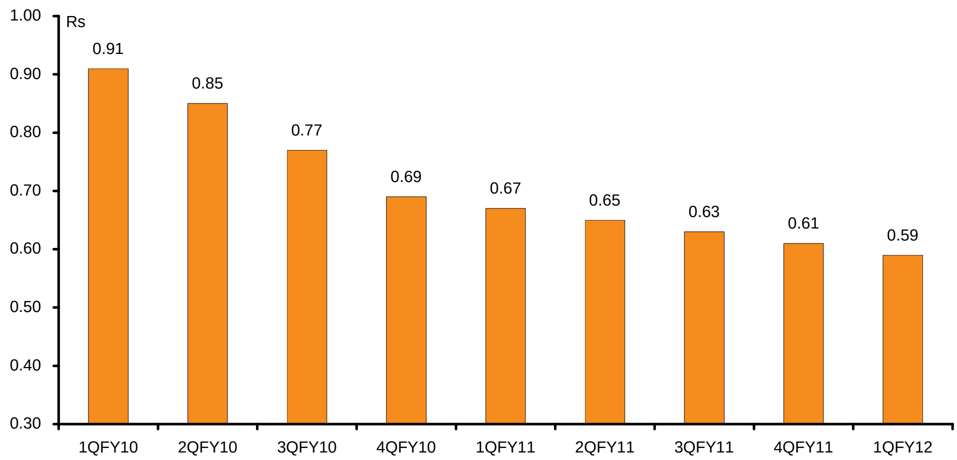
RPM dropped about 30% over the past two years

Chart 25 : Voice RPM declined 30% across operators over past two years



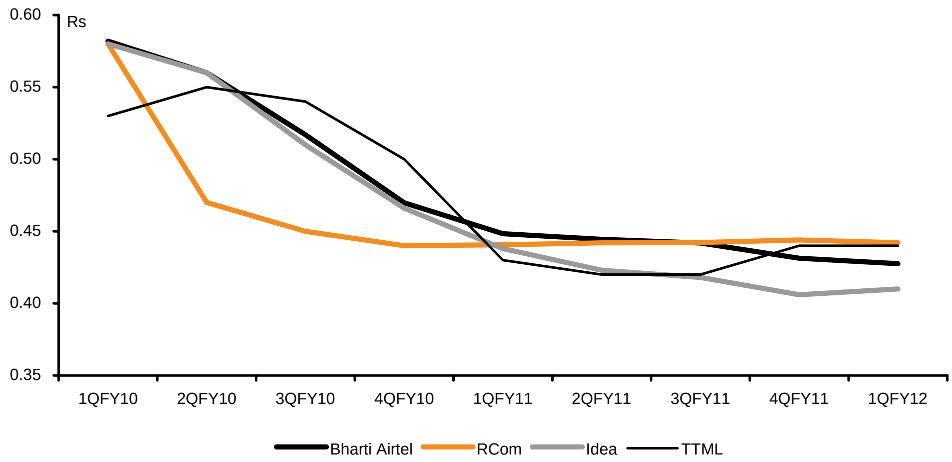
Source: Company data

Chart 26 : Vodafone India's outgoing RPM declined 35% over past two years



Source: Company data

Chart 27 : Blended RPM declined by 20-30% in past two years

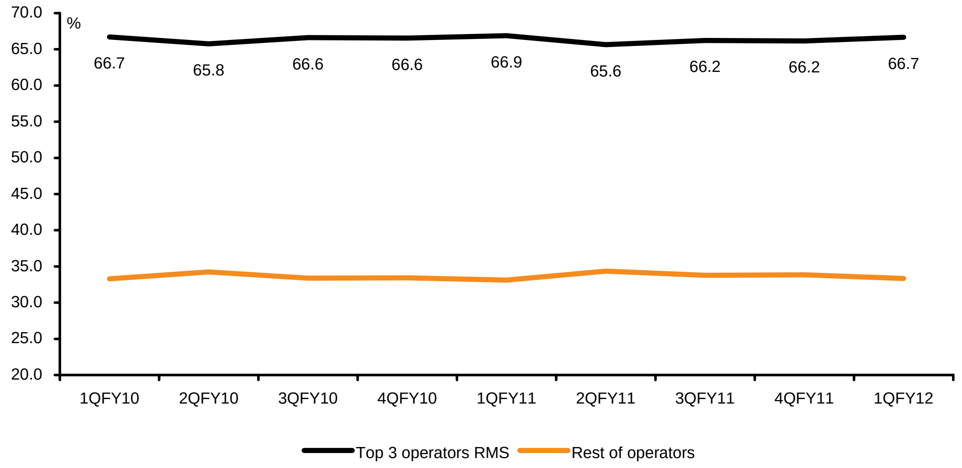


Source: Company data

Consolidation of RMS among top three operators

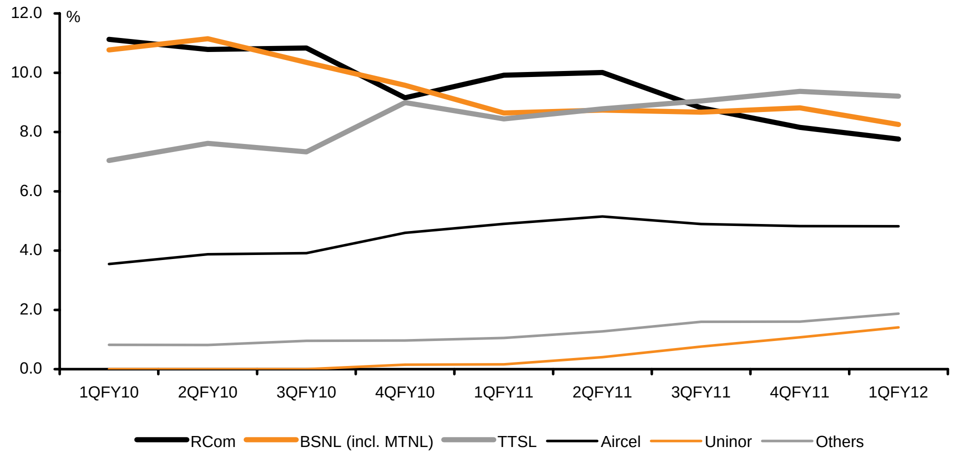
The revenue market share (RMS) trend highlights that the impact of new GSM operators was felt least by India's top three operators. The top three operators in terms of RMS (Bharti, Vodafone India and Idea) remained largely unaffected by the launch of new operators, owing to their fundamental strengths (quality subs base, better network coverage, wider distribution reach, quality customer service and brand strength). Consolidated RMS among the top three remained stable at 66.7% over the past two years (see charts 28-29).

Chart 28 : Top three operators maintained consolidated RMS of 66.7%



Source: TRAI

Chart 29 : RMS changed largely among rest of operators



Source: TRAI

Who benefits from structural improvement?

We believe Idea is likely to be the biggest beneficiary among listed peers owing to higher minute market share gains and a reduction in its churn rate.

We expect Bharti to maintain its leadership position in India, and we expect Idea and Vodafone India to gain market share. We believe Idea is likely to be the biggest beneficiary, owing to higher minute market share (MinMS) gains (200bp gain over FY11-14) and a potential benefit from a reduction in its churn rate. We expect Idea's minutes/revenue/EBITDA to grow at CAGRs of 20.8%, 21.0% and 29.6%, respectively over FY14. We expect Vodafone India minutes to grow at a CAGR of 18.5% over FY11-14. We expect Bharti's India minutes/revenue/EBITDA to grow at CAGRs of 13%, 11.9% and 14.6% over FY11-14.

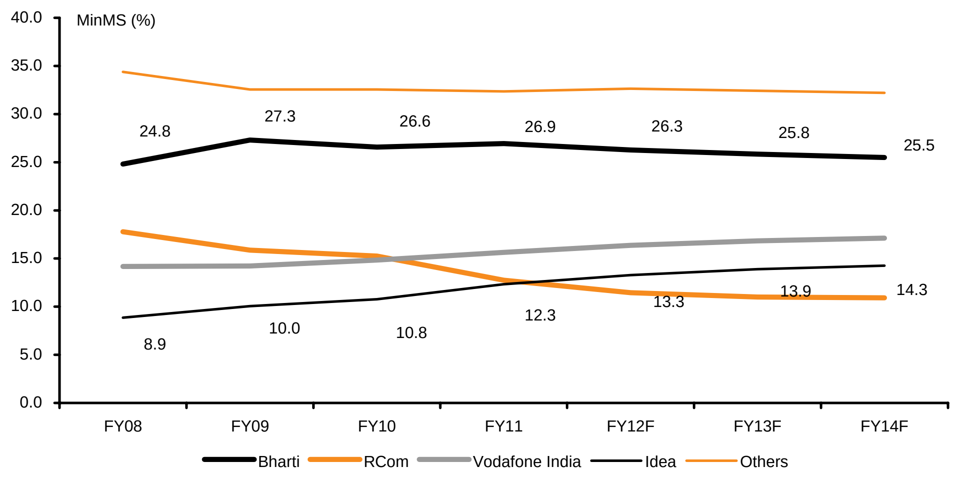
Idea and Vodafone India to consolidate leadership position; Bharti to maintain leadership

We expect Bharti to maintain 25.5% minute market share by capturing about 22.5% incremental minute market share

We discussed in a previous section that we expect voice minutes in India to grow at a CAGR of 14.9% over FY11-14 to 4.5trn minutes. We believe Bharti will conservatively capture incremental minute market share of 22.5% during that period, thus maintaining its leadership position with 25.5% MinMS by FY14 (see Chart 30). We factor in lower incremental MinMS for Bharti, since we expect Vodafone India and Idea to capture higher MinMS due to their deeper rollouts in old circles and their expansion into new circles. We expect Vodafone India to capture 20% incremental MinMS and Idea to capture 18% incremental MinMS. We expect Idea's MinMS to improve by 200bp, from 12.3% in FY11 to 14.3% in FY14, implying a minute CAGR of 20.8%. We expect Vodafone India's MinMS to improve from 15.6% in FY11 to 17.1% by FY14. However, we expect RCom to lose MinMS, owing to its limited network rollout and given that its traffic is more prone to shift due to schemes of new operators and mobile number portability (MNP).

We expect Idea to capture about 18% incremental minute market share

Chart 30 : Minute market share performance: we expect Idea MinMS to expand by 200bp

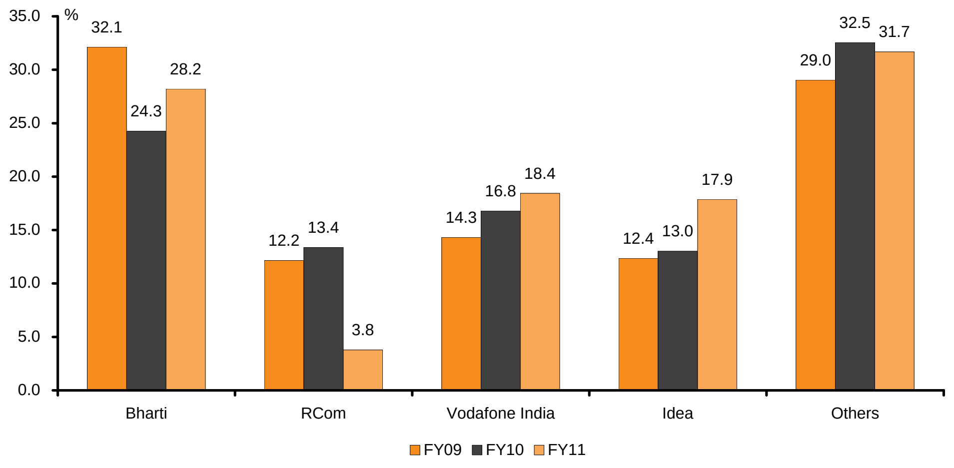


Source: Company data, TRAI, RBS forecasts

Idea and Vodafone India continue to capture higher incremental minute market share

Our analysis of minute market share performance of operators indicates that Idea and Vodafone India continue to gain higher MinMS, which truly reflect their robust operational performance. This is also reflected in RMS gains for the two operators, highlighted in a subsequent section. Bharti also gained higher MinMS in FY11 (see Chart 31).

Chart 31 : Incremental minute market share reflects true operational performance

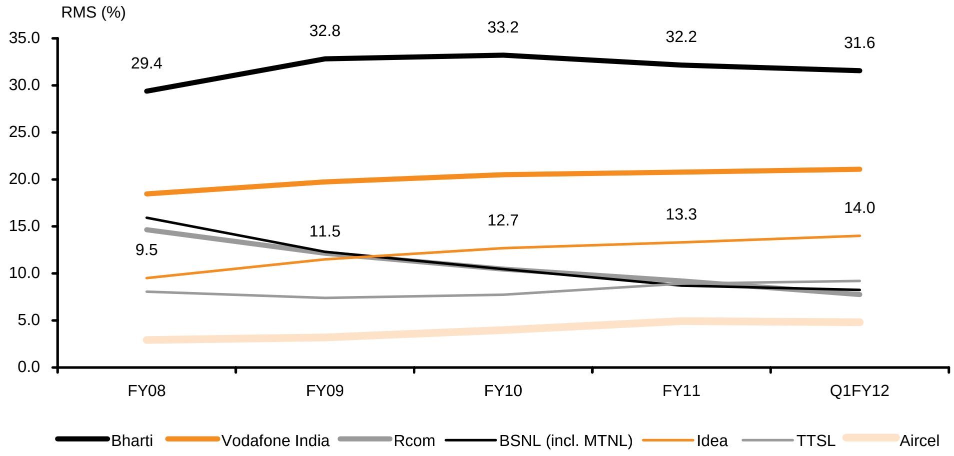


Source: Company data, TRAI

Idea, Vodafone India gain RMS in hyper-competitive period

We saw that during the hyper-competitive period of the past two years, brands with fundamental strengths (better network coverage, wider distribution network, quality customer service and brand appeal) gained or maintained their revenue market share. During FY08-11, Idea gained 450bp RMS and Vodafone gained 260bp market share led by deeper network rollouts in the old circles and market share gains with entry into new circles. The RMS trend over one-, two- and three-year periods (see Chart 32) clearly shows Idea and Vodafone were key gainers over the past few years. Bharti's revenue market share dipped marginally (120bp over FY09-1QFY12). However, it doesn't surprise or worry us, given that Bharti had a disproportionate RMS of about 32.8% as of FY09, which dropped marginally to about 31.6% as of 1QFY12.

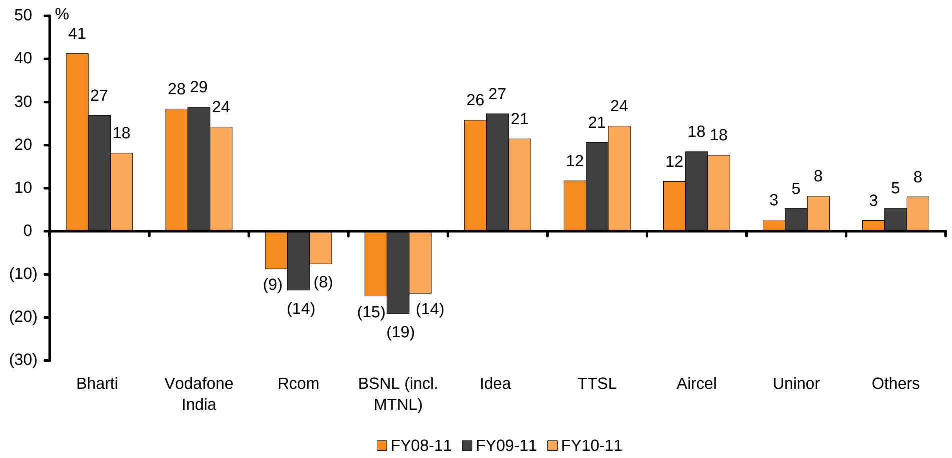
Chart 32 : RMS trend: Idea (450bp) and Vodafone India (260bp) gain RMS in past 3 years



Source: TRAI

Vodafone India and Idea consistently captured higher incremental RMS over one-, two- and three-year periods

Chart 33 : Incremental RMS over 1, 2 and 3 years shows Vodafone India and Idea had higher RMS



Source: TRAI

Table 12 : RMS performance across operators

%	FY08	FY09	FY10	FY11	Q1FY12
Bharti	29.4	32.8	33.2	32.2	31.6
Vodafone India	18.5	19.7	20.5	20.8	21.1
RCom	14.7	12.2	10.5	9.2	7.8
BSNL (including MTNL)	15.9	12.3	10.5	8.7	8.3
Idea	9.5	11.5	12.7	13.3	14.0
TTSL	8.1	7.4	7.7	8.9	9.2
Aircel	2.9	3.2	4.0	4.9	4.8
Uninor	-	-	0.0	0.6	1.4
Others	1.0	0.9	0.9	1.4	1.9

Others include Loop, Etisalat, Shyam, Himachal Futuristic Communications Limited, Videocon and Stel.
MTNL = Mahanagar Telephone Nigam Limited.
Source: TRAI

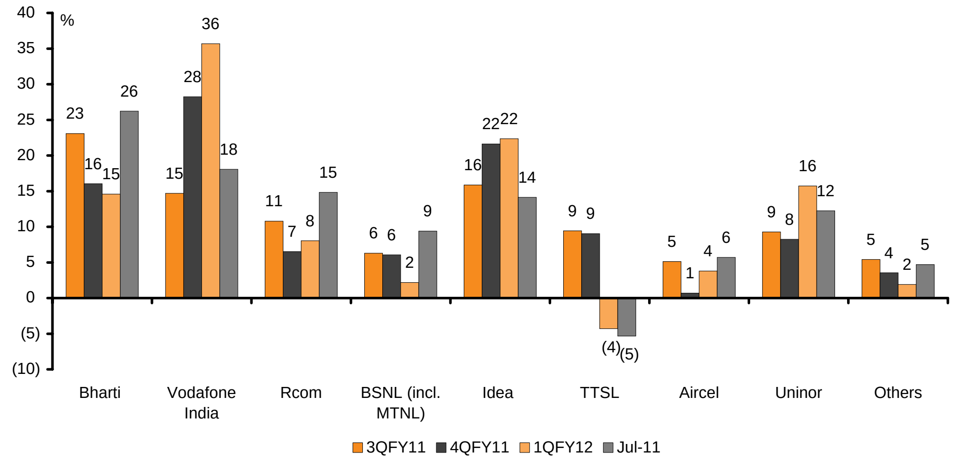
Vodafone India, Idea and Bharti captured higher incremental active subs market share

The India market is plagued by a significant multi-SIM (subscriber identity module) phenomenon. Hence, we are not advocate judging the operational performance of operators based on traditional metrics of reported subs, average revenue per user (ARPU) and minutes of use (MoU) per sub. However, beginning in 2QFY11, the TRAI (regulator in India) began to disclose VLR subs base numbers for operators and the industry. VLR subs numbers reflect an active subs base trend and better show the underlying subs market share trends compared with the reported subs base of operators.

We find merit in the VLR subs base. Our analysis of the VLR subs base indicates Vodafone India, Idea and Bharti captured higher incremental subs market share (in that order) over the past three to four quarters compared with their peers (see Chart 34). TTSL lost incremental active subs market share on a VLR basis during the same period.

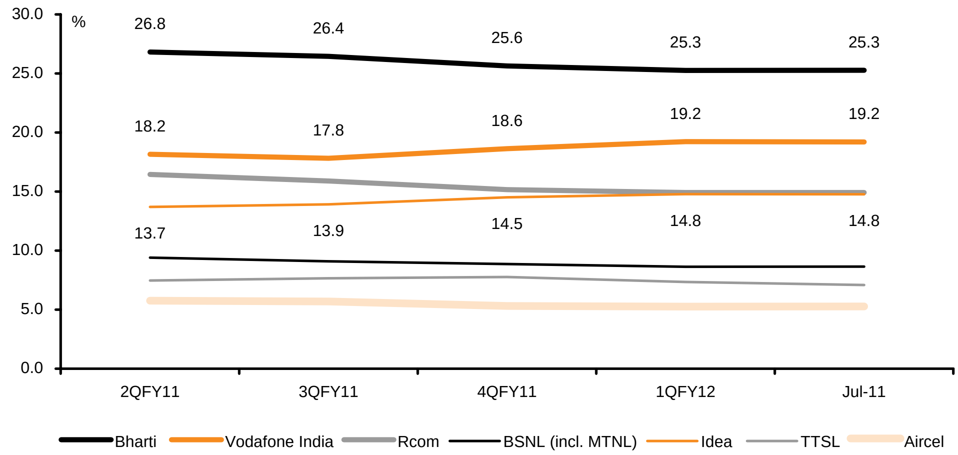
Recent active subs base data reveals incumbent operators gained higher incremental market share, reflecting receding competitive pressure

Chart 34 : Vodafone India, Idea and Bharti captured higher incremental active subs market share over past three quarters, indicating better operational performance



Source: TRAI

Chart 35 : VLR subs market share trends show market share gains for Vodafone India and Idea



Source: TRAI

Table 13 : VLR net subs addition trend

millions	3QFY11	4QFY11	1QFY12	Jul-11 (mom)
Bharti	12.0	7.2	3.0	3.2
Vodafone India	7.7	12.6	7.4	2.2
Idea	8.3	9.7	4.7	1.7
RCom	5.6	2.9	1.7	1.8
TTSL	**4.9**	**4.0**	**(0.9)**	**(0.6)**
BSNL (including MTNL)	3.3	2.7	0.5	1.1
Aircel	2.7	0.3	0.8	0.7
Uninor	4.8	3.7	3.3	1.5
Others	2.8	1.6	0.4	0.6
Total	**52.1**	**44.7**	**20.8**	**12.2**

Source: TRAI

Overall, we believe Idea and Vodafone India are poised to gain higher MinMS and RMS, led by their network expansion, wider distribution reach, quality customer service and preferred brand status in the marketplace. We believe Bharti is likely to maintain its leadership position.

Declining churn rate likely to reduce SAC, improve margins

We believe Idea likely to be biggest beneficiary from reduction in churn rate

We believe Idea is likely to be the biggest beneficiary from a reduction in churn rates among its listed peers. Table 14 shows a potential 1% reduction in the churn rate would likely have a 44bp positive impact on Idea's EBITDA margin. We believe Idea is likely to benefit because its reported churn is the highest among industry participants (9.6% per month) in 1QFY12.

Table 14 : Impact on current EBITDA margin with a 1% potential reduction in churn rate

	Bharti	RCom	Idea
1QFY12			
Subs (m)	169	143	95
Churn (%)	6.4	4.0	9.6
Gross adds (m)	39	24	32
FY11			
Churn (%)	6.8	3.8	9.2
Gross adds (m)	153	87	110
Revenue (Rs bn)	464	206	154
EBITDA (Rs bn)	171	65	37
Potential reduction in gross adds (m) with 1% decline in churn	20	17	11
Potential cost savings with 1% decline in churn (Rs bn)	**1.22**	**1.03**	**0.68**
Impact on EBITDA margins (%)	**0.26**	**0.50**	**0.44**

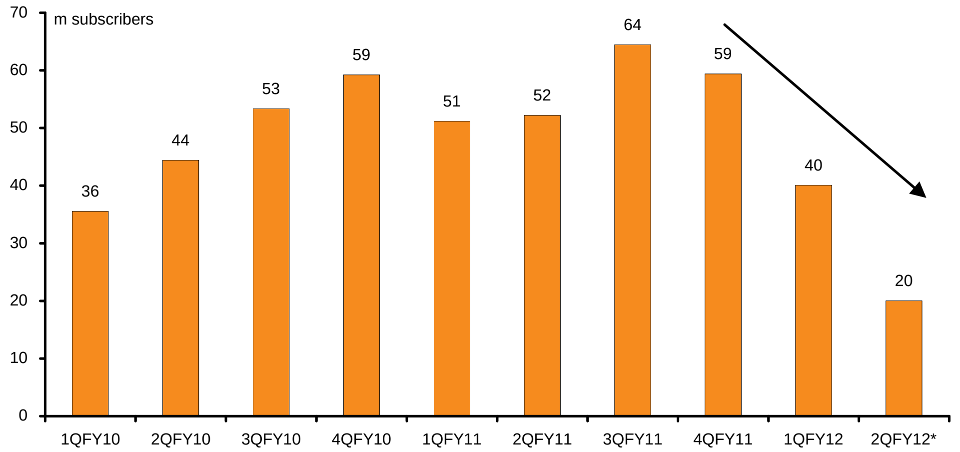
Source: Company data, RBS estimates

Industry gross additions likely to decline meaningfully

Gross subs additions likely to decline, led by lower competitive intensity and a decline in distribution margin

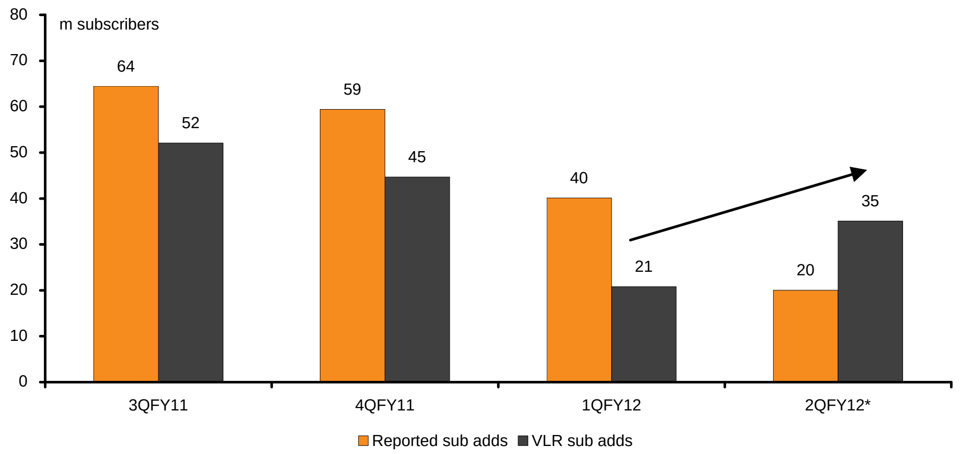
Net subs additions for the industry declined over the past few quarters due to 1) lower competitive intensity; 2) stricter norms on the issue of numbering resources since February 2011; and 3) a decline in distributor margins on the sale of new SIMs. The combined effect of those three factors is a decline in reported net subs addition (see Chart 36). However, the VLR subs base (a reflection of an active subs base) indicates operators' focus on quality and revenue-earnings subs. VLR net additions improved to about 12m subs in July 2011, compared with about 7m sub additions in June (see Chart 37). The combined effect of lower reported subs additions and higher VLR subs additions implies lower gross subs additions, which is a significant positive owing to its impact on subs acquisition costs and margins.

Chart 36 : Industry's subs net adds slipped in past few quarters due to less competition



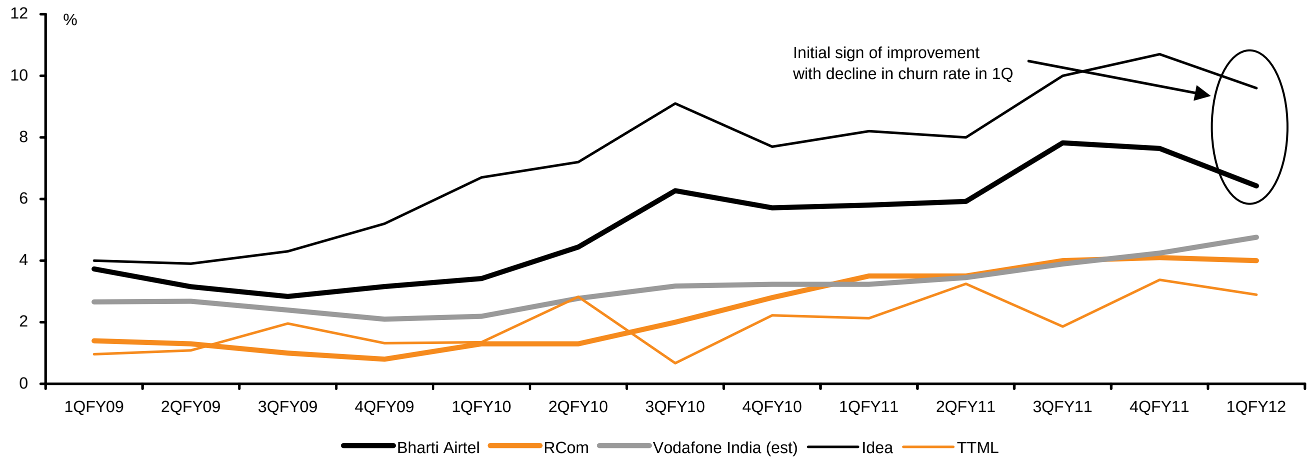
*2QFY12 is calculated based on July 2011 addition trend.
Source: TRAI, RBS estimates

Chart 37 : Active subs base additions showed improvement in July 2011



*2QFY12 is calculated based on July 2011 addition trend.
Source: TRAI, RBS estimates

Chart 38 : Churn rate (per month) across operators has increased significantly…



Source: Company data

Table 15 : … leading to a significant increase in gross additions

Gross subs addition (yoy)					
m	**FY08**	**FY09**	**FY10**	**FY11**	**yoy (%)**
Bharti Airtel	48	62	101	153	52
RCom	24	34	50	87	76
Vodafone India		41	61	86	41
Idea Cellular	20	31	63	110	74
TTML		3	7	8	14

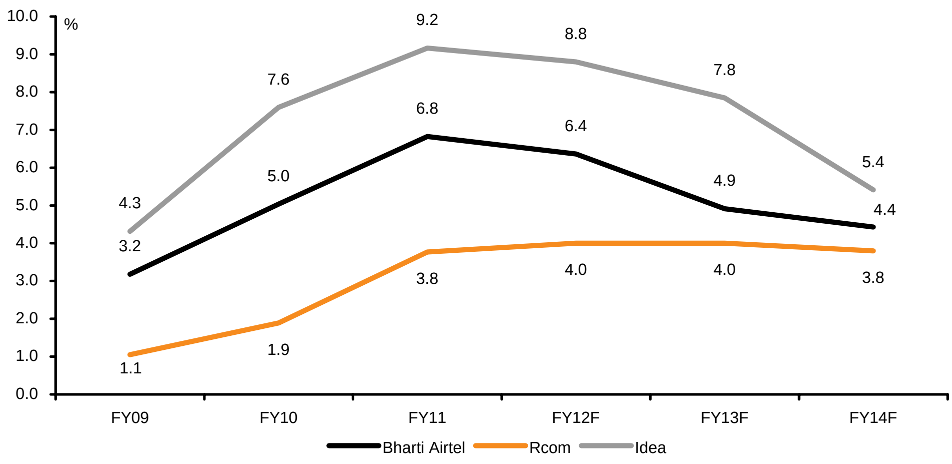
Source: Company data

Table 16 : Improvement with decline in gross adds in 1QFY12 due to lower churn rate

m	1QFY11	2QFY11	3QFY11	4QFY11	1QFY12	qoq (%)
Bharti Airtel	32.0	31.5	43.9	45.8	38.9	(15)
RCom	19.6	18.5	22.9	26.1	24.3	(7)
Vodafone India	18.4	18.1	22.7	26.8	26.7	(1)
Idea Cellular	21.4	22.4	31.0	35.2	32.1	(9)
TTML	1.7	2.4	2.0	2.2	2.0	(10)

Source: Company data

Chart 39 : Churn rate expected to decline

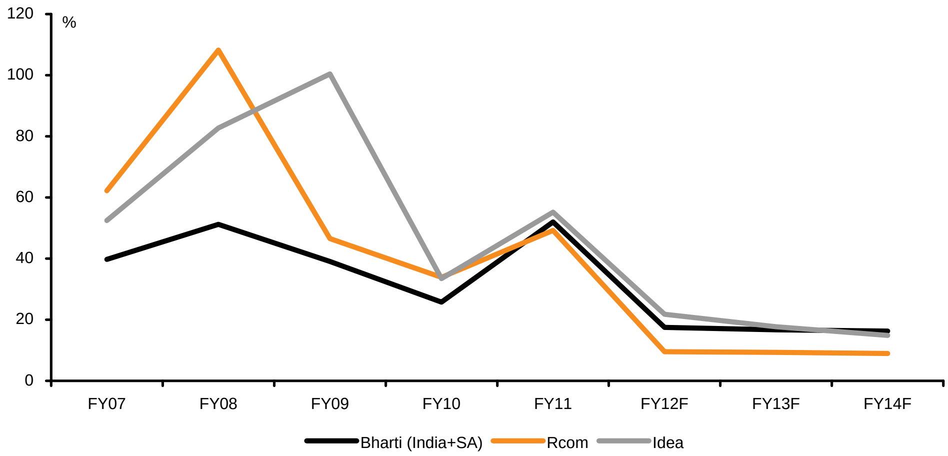


Source: Company data, RBS forecasts

De-leveraging driven by operational improvement and lower capex intensity

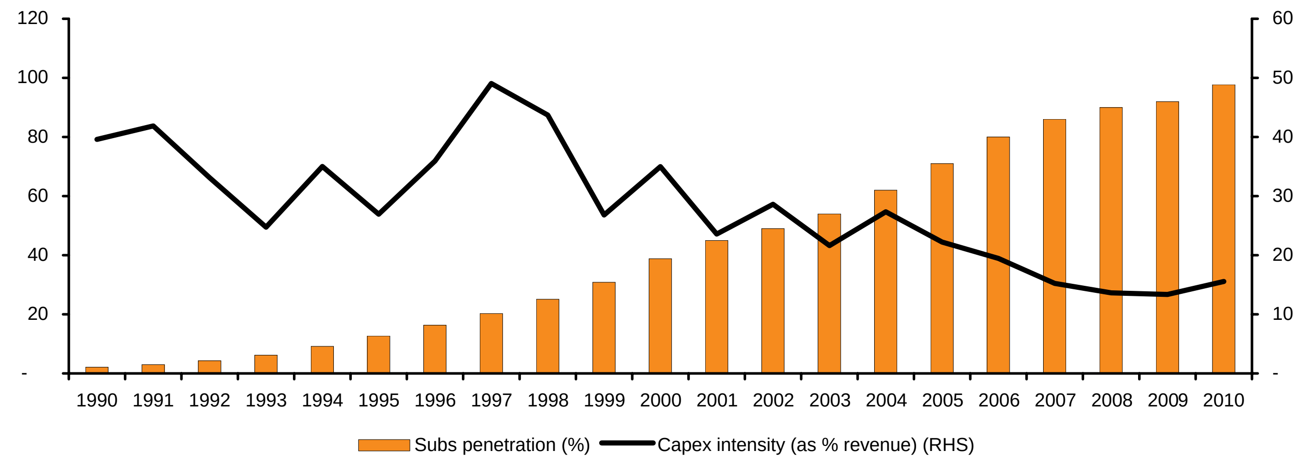
We expect operators' leverage to be reduced due to operational improvement and lower capex intensity.

Chart 40 : We expect capex intensity to decline and stabilise as a percentage of revenue



Source: Company data, RBS forecasts

Chart 41 : USA industry capex intensity as a percentage of revenue declined with rise in subs penetration



Source: FCC

Table 17 : Net debt to decline

Rs bn	FY10	FY11	FY12F	FY13F	FY14F
Bharti	(13)	601	581	522	420
Idea	64	106	121	105	79
RCom	249	337	336	311	270

Source: Company data, RBS forecasts

Table 18 : Net debt/EBITDA

x	FY10	FY11	FY12F	FY13F	FY14F
Bharti		3.0	2.3	1.7	1.3
Idea	1.9	2.8	2.4	1.5	1.0
RCom	3.2	5.2	4.9	4.1	3.3

Source: Company data, RBS forecasts

Regulatory stability likely with NTP'11

Though regulatory uncertainty remains, the NTP'11 (expected by Oct/Nov) should provide a stable regulatory outlook as it addresses known concerns (spectrum renewal charges) and offers guidelines for consolidation.

TRAI recommendations on spectrum pricing may impact operators negatively; we build worst-case scenario into our target price

In May 2010 and February 2011, the Telecom Regulatory Authority of India issued its recommendations on spectrum pricing, allocation and licensing framework, which have implications for capital investment in the sector. TRAI proposes 1) a one-time spectrum charge above 6.2MHz; 2) spectrum-renewal charges to be paid after licence expiry; and 3) a reduction of licence fees to a uniform 6% of adjusted gross revenue (AGR) against present slabs of 6%, 8% and 10% of AGR. Table 19 highlights the net impact of TRAI's recommendations.

Table 19 : Net impact of proposed TRAI recommendations

Operators	Bharti Airtel	Vodafone	Idea Cellular	RCom (GSM)
Rs bn				
One-time spectrum charge for allocation above 6.2MHz of spectrum	(36)	(17)	(15)	(1)
PV of spectrum-renewal charges (to be paid after expiry of licence)	(75)	(79)	(63)	(29)
PV of proposed reduction in licence fees (uniform 6% as a % of AGR)	95	73	45	25
Total net Impact (Rs bn)	(16)	(23)	(33)	(5)
Impact per share (Rs)	**(4)**		**(10)**	**(2)**

Source: TRAI, RBS forecasts

Worst-case impact factored into our target price

Recent media reports indicate that India's Telecom Commission turned down the TRAI's proposal for a reduction in licence fees to a uniform 6% of AGR from present slabs of 6%, 8% and 10% of AGR. This would imply a negative impact on operators that could increase if other proposals are accepted in their current form, as highlighted in Table 20. We build the worst-case impact (see Table 20) into our fair value estimates for the companies under our coverage.

Table 20 : Worst-cast impact of proposed TRAI recs factors in no licence fee reduction

Operators	Bharti Airtel	Vodafone	Idea cellular	RCom (GSM)	BSNL/MTNL
Rs bn					
One-time spectrum charge above 6.2MHz	(36)	(17)	(15)	(1)	(86)
PV of spectrum-renewal charges (to be paid after expiry of licence)	(75)	(79)	(63)	(29)	(92)
Total	**(111)**	**(97)**	**(78)**	**(30)**	**(178)**
Impact per share (Rs)	**(29)**		**(23)**	**(14)**	

Source: TRAI, RBS forecasts

Public sector entities to be hardest hit if the recommendations are implemented

We expect that the TRAI proposals, if implemented; will have the most impact on BSNL/MTNL (public sector undertaking) (see Table 21). These entities have maximum spectrum exceeding 6.2MHz and we also expect will be hardest hit by the TRAI proposals for the one-time spectrum charge above 6.2MHz (see Table 22). The significant negative impact on BSNL and MTNL (public sector undertaking) operators may act as a bottleneck to implement the proposals.

Table 21 : BSNL/MTNL spectrum-renewal charges at time of licence expiry (based on TRAI recs)

Year	Circles	Number of circles	Payouts (Rs m)	NPV (FY13) – Rs m
FY18	Delhi, Mumbai	2	28,082	17,500
FY21	Rest of India	20	153,522	74,561
Total payouts		**22**	**181,604**	**92,061**

Source: TRAI, RBS forecasts

Table 22 : Potential gov't rev from one-time spectrum fees (incumbent GSM operators)

Operators	Rs m	Contribution (%)
BSNL/MTNL	86,281	53.0
Bharti Airtel	36,325	22.3
Vodafone India	17,304	10.6
Idea Cellular	15,223	9.3
Aircel	4,973	3.1
BPL	1,947	1.2
RCom (GSM)	787	0.5
Total	**162,839**	**100.0**

Source: TRAI, RBS forecasts

We believe it would be difficult to implement the TRAI recommendations in their current form, because it would result in an uneven playing field among incumbent operators and new entrants (ie, those that entered the market in 2008). The TRAI recommends that the spectrum prices (see Table 23) may be made effective from 1 April 2010, pro-rated for the remaining validity of the respective licences while charging for excess spectrum.

We believe the TRAI recommendations are not likely to be implemented because they would create an uneven playing field among incumbent and new operators

The TRAI's recommended price implies that 4.4MHz of Pan-India spectrum was worth Rs77.9bn as of April 2010. However, new entrants were given licences (along with 4.4MHz of start-up spectrum) in January 2008 for a meagre Rs16.5bn – one-fifth the price determined by the TRAI. The industry has strongly opposed the TRAI's recommendations. We believe incumbent operators have strong rationale behind their opposition because the recommended charges would result in an uneven playing field because they discriminate against different operators at various points in time. If such charges were to be levied, new entrants (as of 2008) should also invest 5 times the initial capital investment on spectrum. We believe that if the charges are levied retrospectively from 2008, it would warrant huge capital investment for new entrants and might lead to the surrender of licences in some cases.

Table 23 : Comparison of spectrum prices (entry fees in 2001, auction prices in 2010) and TRAI's recommended prices

Rs m /MHz	Entry licence fees (2001)	2.1GHz (3G) auction prices (2010)	TRAI recommended prices for 1800MHz applicable effective from 1 April 2010	
			Up to 6.2MHz	Over 6.2MHz
Circles				
Metros				
Delhi	275	6,634	1,498	2,497
Mumbai	329	6,494	1,011	1,573
Kolkata	126	1,089	495	476
A' Circle				
Maharashtra	305	2,516	1,171	3,745
Gujarat	176	2,152	1,499	3,554
A.P.	166	2,746	1,538	4,320
Karnataka	334	3,160	1,362	3,459
T.N.	376	2,930	1,874	4,261
B' Circle				
Kerala	65	625	740	2,322
Punjab	245	644	729	1,806
Haryana	35	445	145	1,079
U.P. (W)	49	1,028	601	2,526
U.P.(E)	73	729	1,518	3,188
Rajasthan	52	642	1,060	2,788
M.P.	28	517	877	2,545
W.B.	2	247	448	2,170
C' Circle				
H.P.	2	74	93	281
Bihar	16	407	510	1,537
Orissa	8	194	243	733
Assam	8	83	104	313
N.E.	3	85	106	320
JandK	3	61	76	229
Total	**2,675**	**33,501**	**17,698**	**45,719**

Source: TRAI

Table 24 : TRAI's proposed value of 1,800MHz spectrum over 6.2MHz is higher than 2.1GHz spectrum auction prices

%	Deviation over 2001 entry fees		Deviation over 2.1GHz auction prices	
	Up to 6.2MHz	Over 6.2MHz	Up to 6.2MHz	Over 6.2MHz
Metros				
Delhi	444	807	(77)	(62)
Mumbai	208	379	(84)	(76)
Kolkata	293	278	(55)	(56)
A'Circle				
Maharashtra	284	1,129	(53)	49
Gujarat	753	1,921	(30)	65
A.P.	826	2,501	(44)	57
Karnataka	308	937	(57)	9
T.N.	399	1,034	(36)	45
B'Circle				
Kerala	1,031	3,450	18	271
Punjab	198	638	13	180
Haryana	319	3,018	(67)	142
U.P.(W)	1,119	5,023	(42)	146
U.P.(E)	1,979	4,267	108	337
Rajasthan	1,939	5,262	65	334
M.P.	3,021	8,955	70	392
W.B.	27,894	135,500	81	777
C'Circle				
H.P.	5,089	15,522	25	278
Bihar	3,070	9,446	25	278
Orissa	2,904	8,944	25	278
Assam	1,184	3,768	25	278
N.E.	3,216	9,884	25	278
JandK	2,275	7,053	25	278
Total	**562**	**1,609**	**(47)**	**36**

Source: TRAI

TRAI recommends auctioning spectrum in 1,800MHz band, if surplus spectrum is available, to determine the relevant spectrum price

To a certain extent, the impact analysis is academic in nature. In a scenario where some licences are cancelled or licensees surrender spectrum, excess spectrum will be available. In such cases, the TRAI recommends auctioning spectrum in the 1,800MHz band to determine the relevant spectrum price. We quote from the TRAI's recommendations:

"In respect of 1800MHz spectrum, it can be seen in certain licensed service areas (LSAs), spectrum would be available even after meeting requirement of contracted spectrum. ... In that event, it should be possible for government to auction the surplus spectrum and treat this auction price as the relevant price of spectrum beyond 6.2MHz for the given LSA, provided auction is conducted within 12 months of the decision by the government. Ideally, the value of spectrum can only be applied in a given LSA. However, in so far as LSA where auction is not feasible for lack of surplus spectrum, government could consider appropriately modifying the estimated figure of an LSA to reflect the market price based on the auction price in the LSAs where auction was conducted."

We note that surplus spectrum in 1,800MHz is available in 20 out of 22 circles in India (see Table 25), without factoring in any licence cancellations. Additionally, the TRAI recommended on 14 July 2011 that the Department of Telecommunications (DoT) cancel 53 licences (41 GSM and 12 CDMA) on grounds of non-fulfilment of rollout obligations. If the licences are cancelled, it would release an additional 180.4MHz of GSM spectrum, and surplus spectrum would be available in all the circles (see Table 26).

Table 25 : Surplus spectrum in 1,800MHz available in 20 of 22 circles without factoring in licence cancellation

Spectrum (MHz) -->	Available	Allotted	Surplus
Metros			
Delhi	65.2	53.6	11.6
Mumbai	77.4	72.4	5.0
Kolkata	83.4	60.4	23.0
A' Circle			
Maharashtra	75.4	69.4	6.0
Gujarat	64.8	60.4	4.4
A.P.	84.4	69.4	15.0
Karnataka	81.2	69.4	11.8
T.N.	92.4	67.0	25.4
B' Circle			
Kerala	89.2	61.2	28.0
Punjab	64.6	63.2	1.4
Haryana	68.2	63.8	4.4
U.P.(W)	69.4	61.2	8.2
U.P.(E)	62.4	62.4	-
Rajasthan	67.0	63.8	3.2
M.P.	81.0	63.0	18.0
W.B.	57.0	53.0	4.0
C' Circle			
H.P.	64.0	57.6	6.4
Bihar	66.8	66.8	-
Orissa	77.4	59.4	18.0
Assam	58.8	55.0	3.8
N.E.	60.2	53.2	7.0
JandK	55.8	49.4	6.4

Source: TRAI

Table 26 : Surplus spectrum in 1,800MHz available in all 22 circles if DoT cancels 53 licences, as per TRAI recs of 14 July 2011

Spectrum (MHz) -->	Available	Recommended cancellation by TRAI	Allotment post cancellation	Surplus post cancellation
Metros				
Delhi	65.2	4.4	49.2	16.0
Mumbai	77.4	4.4	68.0	9.4
Kolkata	83.4	8.8	51.6	31.8
A' Circle				
Maharashtra	75.4	8.8	60.6	14.8
Gujarat	64.8	8.8	51.6	13.2
A.P.	84.4	13.2	56.2	28.2
Karnataka	81.2	8.8	60.6	20.6
T.N.	92.4	4.4	62.6	29.8
B' Circle				
Kerala	89.2	4.4	56.8	32.4
Punjab	64.6	13.2	50.0	14.6
Haryana	68.2	13.2	50.6	17.6
U.P.(W)	69.4	4.4	56.8	12.6
U.P.(E)	62.4	4.4	58.0	4.4
Rajasthan	67.0	8.8	55.0	12.0
M.P.	81.0	8.8	54.2	26.8
W.B.	57.0	4.4	48.6	8.4
C' Circle				
H.P.	64.0	8.8	48.8	15.2
Bihar	66.8	4.4	62.4	4.4
Orissa	77.4		59.4	18.0
Assam	58.8	13.2	41.8	17.0
N.E.	60.2	17.6	35.6	24.6
JandK	55.8	13.2	36.2	19.6

Source: TRAI

Impact of spectrum charges could be lower as surplus spectrum is available, the latter of which could be auctioned

Hence, there could be surplus spectrum available Pan-India and it could be auctioned to determine the relevant price of spectrum beyond 6.2MHz. We believe prices discovered through the auction process could be drastically lower than the TRAI's proposed prices. However, to be conservative, we build into our target prices a worst-case impact of the TRAI recommendations (see Table 20), providing a margin of safety against our estimates of fair value for the stocks.

NTP'11 to provide stable regulatory outlook

Although a regulatory overhang remains regarding the potential impact owing to spectrum charges, we believe the National Telecom Policy 2011 (NTP'11) will provide a stable regulatory outlook as known concerns (spectrum renewal charges) are addressed in the policy, and the policy framework would set out the framework for consolidation with merger and acquisition guidelines, and spectrum sharing and spectrum trading guidelines. NTP'11 is likely to be introduced by October or November 2011.

Overweight – ripe for profitable growth

We believe sector outperformance will be sustainable as structural improvement leads to profitable growth. Our preferred pick is Bharti, followed by Idea.

We believe the time is ripe for profitable growth in the sector

We initiate coverage of the India telecoms sector at Overweight based on 1) our expectation that industry revenue will double over the next five years (15% CAGR), led by increased minute penetration (12% CAGR), relative voice price stability and increase in broadband penetration; 2) structural improvement in the sector (price stability, consolidation, reduction in churn rate); 3) confidence among stakeholders that NTP'11 will provide a stable regulatory outlook; and 4) the sector's defensive characteristics (better predictability and visibility of cash flows). We believe valuation multiples for the companies under our coverage could expand as a result of high growth, rising ROEs and de-leveraging. We initiate coverage of Bharti and Idea with Buy ratings, and we initiate coverage of RCom with a Hold rating. We prefer Bharti owing to its recent underperformance of about 14% against Idea over the past two months.

Initiate on Bharti with Buy; expect growth across geographies

Our preferred pick is Bharti, owing to synchronized profitable growth across India and Africa

We initiate coverage of Bharti with a Buy rating and a 12-month target price of Rs475/share. Our target price is based on a sum-of-the-parts (SOTP) valuation. We discounted the SOTP-based FV of Mar-13 by six months to derive a 12-month target price (Sept-12). India's mobile business is valued at 7.5x EV/EBITDA (a premium to Idea's mobile business at 7.0x EV/EBITDA) and its tower business is valued at Rs5.0m EV/tower. The Africa business is valued at 6.0x EV/EBITDA (comparable to Bharti's African peers). We factored into our target price a possible negative impact owing to one-time spectrum fees and spectrum-renewal charges.

Our target price implies EV/EBITDA multiples of 7.8x for FY13F and 6.7x for FY14F, based on our forecasts. Bharti's implied FY13 EV/EBITDA multiple is closer to its historical average of 7.7x one-year forward EV/EBITDA. Although the historical average is based on limited history (from Jun-10), we believe the valuation multiples are comparable for Bharti only after June 2010, because the stock's valuation multiple was de-rated after 1) hyper competition in India which led to reduction in its ROE, and 2) its Africa acquisition completed in June 2010.

There is potential for Bharti's valuation multiples to expand led by: 1) structural improvement in India leading to high growth (EBITDA CAGR of 14.6% over FY11-14F; 2) improvement in the profitability of its Africa business (EBITDA CAGR 28% over FY11-14F); and 3) its ROE expanding to 15.2% by FY14 (from 13.4% in FY11).

Key downside risks to our target price and rating: 1) higher-than-expected impact owing to one-time spectrum fees and spectrum renewal charges; 2) lower-than-expected tariffs; and 3) lower-than-expected minute market share performance.

Initiate on Idea with Buy; outperformance led by superior growth and ROE expansion

We believe Idea would be the biggest beneficiary of structural improvement and consolidation, and we recommend Buy

We initiate coverage of Idea with a Buy rating and a 12-month target price of Rs121/share. We believe Idea's valuation multiples will expand as the company outperforms its peers, led by minute market share gains (up 200bp), improvement in network utilisation and a reduction in churn rate. This should lead to outperformance driven by 1) higher growth: revenue/EBITDA/EPS CAGRs of 21.0%, 29.6% and 41.0% over FY11-14, respectively; and 2) expansion of its ROE to 15.8% by FY14 (from 7.6% in FY11).

Our target price is based on a SOTP valuation. We discounted the SOTP-based FV of Mar-13 by six months to derive a 12-month target price (Sept-12). Idea's mobile business is valued at 7.0x EV/EBITDA (a discount to Bharti's mobile business, which we value at 7.5x EV/EBITDA) and its tower business (16% stake in Indus Towers) is valued at Rs5.0m EV/tower. Our target price of Rs121/share factors in the possible negative impact of the TRAI's recommendations (Rs23/share) on Idea; hence factoring in a significant margin of safety against its fair value of Rs144/share.

Our target price implies EV/EBITDA multiples of 7.2x FY13F and 5.9x FY14F, based on our forecasts. Idea's implied FY13 EV/EBITDA multiple is closer to its historical average of 7.4x one-year forward EV/EBITDA. We believe its consolidated business historical valuation multiple is comparable only from November 2009, since the sector was de-rated during October/November 2009 due to hyper-competition leading to a reduction in ROEs.

Idea offers significant potential upside if spectrum-renewal charges are lower than those proposed in the TRAI's recommendations. Idea offers maximum upside potential if pricing power improves for the sector. We believe that if Idea's ARPU is 5% higher than our estimate, the stock's fair value would increase by about 22%.

Key downside risks: 1) a higher-than-expected impact owing to one-time spectrum fees and spectrum renewal charges; 2) lower-than-expected tariffs; 3) lower-than-expected minute market share performance; and 4) higher-than-expected competitive intensity.

Initiate on RCom with Hold; no visible turnaround

We initiate our coverage of RCom with a Hold rating and a 12-month target price of Rs67/share. We discounted our fair value estimate of Mar-13 by six months to derive a 12-month target price (Sept-12). Our fair value estimate for RCom is based on 5.6x FY14E EV/EBITDA (implying a 25% discount to Bharti's India mobile business valuation multiple). Our target price implies EV/EBITDA multiples of 6.0x FY13F and 5.2x FY14F, based on our forecasts.

We believe RCom's discount to Bharti is justified because of 1) RCom's performance lagging that of its peers and it continues to lose MinMS; 2) its inherent risk of a dual network; 3) and its weaker financial performance (we forecast EBITDA CAGR 7.5% over FY11-14E). In addition, RCom's high financial leverage poses additional risk.

Key upside risks: We believe RCom could be re-rated if it can raise fresh equity (at the parent level or in its tower subsidiary) that exceeds its fair value. However, we believe regulatory uncertainty has reduced the likelihood of equity dilution.

Key downside risks: 1) lower-than-expected tariffs; and 2) lower-than-expected minute market share.

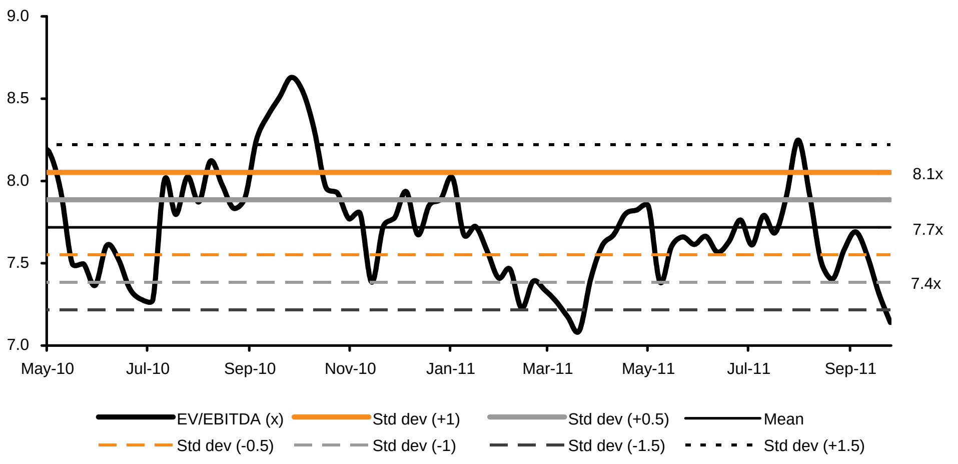
Table 27 : Peer valuation comparison

Company	Recom	Target price	CAGR in % (FY11-14F)			ROE (%)	EV/EBITDA (x)		PE (x)	
		(Rs)	Revenue	EBITDA	EPS	FY14F	FY13F	FY14F	FY13F	FY14F
Bharti	Buy	475	12.8	17.1	17.6	15.2	6.5	5.6	16.8	14.6
Idea	Buy	121	21.0	29.6	40.8	15.8	6.1	5.0	18.4	13.0
RCom	Hold	67	6.4	7.5	(14.8)	2.0	6.0	5.1	19.6	17.7

Source: RBS forecasts

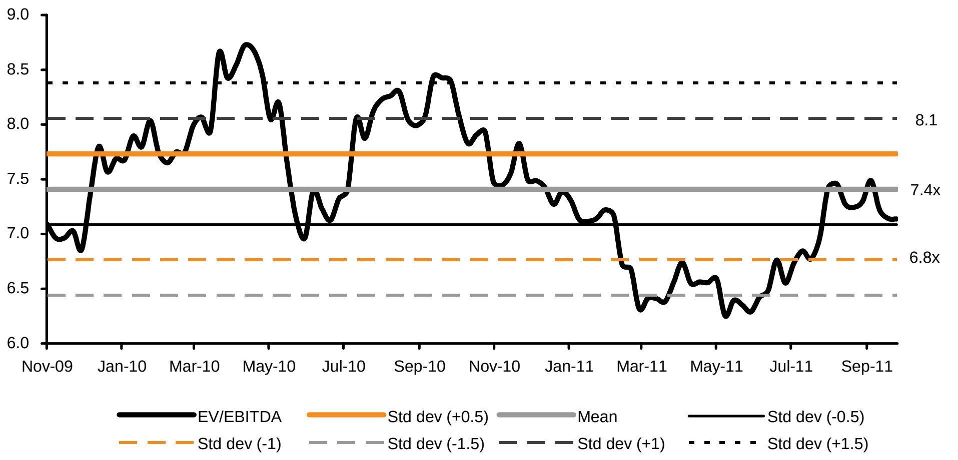
Bharti's one-year forward EV/EBITDA is below 1.5 std deviation

Chart 42 : Bharti – EV/EBITDA (1 year forward)



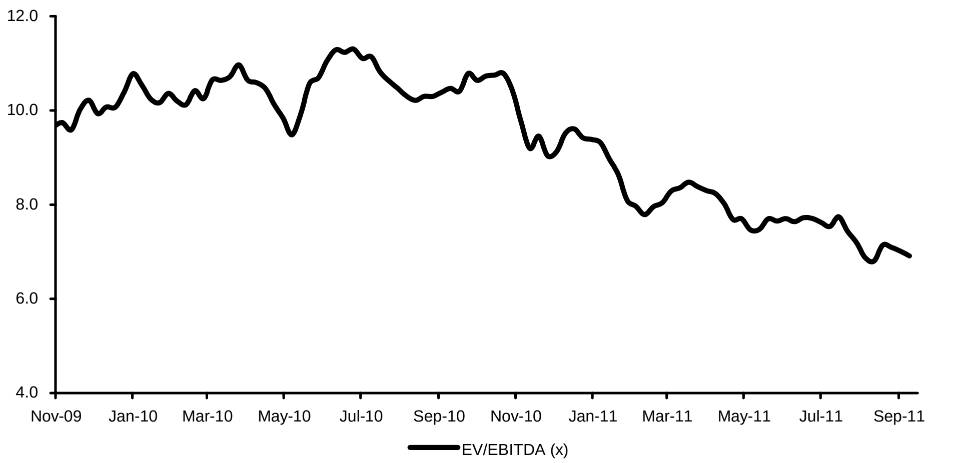
Source: Company data, Bloomberg, RBS forecasts

Chart 43 : Idea – EV/EBITDA (1 year forward)



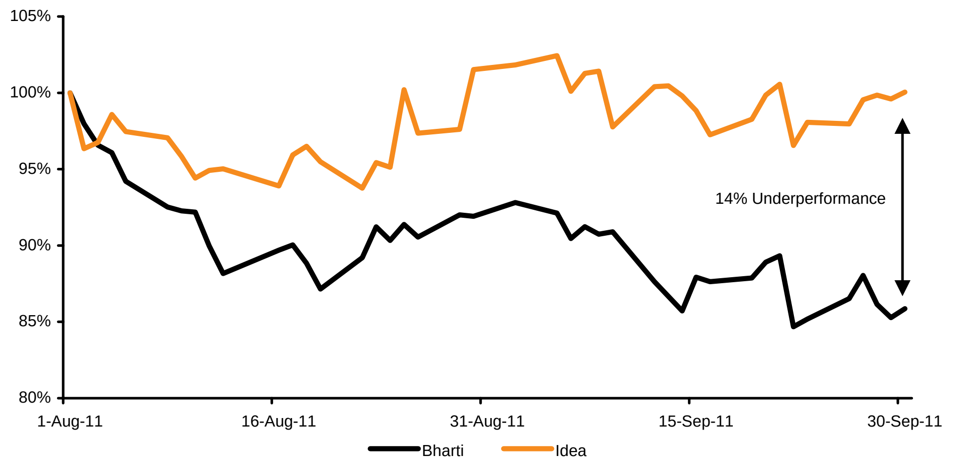
Source: Company data, Bloomberg, RBS forecasts

Chart 44 : RCom – EV/EBITDA (1 year forward)



Source: Company data, Bloomberg, RBS forecasts

Chart 45 : Bharti's recent underperformance against Idea is unwarranted, in our view



Source: Bloomberg

Industry risks to our investment case

Key downside risks to our investment case:

- Lower-than-expected tariffs owing to competition is a key risk.
- Unfavourable changes in licensing conditions in India (over spectrum pricing and allocation, spectrum re-farming, reduction in mobile termination charges) pose a risk. If spectrum renewal charges exceed the TRAI's proposed charges, it could pose a risk to our fair value estimates.
- Increased competition in the wireless broadband market with the entry of new players.

Key upside risks to our investment case:

- Higher-than-expected tariffs.
- Higher-than-expected voice minute growth.
- An increase in wireless broadband penetration at a faster pace than we expect.
- If spectrum-renewal charges are lower than the TRAI's recommended charges, it would likely be positive, as we have factored into our target prices a worst-case impact.

Company profiles

The following are the latest reports published on these companies:

COMPANY PROFILES

RBS The Royal Bank of Scotland

3 October 2011

Produced by: The Royal Bank of Scotland N.V., (India) Office

Bharti Airtel

Growth across geographies

Falling capex intensity, stable pricing in India and growth in profitability of the Africa business are transforming the outlook for Bharti. We expect the company to repay US$4bn debt over the next three years and expand ROE to 15.2% in FY14 (an EPS CAGR of 18% over FY11-14F). We initiate at Buy.

Initiation of coverage

Buy

Target price
Rs475.00

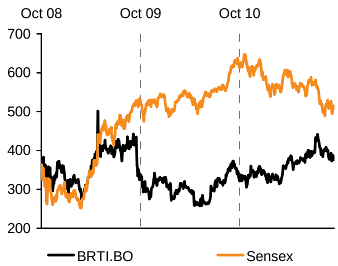
Price
Rs378.00

Short term (0-60 days)
n/a

Market view
Underweight

Price performance

	(1M)	(3M)	(12M)
Price (Rs)	404.6	394.9	366.3
Absolute (%)	-6.6	-4.3	3.2
Rel market (%)	-5.3	9.6	25.9
Rel sector (%)	-6.6	-4.3	3.2



Market capitalisation
Rs1.44t (US$29.12bn)

Average (12M) daily turnover
Rs1858.38m (US$41.87m)

Sector: BSE Tech
RIC: BRTI.BO, BHARTI IN
Priced Rs378.00 at close 30 Sep 2011.
Source: Bloomberg

Key forecasts

	FY10A	FY11A	FY12F	FY13F	FY14F
Revenue (Rsm)	396,150	594,672	715,282	814,947	894,675
EBITDA (Rsm)	161,243	199,664	252,355	300,709	331,394
Reported net profit (Rsm)	91,026	60,467	60,154	85,679	98,530
Normalised net profit (Rsm)[1]	88,782	60,467	60,154	85,679	98,530
Normalised EPS (Rs)	23.38	15.92	15.82	22.50	25.88
Dividend per share (Rs)	1.00	1.00	1.00	1.00	1.00
Dividend yield (%)	0.26	0.26	0.26	0.26	0.26
Normalised PE (x)	16.17	23.74	23.89	16.80	14.61
EV/EBITDA (x)	8.82	10.20	7.99	6.51	5.60
Price/book value (x)	3.47	2.94	2.75	2.39	2.06
ROIC (%)	22.70	17.50	7.39	9.44	10.30

1. Post-goodwill amortisation and pre-exceptional items
Accounting standard: IFRS
Source: Company data, RBS forecasts
year to Mar, fully diluted

Structural improvement in India – price stability and decline in churn rate

We expect Bharti's India and South Asia FY11-14F revenue and EBITDA CAGRs to grow 11.9% and 14.6%, respectively, driven by: 1) a minutes of use CAGR of 13%; 2) stable revenue per minute; and 3) incremental 3G data revenue. We expect non-voice revenue (including 3G) to grow from 14.6% in 1QFY12 to 16.2% of mobile revenue in FY14. EBITDA margin expansion will be driven by decline in churn rate and network utilization improvement.

Can it replicate success in Africa? Early signs visible in 47.4% yoy minute growth

Bharti's current Africa minutes of use (MoU) is equivalent to its India MoU in FY06. Can Bharti replicate its success in India during FY06-09, when it achieved mobile MoU and revenue CAGRs of 90% and 54%? Bharti's Africa EBITDA has grown at a quarterly CAGR of 9.2% for the last three quarters, driven by 47.4% yoy MoU growth to 16.3bn in 1Q. While we expect an Africa EBITDA CAGR of 28% for FY11-14, led by EBITDA margin expansion to 31% by FY14 (+600bp from 1QFY12), there could be upside from higher MoU growth.

We expect a re-rating led by synchronized profitable growth across geographies

Bharti's stock has been de-rated due to the dual impact of competition in India and leveraged acquisition in Africa. With the worst now behind the company, we expect synchronized profitable growth across geographies to lead to a valuation re-rating. We expect an FY11-14 EPS CAGR of 18% led by: 1) EBITDA CAGR of 17.1% to US$7.4bn in FY14F 2) lower capex intensity to 17.9% of revenue in FY14F, and 3) lower interest cost due to a fall in net debt by US$4bn to US$9.4bn in FY14F.

We initiate with a Buy rating and target price of Rs475

Our target price of Rs475 is based on SOTP valuation. We discount our SOTP-based FV of March 2013 by six months to derive the 12-month target price. Our target price implies an EV/EBITDA multiple of 7.8x FY13F and 6.7x FY14F.

This note should be read along with our sector report (*Ripe for profitable growth,* 3 October 2011) for a better understanding of the investment argument.

Important disclosures can be found in the Disclosures Appendix.

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The basics

Vs consensus

EPS (Rs)	RBS	Cons	% diff
2012F	15.8	18.8	-16%
2013F	22.5	27.6	-18%
2014F	25.9	35.6	-27%

Source: Bloomberg, RBS forecasts

Forced ranking*

Company	Rec	Upside / Downside
Bharti	Buy	26%
Idea	Buy	23%
China Mobile	Buy	14%
RCom	Hold	-7%

* by difference to target price as at time of publication. Recommendations may lie outside the structure outlined in the disclosure page.
Source: RBS forecasts

Key events

Date	Event
Oct-Nov, 2011	2Q FY12 results release
Oct-Nov, 2011	National Telecom Policy-2011 to be introduced

Source: Company data, Industry

Catalysts for share price performance

We believe key catalysts for share price performance are:

- Increase in voice revenue per minute (RPM) in the next few quarters in India business.
- Consistent improvement in revenue and profitability of Africa business.
- The outcome of the National Telecom Policy 2011 is expected to provide a stable regulatory outlook as known concerns (such as spectrum renewal charges) should be addressed by the policy.

Earnings momentum

- Bharti's India business growth is likely to improve due to price stability and increase in non-voice revenue. We expect revenue/EBITDA to grow at 11.9%/14.6% CAGRs in FY11-14.
- The profitability of Bharti's Africa business is likely to improve (we forecast an FY11-14 EBITDA CAGR of 28%) driven by market share gains, higher network use and benefits of outsourcing, in our opinion.
- Overall, we expect a consolidated EPS CAGR of 18% in FY11-14F led by improvement across geographies.

Valuation and target price

We initiate with a Buy rating and 12-month target price of Rs475. We derive our target price from a SOTP methodology. We discount our SOTP-based FV of March 2013 by six months to derive our 12-month target price (September 2012). We value India's mobile business at 7.5x EV/EBITDA (at a premium to Idea's mobile business of 7.0x EV/EBITDA) and tower business at Rs5.0m EV/tower. We value Africa business at 6.0x EV/EBITDA (comparable to African peers). We factor a possible Rs29 per share impact from one-time spectrum fees and spectrum renewal charges into our target price.

Our target price implies an EV/EBITDA multiple of 7.8x FY13F and 6.7x FY14F.

How we differ from consensus

Our revenue forecast for Bharti is largely in line with Bloomberg's consensus estimates. Our EBITDA forecast in FY12 and FY13 is in line with Bloomberg's consensus estimates. However, our lower FY14 EBITDA forecast (about 6% below consensus estimates) is attributable to our lower margin expectation (31%) for Bharti Airtel Africa.

Our EPS forecasts are about 15-20% lower than Bloomberg's consensus estimates, which we believe is primarily due to: 1) higher depreciation and amortisation expense due to 3G spectrum cost amortisation and 2) higher tax forecasts (effective tax rate at about 30-31%).

Risks to our central scenario

Key risks to our target price and rating are:

- Higher impact than we expected due to one-time spectrum fees and spectrum renewal charges
- Lower tariffs than we expected
- Lower minute market share performance than we expected
- Higher competition than we expected, leading to higher marketing and subscriber acquisition costs

Key assumptions and sensitivities

Table 1 : Key assumptions

	FY12F	FY13F	FY14F
Bharti India			
Minute market share (%)	26.3	25.8	25.5
Minutes (bn)	927	1,050	1,146
Blended RPM (p/min)	43.6	44.1	43.8
Voice RPM (p/min)	37.4	37.4	36.6
3G subs (m)	6.5	11.0	19.6
Non-voice revenue (%)	14.2	15.1	16.2
Churn rate (%)	6.4	4.9	4.4
Bharti Africa			
Revenue growth - yoy (%)	15	16	15
EBITDA margin	26.5	28.5	31.0
Consolidated			
Capex intensity (% of revenue)	22.5	20.7	17.9

Source: RBS forecasts

Table 2 : Sensitivity analysis

Bharti Airtel Rs/sh	% change	Target price	% change in TP	EPS	% change in EPS
Base case		**475**		**25.9**	
Change in voice RPM	+2.5	494	4	27.3	6
	-2.5	457	-4	24.4	-6
Change in ARPU	+2.5	496	4	27.5	6
	-2.5	455	-4	24.2	-6
Change in Africa EBITDA margin	+100bp	479	1	26.5	2
	-100bp	472	-1	25.2	-2

Source: RBS forecasts

Table 3 : Our forecasts vs consensus

Rsm	FY12F			FY13F			FY14F		
	RBS	Consensus	Difference (%)	RBS	Consensus	Difference (%)	RBS	Consensus	Difference (%)
Revenue	715,282	717,375	**(0.3)**	814,947	825,404	**(1.3)**	894,675	911,645	**(1.9)**
EBITDA	252,355	250,572	**0.7**	300,709	304,416	**(1.2)**	331,394	353,396	**(6.2)**
PAT	60,154	71,324	**(15.7)**	85,679	104,652	**(18.1)**	98,530	135,046	**(27.0)**

Source: Bloomberg, RBS forecasts

Structural improvement in India

We expect Bharti to maintain its leadership position in India and improve its profitability, led by price stability, higher non-voice revenue and decline in churn rate.

Price stability expected in Indian market

Growth driven by stable RPM and a 13% minute CAGR

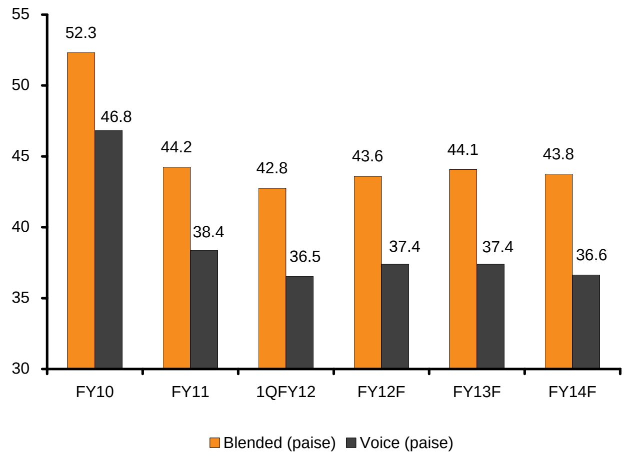
We expect Bharti's India and South Asia revenue/EBITDA to grow at an 11.9% and 14.6% CAGR, respectively, over FY11-14 due to: 1) a minutes CAGR of 13% over FY11-14F to 1146bn minutes; 2) stable RPM (44.2p/min in FY11 to 43.8p/min in FY14F). Blended RPM in India is supported by a marginal decline in voice RPM (from 38.4p in FY11 to 36.6p in FY14F); and 3) incremental 3G data revenue. We expect non-voice revenue (including 3G) as a percentage of mobile revenue to grow from 13.3% in FY11 (14.6% in 1QFY12) to 16.2% in FY14. EBITDA growth is likely to be driven by a decline in churn rate (from 6.8% in FY11 to 4.4% in FY14F) and an improvement in network use (7.6m min/cell site in 1QFY12 to 8.4m min/cell site by FY14F).

Table 4 : Bharti India and South Asia – financial performance

US$m	FY09	FY10	FY11	FY12F	FY13F	FY14F	CAGR (FY11-14F)
Revenue	8,214	8,803	10,360	11,875	13,447	14,519	11.9
yoy (%)		7.2	17.7	14.6	13.2	8.0	
EBITDA	3,371	3,583	3,793	4,543	5,354	5,702	14.6
Margin (%)	41.0	40.7	36.6	38.3	39.8	39.3	
PAT	2,057	1,973	1,680	1,706	2,196	2,326	11.5
Margin (%)	25.0	22.4	16.2	14.4	16.3	16.0	

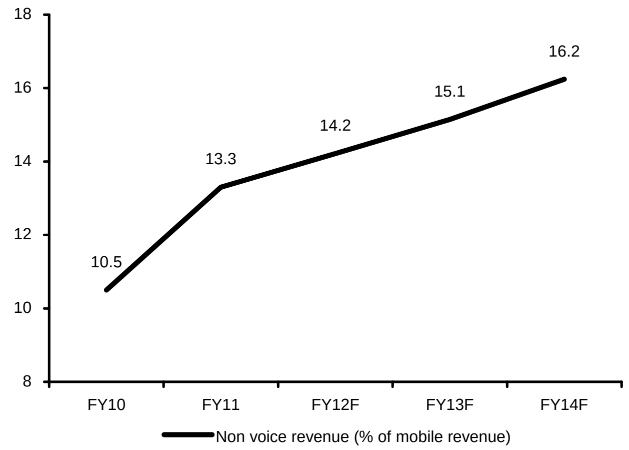
Source: Company data, RBS forecasts

Chart 1 : Price stability driven by stable voice RPM …



Source: Company data, RBS forecasts

Chart 2 : …and increase in non-voice revenue (%)

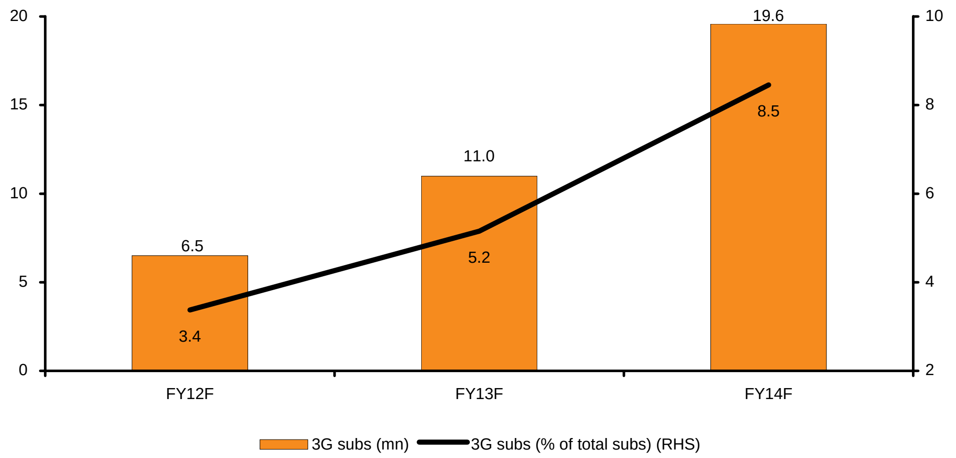


Source: Company data, RBS forecasts

We believe 3G penetration is likely to take longer

We expect Bharti's 3G subs to increase from about 2m in FY11 to about 19.6m in FY14 (about 8.5% of its subscriber base). We believe 3G ecosystems (network coverage, backhaul, handset penetration, mass appeal or demand for data and affordable access charges) will take a few years to stabilise before we witness significant 3G penetration improvement. Our expectation of about 20m 3G subs by FY14 for Bharti is based on the assumption that the company's subscribers (it had about 20m subs and an average ARPU of about Rs500 in FY06) would have the affordability and willingness to adapt 3G services by FY14. In addition, our top-down 3G subs model expects Bharti to have about 30% 3G subs market share by FY14 (which is in line with Bharti's revenue market share).

Chart 3 : 3G penetration to improve, albeit at a slower pace



Source: RBS forecasts

Table 5 : Key assumptions: 3G subs and revenue

	FY12F	FY13F	FY14F
3G subs (m)	6.5	11.0	19.6
3G revenue (Rsm)	5,854	15,739	27,507
Total non-voice revenue (Rsm)	57,486	70,058	81,437

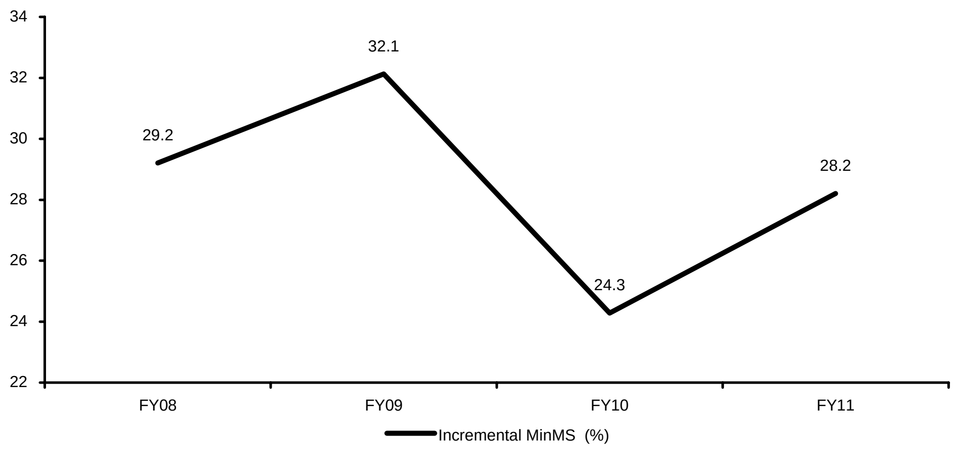
Source: RBS forecasts

Bharti to sustain leadership with 25.5% MinMS

Bharti recaptured minute market share in FY11. However, we build a conservative 22.5% incremental minute market share assumption

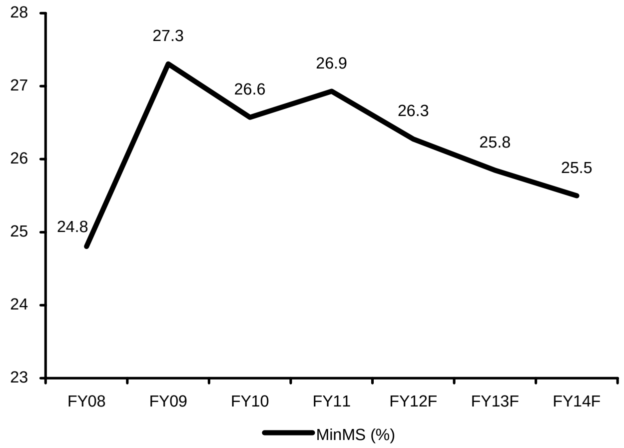
We believe Bharti will gain incremental minute market share (MinMS) of 22.5%, hence maintaining its leadership with 25.5% MinMS by FY14F vs 26.9% MinMS in FY11 (see Chart 5). We factor in lower incremental MinMS for Bharti since we expect Vodafone India and Idea to gain higher MinMS due to their expansion into new circles. We are not concerned by a marginal decline in Bharti's revenue market share (RMS) by 120bp from 32.8% in FY09 to 31.6% in FY11 since the company had a disproportionately higher RMS.

Chart 4 : Bharti recaptured MinMS; its incremental MinMS improved in FY11



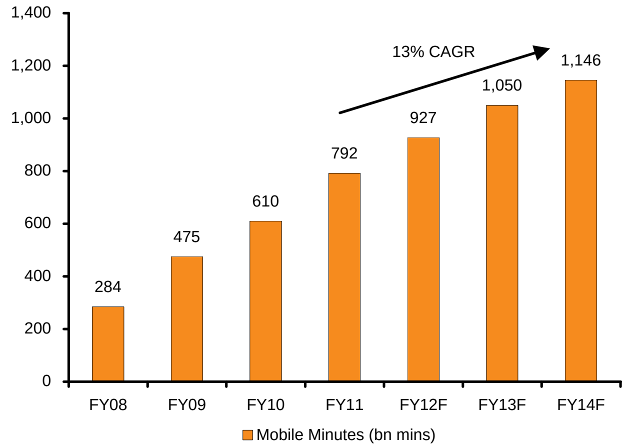
Source: Company data, TRAI

Chart 5 : Bharti to remain the leader with 25.5% MinMS by FY14F…



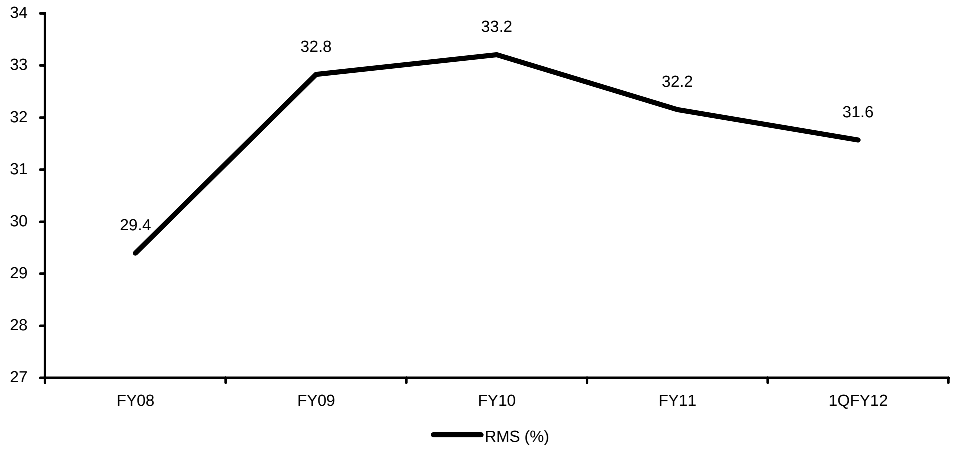
Source: Company data, TRAI, RBS forecasts

Chart 6 : … leading to an FY11-14F mobile MoU CAGR of 13%



Source: Company data, RBS forecasts

Chart 7 : Bharti held on to RMS despite competition and disproportionately higher RMS



Source: TRAI

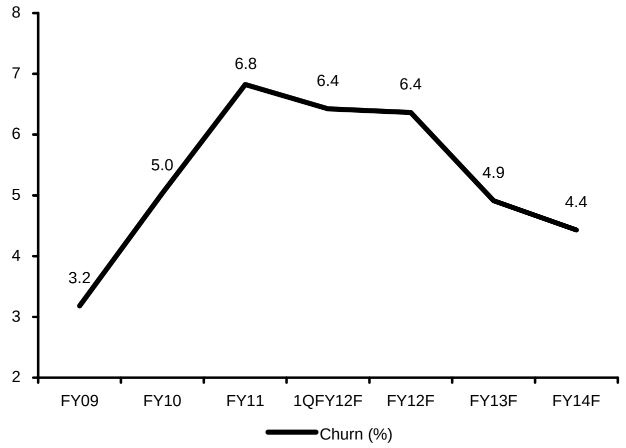
India and South Asia EBITDA margin to expand

We expect EBITDA margin to expand to 39.3% by FY14 and an EBITDA CAGR of 14.6% in FY11-14. We expect EBITDA growth to be driven by: 1) a decline in churn rate (from 6.8% in FY11 to 4.4% in FY14F), and 2) improved utilisation (7.6m min/cell site in 1QFY12 to 8.4m min/cell site by FY14F).

Churn rate to decline

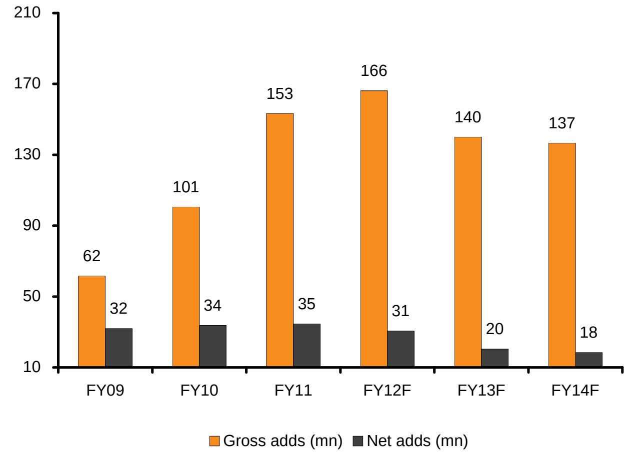
We note gross subscribers increased materially (2.46x) from 62m in FY09 to 153m in FY11 while net adds over the same period remained stable at about 32-35m per year due to high competition (see Chart 9). We expect the churn rate to decline and gross sub additions to fall to 137m by FY14, thus leading to EBITDA margin expansion.

Chart 8 : Churn rate to decline…



Source: Company data, RBS forecasts

Chart 9 : …leading to decline in gross subs addition



Source: Company data, RBS forecasts

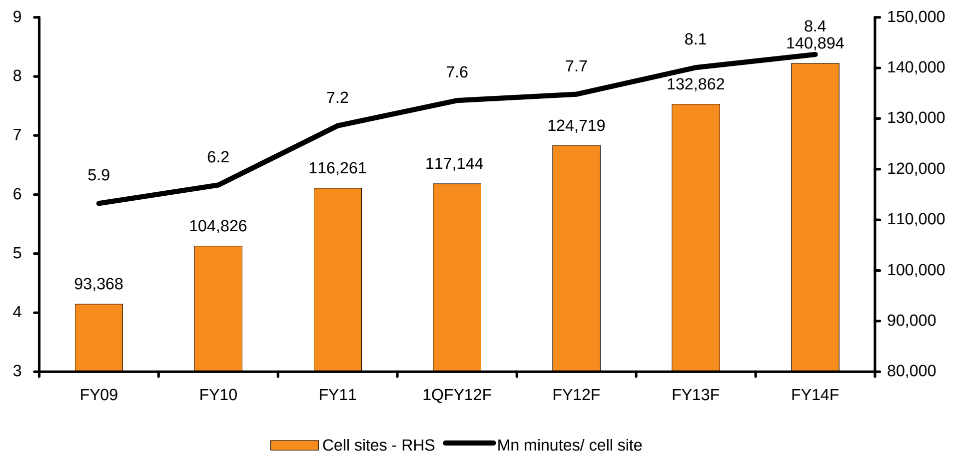
Network utilisation to improve

We believe Bharti's incremental 2G network rollout is primarily led by capacity vs coverage requirements. This should support improvement in Bharti's network use (m minutes per cell site) to rise further to 8.4m min/cell site by FY14F vs 7.6m min/cell site in 1QFY12. Bharti India already reached population coverage of 86% in FY11 (vs 42% in FY06).

Incremental 2G network rollout driven by capacity requirement as the company already covers 86% of India's population

We note that Bharti's coverage expanded (5.9x) from about 20,000 cell sites in FY06 (42% population coverage) to about 116,000 in FY11 (86% population coverage). During FY06-09, its utilisation level remained restricted to 5.9m minutes per cell site. However, the company's network utilisation has increased for the last two years, from 5.9m minutes in FY09 to 7.2m minutes per cell site by FY11. Hence, we believe capacity utilisation will improve since a majority of incremental network rollout will be driven by capacity vs coverage requirement.

Chart 10 : Network utilisation to improve as incremental coverage expansion is low

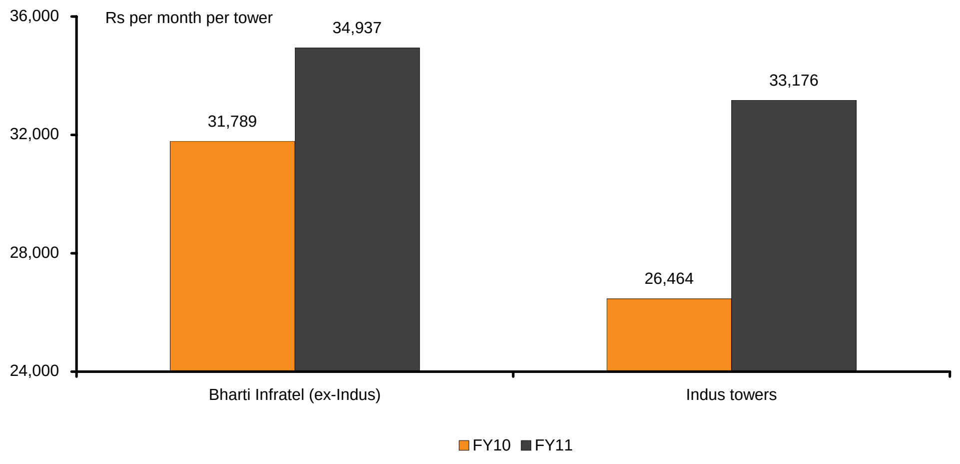


Source: Company data, RBS forecasts

Tower business profitability improves

Bharti Infratel's annual report indicates tower business profitability increased materially yoy and is likely to contribute to margin expansion (see Chart 11) going forward. In addition, Bharti Infratel's non-captive revenue proportion rose from 10.7% in FY09 to 31.6% in FY11.

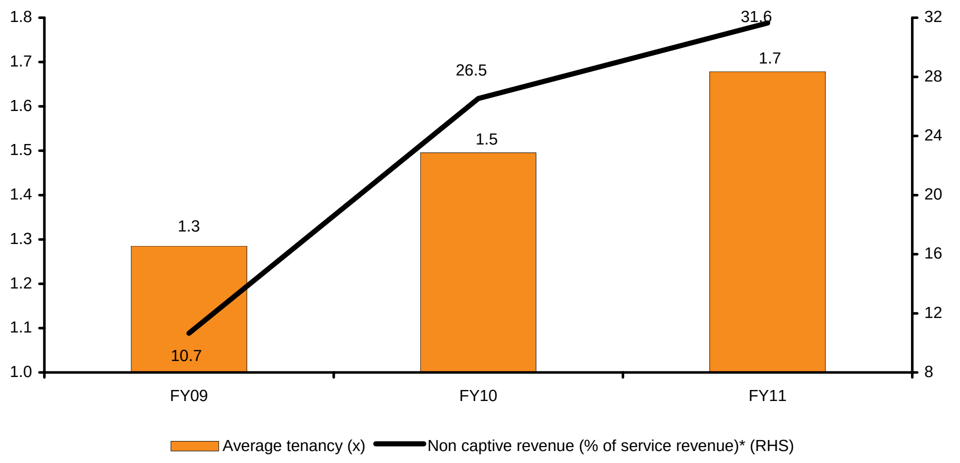
Chart 11 : EBITDA per tower improves for Bharti Infratel and Indus Tower



Source: Company data

Tower business revenue from external tenants rose in the last two years

Chart 12 : Bharti Infratel non-captive revenue proportion rose to 31.6%



Source: Company data

Can it replicate success in Africa? Early signs visible in 47.4% yoy minute growth

Bharti's entry into the African continent, which is significantly under-penetrated, could raise the company's long-term growth profile. We estimate an EBITDA CAGR of 28% over FY11-14F to US$1.7bn in FY14F.

EBITDA growth trajectory to improve in Africa

Africa revenue and EBITDA quarterly CAGRs were 5.3% and 9.2%, respectively, from 2QFY11 to 1QFY12…

Bharti's African operations have started to show steady revenue and EBITDA growth. Management indicated during the earnings call that it pulled back 1% RMS in Africa. Revenue grew from US$838m in 2QFY11 to US$979m in 1QFY12 (a quarterly CAGR of 5.3%) and EBITDA grew from US$201m in 2QFY11 to US$261m in 1QFY12 (a quarterly CAGR of 9.2%). Bharti's Africa growth was driven by robust 47.4% yoy minute growth (16.4bn minutes in 1QFY12 vs 11.1bn in 1QFY11). During the same period, RPM decline was restricted to 16.8% yoy (US$ 6.0 cents in 1QFY12 vs US$ 7.2 in 1QFY11).

Bharti's Africa minutes of use is now equivalent to its India minutes of use in FY06. Can Bharti replicate its success in India during FY06-09? In this period, the company's India mobile business witnessed minute and revenue CAGRs of 90% and 54%, respectively.

Though it is difficult to accurately predict Bharti's Africa growth potential due to the continent's mix of 17 countries, different consumer habits in each country and unique challenges in each market, we believe the steps taken by management in various departments (BPO, IT, network management, and passive infrastructure sharing) will gradually expand margins in a few years. In addition, there is room to improve network utilisation, which was 5.1m minutes/cell site in Africa (vs 7.6m in India as of 1QFY12). Hence, we expect the company's Africa EBITDA margin to expand to 28.5% by FY13 (+350bp from 1QFY12) and 31% by FY14 (US$1.66bn EBITDA by FY14). We would like to highlight that our estimates are lower than management's target of US$5.0bn revenue and US$2.0bn EBITDA by 2013.

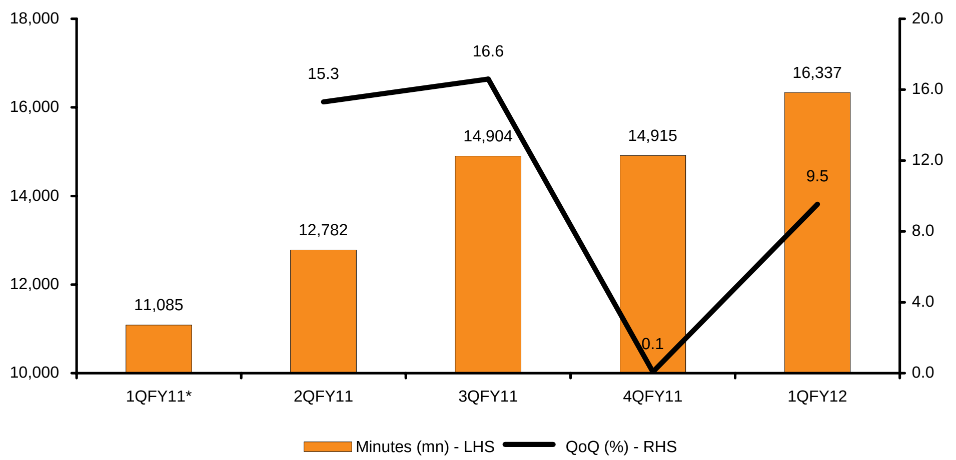
…led by 47.4% yoy growth in minutes of use

Table 6 : Bharti Africa – financial performance

US$m	FY11*	FY12F	FY13F	FY14F	CAGR (FY11-14F)
Revenue	3,492	4,020	4,663	5,362	15.4
yoy (%)		15	16	15	
EBITDA	791	1,065	1,329	1,662	28.1
Margin (%)	22.6	26.5	28.5	31.0	
PAT		(369)	(292)	(136)	

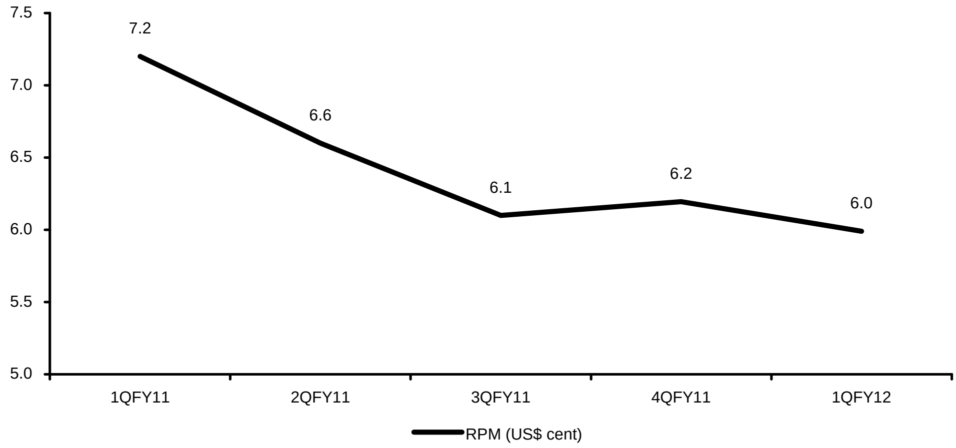
*These are pro-forma numbers. Company-reported 1QFY11 numbers were for 23 days.
Source: Company data, RBS forecasts

Chart 13 : Minutes grew 47.4% yoy in 1QFY12…



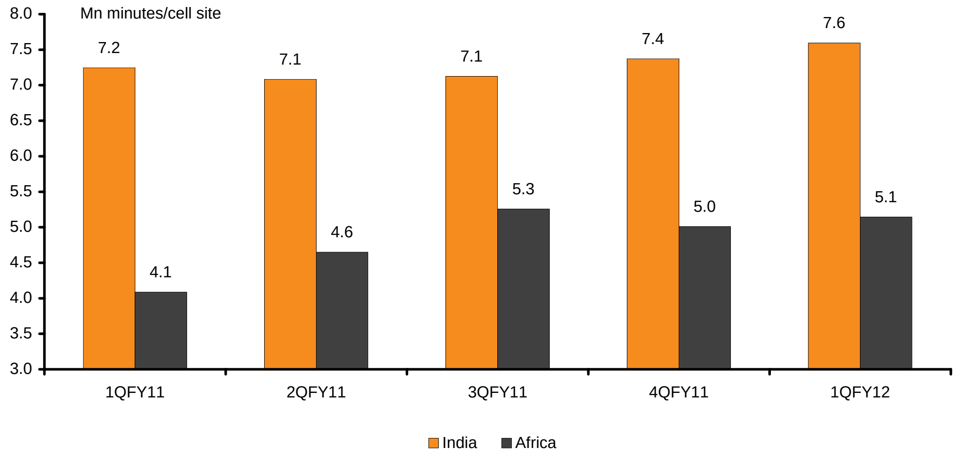
Source: Company data

Chart 14 : …despite stable RPM over the last few quarters



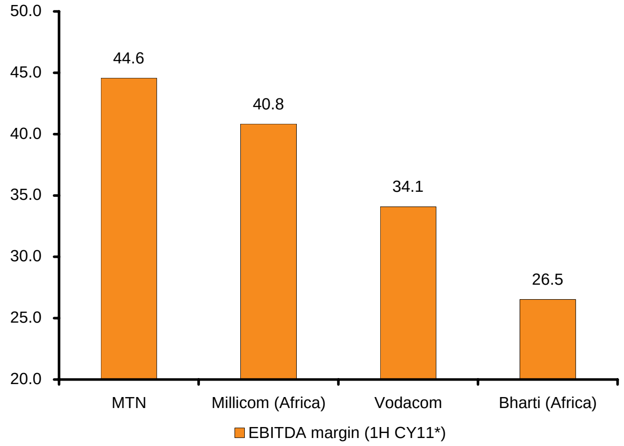
Source: Company data

Chart 15 : Africa capacity utilisation has significant headroom, which should expand margin



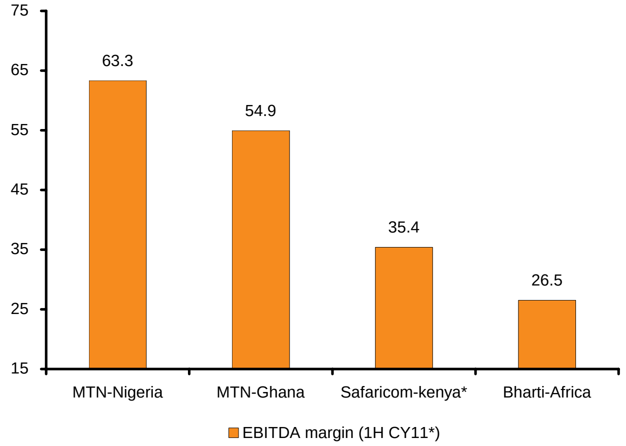
Source: Company data, RBS estimates

Chart 16 : Bharti Africa's margin is significantly below peers'



*2H FY11 for Vodacom
Source: Company data

Chart 17 : EBITDA margin profile of a few countries where Bharti Africa operates



*2H FY11 for Safaricom
Source: Company data

Table 7 : Bharti Africa footprint countries (17) have low subs penetration of 45%

Country	Population (m)- CY10	GDP ($bn)-CY10	Per capita income ($)-CY10	Mobile subs (m)-CY10	Mobile penetration (%)-CY10	Bharti Africa revenue contribution in % (FY11)
Nigeria	156.1	202.6	1298	87.3	56%	33.3
DRC	70.5	13.1	186	11.4	16%	8
Tanzania	41.3	22.5	545	21.0	51%	6.1
Kenya	39.7	32.1	808	25.0	63%	4.1
Uganda	34.0	17.0	501	12.8	38%	2.3
Ghana	23.7	32.3	1364	17.4	74%	3.5
Madagascar	21.3	8.8	415	8.2	39%	2.5
Malawi	15.7	5.4	343	3.0	19%	4.3
Burkina Faso	14.7	9.0	610	5.7	39%	3.8
Niger	14.6	5.5	375	3.8	26%	4.9
Zambia	13.3	16.2	1221	4.9	37%	9.8
Chad	10.2	8.6	837	2.6	26%	3.4
Rwanda	10.0	5.6	558	3.5	35%	
Sierra Leone	5.8	1.9	326	2.0	34%	1.1
Republic of the Congo	3.9	12.0	3113	3.8	98%	4.9
Gabon	1.5	13.1	8779	1.6	108%	7.6
Seychelles	0.1	0.9	10617	0.1	134%	0.3
Total	476.4	406.7	854	214.3	45%	100

Source: IMF estimates, ITU, Company data

Bharti continues to expand in Africa

In September 2011, Bharti expanded in Africa and was awarded a license in the Rwanda market. The new license in Rwanda confirms the company's intent to expand in Africa and confidence in the African continent. There are 36 African countries (about US$1,300bn GDP in CY10) where Bharti Airtel doesn't have a footprint. Out of the 36 countries, 10 countries (see table 8) qualify for the following criteria: 1) GDP (+US$5bn) or population (+5m); 2) subscriber penetration less than 60% and 3) limited competition (four or fewer operators). We believe Bharti Airtel will continuously evaluate opportunities to expand in the African market to capture higher growth.

Table 8 : Africa: non-footprint countries which meet certain criteria (see above)

Country	Population (m)- CY10	Nominal GDP ($bn)-CY10	Nominal per capita income ($)-CY10	Mobile subs (m)-CY10	Mobile penetration (%)-CY10	No. of operators
Ethiopia	84.8	29.7	350	6.5	8%	1
Sudan	40.1	65.4	1,629	17.7	44%	4
Mozambique	21.6	9.5	440	7.2	33%	2
Cameroon	20.4	22.5	1,103	8.2	40%	2
Angola	19.1	82.5	4,329	8.9	47%	2
Mali	13.4	9.4	701	7.3	55%	2
Zimbabwe	12.6	7.5	594	7.5	60%	3
Togo	7.0	3.2	457	2.5	35%	2
Eritrea	5.3	2.1	398	0.2	3%	1
Equatorial Guinea	1.3	14.5	11,045	0.4	30%	2

Source: IMF estimates, ITU, Company data

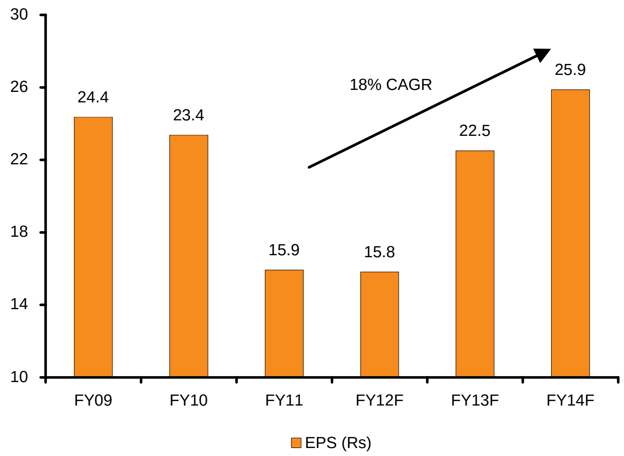
ROE to expand due to improvement across geographies

We expect Bharti's ROE to expand to 15.2% in FY14F, led by profitable growth across Indian and African markets, reduction in capex intensity and lower interest cost owing to reduction in net debt by US$4bn over next three years.

EPS growth expected to resume after three years of decline

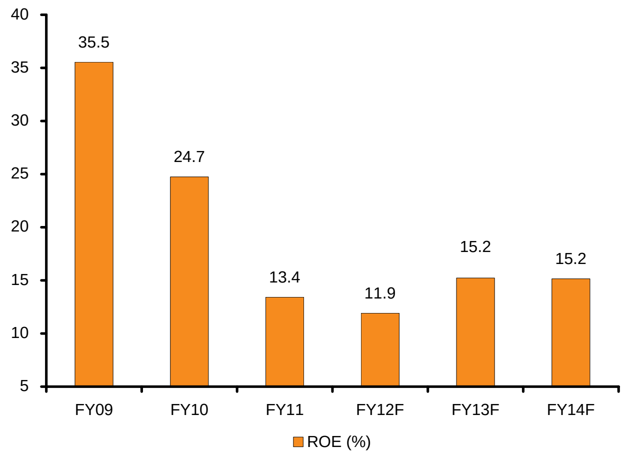
We expect an EPS CAGR of 18% over FY11-14 due to: 1) a consolidated revenue CAGR of 12.8% over FY11-14F to US$19.9bn; 2) an EBITDA CAGR of 17.1% over FY11-14F to US$7.4bn; 3) lower capex intensity (from 22.5% of revenue in FY11 to 17.9% in FY14F); and 4) lower interest cost due to a reduction in net debt from US$13.5bn in FY11 to US$9.4bn in FY14F.

Chart 18 : EPS CAGR of 18% over FY11-14F



Source: Company data, RBS forecasts

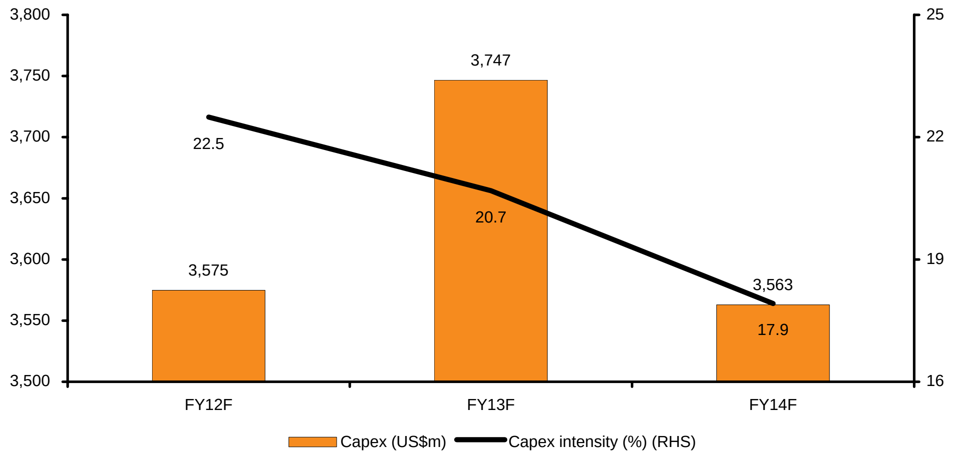
Chart 19 : ROE to expand to 15.2%



Source: Company data, RBS forecasts

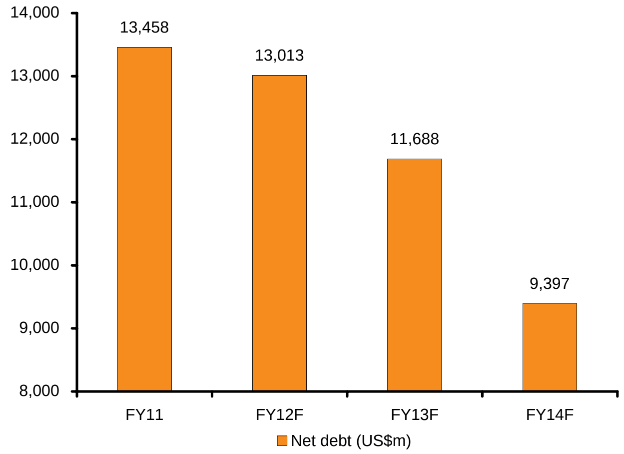
Deleveraging to begin as capex intensity falls

Chart 20 : Capex intensity to decline



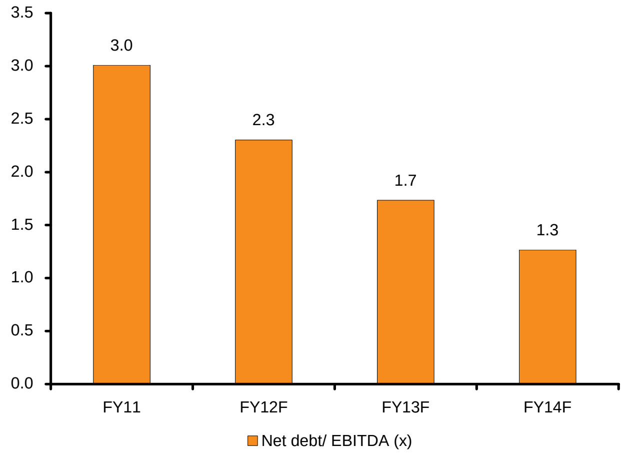
Source: RBS forecasts

Chart 21 : Net debt likely to decline



Source: Company data, RBS forecasts

Chart 22 : Net debt/EBITDA to decline



Source: Company data, RBS forecasts

Initiate at Buy; valuation multiple to expand

We initiate coverage at Buy, with Bharti our top sector pick. The stock has been de-rated due to the dual impact of competition in India and leveraged acquisition in Africa. We expect synchronized profitable growth across geographies to lead to a valuation re-rating.

Re-rating led by synchronized profitable growth across geographies

We expect Bharti's valuation multiples to expand because of: 1) structural improvement in India leading to high growth (an EBITDA CAGR of 14.6% in FY11-14F); 2) improvement in profitability of the Africa business (an EBITDA CAGR of 28% in FY11-14F), and 3) ROE expansion to 15.2% by FY14F (from 13.4% in FY11).

We initiate with a Buy rating and 12-month target price of Rs475. We derive our target price from a SOTP valuation. We discount our SOTP-based FV for March 2013 by six months to derive our 12-month target price (September 2012). We value Bharti India's mobile business at 7.5x EV/EBITDA (at a premium to our target for Idea's mobile business at 7.0x EV/EBITDA) and tower business at Rs5.0m EV/tower. We value Bharti Africa at 6.0x EV/EBITDA (comparable to African peers). We factor a possible Rs29 per share impact from one-time spectrum fees and spectrum renewal charges into our target price. We prefer to value India telco services stocks using EV/EBITDA rather than PE since depreciation policies differ across peers and the companies are at different stages of maturity.

Bharti is our top pick in the sector

Our target price implies an EV/EBITDA multiple of 7.8x FY13F and 6.7x FY14F. We note Bharti's implied FY13F EV/EBITDA multiple is closer to its historical average of 7.7x one-year forward EV/EBITDA , though we note the historical average has a limited history (from June 2010). We believe valuation multiples are comparable only after June 2010 as the stock's valuation multiple was de-rated due to: 1) intense competition in India leading to a reduction in ROE; and 2) Bharti's Africa acquisition, which completed in June 2010.

Table 9 : Bharti's SOTP-based fair value

Business units	Valuation methodology	Rs bn	Value/sh (Rs)	Remarks
India core business	EV/EBITDA multiple	1,610	423	7.5x EV/EBITDA
Africa business	EV/EBITDA multiple	346	91	6x EV/EBITDA
Infratel (incl Indus)	EV/Tower	378	99	EV/tower of Rs5m
DTH	EV/sub	45	12	EV/sub = Rs4500
Sri Lanka	P/BV	10	3	1.0x P/B
Bangladesh	P/BV	15	4	1.0x P/B
Total enterprise value		2,404	631	
Less: net debt/minority int (FY14F)		360	95	
Equity value		2,045	537	
Less: Net possible impact of one-time spectrum charges		111	29	
SOTP fair value (Mar-13)		1,921	508	
12-month target price (Sep-12)			**475**	

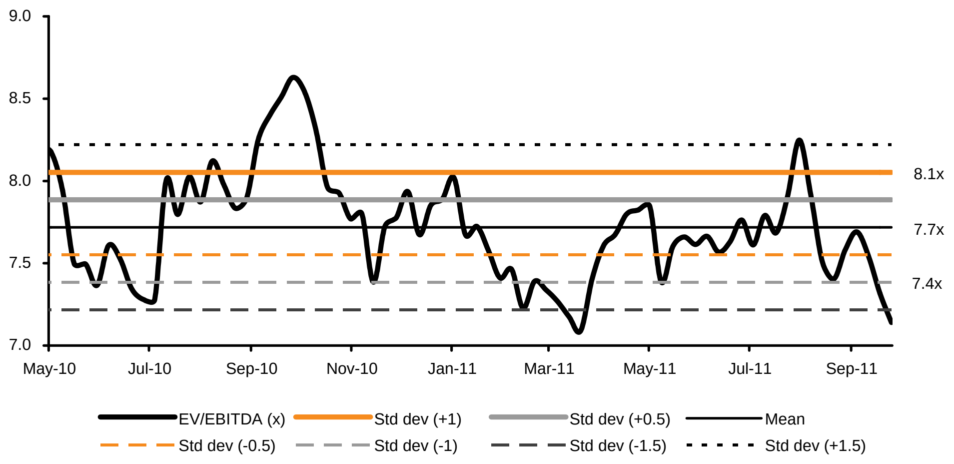
Source: RBS forecasts

Table 10 : Implied valuation metrics at target price

	FY13F	FY14F
Target price (Rs/sh)	475	475
EPS (Rs)	22.5	25.9
Implied PE (x)	**21.1**	**18.4**
Enterprise value (Rs bn)	2,340	2,233
EBITDA (Rs bn)	301	331
Implied EV/EBITDA (x)	**7.8**	**6.7**

Source: RBS forecasts

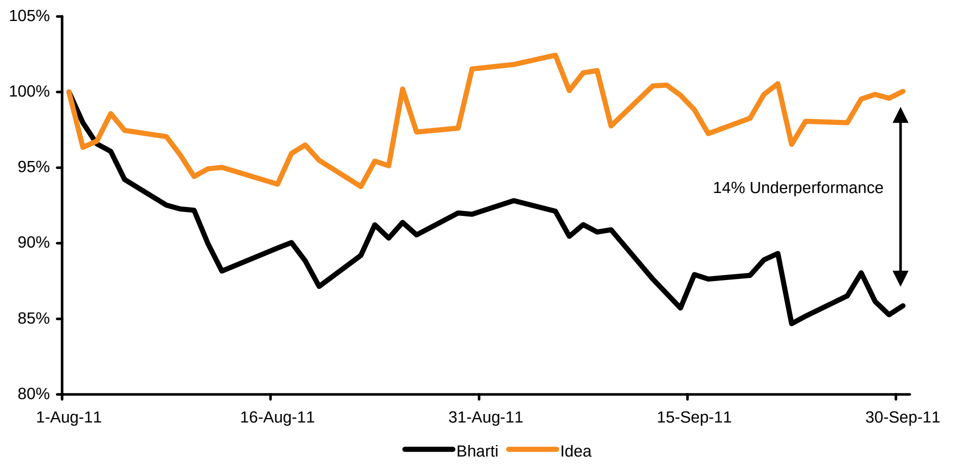
Chart 23 : Bharti – EV/EBITDA (1-year forward)



Source: Company data, Bloomberg, RBS forecasts

Bharti's shares underperformed Idea in the last two months by about 14% due to concerns on the potential impact of foreign currency exposure (the rupee depreciated by 9.5% in 2QFY12). We believe the concerns are overdone as any currency impact on profit and loss is primarily non-cash in nature, the company hedges its short-term foreign currency payments, and short-term currency movements do not change the fundamental enterprise value of the business.

Chart 24 : Bharti's recent underperformance against Idea seems unwarranted



Source: Bloomberg

Table 11 : Bharti – summary impact of TRAI recommendations

Rs bn, except impact per share value	
One-time spectrum charge above 6.2MHz	(36)
PV of spectrum renewal charges (to be paid post-expiry of licence period)	(75)
Total	(111)
Impact per share (Rs)	**(29)**

Source: TRAI, RBS forecasts

Table 12 : Bharti: spectrum renewal charges on licence expiry (based on TRAI recommendations)

Year	Circles	No. of circles	Payouts (Rs m)	NPV (FY13) (Rs m)	Revenue dependence (%)
FY15	Delhi, Kolkata	2	16,604	13,975	10.4
FY16	AP, Karnataka, Punjab, HP, N.E	5	33,495	25,127	29.1
FY17	Rajasthan	1	8,049	5,855	7.6
FY18-FY21					
FY22	Mumbai, Maharashtra, Gujarat, Tamil Nadu, Kerala, Haryana, UP (W) & MP	8	50,075	20,651	30.4
FY24	UP (E), WB, Bihar, Orissa & J&K	5	28,592	9,207	20.5
FY25	Assam	1	741	229	1.9
Total payouts		**22**	**137,555**	**75,043**	**100.0**

Source: TRAI, RBS forecasts

Table 13 : Sensitivity of EPS (FY14F) to India ARPU and Africa EBITDA margin

		India ARPU (% change from base case in India)				
		5.0	**1.0**	**0.0**	**(1.0)**	**(5.0)**
Africa EBITDA margin (change from base case)	**5.0**	32.4	29.7	29.0	28.4	25.7
	1.0	29.8	27.2	26.5	25.8	23.2
	-	29.2	26.5	**25.9**	25.2	22.6
	(1.0)	28.6	25.9	25.2	24.6	21.9
	(5.0)	26.0	23.4	22.7	22.0	19.4

Source: RBS forecasts

Valuation and EPS are more sensitive to a 1% change in India ARPU than a 100bp improvement in Africa EBITDA margin

Table 14 : Sensitivity of valuation to India ARPU and Africa EBITDA margin

		India ARPU (% change from base case in India)				
		5.0	**1.0**	**0.0**	**(1.0)**	**(5.0)**
Africa EBITDA margin (change from base case)	**5.0**	536	503	495	487	454
	1.0	520	488	479	471	438
	-	516	484	**475**	467	435
	(1.0)	513	480	472	463	431
	(5.0)	497	464	456	448	415

Source: RBS forecasts

Management team

Table 15 : Management team

Name	Designation	Qualification and experience
Sunil Bharti Mittal	Chairman	Sunil started his career after graduating from Punjab university in India in 1976 and formed Bharti. He was president of the confederation of Indian Industry (CII) during 2007-08. Sunil has been honoured with Padma Bhushan, one of India's highest civilian awards. He is a member of several premier international bodies – International Advisory Committee to the NYSE Euronext Board of Directors, the International Business Advisory Council of London and the Advisory Board of the Global Economic Symposium.
Manoj Kohli	CEO (International) & Joint Managing Director	Manoj holds degrees in commerce, law and an MBA from Delhi University. He also attended the Executive Business Program at the Michigan Business School and the Advanced Management Program at the Wharton Business School. Prior to becoming CEO (international) and Joint MD, he held multiple roles as CEO and Joint MD, President & CEO, Head of Mobile Services business at Bharti Airtel. Manoj started his career in 1979 with DCM Ltd., where he initially led HR, followed by leadership positions in the foods, chemicals and fertiliser businesses and assignments in engineering projects.
Sanjay Kapoor	CEO (India & South Asia)	Sanjay has a Bcom (H) from Delhi University, India, and MBA from Cranfield School of Management (UK) and is also a Graduate of The Wharton Advanced Management Program. He has over 26 years of professional experience, 13 years of which have been in the telecom sector. Prior to joining the Bharti Group, Sanjay worked with Xerox India as Director - Operations support. Sanjay joined the Bharti group in 1998 and since then has held a number of senior management positions across businesses.
K Srinivas	President, Consumer Business	A Mechanical Engineering graduate and PGDM from IIM Bangalore. Prior to becoming President, consumer business, he served as President of Bharti's Telemedia business. Srini joined Bharti Airtel in November 2002, and as a CEO, he led the operations of mobile services in various circles. Of his 22 years of rich working experience, Srini spent his early years with Britannia Industries and HLL performing various sales, marketing and business development roles.
Drew Kelton	President, Business to Business	Drew has a BSc in Electrical & Electronic Engineering (Hons). In addition, Drew is a Chartered Engineer (EEng) and MIET. He joined Bharti in July 2010 as President, Enterprise Services. Prior to Bharti, Drew was part of Telstra group as its MD, International Business. Drew's 30-year career in the IT and telecommunications sectors began as a graduate with IBM and he has held senior management roles with TimePlex/Unisys, IXNET, Saturn Global and Asia Global Crossing.
Manik Jhangiani	Group CFO-Bharti Enterprises Limited.	Manik is an accounting and economics graduate from Rutgers University and a Certified Public Accountant (CPA) from the State of New York. He joined Bharti Enterprises Ltd in May 2009 as Group CFO. He is also a member of the Bharti management Board. Prior to Bharti, Manik worked with Coca-Cola Hellenic based in Athens as CFO and with Colgate-Palmolive as Group Financial Director for its Nigerian operations.
Srikanth Balachander	CFO-Bharti Airtel Limited	Srikanth is a Chartered Accountant. He joined Bharti as CFO in November 2008. Srikanth is leading a huge finance transformation programme including shared services, process excellence and automation. Srikanth worked with Unilever for more than 23 years.

Source: Company data

Income statement

Rsm	FY10A	FY11A	FY12F	FY13F	FY14F
Revenue	396150	594672	715282	814947	894675
Cost of sales	-234907	-395008	-462926	-514238	-563281
Operating costs	-250839	-398984	-480745	-529129	-354468
EBITDA	**161243**	**199664**	**252355**	**300709**	**331394**
DDA & Impairment (ex gw)	-60457	-102066	-130019	-145199	-160872
EBITA	**100786**	**97598**	**122337**	**155510**	**170522**
Goodwill (amort/impaired)	n/a	n/a	n/a	n/a	n/a
EBIT	**100786**	**97598**	**122337**	**155510**	**170522**
Net interest	3948	-20816	-33740	-29412	-24216
Associates (pre-tax)	0.00	0.00	0.00	0.00	0.00
Forex gain / (loss)	0.00	0.00	0.00	0.00	n/a
Exceptionals (pre-tax)	n/a	n/a	n/a	n/a	n/a
Other pre-tax items	0.00	0.00	0.00	0.00	0.00
Reported PTP	**104734**	**76782**	**88597**	**126098**	**146307**
Taxation	-13958	-17790	-28811	-39355	-43909
Minority interests	-1994	1475	368.0	-1064	-3868
Exceptionals (post-tax)	2244	0.00	0.00	0.00	0.00
Other post-tax items	0.00	0.00	0.00	0.01	0.00
Reported net profit	**91026**	**60467**	**60154**	**85679**	**98530**
Normalised Items Excl. GW	2244	0.00	0.00	0.00	0.00
Normalised net profit	**88782**	**60467**	**60154**	**85679**	**98530**

Source: Company data, RBS forecasts

year to Mar

Balance sheet

Rsm	FY10A	FY11A	FY12F	FY13F	FY14F
Cash & market secs (1)	77425	15799	39412	123243	214942
Other current assets	52093	96278	113681	122402	129127
Tangible fixed assets	459712	900693	896399	920604	921169
Intang assets (incl gw)	36771	388050	388050	388050	388050
Oth non-curr assets	19728	51757	52716	53723	54781
Total assets	**645730**	**1452577**	**1490258**	**1608022**	**1708068**
Short term debt (2)	0.00	0.00	0.00	0.00	0.00
Trade & oth current liab	130279	285475	286181	294672	307309
Long term debt (3)	64618	616708	620446	645124	634519
Oth non-current liab	8644	34163	31234	32171	33136
Total liabilities	**203541**	**936346**	**937860**	**971967**	**974963**
Total equity (incl min)	442188	516231	552398	636055	733105
Total liab & sh equity	**645730**	**1452577**	**1490258**	**1608022**	**1708068**
Net debt	-12807	600909	581034	521881	419577

Source: Company data, RBS forecasts

year ended Mar

Cash flow statement

Rsm	FY10A	FY11A	FY12F	FY13F	FY14F
EBITDA	161243	199664	252355	300709	331394
Change in working capital	12070	9577	-7391	-1632	4295
Net interest (pd) / rec	3948	-20816	-33740	-29412	-24216
Taxes paid	-13958	-17790	-28811	-39355	-43909
Other oper cash items	-8113	4289	2233	1340	-893.0
Cash flow from ops (1)	**155190**	**174924**	**184646**	**231649**	**266672**
Capex (2)	-101972	-277094	-160345	-168070	-159913
Disposals/(acquisitions)	-75.0	-373991	0.00	0.00	0.00
Other investing cash flow	-22776	46590	5974	-64200	-99200
Cash flow from invest (3)	**-124823**	**-604495**	**-154371**	**-232270**	**-259113**
Incr / (decr) in equity	194.3	-306.0	22.2	29.7	0.00
Incr / (decr) in debt	-23066	429586	3738	24678	-10605
Ordinary dividend paid	-4442	-4428	-4448	-4455	-4455
Preferred dividends (4)	n/a	n/a	n/a	n/a	n/a
Other financing cash flow	0.00	0.00	0.00	0.00	n/a
Cash flow from fin (5)	**-27314**	**424852**	**-688.0**	**20252**	**-15060**
Forex & disc ops (6)	n/a	n/a	n/a	n/a	n/a
Inc/(decr) cash (1+3+5+6)	**3053**	**-4719**	**29587**	**19631**	**-7501**
Equity FCF (1+2+4)	53218	-102170	24301	63579	106760

Lines in bold can be derived from the immediately preceding lines.

year to Mar

Source: Company data, RBS forecasts

Standard ratios

Performance	Bharti Airtel FY10A	FY11A	FY12F	FY13F	FY14F	Idea Cellular FY12F	FY13F	FY14F	Reliance Comm FY12F	FY13F	FY14F
Sales growth (%)	7.18	50.1	20.3	13.9	9.78	27.9	23.2	12.4	4.02	9.24	5.97
EBITDA growth (%)	6.31	23.8	26.4	19.2	10.2	36.6	38.0	15.5	4.08	12.0	6.61
EBIT growth (%)	-3.18	-3.16	25.3	27.1	9.65	68.3	63.2	23.6	0.05	15.7	0.68
Normalised EPS growth (%)	-4.12	-31.9	-0.63	42.2	15.0	-1.55	100.1	41.7	-49.9	11.2	10.9
EBITDA margin (%)	40.7	33.6	35.3	36.9	37.0	25.8	28.9	29.7	31.8	32.6	32.8
EBIT margin (%)	25.4	16.4	17.1	19.1	19.1	11.3	15.0	16.5	12.1	12.9	12.2
Net profit margin (%)	22.4	10.2	8.41	10.5	11.0	4.49	7.30	9.20	3.17	3.23	3.38
Return on avg assets (%)	14.1	7.15	5.61	6.91	7.20	5.15	7.99	9.54	2.26	2.72	2.78
Return on avg equity (%)	24.7	13.4	11.9	15.2	15.2	7.05	12.9	15.8	1.66	1.83	1.99
ROIC (%)	22.7	17.5	7.39	9.44	10.3	6.79	10.0	12.3	2.76	3.17	3.27
ROIC - WACC (%)	12.0	6.75	-3.32	-1.28	-0.41	-3.66	-0.43	1.87	-9.85	-9.43	-9.33
					year to Mar			year to Mar			year to Mar
Valuation											
EV/sales (x)	3.59	3.42	2.82	2.40	2.07	2.26	1.77	1.48	2.26	1.96	1.69
EV/EBITDA (x)	8.82	10.2	7.99	6.51	5.60	8.78	6.12	4.99	7.12	6.02	5.14
EV/EBITDA @ tgt price (x)	11.1	12.0	9.45	7.73	6.71	10.2	7.18	5.90	6.97	5.89	5.02
EV/EBIT (x)	14.1	20.9	16.5	12.6	10.9	20.0	11.8	8.97	18.6	15.3	13.8
EV/invested capital (x)	3.31	1.82	1.78	1.69	1.61	1.77	1.69	1.59	0.64	0.62	0.59
Price/book value (x)	3.47	2.94	2.75	2.39	2.06	2.54	2.23	1.90	0.36	0.36	0.35
Equity FCF yield (%)	3.71	-7.12	1.69	4.42	7.42	-4.83	5.04	7.83	0.75	17.3	27.5
Normalised PE (x)	16.17	23.74	23.89	16.80	14.61	36.78	18.38	12.97	21.85	19.64	17.71
Norm PE @tgt price (x)	20.3	29.8	30.0	21.1	18.4	45.2	22.6	15.9	20.4	18.3	16.5
Dividend yield (%)	0.26	0.26	0.26	0.26	0.26	0.00	0.00	0.00	0.00	0.00	0.00
					year to Mar			year to Mar			year to Mar

Per share data	FY10A	FY11A	FY12F	FY13F	FY14F
Tot adj dil sh, ave (m)	3798	3798	3802	3808	3808
Reported EPS (INR)	24.0	15.9	15.8	22.5	25.9
Normalised EPS (INR)	23.38	15.92	15.82	22.50	25.88
Dividend per share (INR)	1.00	1.00	1.00	1.00	1.00
Equity FCF per share (INR)	14.0	-26.9	6.39	16.7	28.0
Book value per sh (INR)	108.9	128.4	137.3	158.4	183.1
					year to Mar

Solvency	FY10A	FY11A	FY12F	FY13F	FY14F
Net debt to equity (%)	-2.90	116.4	105.2	82.0	57.2
Net debt to tot ass (%)	-1.98	41.4	39.0	32.5	24.6
Net debt to EBITDA	-0.08	3.01	2.30	1.74	1.27
Current ratio (x)	0.99	0.39	0.53	0.83	1.12
Operating CF int cov (x)	-41.8	10.3	7.33	10.2	13.8
Dividend cover (x)	20.0	13.7	13.5	19.2	22.1
					year to Mar

Priced as follows: BRTI.BO - Rs378.00
Source: Company data, RBS forecasts

Valuation Methodology- SOTP valuation

Business units	Valuation methodology	Rsbn	Value/sh (Rs)	Remarks
India core business	EV/EBITDA multiple	1,610	423	7.5x EV/EBITDA
Africa business	EV/EBITDA multiple	346	91	6x EV/EBITDA
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DTH	EV/sub	45	12	EV/sub = Rs4,500
Sri Lanka	P/BV	10	3	1.0x P/B
Bangladesh	P/BV	15	4	1.0x P/B
Total Enterprise Value		2,404	631	
Less: Net Debt/Minority Int (FY14F)		360	95	
Equity Value		2,045	537	
Less: Net possible impact owing spectrum charges		111	29	
SOTP fair value (Mar-13)		1,921	508	
12-month target price (Sep-12)			**475**	

Source: RBS forecasts

Company description — Buy

Bharti Airtel is the world's leading integrated telecom services provider with operations in 19 countries across Asia and Africa. The group offers mobile voice and data services, fixed line, high-speed broadband, IPTV, DTH, telecom solutions for enterprises, and national and international long-distance services to carriers. Bharti is the leading service provider in India with about 32% revenue market share and a mobile subscriber base of 162m in India as of FY11. Its African footprint is spread over 17 countries with a subscriber base of about 44m. Bharti owns a 42% stake in Indus Tower (about 109,000 towers), a joint venture with Vodafone-Essar and Idea Cellular.

Price relative to country

Strategic analysis — Average SWOT company score: 4

Strengths — 4
Leading mobile operator in India with 20% of subscribers and about 32% revenue market share (RMS) (FY11). Higher RMS is a reflection of the company's quality subs base. Pan-India network coverage (86% population coverage), strong brand and wide distribution reach covering more than 1.6m outlets.

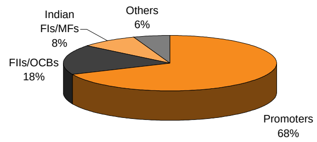
Weaknesses — 4
Growth rate for India mobile business would be lower than that of other listed peers, given disproportionate revenue market share of about 32% as of FY11. However, expansion into African markets is likely to improve its long-term growth profile.

Opportunities — 4
The company is better positioned to capture higher market share of the under-penetrated Indian telecom market (48% active subs penetration and less than 1% broadband penetration). In Africa, 475m population and about 45% wireless penetration reflect the growth potential.

Threats — 3
Unfavourable changes in licensing conditions in India (over spectrum pricing and allocation, spectrum re-farming, reduction in MTC charges) pose a threat. Increase in competitive intensity in wireless broadband market with entry of new players.

Scoring range is 1-5 (high score is good)

Shareholding pattern



Source: BSE

Market data

Headquarters
Bharti Airtel Limited, Bharti Crescent, 1- Nelson Mandela Road, Vasant kunj, Phase-2, New Delhi-110070

Website
www.airtel.in

Shares in issue
3797.5m

Freefloat
32%

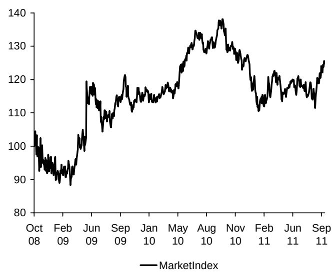
Majority shareholders
Bharti Telecom (46%), Singtel (16%), LIC (5%)

Country view: India

The compression of multiples typically characteristic of a market undergoing the transition from growth to value continued to pressure Indian equities in the 2Q. While the economic deceleration is well under way, we continue to view the country as a major potential loser from higher costs of capital in quarters and perhaps even years ahead. Still, given the significant short-term relative underperformance and the expected decline in commodities prices, clearly a bounce is possible. Yet, as valuations are broadly unattractive and returns declining, we continue to consider the risk-reward trade-off as unattractive.

The country view is set in consultation with the relevant company analyst but is the ultimate responsibility of the Strategy Team.

Country rel to Asia Pacific



Competitive position — Average competitive score: 4+

Supplier power — 4+
Large scale of company's operations improved its bargaining power against suppliers. The rise of Chinese players also intensified price competition among suppliers.

Barriers to entry — 4+
During 2008, new licences were rewarded, removing barriers to entry. However, significant capital investment is required to compete with incumbent operators, acting as a barrier to entry.

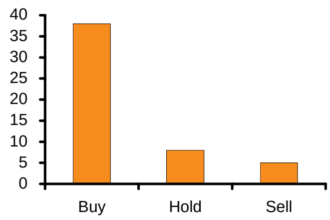
Customer power — 3+
With 8-plus operators in most circles, tariffs in India are already among the lowest worldwide. However, operators with better network coverage and distribution command a premium on the tariffs.

Substitute products — 5+
Mobile telephony tariffs in India are among the lowest in the world and eat into the share of fixed-line telephony. Internet-based telephony has not had an impact, as PC penetration is very low.

Rivalry — 3+
We expect consolidation in industry in FY13/FY14 as merger and acquisition guidelines, and spectrum sharing and spectrum-trading guidelines are laid out in the upcoming National Telecom Policy 2011.

Scoring range 1-5 (high score is good) Plus = getting better Minus = getting worse

Broker recommendations



Source: Bloomberg

3 October 2011

Produced by: The Royal Bank of Scotland N.V., (India) Office

Idea Cellular

On a high growth path

We expect Idea's EBITDA to touch 2.2x in three years led by price stability, minute market share gains, improvement in network utilisation and a fall in churn rate. We believe ROE will expand to 15.8% by FY14. Initiate coverage with Buy.

Initiation of coverage

Buy

Target price
Rs121.00

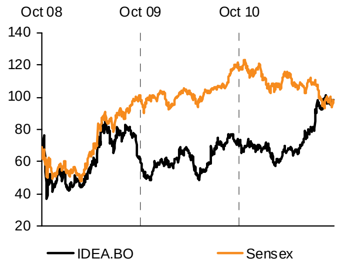
Price
Rs98.50

Short term (0-60 days)
n/a

Market view
Underweight

Price performance

	(1M)	(3M)	(12M)
Price (Rs)	99.95	79.85	73.65
Absolute (%)	-1.5	23.4	33.7
Rel market (%)	-0.1	41.3	63.1
Rel sector (%)	-1.5	23.4	33.7



Market capitalisation
Rs325.37bn (US$6.60bn)

Average (12M) daily turnover
Rs456.64m (US$10.31m)

Sector: BSE Tech
RIC: IDEA.BO, IDEA IN
Priced Rs98.50 at close 30 Sep 2011.
Source: Bloomberg

Key forecasts

	FY10A	FY11A	FY12F	FY13F	FY14F
Revenue (Rsm)	123,979	154,384	197,447	243,333	273,609
EBITDA (Rsm)	33,580	37,258	50,902	70,266	81,173
Reported net profit (Rsm)	9,539	8,987	8,863	17,767	25,177
Normalised net profit (Rsm)[1]	9,539	8,987	8,863	17,767	25,177
Normalised EPS (Rs)	2.89	2.72	2.68	5.36	7.60
Dividend per share (Rs)	0.00	0.00	0.00	0.00	0.00
Dividend yield (%)	0.00	0.00	0.00	0.00	0.00
Normalised PE (x)	34.07	36.20	36.78	18.38	12.97
EV/EBITDA (x)	11.60	11.60	8.78	6.12	4.99
Price/book value (x)	2.86	2.65	2.54	2.23	1.90
ROIC (%)	6.94	6.64	6.79	10.00	12.30

1. Post-goodwill amortisation and pre-exceptional items
Accounting standard: Local GAAP
Source: Company data, RBS forecasts

year to Mar, fully diluted

We believe revenue growth momentum will improve due to price stability

We expect Idea's revenue to grow at about a 21% CAGR over FY11-14F led by: 1) a minutes of use (MoU) CAGR of about 21% over FY11-14 to 639bn minutes; and 2) stable revenue per minute (RPM) of 43.1p in FY11 to 42.8p in FY14. We expect the company to gain incremental minute market share (MinMS) of 18% over FY11-14 led by gains from mobile number portability (MNP), consolidation of leadership in the old circles, and improved market share in the new circles, including the Punjab and Karnataka circles acquired from Spice. We forecast this will lead to a MoU CAGR of about 21% over FY11-14.

EBITDA likely to touch 2.2x in three years, in our view

We expect Idea's EBITDA to grow at a CAGR of 29.6% over FY11-14. We also expect the EBITDA margin to expand from 24.1% in FY11 (26.6% in 1QFY12) to 29.7% in FY14 led by: 1) an improvement in network utilisation (from 5.8m minutes/cell site in 1QFY12 to 6.7m by FY14); and 2) a reduction in the churn rate (from 9.2% in FY11 to 5.4% in FY14). The EBITDA losses from new circles (Rs5.4bn loss in FY11) could contract.

TRAI recommendations, if implemented, could have a negative impact

We believe it would be difficult to implement the Telecom Regulatory Authority of India's recommendations on spectrum charges in their current form because it may lead to an unlevel playing field among new and existing companies. However, our target price factors in the worst-case impact of the recommendations: a downside of Rs23/sh, in our view**.**

We initiate with a Buy; Idea is the biggest beneficiary of structural improvement

We initiate with a Buy and a 12-month target price of Rs121. We believe Idea would outperform its peers driven by: 1) higher growth: EBITDA CAGR of 29.6% over FY11-14; and 2) an expansion of ROE to 15.8% by FY14 (from 7.6% in FY11). Our target price implies EV/EBITDA multiples of 7.2x FY13F and 5.9x FY14F.

This note should be read along with our sector report (*Ripe for profitable growth,* 3 October 2011) for a better understanding of the investment argument.
Important disclosures can be found in the Disclosures Appendix.

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The basics

Versus consensus

EPS (Rs)	RBS	Cons	% diff
2012F	2.7	2.5	6%
2013F	5.4	4.4	21%
2014F	7.6	6.9	10%

Source: Bloomberg, RBS forecasts

Forced ranking*

Company	Rec	Upside / Downside
Bharti	Buy	26%
Idea	Buy	23%
China Mobile	Buy	14%
RCom	Hold	-7%

* by difference to target price as at time of publication. Recommendations may lie outside the structure outlined in the disclosure page.
Source: RBS forecasts

Key events

Date	Event
Oct-Nov, 2011	2Q FY12 results release
Oct-Nov, 2011	National Telecom Policy-2011 to be introduced

Source: Company data, Industry

Catalysts for share price performance

We believe the key catalysts for Idea's share price performance are:

- Increase in voice RPM over the next few quarters.
- Reduction in the churn rate leading to an improvement in profitability.
- Consistent improvement in the company's minute market share and revenue market share.

However, we emphasize that 2Q12 is a seasonally weak quarter and the EBITDA is likely to decline qoq owing to higher employee costs (salary hike is effective from 2Q) and higher network cost (diesel prices increased about 10%).

On the regulatory front, we expect National Telecom Policy 2011, once implemented, would provide a stable regulatory outlook as the known concerns (such as spectrum renewal charges) will be addressed by the policy. The policy would also lay the guidelines for consolidation, spectrum sharing and spectrum trading.

Earnings momentum

- We believe Idea's financial performance is likely to beat its peers on the back of improvement in its minute market share by 200bp over FY11-14, implying a MoU CAGR of 21% in the same period. We expect a revenue CAGR of 21.0% over FY11-14 mainly because of price stability in its voice business.
- We expect the operating margin to expand from 26.6% in 1QFY12 to 29.7% by FY14, leading to an EBITDA CAGR of 29.6% and an EPS CAGR of 41.0% over FY11-14.

Valuation and target price

We initiate with a Buy and a 12-month target price of Rs121. Our target price is based on SOTP valuation; we discounted the SOTP-based fair value of March 2013 by six months to derive the 12-month target price (September 2012). Idea's mobile business is valued at 7.0x EV/EBITDA (a discount to our target EV/EBITDA of 7.5x for Bharti's mobile business) and the tower business (a 16% stake in Indus Towers) is valued at Rs5.0m EV/tower. Our target price of Rs121 factors in the possible impact of TRAI's recommendations (a potential downside of Rs23, in our view) on spectrum pricing; hence, there is a significant margin of safety in our fair value of Rs144. Our target price implies EV/EBITDA multiples of 7.2x FY13F and 5.9x FY14F.

How we differ from consensus

Our revenue forecasts are 4-7% higher than Bloomberg consensus estimates for FY13 and FY14. We expect the company to continue to positively surprise on revenue growth owing to higher-than-expected market share gains. Our EBITDA forecasts are 6-11% higher than Bloomberg consensus estimates for FY13 and FY14. We believe the consensus is not factoring in entirely the operating margin levers that could benefit Idea (among the listed peers) on the back of structural improvement in the sector (price stability and reduction in churn rate).

Risks to central scenario

The key risks to our target price and rating:

- Higher-than-expected impact from one-time spectrum fees and spectrum renewal charges
- Lower-than-expected tariffs
- Lower-than-expected minute market share performance
- Higher-than-expected competitive intensity leading to higher marketing and subscriber acquisition costs

Key assumptions and sensitivities

Table 1 : Key assumptions

	FY12F	FY13F	FY14F
Minute market share (%)	13.3	13.9	14.3
Minutes (bn)	466	563	639
Blended RPM (p/min)	42.3	43.2	42.8
Voice RPM (p/min)	36.6	36.6	35.8
3G subs (m)	4	7	9
Non-voice revenue (%)	13.6	15.4	16.3
Churn rate (%)	8.8	7.8	5.4
Capex intensity (% of revenue)	21.8	17.7	14.8

Source: RBS forecasts

Table 2 : Sensitivity analysis

	Change	Target price Rs/sh	Change in TP	EBITDA Rs bn	Change in EBITDA
Base case		**121**		**81.2**	
Change in Voice RPM	+2.5%	132	9%	85.9	6%
	-2.5%	109	-9%	76.4	-6%
Change in ARPU	+2.5%	134	11%	86.5	7%
	-2.5%	107	-11%	75.8	-7%
Change in Churn rate	-25%	125	4%	82.8	2%
	+25%	116	-4%	79.5	-2%

Source: RBS forecasts

Table 3 : Our forecasts are higher than consensus estimates

Rsm	FY12F			FY13F			FY14F		
	RBS	Consensus	Difference (%)	RBS	Consensus	Difference (%)	RBS	Consensus	Difference (%)
Revenue	197,447	192,938	**2.3**	243,333	228,536	**6.5**	273,609	262,674	**4.2**
EBITDA	50,902	50,634	**0.5**	70,266	63,379	**10.9**	81,173	76,231	**6.5**
PAT	8,863	8,326	**6.4**	17,767	14,691	**20.9**	25,177	22,768	**10.6**

Source: Bloomberg, RBS forecasts

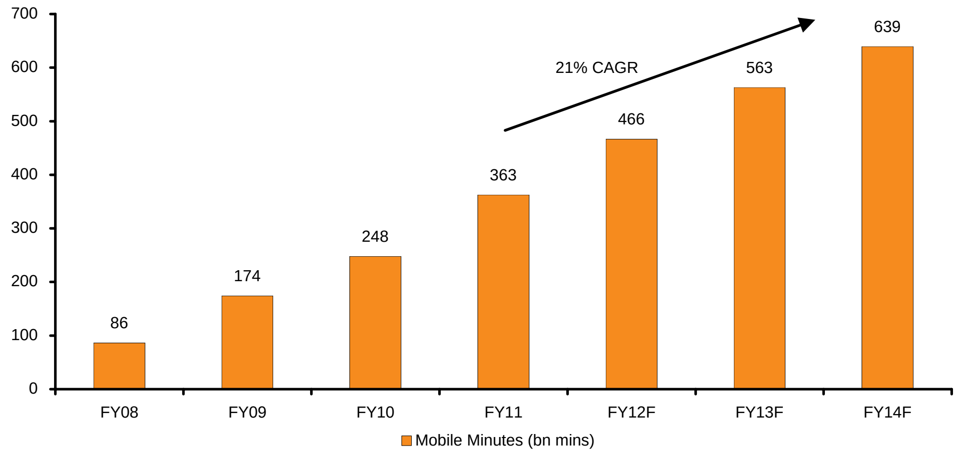
Revenue growth momentum to improve…

We believe Idea's revenue growth momentum will improve given our expectation of price stability in the industry. We expect Idea to gain higher incremental minute market share, leading to a 200bp improvement in its minute market share to 14.3% by FY14.

…led by price stability and minute market share expansion

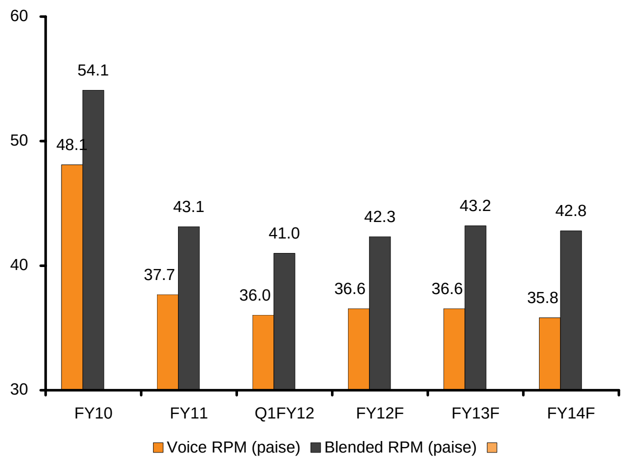
We expect Idea's revenue to grow at about a 21% CAGR over FY11-14 led by: 1) a minute CAGR of about 21% over FY11-14 to 639bn minutes; 2) stable revenue per minute (RPM) of 43.1p in FY11 to 42.8p in FY14; and 3) incremental 3G data revenue. Idea's blended RPM is supported by voice RPM (expected to grow from 37.7p/min in FY11 and 36.0p/min in 1QFY12 to 35.8p/min in FY14). We expect the share of non-voice revenue (including 3G revenue) in mobile revenue to grow from 12.6% in FY11 to 16.3% in FY14.

Chart 1 : Minute CAGR of 21% over FY11-14



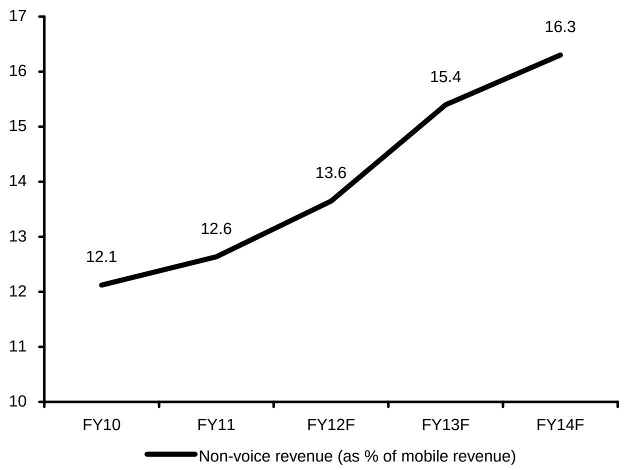
Source: Company data, RBS forecasts

Chart 2 : Price stability driven by stable voice RPM…



Source: Company data, RBS forecasts

Chart 3 : …and increase in non-voice revenue

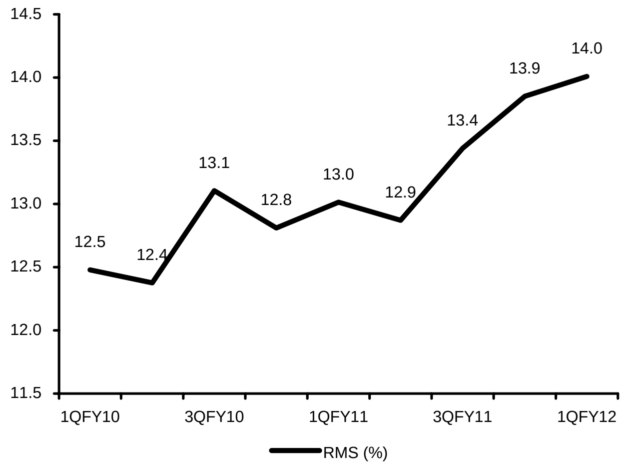


Source: Company data, RBS forecasts

RMS improved to 14.0% in 1QFY12…

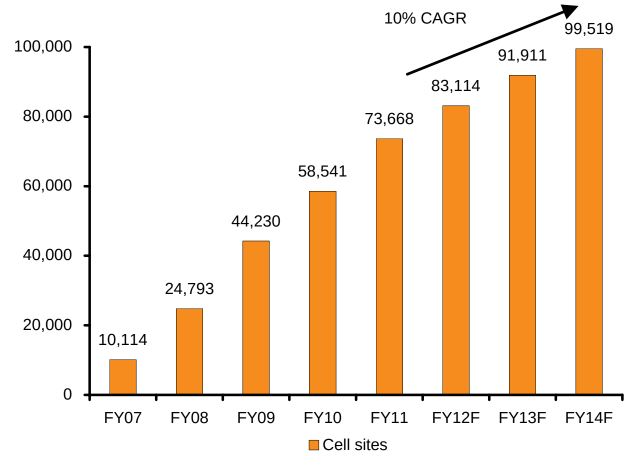
Idea's RMS improved to 14.0% in 1QFY12 (vs 9.5% in FY08) amid hyper-competition. This was driven by the company's huge investment in its network, which has expanded seven times over the past four years from around 10,000 cell sites in FY07 to 73,668 cell sites in FY11.

Chart 4 : RMS improved to 14.0% in 1QFY12…



Source: TRAI

Chart 5 : …led by network coverage expansion



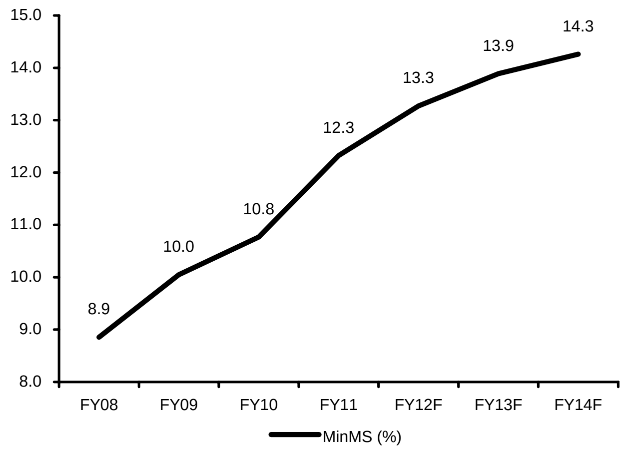
Source: Company data, RBS forecasts

…we expect Idea to capture 14.3% MinMS by FY14 (+200bp)

We expect Idea to gain 18% incremental minute market share

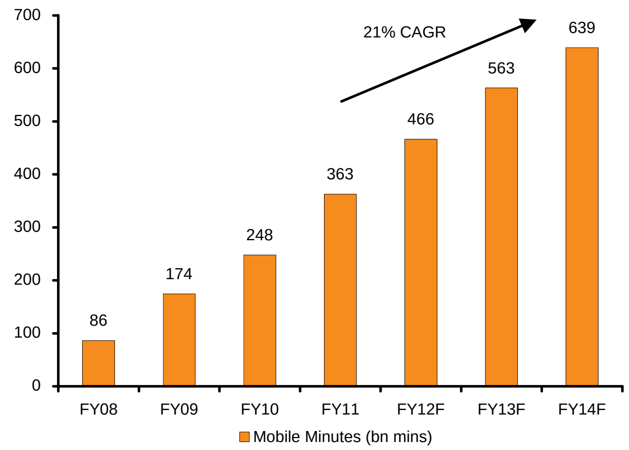
Idea's RMS expansion is driven by its higher MinMS, which expanded from 8.9% in FY08 to 12.3% in FY11, implying an incremental MinMS of 15% over this period. During FY11, Idea captured about 17.9% incremental MinMS, which expanded its MinMS from 10.8% in FY10 to 12.3% in FY11. We expect the company to gain incremental MinMS of about 18% over FY11-14 led by gains from mobile number portability (MNP), consolidation of leadership in the old circles, and improvement in its market share in the new circles, including the Punjab and Karnataka circles acquired from Spice. We expect Idea to capture 14.3% MinMS by FY14, resulting in a CAGR of 21% over FY11-14 to 639bn minutes by FY14 (vs 362bn in FY11).

Chart 6 : MinMS improved to 12.3% in FY11; expect MinMS to improve to 14.3% by FY14…



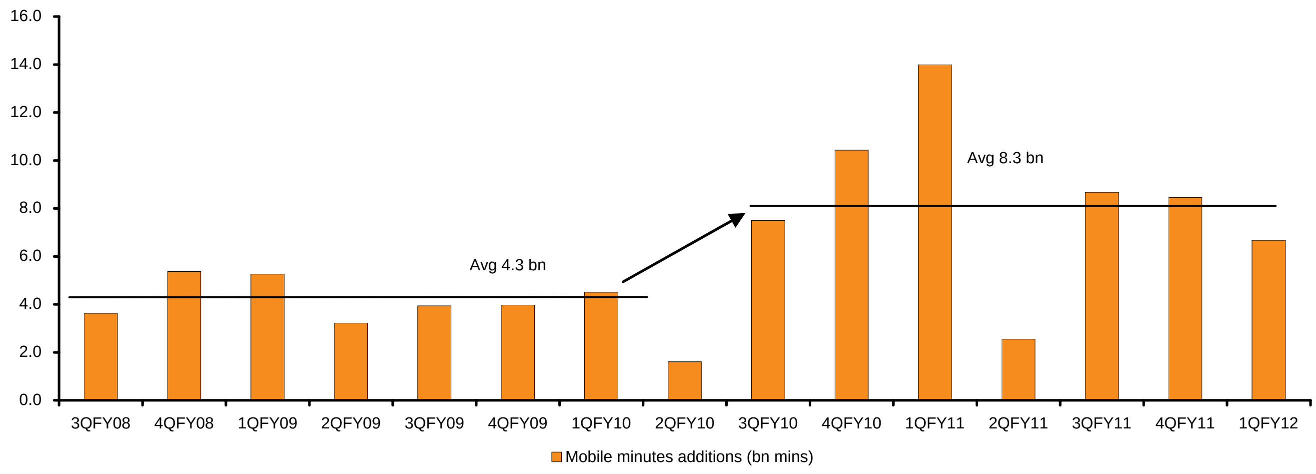
Source: Company data, TRAI, RBS forecasts

Chart 7 : …leading to a minute CAGR of 21% over FY11-14



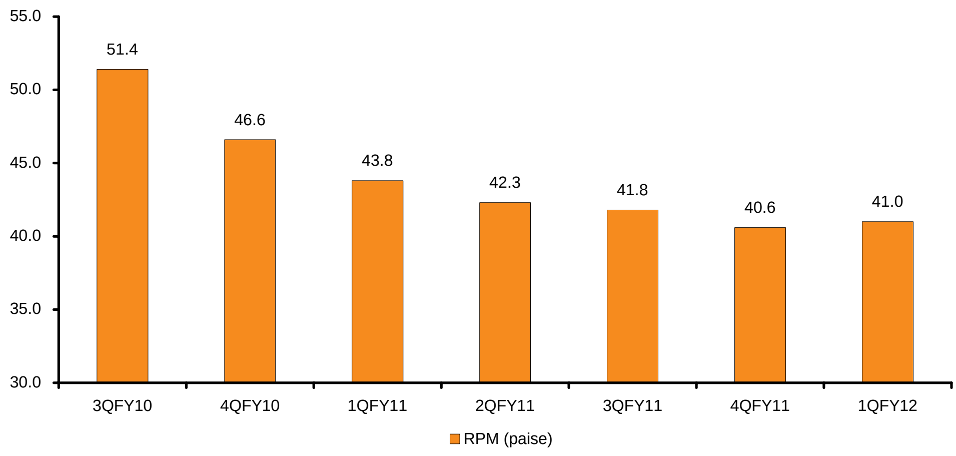
Source: Company data, RBS forecasts

Chart 8 : Idea's minute addition trajectory improved since 3QFY10…



Source: Company data

Chart 9 : …despite arrest in RPM over last few quarters displaying execution



Source: Company data

Improvement in RMS across the circles indicates robust execution

Idea's execution and brand resilience is exhibited by its performance in the old circles where it continues to gain revenue market share amid hyper-competition (see Table 4). Idea's revenue market share in the new circles (8.4% in Bihar and 5.5% in Mumbai) has improved remarkably within two years of launch (see Table 6).

The company also acquired the Punjab and Karnataka circles from Spice during 1HFY09; these circles have spectrum in 900MHz. Since the acquisition, Idea invested in building its network and distribution capabilities. The company witnessed significant improvement in these circles (see Table 5) over the past few quarters. Idea's RMS in the Karnataka circle improved from 6.4% in 3QFY09 to 7.7% in 1QFY12. Karnataka is a significantly large circle with industry revenue of Rs64bn (7.3% of industry revenue) during FY11; Idea's RMS is meager at about 7% (Rs4.4bn of its revenue) during FY11. Bharti is the largest RMS operator in Karnataka with 48% RMS as of 1QFY12. We expect Idea to capture higher RMS in Karnataka due to its network expansion, brand strength and its competitive advantage owing to spectrum in 900MHz.

Table 4 : RMS improved across old circles amid hyper-competition

(%)	3QFY09	4QFY09	1QFY10	2QFY10	3QFY10	4QFY10	1QFY11	2QFY11	3QFY11	4QFY11	1QFY12	Rank	RMS change from 3QFY09
M.P.	27.7	27.7	29.9	30.8	30.2	32.8	33.0	31.8	33.3	34.7	34.3	1	6.6
Kerala	29.0	31.3	31.0	31.5	34.5	33.6	31.3	33.4	32.3	33.6	33.7	1	4.7
Maharashtra	28.2	29.6	30.4	30.4	31.6	31.7	32.5	31.2	31.2	33.3	31.9	1	3.7
U.P.(W)	26.0	27.4	27.9	28.6	29.9	29.2	28.9	28.5	28.9	28.7	28.7	1	2.7
Haryana	18.8	19.7	20.6	19.9	19.3	20.7	19.9	19.6	19.8	20.3	21.3	2	2.5
Gujarat	16.5	17.2	17.8	17.9	18.7	17.7	17.6	17.0	17.6	18.6	18.3	2	1.9
A.P.	17.1	18.0	18.1	16.9	18.1	16.5	16.3	16.2	16.4	16.9	17.2	2	0.1
U.P.(E)	6.5	7.5	7.9	8.2	9.4	9.4	9.4	9.5	10.4	10.7	11.2	3	4.7
Rajasthan	5.3	5.0	5.2	5.4	6.4	6.5	6.4	6.7	7.8	8.1	8.9	3	3.5
Delhi	9.7	9.8	9.4	9.4	9.5	8.9	8.4	8.5	8.5	9.4	8.7	5	(1.0)
H.P.	4.0	4.1	4.9	5.1	3.5	3.8	4.4	4.3	4.5	4.2	4.4	6	0.5
Old circles RMS	**16.6**	**17.2**	**17.7**	**17.5**	**18.4**	**18.0**	**18.0**	**17.9**	**18.5**	**19.2**	**19.1**		

Source: TRAI

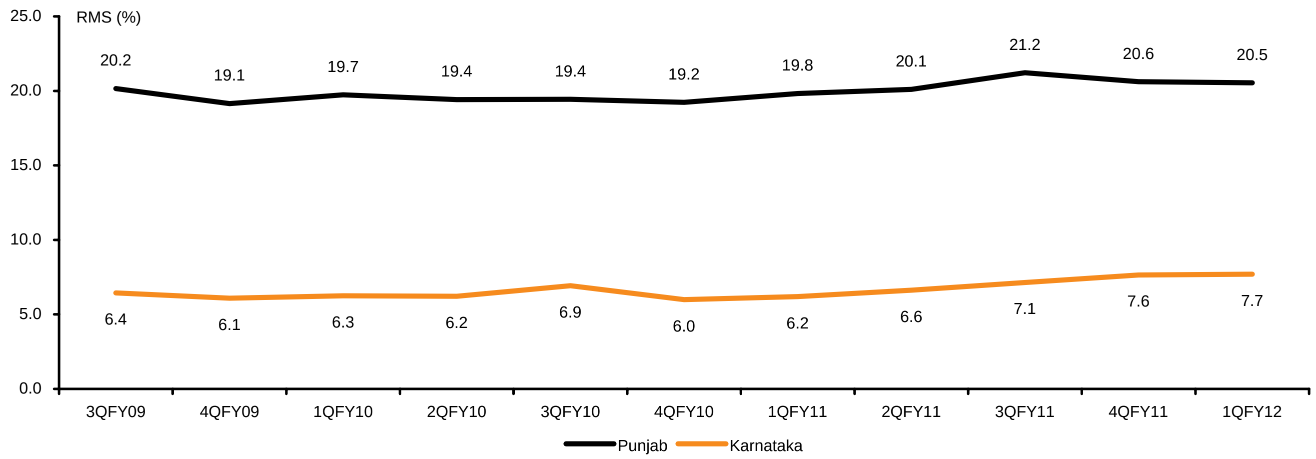
Punjab and Karnataka circles, acquired from Spice in 1HFY09, have started to show robust growth

Table 5 : Punjab and Karnataka circles revenue performance showed improvement over last few quarters

Rsm	3QFY09	4QFY09	1QFY10	2QFY10	3QFY10	4QFY10	1QFY11	2QFY11	3QFY11	4QFY11	1QFY12
Punjab	1,702	1,603	1,607	1,562	1,558	1,513	1,654	1,651	1,756	1,671	1,798
qoq (%)		(5.8)	0.3	(2.8)	(0.2)	(2.9)	9.3	(0.2)	6.3	(4.8)	7.6
Highest RMS operator (Bharti)	3,293	3,252	3,180	3,136	3,095	3,107	3,210	2,948	3,013	3,124	3,276
Karnataka	973	917	946	928	1,004	924	993	1,034	1,157	1,257	1,346
qoq (%)		**(5.7)**	**3.1**	**(1.8)**	**8.2**	**(8.0)**	**7.4**	**4.1**	**11.9**	**8.7**	**7.1**
Highest RMS operator (Bharti)	8,283	8,257	8,194	8,024	7,702	8,062	8,459	7,897	8,001	8,170	8,415

Source: TRAI

Chart 10 : RMS in Punjab and Karnataka - significant potential for improvement in Karnataka



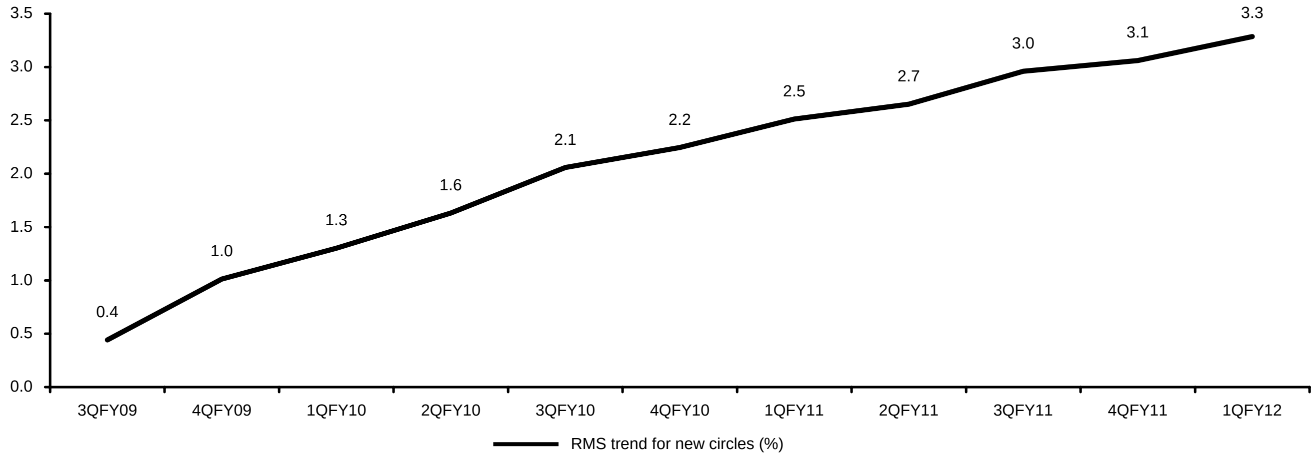
Source: TRAI

Table 6 : RMS expanded in new circles - Bihar and Mumbai are focus circles which saw significant improvement

%	3QFY09	4QFY09	1QFY10	2QFY10	3QFY10	4QFY10	1QFY11	2QFY11	3QFY11	4QFY11	1QFY12	Rank	RMS change since 3QFY09
Bihar	1.1	3.2	4.5	5.5	6.8	6.9	7.2	7.8	8.6	8.5	8.4	4	7.4
Mumbai	1.3	2.8	2.8	3.0	3.2	3.2	3.9	3.9	4.5	4.5	5.5	5	4.2
W.B.	-	-	-	-	0.3	1.0	1.4	1.7	2.2	1.9	2.4	7	2.4
Orissa	-	-	0.6	1.6	1.8	1.9	1.9	2.0	2.0	2.0	1.9	7	1.9
Kolkata	-	-	-	-	0.5	1.2	1.3	1.6	1.8	1.7	1.8	7	1.8
N.E.	-	-	-	-	-	0.1	0.5	0.7	1.0	1.5	1.7	7	1.7
Assam	-	-	-	-	0.0	0.5	0.8	1.0	1.2	1.4	1.4	7	1.4
J&K	-	-	-	-	0.2	0.4	0.7	0.9	1.0	1.3	1.2	7	1.2
T.N.	-	-	0.0	0.3	0.7	0.7	0.6	0.6	0.7	0.7	0.7	7	0.7
Total	0.4	1.0	1.3	1.6	2.1	2.2	2.5	2.7	3.0	3.1	3.3		

Source: TRAI

Chart 11 : RMS performance (cumulative) across new circles



Source: TRAI

We expect EBITDA to be 2.2x in three years

We expect Idea to be the biggest beneficiary of structural improvement among listed peers. We expect Idea's EBITDA to be 2.2x in three years driven by price stability, higher network utilization and reduction in churn rate.

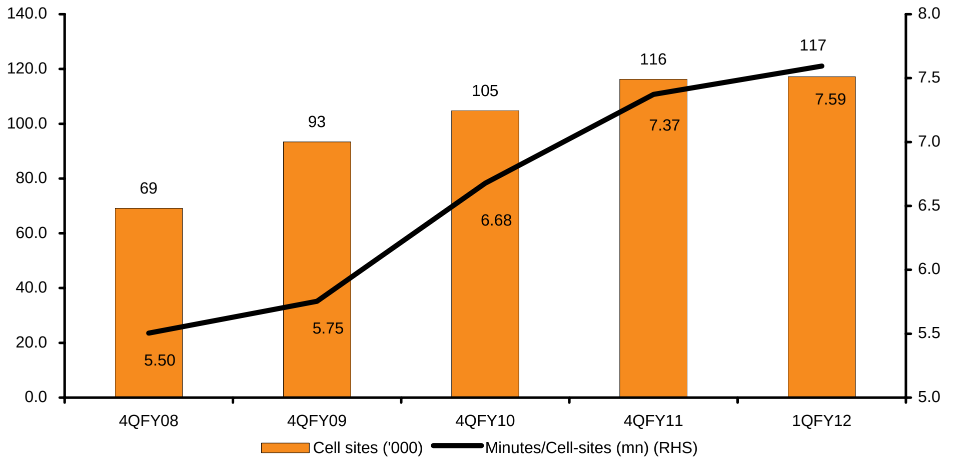
We expect Idea's EBITDA to grow at a CAGR of 29.6% over FY11-14. We expect the EBITDA margin to expand from 24.1% in FY11 (26.6% in 1Q12) to 29.7% in FY14 led by: 1) higher network utilisation (from 5.2m minutes/cell site in FY11 and 5.8m in 1Q12 to 6.7m by FY14); and 2) a reduction in churn rate (from 9.2% in FY11 to 5.4% in FY14). The EBITDA losses from new circles (Rs5.4bn loss vs. reported EBITDA profit of Rs37.3bn in FY11) could contract leaving headroom for margin expansion. There were initial signs of margin expansion during the past year as the EBITDA margin expanded to 26.6% in 1QFY12 (from 24.2% in 1Q11).

Idea hits the sweet spot in network coverage; higher utilisation would result in margin expansion

Network utilisation to improve

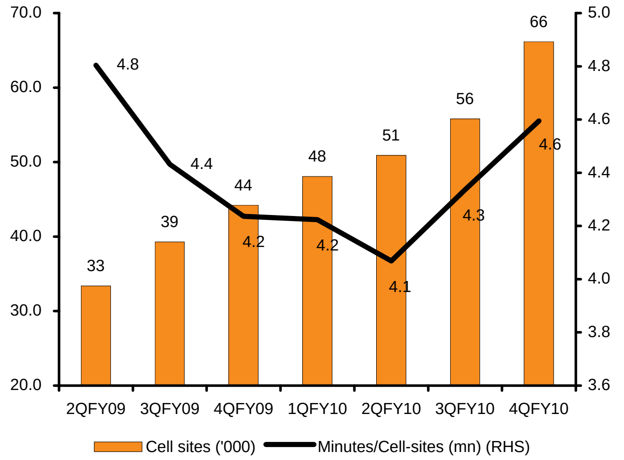
In FY08, Bharti reached population coverage of about 70% with around 69,000 cell sites. Over the past three years, Bharti added around 45,000 cell sites and 508bn minutes, implying 10.7m incremental minutes/cell site. This improved its network utilisation to 7.4m min/cell site in 4QFY11 (vs 5.5m in 4QFY08). We believe Idea has reached a similar sweet spot with around 74,000 cell sites in FY11. We expect an improvement in Idea's network utilisation from 5.2m minutes/cell site in FY11 (5.8m minutes/cell site in 1QFY12) to 6.7m by FY14. Higher utilisation is also driven by co-location of 3G cell sites.

Chart 12 : Bharti's capacity utilisation improved since 4QFY08 when it reached 70% population coverage with 69,000 cell sites



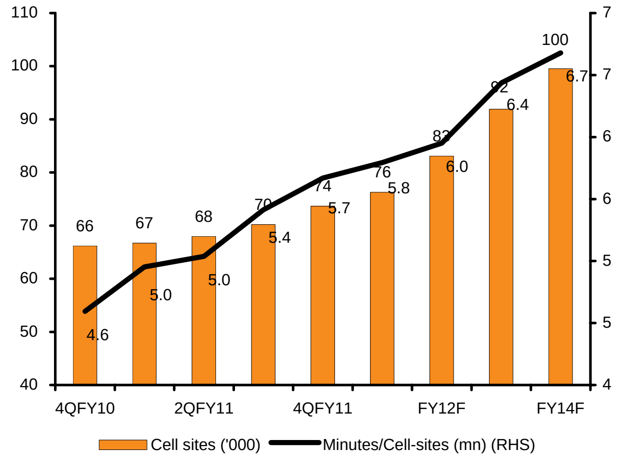
Source: Company data

Chart 13 : Idea's utilisation dropped with new circle rollout



Source: Company data

Chart 14 : Idea's network utilisation is likely to improve

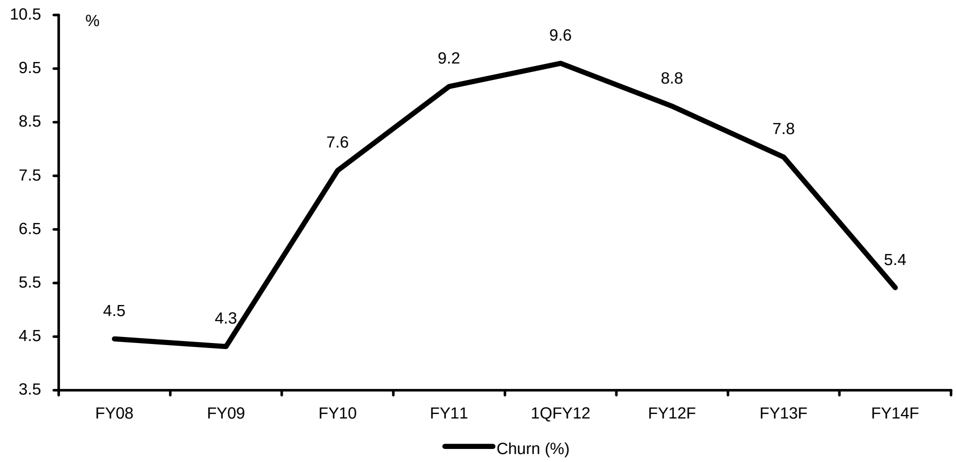


Source: Company data, RBS forecasts

Churn rate to decline with lower competitive intensity

We note the company's gross subscriber additions increased materially (5.5 times) from 20mn in FY08 to 110mn in FY11 due to high competitive intensity, while net additions over the same period expanded 2.57 times from about 10m in FY08 to about 26m in FY11 (see Chart 16). The churn rate during FY08-11 increased from 4.5% to 9.2% by FY11. We expect the churn rate to decline and expect gross subscriber additions to decline to 104mn by FY14, contributing to EBITDA margin expansion due to lower subscriber acquisition costs.

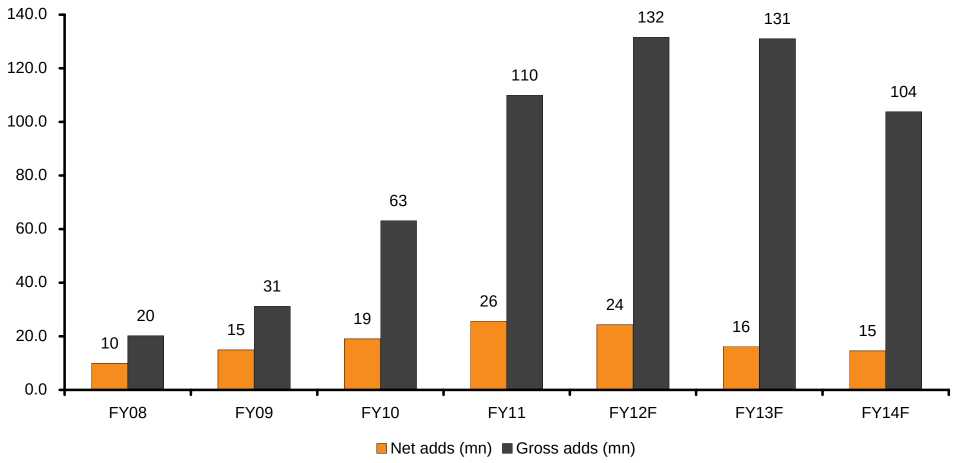
Chart 15 : Churn rate likely to decline



Source: Company data, RBS forecasts

Gross subscriber additions 4.2x net additions during FY11

Chart 16 : Gross subscriber additions increased phenomenally and likely to decline



Source: Company data, RBS forecasts

Idea likely to be the biggest beneficiary of reduction in churn rate among listed peers

We believe Idea is likely to be the biggest beneficiary of reduction in the churn rate among listed peers. Table 7 highlights a 1% reduction in churn rate is likely to increase Idea's EBITDA margin positively about 44bp. We believe Idea is likely to benefit since its reported churn is the highest among industry participants (9.6% per month) during 1QFY12.

Table 7 : Impact on EBITDA owing to potential reduction in churn

	Bharti	RCom	Idea
1QFY12			
Subs (m)	169	143	95
Churn (%)	6.4	4.0	9.6
Gross adds (m)	39	24	32
FY11			
Churn (%)	6.8	3.8	9.2
Gross adds (m)	153	87	110
Revenue (Rs bn)	464	206	154
EBITDA (Rs bn)	171	65	37
Potential reduction in gross adds (m) with 1% decline in churn	20	17	11
Potential cost savings with 1% decline in churn (Rs bn)	1.22	1.03	0.68
Impact on EBITDA (%)	0.7	1.6	1.8
Impact on EBITDA margins (%)	**0.26**	**0.50**	**0.44**

Source: Company data, RBS estimates

EBITDA loss in the new circles could contract, leaving headroom for margin expansion

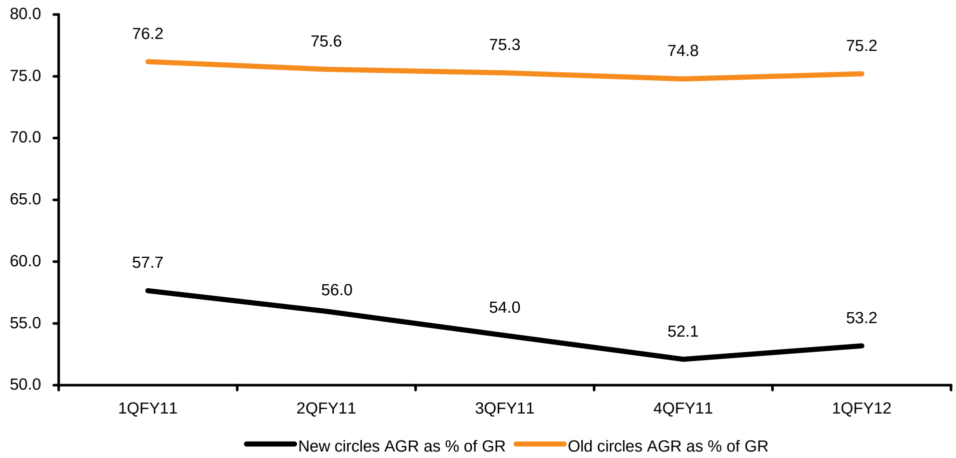
Idea's EBITDA losses from the new circles stood at Rs5.4bn in FY11 (vs Rs4.2bn in FY10). We believe the EBITDA losses in the new circles could contract led by higher RMS, price stability and improved utilisation. This leaves headroom for EBITDA margin expansion.

Table 8 : New circles EBITDA losses to contract with price stability and improved utilisation

Rs m	2QFY09	3QFY09	4QFY09	1QFY10	2QFY10	3QFY10	4QFY10	1QFY11	2QFY11	3QFY11	4QFY11	1QFY12
Revenue	52	483	985	1,427	1,822	2,384	2,761	3,063	3,384	3,960	4,393	4,814
EBITDA loss	**(337)**	**(765)**	**(654)**	**(644)**	**(830)**	**(1,288)**	**(1,422)**	**(1,401)**	**(1,429)**	**(1,384)**	**(1,173)**	**(1,397)**
Reported total EBITDA	6,024	6,950	7,983	8,588	8,039	8,005	8,948	8,851	8,563	9,452	10,392	11,991
EBITDA without new circle losses	6,361	7,715	8,637	9,232	8,869	9,293	10,370	10,252	9,992	10,836	11,565	13,388

Source: Company data

Chart 17 : New circles vs old circles (adjusted gross revenue as % of gross revenue) shows headroom for improvement



Source: TRAI

There are initial signs of EBITDA margin improvement

Idea's EBITDA margin expanded from 24.2% in 1QFY11 to 26.6% in 1QFY12. We would like to emphasise the incremental EBITDA margin performance over the past three quarters is driven by higher network utilisation and price stability. In particular, the 1QFY12 incremental EBITDA margin stood at about 50% driven by 1% qoq increase in RPM to 41.0p (vs 40.6p in 4QFY11).

Incremental EBITDA margin in 1QFY12 at about 50%, led by a 1% qoq increase in RPM

Table 9 : Initial signs of improvement witnessed with margin expansion

	3QFY11	4QFY11	1QFY12
RPM (p/min)	41.8	40.6	41.0
Minutes (m minutes)	93,503	101,960	108,630
Revenue (Rs m)	39,526	41,987	45,158
EBITDA (Rs m)	9,452	10,392	11,991
EBITDA margin (%)	23.9	24.8	26.6
Incremental revenue (Rs m)	3,159	2,461	3,171
Incremental EBITDA (Rs m)	889	940	1,599
Incremental EBITDA margin (%)	**28.2**	**38.2**	**50.4**

Source: Company data, RBS estimates

TRAI recommendations, if implemented, could have a negative impact

Idea could be negatively affected if the regulators' recommendations on spectrum pricing are implemented in their current form. Though we don't expect them to be implemented entirely, we have factored a worst-case impact of Rs23/sh into our target price.

Our target price factors in the worst-case impact

Our target price factors in the worst-case impact

Telecom Regulatory Authority of India (TRAI) recommendations on spectrum pricing, if implemented, could have a negative impact on Idea of Rs23/sh (see Table 10). As discussed earlier in the industry section of this report, we believe it would be difficult to implement the recommendations on spectrum charges in their current form because they would lead to an uneven playing field among new (ie, those who entered the market in 2008) and existing companies. In addition, to a certain extent, the impact analysis based on TRAI's recommendations may turn out to be academic. In a scenario where some licences get cancelled or licensees surrender spectrum, excess spectrum will be available. In such an event, TRAI may recommend auctioning spectrum in the 1800MHz band to determine the relevant spectrum price, which could be materially lower than TRAI's recommended spectrum price.

However, if TRAI's recommendations are implemented, Idea would need to pay the first tranche of spectrum renewal charges of Rs48bn during FY16 (see Table 11). Based on our estimates, Idea's net debt would decline to Rs79.3bn by FY14 (0.98x net debt/EBITDA) from Rs105.9bn (2.8x net debt/EBITDA) in FY11 and would continue to decline thereafter as well. This should enable the company to again leverage, if required, and meet such spectrum payouts during FY16 and FY17, in our opinion.

Table 10 : Impact of TRAI recommendations on Idea (assuming no reduction in licence fees)

Rs bn	FY13F
One-time spectrum charge above 6.2MHz	(15)
PV of Spectrum Renewal Charges (to be paid post-expiry of licence period)	(63)
Total	(78)
Impact per share (Rs)	**(23)**

Source: TRAI, RBS forecasts

Table 11 : Idea - Spectrum renewal charges at time of licence expiry (based on recommendations)

Year	Circles	No. of circles	Payouts (Rs m)	NPV (FY13) (Rs m)	Revenue dependence 1QFY12 (%)
FY16	Maha, Guj, AP, Kerala, UP(w), MP, Har	7	48,206	36,398	70.1
FY17	Punjab, Karnataka	2	14,208	10,374	9.4
FY18-21					
FY22	Delhi, UP (e), Raj, HP	4	24,877	10,239	13.0
FY23 -26					
FY27	Mumbai, Bihar	2	7,553	1,812	5.5
FY28	Kol, TN, WB, Orissa, Assam, NE, J&K	7	17,559	3,741	2.0
Total		**22**	**112,404**	**62,565**	**100**

Source: TRAI, RBS forecasts

What if Idea surrenders part of its spectrum?

However, we believe that the impact of TRAI's recommendations may be academic because the companies may be well equipped with different strategies to minimise payouts. We note that Idea has acquired spectrum in the 2.1GHz band during the 3G auctions in all circles, except Karnataka, which will be due for licence renewal in FY16 and FY17 (see Table 11). In a scenario where a significant portion of Idea's voice traffic is migrated to the 2.1GHz band, the company may be well equipped to surrender some portion of spectrum. Hence, our assertion that the impact analysis based on TRAI's recommendations may turn out to be academic.

Table 12 : What if Idea surrenders part of its spectrum?

Circles	Spectrum (in MHz) with Idea 2G	3G	Revenue/ MHz (Rs m) Idea	Bharti	Vodafone	Spectrum charges (Idea) - (Rs m) One-time	PV of licence renewal charges	Idea licence expiry dates
Metros								
Delhi	8.0		1,405	4,014	2,911	2,587	4,324	Sep-21
Mumbai	4.4		1,458	1,834	2,839		1,204	Nov-26
Kolkata	4.4		219	1,113	991		553	Jan-28
A' Circle								
Maharashtra	9.8	5.0	3,072	2,553	3,914	5,327	8,001	Dec-15
Gujarat	6.2	5.0	2,116	2,198	3,090		6,949	Dec-15
A.P.	8.0	5.0	2,259	4,295	1,867	2,220	8,501	Dec-15
Karnataka	6.2		1,293	4,407	1,582		6,200	Apr-16
T.N.	4.4		503	5,398	3,515		2,095	Jan-28
B' Circle								
Kerala	8.0	5.0	2,167	1,532	1,966	1,189	4,094	Dec-15
Punjab	7.8	5.0	1,259	2,351	1,402	1,304	4,174	Apr-16
Haryana	6.2	5.0	925	790	1,252		672	Dec-15
U.P.(W)	8.0	5.0	1,974	1,626	2,212	1,293	3,327	Dec-15
U.P.(E)	6.2	5.0	1,563	3,250	2,943		3,395	Sep-21
Rajasthan	6.2		1,019	3,536	2,316		2,372	Sep-21
M.P.	8.0	5.0	2,373	2,144	741	1,303	4,854	Dec-15
W.B.	4.4		310	1,799	2,518		501	Jan-28
C' Circle								
H.P.	4.4	5.0	161	627	179		148	Sep-21
Bihar	4.4		1,400	3,149	1,645		608	Dec-26
Orissa	4.4		203	1,246	705		272	Jan-28
Assam	4.4		101	1,192	600		116	Jan-28
N.E.	4.4		81	829	326		119	Jan-28
J&K	4.4	5.0	63	879	251		85	Jan-28
Total						**15,223**	**62,565**	

Source: TRAI, RBS forecasts

We initiate coverage with Buy

We initiate on Idea with a Buy rating as we expect the company to be the biggest beneficiary of structural improvement in the sector with its industry-leading EBITDA growth (we expect EBITDA of 2.2x in three years).

Outperformance to be led by superior growth and ROE expansion

We initiate coverage on Idea with a Buy rating and 12-month target price of Rs121. We believe the valuation multiple for Idea will expand as the company outperforms its peers with minute market share gains (200bp over three years), an improvement in network utilisation and a reduction in churn rate. We believe Idea will outperform its peers driven by: 1) higher growth: revenue/EBITDA/EPS CAGRs of 21.0%/29.6%/41.0% over FY11-14E; and 2) ROE expansion to 15.8% by FY14 (from 7.6% in FY11).

Our target price is based on SOTP valuation; we discounted the SOTP-based fair value of March 2013 by six months to derive a 12-month target price (September 2012). Idea's mobile business is valued at 7.0x EV/EBITDA (a discount to our target of 7.5x EV/EBITDA for Bharti's mobile business) and the tower business (a 16% stake in Indus Towers) is valued at Rs5.0m EV/tower. We prefer to value India telco services stocks using EV/EBITDA rather than PE since depreciation policies differ across peers and the companies are at different stages of maturity. Our target price of Rs121 factors in the possible impact of TRAI's recommendations (potential downside of Rs23, in our view) on spectrum pricing; hence, it provides a significant margin of safety against our fair value of Rs144.

Our target price implies EV/EBITDA multiples of 7.2x FY13F and 5.9x FY14F. We note Idea's implied FY13F EV/EBITDA multiple is closer to its historical average of 7.4x one-year forward EV/EBITDA. In our opinion, Idea's consolidated business historical valuation multiple is comparable from November 2009, since the sector was de-rated due to hyper-competition.

Significant upside if spectrum renewal charges are lower

In our view, Idea offers significant upside risk if spectrum renewal charges are lower than proposed in TRAI's recommendations. In addition, Idea may offer more upside if pricing power improves for the sector. Based on our estimate, if Idea's ARPU is 2.5% higher than our estimate, the stock's fair value would increase by about 11%.

Table 13 : Idea's SOTP-based valuation of Rs121

Business units	
Equity Value	
Mobile business	132
Tower value - ABTL	21
Total	**152**
Possible impact of TRAI's recommendations	(23)
Idea's SOTP fair value (Mar-13)	129
Idea's 12-month target price (Sep-12)	**121**

Source: RBS forecasts

Table 14 : Implied valuation at target price

	FY13F	FY14F
Target price (Rs)	120.5	120.5
EPS (Rs)	5.4	7.6
Implied PE (x)	**22.5**	**15.9**
EV (Rs bn)	507	482
EBITDA (FY14F) (Rs bn)	70	81
Implied EV/EBITDA (x)	**7.2**	**5.9**

Source: RBS forecasts

Table 15 : Idea's mobile business fair value

	FY14E
EBITDA (mobile) - IDEA	71,890
EV/EBITDA multiple	7.0
EV (Rs m)	503,233
Less: Net Debt (Rs m)	67,176
Equity Value (Rs m)	436,056
Value per share (Rs)	**132**

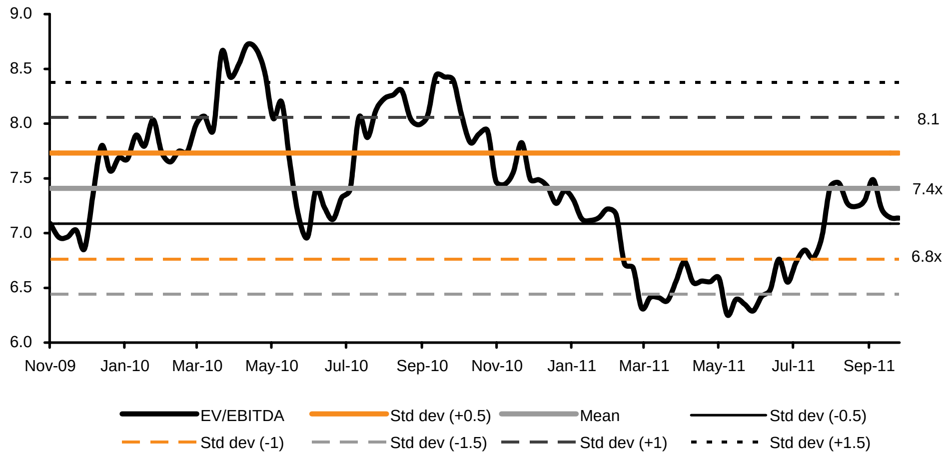
Source: RBS forecasts

Table 16 : Idea's tower business fair value

	FY14E
No. of Indus towers	120,722
EV/tower (Rs m)	5
Enterprise value (Rs bn)	604
Less: Debt (Rs bn)	95
Equity Value (Rs bn)	509
ABTL's stake in Indus	16%
Equity Value - ABTL (Rs bn)	81
Less: Providence equity stake -16.14% (Rs bn)	13
Total equity value attributable to IDEA (Rs bn)	68
Value per share (Rs)	**21**

Source: RBS forecasts

Chart 18 : Idea - EV/EBITDA (one-year forward)



Source: Company data, Bloomberg, RBS forecasts

Table 17 : Sensitivity of valuation to ARPU and MoU

		ARPU (% change from base case)				
		10.0	**5.0**	**0.0**	**(5.0)**	**(10.0)**
MoU (% change from base case)	**10.0**	204	175	145	116	86
	5.0	189	161	133	105	76
	0.0	175	148	**121**	93	66
	(5.0)	160	134	108	82	55
	(10.0)	145	121	96	71	45

Source: RBS forecasts

Table 18 : Sensitivity of EBITDA (FY14F) to churn and voice RPM

		Churn (% change from base case)				
		75.0	**50.0**	**0.0**	**(25.0)**	**(50.0)**
Voice RPM (% change from base case)	**5.0**	85,690	87,340	90,641	92,291	93,942
	2.5	80,956	82,606	85,907	87,557	89,208
	0.0	76,222	77,872	**81,173**	82,823	84,474
	(2.5)	71,488	73,138	76,439	78,089	79,740
	(5.0)	66,754	68,404	71,705	73,355	75,006

Source: RBS forecasts

Management Team

Table 19 : Key management team

Name	Designation	Qualification and Experience
Kumar Mangalam Birla	Chairman	Chartered accountant and MBA from London Business School, Kumar Mangalam Birla is chairman of the Aditya Birla Group. He serves as director on the board of the group's international companies spanning Thailand, Indonesia, Malaysia, Philippines and Egypt. He holds several key positions on various regulatory and professional boards. He is a director of the central board of directors of the RBI and chairman of the staff sub-committee of the central board of the RBI.
Himanshu Kapania	Managing Director	Himanshu Kapania holds a BE from BIT, Ranchi and a PGDM from IIM Bangalore. He became managing director of Idea from April 1, 2011. Prior to this role, he had served Idea as deputy managing director and director, operations. Mr Kapania joined Idea in September 2006 with over 21 years of industry experience. His last assignment was with Reliance Infocomm as their CEO for northern operations. Mr Kapania serves as a director of Idea Cellular Limited.
Ambrish Jain	Deputy Managing Director	Ambrish Jain is an engineering graduate from IIT Delhi and a postgraduate from IIM, Ahmedabad. He joined Idea in October 2001 with over 22 years of industry experience. Prior to the current role, he was director, operations for the north and east circles. Prior to Idea, he worked with Aircel Digilink , RPG Cellcom, Escotel Mobile on various sales and marketing assignments.
Akshaya Moondra	Chief Financial Officer	Joined IDEA as CFO in 2008, after spending two decades in various Aditya Birla Group companies. He is a chartered accountant and a member of the Institute of Chartered Accountants of India. Also a member of the Institute of Company Secretaries of India.

Source: Company data

Income statement

Rsm	FY10A	FY11A	FY12F	FY13F	FY14F
Revenue	123979	154384	197447	243333	273609
Cost of sales	-90399	-117126	-146545	-173067	-192436
Operating costs	-19416	-22281	-24812	n/a	n/a
EBITDA	**33580**	**37258**	**50902**	**70266**	**81173**
DDA & Impairment (ex gw)	-20149	-23973	-28539	-33776	-36068
EBITA	**13430**	**13285**	**22363**	**36490**	**45105**
Goodwill (amort/impaired)	n/a	n/a	n/a	n/a	n/a
EBIT	**13430**	**13285**	**22363**	**36490**	**45105**
Net interest	-4005	-3965	-9775	-10278	-8222
Associates (pre-tax)	n/a	n/a	n/a	n/a	n/a
Forex gain / (loss)	n/a	n/a	n/a	n/a	n/a
Exceptionals (pre-tax)	n/a	n/a	n/a	n/a	n/a
Other pre-tax items	1328	648.2	0.00	0.00	0.00
Reported PTP	**10754**	**9969**	**12588**	**26212**	**36883**
Taxation	-1214	-981.5	-3725	-7997	-11212
Minority interests	n/a	0.00	0.00	-447.8	-494.0
Exceptionals (post-tax)	0.00	0.00	0.00	n/a	n/a
Other post-tax items	0.00	-0.00	0.00	0.00	0.00
Reported net profit	**9539**	**8987**	**8863**	**17767**	**25177**
Normalised Items Excl. GW	0.00	0.00	0.00	0.00	0.00
Normalised net profit	**9539**	**8987**	**8863**	**17767**	**25177**

Source: Company data, RBS forecasts

year to Mar

Balance sheet

Rsm	FY10A	FY11A	FY12F	FY13F	FY14F
Cash & market secs (1)	14204	14777	4299	10946	11498
Other current assets	33730	25980	32283	33424	34474
Tangible fixed assets	170945	212465	201491	215744	225215
Intang assets (incl gw)	16260	48912	70788	65874	60961
Oth non-curr assets	-0.00	-0.00	0.01	-0.01	0.00
Total assets	**235138**	**302135**	**308860**	**325989**	**332148**
Short term debt (2)	n/a	n/a	n/a	n/a	n/a
Trade & oth current liab	38447	53555	49955	58322	63583
Long term debt (3)	78593	120705	125775	115775	90775
Oth non-current liab	4375	4876	4585	4930	5158
Total liabilities	**121415**	**179136**	**180314**	**179027**	**159515**
Total equity (incl min)	113724	122999	128546	146962	172632
Total liab & sh equity	**235138**	**302135**	**308860**	**325989**	**332148**
Net debt	64389	105928	121476	104829	79277

Source: Company data, RBS forecasts

year ended Mar

Cash flow statement

Rsm	FY10A	FY11A	FY12F	FY13F	FY14F
EBITDA	33580	37258	50902	70266	81173
Change in working capital	-7504	15536	-10194	7572	4439
Net interest (pd) / rec	-4005	-3965	-9775	-10278	-8222
Taxes paid	-1214	-981.5	-3725	-7997	-11212
Other oper cash items	-1627	-5228	0.00	0.00	0.00
Cash flow from ops (1)	**19229**	**42621**	**27208**	**59562**	**66178**
Capex (2)	-41580	-85473	-42957	-43116	-40626
Disposals/(acquisitions)	106.5	271.3	0.00	0.00	0.00
Other investing cash flow	10036	1576	10200	-1600	-1600
Cash flow from invest (3)	**-31438**	**-83625**	**-32757**	**-44716**	**-42226**
Incr / (decr) in equity	23.4	138.4	200.8	200.8	0.00
Incr / (decr) in debt	-15779	42543	5070	-10000	-25000
Ordinary dividend paid	0.00	0.00	0.00	n/a	n/a
Preferred dividends (4)	n/a	n/a	n/a	n/a	n/a
Other financing cash flow	n/a	n/a	n/a	n/a	n/a
Cash flow from fin (5)	**-15755**	**42681**	**5270**	**-9799**	**-25000**
Forex & disc ops (6)	n/a	n/a	n/a	n/a	n/a
Inc/(decr) cash (1+3+5+6)	**-27964**	**1678**	**-278.7**	**5047**	**-1048**
Equity FCF (1+2+4)	-22351	-42852	-15749	16446	25552

Lines in bold can be derived from the immediately preceding lines.

year to Mar

Source: Company data, RBS forecasts

Standard ratios

Performance	Idea Cellular					Bharti Airtel			Reliance Comm		
	FY10A	FY11A	FY12F	FY13F	FY14F	FY12F	FY13F	FY14F	FY12F	FY13F	FY14F
Sales growth (%)	22.4	24.5	27.9	23.2	12.4	20.3	13.9	9.78	4.02	9.24	5.97
EBITDA growth (%)	19.4	11.0	36.6	38.0	15.5	26.4	19.2	10.2	4.08	12.0	6.61
EBIT growth (%)	-4.79	-1.08	68.3	63.2	23.6	25.3	27.1	9.65	0.05	15.7	0.68
Normalised EPS growth (%)	1.66	-5.89	-1.55	100.1	41.7	-0.63	42.2	15.0	-49.9	11.2	10.9
EBITDA margin (%)	27.1	24.1	25.8	28.9	29.7	35.3	36.9	37.0	31.8	32.6	32.8
EBIT margin (%)	10.8	8.61	11.3	15.0	16.5	17.1	19.1	19.1	12.1	12.9	12.2
Net profit margin (%)	7.69	5.82	4.49	7.30	9.20	8.41	10.5	11.0	3.17	3.23	3.38
Return on avg assets (%)	5.25	4.68	5.15	7.99	9.54	5.61	6.91	7.20	2.26	2.72	2.78
Return on avg equity (%)	7.74	7.59	7.05	12.9	15.8	11.9	15.2	15.2	1.66	1.83	1.99
ROIC (%)	6.94	6.64	6.79	10.0	12.3	7.39	9.44	10.3	2.76	3.17	3.27
ROIC - WACC (%)	-3.50	-3.80	-3.66	-0.43	1.87	-3.32	-1.28	-0.41	-9.85	-9.43	-9.33
					year to Mar			year to Mar			year to Mar
Valuation											
EV/sales (x)	3.14	2.79	2.26	1.77	1.48	2.82	2.40	2.07	2.26	1.96	1.69
EV/EBITDA (x)	11.6	11.6	8.78	6.12	4.99	7.99	6.51	5.60	7.12	6.02	5.14
EV/EBITDA @ tgt price (x)	13.8	13.6	10.2	7.18	5.90	9.45	7.73	6.71	6.97	5.89	5.02
EV/EBIT (x)	29.0	32.5	20.0	11.8	8.97	16.5	12.6	10.9	18.6	15.3	13.8
EV/invested capital (x)	2.16	1.86	1.77	1.69	1.59	1.78	1.69	1.61	0.64	0.62	0.59
Price/book value (x)	2.86	2.65	2.54	2.23	1.90	2.75	2.39	2.06	0.36	0.36	0.35
Equity FCF yield (%)	-6.88	-13.2	-4.83	5.04	7.83	1.69	4.42	7.42	0.75	17.3	27.5
Normalised PE (x)	34.07	36.20	36.78	18.38	12.97	23.89	16.80	14.61	21.85	19.64	17.71
Norm PE @tgt price (x)	41.9	44.5	45.2	22.6	15.9	30.0	21.1	18.4	20.4	18.3	16.5
Dividend yield (%)	0.00	0.00	0.00	0.00	0.00	0.26	0.26	0.26	0.00	0.00	0.00
					year to Mar			year to Mar			year to Mar

Per share data	FY10A	FY11A	FY12F	FY13F	FY14F
Tot adj dil sh, ave (m)	3300	3303	3309	3315	3315
Reported EPS (INR)	2.89	2.72	2.68	5.36	7.60
Normalised EPS (INR)	2.89	2.72	2.68	5.36	7.60
Dividend per share (INR)	0.00	0.00	0.00	0.00	0.00
Equity FCF per share (INR)	-6.77	-13.0	-4.76	4.96	7.71
Book value per sh (INR)	34.5	37.2	38.8	44.2	51.8
					year to Mar

Solvency	FY10A	FY11A	FY12F	FY13F	FY14F
Net debt to equity (%)	56.6	86.1	94.5	71.3	45.9
Net debt to tot ass (%)	27.4	35.1	39.3	32.2	23.9
Net debt to EBITDA	1.92	2.84	2.39	1.49	0.98
Current ratio (x)	1.25	0.76	0.73	0.76	0.72
Operating CF int cov (x)	6.10	12.0	4.16	7.57	10.4
Dividend cover (x)	0.00	0.00	0.00	0.00	0.00
					year to Mar

Priced as follows: IDEA.BO - Rs98.50
Source: Company data, RBS forecasts

Valuation methodology - SOTP valuations

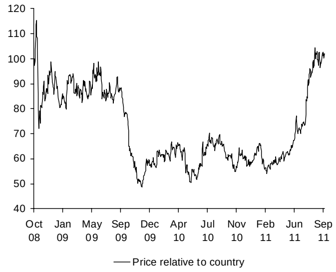
Business units	Rs/sh
Equity Value	
Mobile business	132
Tower value - ABTL	21
Total	152
Possible impact of TRAI's recommendations	(23)
Idea's SOTP fair value (Mar-13)	129
Idea's 12-month target price (Sep-12)	**121**

Source: RBS forecasts

Company description — Buy

Idea Cellular is the third-largest mobile operator in India, with 90m subscribers. Its wireless subs market share is 11% and its wireless revenue market share is 13.3% as of FY11. Idea provides wireless and long-distance voice and Internet services to consumer and enterprise markets. Idea's holdings in towers were pooled into a 16% stake in Indus, a joint venture with Bharti Airtel and Vodafone-Essar. The company is promoted by the Aditya Birla group, whose companies (ABNL, Birla TMT Holdings, Hindalco and Grasim) collectively own the promoter's stake.

Price relative to country



Strategic analysis — Average SWOT company score: 3

Strengths — 4

Idea's network coverage significantly expanded to 74,000 cell sites, which creates a sustainable competitive edge for the company. Idea won 3G spectrum in 11 circles, which contributes 81% of Idea's revenue.

Weaknesses — 3

Late entry into nine circles (which form 32% of the India industry's revenue) places the company at a disadvantage against Pan-India incumbent operators. However, entry into new circles expands the addressable market and increases its long-term growth profile.

Opportunities — 4

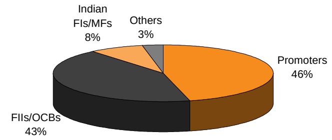
Idea has a significant competitive advantage with its deep network coverage and wide distribution reach in the Indian market. Hence, it is better positioned to capture higher market share of the under-penetrated Indian telecom market (48% active subs penetration).

Threats — 2

Unfavourable changes in licensing conditions in India (over spectrum pricing and allocation, spectrum refarming, reduction in MTC charges) pose a threat. An increase in competitive intensity in the wireless broadband market with entry of new players poses a challenge.

Scoring range is 1-5 (high score is good)

Shareholding pattern



Source: Company data

Market data

Headquarters
Idea Cellular Limited, 'Windsor', 5th Floor, Off CST Road,Near Vidya Nagari, Kalina, Santacruz(E), Mumbai – 400098
Website
www.ideacellular.com
Shares in issue
3303.3m
Freefloat
35%
Majority shareholders
Promoter companies (46%), TMI group (19%), P5 Asia Investments Mauritius Ltd (5%)

Country view: India

The compression of multiples typically characteristic of a market undergoing the transition from growth to value continued to pressure Indian equities in the 2Q. While the economic deceleration is well under way, we continue to view the country as a major potential loser from higher costs of capital in quarters and perhaps even years ahead. Still, given the significant short-term relative underperformance and the expected decline in commodities prices, clearly a bounce is possible. Yet, as valuations are broadly unattractive and returns declining, we continue to consider the risk-reward trade-off as unattractive.

The country view is set in consultation with the relevant company analyst but is the ultimate responsibility of the Strategy Team.

Country rel to Asia Pacific

Competitive position — Average competitive score: 4+

Supplier power — 4+

The company's scale of operation expanded over the past few years, significantly improving its bargaining power with suppliers. A rise of Chinese players has intensified competition among suppliers.

Barriers to entry — 4+

During 2008, new licences were rewarded, removing barriers to entry. However, significant capital investment is required to compete with incumbent operators, acting as a barrier to entry.

Customer power — 3+

With 8-plus operators in most circles, tariffs in India are already among the lowest worldwide. However, operators with better network coverage and distribution command a premium on the tariffs.

Substitute products — 5+

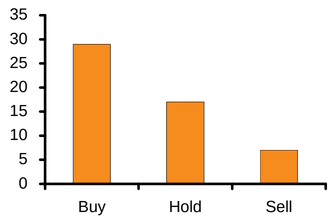
Mobile telephony tariffs in India are among the lowest in the world and eat into the share of fixed-line telephony. Internet-based telephony has not had an impact, as PC penetration is very low.

Rivalry — 3+

We expect industry consolidation in FY13/FY14 as merger and acquisition guidelines, and spectrum sharing and spectrum trading guidelines are laid out in the upcoming National Telecom Policy 2011.

Scoring range 1-5 (high score is good) Plus = getting better Minus = getting worse

Broker recommendations



Source: Bloomberg

Reliance Communications

No visible turnaround

Initiation of coverage

Hold

Target price
Rs67.00

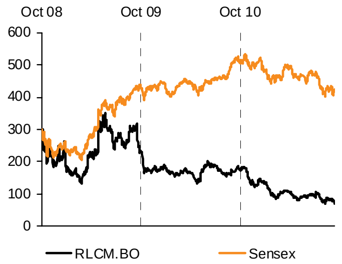
Price
Rs71.75

Short term (0-60 days)
n/a

Market view
Underweight

Price performance

	(1M)	(3M)	(12M)
Price (Rs)	79.55	95.70	168.5
Absolute (%)	-9.8	-25.0	-57.4
Rel market (%)	-8.6	-14.1	-48.1
Rel sector (%)	-9.8	-25.0	-57.4



Market capitalisation
Rs148.09bn (US$3.01bn)

Average (12M) daily turnover
Rs1003.22m (US$22.18m)

Sector: BSE Tech
RIC: RLCM.BO, RCOM IN
Priced Rs71.75 at close 30 Sep 2011.
Source: Bloomberg

We expect RCom's share of minutes to fall to 10.9% by FY14 from 12.7% in FY11 due to low brand visibility, limited network expansion and likely loss of CDMA subs. This would restrict the company's EBITDA CAGR to 7.5% in FY11-14. High financial leverage (net debt/EBITDA of 5.2x in FY11) poses a risk. Hold.

Key forecasts

	FY10A	FY11A	FY12F	FY13F	FY14F
Revenue (Rsm)	221,323	205,626	213,891	233,655	247,609
EBITDA (Rsm)	78,205	65,366	68,036	76,180	81,216
Reported net profit (Rsm)	46,550	13,457	4,254	7,539	8,363
Normalised net profit (Rsm)[1]	46,925	13,526	6,778	7,539	8,363
Normalised EPS (Rs)	22.73	6.55	3.28	3.65	4.05
Dividend per share (Rs)	0.85	0.50	0.00	0.00	0.00
Dividend yield (%)	1.18	0.70	0.00	0.00	0.00
Normalised PE (x)	3.16	10.95	21.85	19.64	17.71
EV/EBITDA (x)	5.07	7.43	7.12	6.02	5.14
Price/book value (x)	0.34	0.37	0.36	0.36	0.35
ROIC (%)	5.24	3.74	2.76	3.17	3.27

1. Post-goodwill amortisation and pre-exceptional items
Accounting standard: Local GAAP
Source: Company data, RBS forecasts

year to Mar, fully diluted

Minute CAGR restricted to 9.1% over FY11-14F owing to decline in MinMS

RCom's revenue market share (RMS) declined to 7.8% in 1Q12 despite its GSM foray (in 4Q09) and the reduction in competitive intensity over last few quarters. The company's minute market share (MinMS) dropped from 15.9% in FY09 to 12.7% in FY11, implying incremental MinMS of 8.2%. We expect RCom to capture 7.4% incremental MinMS over FY11-14, leading to a restricted minute CAGR of 9.1% to 487bn minutes, due to low brand visibility, limited network rollout, limited 3G footprint and likely loss of CDMA market share owing to mobile number portability (MNP). Hence, we expect RCom's MinMS to decline to 10.9% by FY14.

Low capex intensity; potential increase in coverage gap against peers

RCom's high financial leverage (net debt/EBITDA of 5.2x in FY11) has left little scope for aggressive network expansion. RCom's capex guidance stands at Rs15bn for FY12, significantly lower than listed peers. Lower capex intensity poses a risk of market share loss, as its network coverage gap against its peers could widen. Also, 3G footprint, restricted to 13 circles (46% of industry revenue), poses further risk of market share loss.

High financial leverage poses risk

RCom's high financial leverage remains a concern. Its net debt stood at Rs337bn and net debt/EBITDA at 5.2x in FY11. Debt repayment of US$1.7bn is scheduled over CY12. This includes FCCB repayment of US$1.18bn, maturing in February 2012. In our view, regulatory uncertainty has reduced the likelihood of equity dilution.

We initiate at Hold

We initiate at Hold with a 12-month target price of Rs67. Our fair value estimate for RCom is based on 5.6x EV/EBITDA (implying a 25% discount to Bharti's target India valuation multiple). We believe a discount to Bharti is justified owing to RCom's lower return profile.

This note should be read along with our sector report (*Ripe for profitable growth,* 3 October 2011) for a better understanding of the investment argument.
Important disclosures can be found in the Disclosures Appendix.

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The basics

Versus consensus

EPS (Rs)	RBS	Cons	% diff
2012F	3.3	5.4	-39%
2013F	3.7	7.9	-54%
2014F	4.1	10.7	-62%

Source: Bloomberg, RBS forecasts

Catalysts for share price performance

We see no near-term operational catalyst for share price performance and no visible turnaround in RCom's mobile business (accounting for around 81% of the company's revenue during FY11). We expect the mobile business to continue losing market share due to low brand visibility, limited network expansion, limited 3G footprint and likely loss of CDMA market share owing to MNP.

Earnings momentum

We forecast RCom's financial performance will lag behind its peers as it continues losing MinMS. Our forecast implies an FY11-14 CAGR of 7.5% for EBITDA. However, we expect EPS to decline by around 38% over this period owing to higher interest obligations.

Valuation and target price

We initiate on RCom with Hold rating and a 12-month target price of Rs67. We have discounted our fair value estimate for March 2013 by six months to derive a 12-month target price (September 2012). Our fair value estimate for RCom is based on 5.6x FY14F EV/EBITDA (implying a 25% discount to Bharti's mobile business). Our target price implies EV/EBITDA multiples of 6.0x FY13F and 5.2x FY14F. We factor in a possible negative Rs14 impact from one-time spectrum fees and spectrum renewal charges into our target price.

Forced ranking*

Company	Rec	Upside / Downside
Bharti	Buy	26%
Idea	Buy	23%
China Mobile	Buy	14%
RCom	Hold	-7%

* by difference to target price as at time of publication. Recommendations may lie outside the structure outlined in the disclosure page.
Source: RBS forecasts

How we differ from consensus

Our revenue and EBITDA forecasts are around 6% lower than Bloomberg consensus estimates. Our EPS estimates are around 50% below Bloomberg consensus estimates. We believe our estimates are significantly lower as we factor in interest payments going forward on the current non-interest bearing loan, which is scheduled for repayment (FCCB obligation of US$1.18bn in February 2012.

Risks to central scenario

Key risks to our target price and rating are:

- If the company is able to de-leverage significantly by raising equity at a higher-than-estimated fair value of the assets.
- Higher-than-expected MinMS performance.
- Higher-than-expected tariffs could lead to significant change in operating profits.

Key events

Date	Event
Oct-Nov, 2011	2Q FY12 results release
Oct-Nov, 2011	National Telecom Policy-2011 to be introduced

Source: Company data, Industry

Key assumptions and sensitivities

Table 1 : Key assumptions

	FY12F	FY13F	FY14F
MinMS (%)	11.5	11.0	10.9
Minutes (bn)	404	447	487
Blended RPM (p/min)	44.2	45.2	44.6
3G subs (m)	3	5	7
Churn rate (%)	4.0	4.0	3.8
Capex intensity (% of revenue)	9.5	9.3	8.9

Source: RBS forecasts

Table 2 : Sensitivity analysis

	Change	Target price Rs/sh	Change in TP	EBITDA Rsbn	Change in EBITDA
Base case		**67**		**81.2**	
Change in Voice RPM	+2.5%	75	13%	83.9	3%
	-2.5%	59	-13%	78.5	-3%
Change in MoU	+2.5%	71	6%	82.6	2%
	-2.5%	63	-6%	79.9	-2%

Source: RBS forecasts

Table 3 : Our forecasts are below consensus estimates

Rsm	FY12F			FY13F			FY14F		
	RBS	Consensus	Difference (%)	RBS	Consensus	Difference (%)	RBS	Consensus	Difference (%)
Revenue	213,891	225,127	**(5.0)**	233,655	248,536	**(6.0)**	247,609	264,156	**(6.3)**
EBITDA	68,036	72,191	**(5.8)**	76,180	81,283	**(6.3)**	81,216	88,828	**(8.6)**
PAT	6,778	11,182	**(39.4)**	7,539	16,261	**(53.6)**	8,363	21,995	**(62.0)**

Source: Bloomberg, RBS forecasts

Minute CAGR restricted to 9% over FY11-14

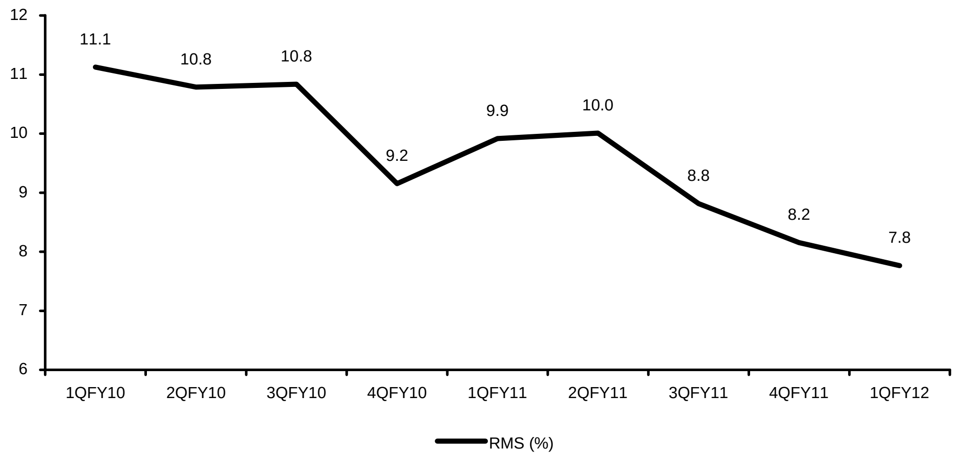
We expect RCom to lose minute market share due to low brand visibility, limited network rollout, limited 3G footprint and likely loss of CDMA market share owing to MNP.

RMS continues to decline....

RMS continues to decline despite GSM foray

RCom's revenue market share (RMS) decline has not been arrested despite its GSM foray and reduction in competitive intensity over last few quarters. As per TRAI, the company's RMS has dropped further to 7.8% in 1Q12.

Chart 1 : RMS declines to 7.8% in 1Q12



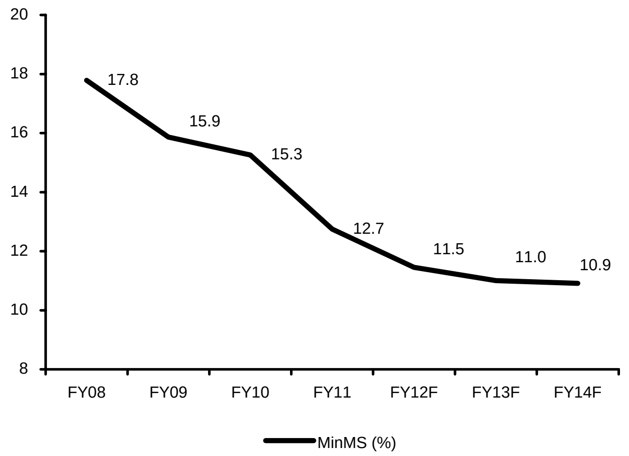
Source: TRAI

....led by decline in MinMS

Minute CAGR restricted to 9.1% due to MinMS share loss

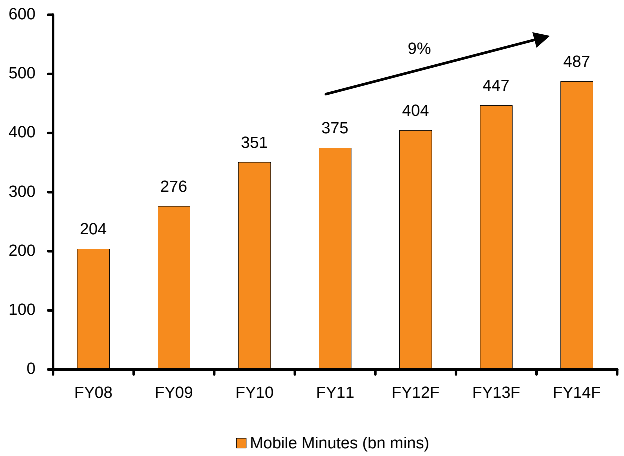
Since its GSM foray (in 4Q09), RCom's RMS and MinMS continued to decline. RCom's MinMS dropped from 15.9% in FY09 to 12.7% in FY11, implying incremental MinMS of 8.2% over FY09-11. We expect RCom to capture 7.4% incremental MinMS over FY11-14, leading to minute CAGR of 9.1% to 487bn minutes. This is led by low brand visibility, limited network rollout, limited 3G footprint and likely loss of CDMA market share due to MNP. Hence, we expect RCom's MinMS to decline to 10.9% by FY14.

Chart 2 : RCom expected to lose MinMS to 10.9% by FY14



Source: Company data, TRAI, RBS forecasts

Chart 3 : Minute CAGR restricted to around 9% over FY11-14



Source: Company data, RBS forecasts

Low capex intensity – potential increase in coverage gap against peers

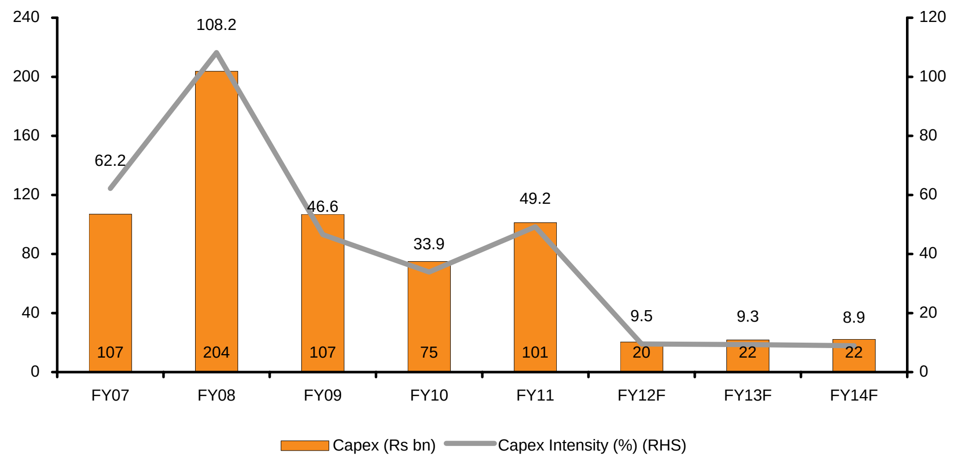
RCom's capex guidance stands at Rs15bn for FY12, significantly lower than listed peers. In our view, lower capex intensity poses a risk of market share loss, as the company's network coverage gap against peers could widen.

Capex intensity significantly lower than peers

RCom's high financial leverage (net debt/EBITDA of 5.2x in FY11) and weak operational performance leave little scope for aggressive network expansion. The company's capex guidance stands at Rs15bn for FY12, significantly lower than listed peers (Idea's capex guidance is Rs40bn for stand-alone business and Bharti's capex guidance is Rs68bn for India stand-alone business). This indicates the company's lower capex intensity poses further risk of market share loss, as its network coverage gap could increase against peers, in our opinion.

In addition, RCom won 3G spectrum in 13 circles (46% of industry revenue). The company has not entered into any intra-circle roaming (ICR) arrangement with another operator to provide 3G services in its non-footprint circles. This would potentially lower its addressable market size in the wireless broadband market. In our view, sporadic 3G network coverage and lack of roaming facility on 3G (pan-India) would be a potential bottleneck to attract high ARPU customers. This poses further risk of market share loss in the wireless broadband market. In addition, we believe failure to get 3G service (coupled with launch of MNP) could potentially lead to loss of current subs base.

Chart 4 : Capex intensity drops to 9-9.5% of revenue



Source: Company data, RBS forecasts

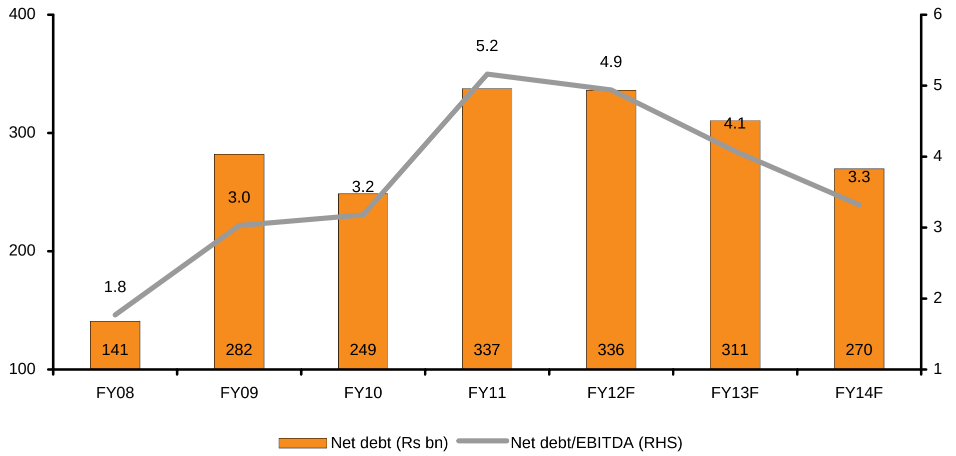
High financial leverage poses risk

RCom's high financial leverage (net debt/EBITDA at 5.2x) remains a concern to us. In our view, regulatory uncertainty has reduced the likelihood of equity dilution.

RCom's high financial leverage remains a concern to us. Its net debt stood at Rs337bn and net debt/EBITDA at 5.2x in FY11. Debt repayment of US$1.7bn is scheduled over CY12. This includes FCCB repayment maturing in February 2012, amounting to US$1.18bn. In addition, we believe regulatory uncertainty has reduced the likelihood of equity dilution, which RCom expected to reduce the company's financial leverage.

FCCB repayment of US$1.18bn due in February 2012

Chart 5 : High net debt and Net debt/EBITDA



Source: Company data, RBS forecasts

Table 4 : Debt re-payment of USD1.7bn by December 2012

Issue date	Type	Maturity date	Amount ($m)	Redemption premium (%)	Amount payable ($m)
Feb-07	FCCB	Feb-12	925	28	1,182
Mar-07	ECB	May-12	250		250
Mar-07	ECB	Dec-12	250		250
Total					**1,682**

Source: RBI, Company data

Initiate at Hold – no visible turnaround

We see no near-term operational catalyst and no visible turnaround in RCom's mobile business. We initiate at Hold.

We initiate on RCom with Hold rating and a 12-month target price of Rs67. We discounted our fair value estimate of March 2013 by six months to derive a 12-month target price (September 2012). Our fair value estimate for RCom is based on 5.6x FY14F EV/EBITDA (implying a 25% discount to Bharti's target India mobile business valuation multiple). We prefer to value India telco services stocks using EV/EBITDA rather than PE since depreciation policies differ across peers and the companies are at different stages of maturity. Our target price implies EV/EBITDA multiples of 6.0x FY13F and 5.2x FY14F.

Weak operational performance limits upside

We believe the discount to Bharti is justified, given RCom's lower return profile, its performance lags behind its peers, it continues to lose MinMS, inherent risk of dual network and weaker financial performance (EBITDA CAGR 7.5% over FY11-14E). In addition, RCom's high financial leverage poses additional risk. We believe re-rating for RCom could happen if it is able to raise fresh equity (at a parent level or in its tower subsidiary) at higher than its fair value. However, regulatory uncertainty has reduced the likelihood of equity dilution, in our view.

Table 5 : RCom's 12-month target price

EBITDA (Rsm)	81,216
EV/EBITDA (x)	5.6
Enterprise Value (Rsm)	458,869
Less: Net Debt & minority interest (Rsm)	281,666
Equity Value (Rsm)	**177,204**
No. of shares (m)	2,064
Equity value per share (Rs)	86
Less: Impact of spectrum charges (Rs/share)	14
RCom's fair value (Mar-13)	71
Our RCom 12-month target price (Sep-12)	**67**

Source: RBS forecasts

Table 6 : Implied valuation at target price

	FY13F	FY14F
Target price (Rs)	67	67
EPS (Rsm)	3.7	4.1
Implied PE (x)	**18**	**17**
EV (Rsbn)	461	420
EBITDA (Rsm)	76	81
Implied EV/EBITDA (x)	**6.0**	**5.2**

Source: RBS forecasts

Management team

Table 7 : Management team

Name	Designation	Qualification & experience
Anil D. Ambani	Chairman	He holds BSc from Bombay University and MBA from Wharton School. He joined Reliance in 1983 as Co-CEO. He is the chairman of Reliance Capital, Reliance Infra & Reliance Power Limited. He is also on the board of Reliance Infratel Limited and Reliance Anil D. Ambani Group Limited.
Syed Safawi	President, Wireless Business	He holds MBA from Wharton School, USA and he brings in 22 years of experience across the FMCG and telecoms space. Before joining RCom he was executive director at Bharti Airtel. Mr Safawi had been handling Bharti Airtel's international operations and its eastern and western circles. Prior to Airtel, he spent 11 years at Coca-Cola Co.

Source: Company data

Income statement

Rsm	FY10A	FY11A	FY12F	FY13F	FY14F
Revenue	221323	205626	213891	233655	247609
Cost of sales	-143118	-140261	-145855	-157475	-166393
Operating costs	-182063	-207436	n/a	n/a	n/a
EBITDA	**78205**	**65366**	**68036**	**76180**	**81216**
DDA & Impairment (ex gw)	-37465	-39398	-42055	-46129	-50961
EBITA	**40740**	**25967**	**25981**	**30051**	**30255**
Goodwill (amort/impaired)	n/a	n/a	n/a	n/a	n/a
EBIT	**40740**	**25967**	**25981**	**30051**	**30255**
Net interest	-14587	-9558	-14224	-17136	-16136
Associates (pre-tax)	n/a	n/a	n/a	n/a	n/a
Forex gain / (loss)	26450	-1164	n/a	n/a	n/a
Exceptionals (pre-tax)	-374.7	-69.0	-2524	0.00	0.00
Other pre-tax items	0.00	-0.00	0.00	0.00	0.00
Reported PTP	**52228**	**15176**	**9233**	**12916**	**14120**
Taxation	-4454	-117.9	-2351	-2583	-2824
Minority interests	-1224	-1602	-2628	-2793	-2933
Exceptionals (post-tax)	n/a	n/a	n/a	n/a	n/a
Other post-tax items	-0.00	0.00	0.00	0.00	0.00
Reported net profit	**46550**	**13457**	**4254**	**7539**	**8363**
Normalised Items Excl. GW	-374.7	-69.0	-2524	0.00	0.00
Normalised net profit	**46925**	**13526**	**6778**	**7539**	**8363**

Source: Company data, RBS forecasts — year to Mar

Balance sheet

Rsm	FY10A	FY11A	FY12F	FY13F	FY14F
Cash & market secs (1)	48585	53272	16606	22173	42961
Other current assets	113388	115984	118576	120481	121187
Tangible fixed assets	712539	729409	707730	683388	654570
Intang assets (incl gw)	49976	47473	47473	47473	47473
Oth non-curr assets	1199	1089	1089	1089	1089
Total assets	**925686**	**947227**	**891474**	**874605**	**867281**
Short term debt (2)	n/a	n/a	n/a	n/a	n/a
Trade & oth current liab	147085	106018	83339	78245	81859
Long term debt (3)	297154	390714	352714	332714	312714
Oth non-current liab	41257	37259	37931	38616	39315
Total liabilities	**485496**	**533990**	**473983**	**449575**	**433887**
Total equity (incl min)	440190	413237	417491	425030	433393
Total liab & sh equity	**925686**	**947227**	**891474**	**874605**	**867281**
Net debt	248569	337442	336108	310541	269753

Source: Company data, RBS forecasts — year ended Mar

Cash flow statement

Rsm	FY10A	FY11A	FY12F	FY13F	FY14F
EBITDA	78205	65366	68036	76180	81216
Change in working capital	25293	-35020	-24599	-6314	3607
Net interest (pd) / rec	-14408	-13624	-16978	-17136	-16136
Taxes paid	-4454	-117.9	-2351	-2583	-2824
Other oper cash items	-3084	-5878	-2628	-2793	-2933
Cash flow from ops (1)	**81552**	**10726**	**21479**	**47354**	**62930**
Capex (2)	-74960	-103273	-20376	-21787	-22143
Disposals/(acquisitions)	1.30	2064	0.00	0.00	0.00
Other investing cash flow	56572	36630	4839	0.00	0.00
Cash flow from invest (3)	**-18387**	**-64579**	**-15537**	**-21787**	**-22143**
Incr / (decr) in equity	0.00	0.00	n/a	n/a	n/a
Incr / (decr) in debt	-69898	96356	-38000	-20000	-20000
Ordinary dividend paid	-1911	-2025	0.00	0.00	0.00
Preferred dividends (4)	n/a	n/a	n/a	n/a	n/a
Other financing cash flow	n/a	n/a	n/a	n/a	n/a
Cash flow from fin (5)	**-71809**	**94331**	**-38000**	**-20000**	**-20000**
Forex & disc ops (6)	0.00	0.00	n/a	n/a	n/a
Inc/(decr) cash (1+3+5+6)	**-8644**	**40478**	**-32058**	**5567**	**20788**
Equity FCF (1+2+4)	6592	-92547	1103	25567	40788

Lines in bold can be derived from the immediately preceding lines. — year to Mar
Source: Company data, RBS forecasts

Standard ratios

Performance	Reliance Comm FY10A	FY11A	FY12F	FY13F	FY14F	Bharti Airtel FY12F	FY13F	FY14F	Idea Cellular FY12F	FY13F	FY14F
Sales growth (%)	-3.56	-7.09	4.02	9.24	5.97	20.3	13.9	9.78	27.9	23.2	12.4
EBITDA growth (%)	-16.0	-16.4	4.08	12.0	6.61	26.4	19.2	10.2	36.6	38.0	15.5
EBIT growth (%)	-28.5	-36.3	0.05	15.7	0.68	25.3	27.1	9.65	68.3	63.2	23.6
Normalised EPS growth (%)	-22.5	-71.2	-49.9	11.2	10.9	-0.63	42.2	15.0	-1.55	100.1	41.7
EBITDA margin (%)	35.3	31.8	31.8	32.6	32.8	35.3	36.9	37.0	25.8	28.9	29.7
EBIT margin (%)	18.4	12.6	12.1	12.9	12.2	17.1	19.1	19.1	11.3	15.0	16.5
Net profit margin (%)	21.2	6.58	3.17	3.23	3.38	8.41	10.5	11.0	4.49	7.30	9.20
Return on avg assets (%)	6.32	2.63	2.26	2.72	2.78	5.61	6.91	7.20	5.15	7.99	9.54
Return on avg equity (%)	11.0	3.23	1.66	1.83	1.99	11.9	15.2	15.2	7.05	12.9	15.8
ROIC (%)	5.24	3.74	2.76	3.17	3.27	7.39	9.44	10.3	6.79	10.0	12.3
ROIC - WACC (%)	-7.36	-8.87	-9.85	-9.43	-9.33	-3.32	-1.28	-0.41	-3.66	-0.43	1.87
					year to Mar			year to Mar			year to Mar
Valuation											
EV/sales (x)	1.79	2.36	2.26	1.96	1.69	2.82	2.40	2.07	2.26	1.77	1.48
EV/EBITDA (x)	5.07	7.43	7.12	6.02	5.14	7.99	6.51	5.60	8.78	6.12	4.99
EV/EBITDA @ tgt price (x)	4.95	7.28	6.97	5.89	5.02	9.45	7.73	6.71	10.2	7.18	5.90
EV/EBIT (x)	9.74	18.7	18.6	15.3	13.8	16.5	12.6	10.9	20.0	11.8	8.97
EV/invested capital (x)	0.58	0.64	0.64	0.62	0.59	1.78	1.69	1.61	1.77	1.69	1.59
Price/book value (x)	0.34	0.37	0.36	0.36	0.35	2.75	2.39	2.06	2.54	2.23	1.90
Equity FCF yield (%)	4.45	-62.5	0.75	17.3	27.5	1.69	4.42	7.42	-4.83	5.04	7.83
Normalised PE (x)	3.16	10.95	21.85	19.64	17.71	23.89	16.80	14.61	36.78	18.38	12.97
Norm PE @tgt price (x)	2.95	10.2	20.4	18.3	16.5	30.0	21.1	18.4	45.2	22.6	15.9
Dividend yield (%)	1.18	0.70	0.00	0.00	0.00	0.26	0.26	0.26	0.00	0.00	0.00
					year to Mar			year to Mar			year to Mar

Per share data	FY10A	FY11A	FY12F	FY13F	FY14F
Tot adj dil sh, ave (m)	2064	2064	2064	2064	2064
Reported EPS (INR)	22.6	6.52	2.06	3.65	4.05
Normalised EPS (INR)	22.73	6.55	3.28	3.65	4.05
Dividend per share (INR)	0.85	0.50	0.00	0.00	0.00
Equity FCF per share (INR)	3.19	-44.8	0.53	12.4	19.8
Book value per sh (INR)	210.1	196.2	198.3	201.9	206.0
					year to Mar

Solvency	FY10A	FY11A	FY12F	FY13F	FY14F
Net debt to equity (%)	56.5	81.7	80.5	73.1	62.2
Net debt to tot ass (%)	26.9	35.6	37.7	35.5	31.1
Net debt to EBITDA	3.18	5.16	4.94	4.08	3.32
Current ratio (x)	1.10	1.60	1.62	1.82	2.01
Operating CF int cov (x)	6.97	1.80	2.40	3.91	5.08
Dividend cover (x)	24.6	6.68	0.00	0.00	0.00
					year to Mar

Priced as follows: RLCM.BO - Rs71.75
Source: Company data, RBS forecasts

Valuation methodology – EV/EBITDA valuations

EBITDA (Rsm)	81,216
EV/EBITDA (x)	5.6
Enterprise Value (Rsm)	458,869
Less: Net Debt & minority interest (Rsm)	281,666
Equity Value (Rsm)	**177,204**
No. of shares (m)	2,064
Equity value per share (Rs)	86
Less: Impact of spectrum charges (Rs/share)	14
RCom's fair value (Mar-13)	71
RCom's 12-month target price (Sep-12)	**67**

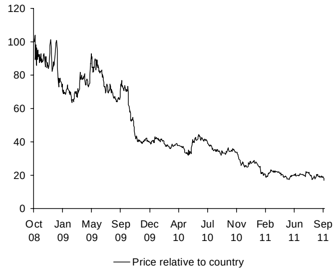
Source: RBS estimates

Company description

Hold

Reliance Communications is a leading integrated telecom service provider in India, with 136m wireless subs as of FY11. Its wireless subs market share is 17% and its wireless revenue market share is 9.2%. It serves consumer, enterprise and carrier customers. It provides a full spectrum of wireless (both GSM and CDMA services), wire line, long-distance voice and data, video and Internet communication services. It also offers direct-to-home (DTH) TV. Subsidiary Reliance Infratel had a tower portfolio of 50,000 as of Mar-11. The company is part of the Anil Dhirubhai Ambani group.

Price relative to country



Strategic analysis

Average SWOT company score: 3

Strengths — 3

The company has a Pan-India network coverage with 50,000 cell sites and offers mobile services across both technologies (GSM and CDMA).

Weaknesses — 1

Due to the company's late entry into GSM services (preferred technology in India), its quality of subs base is weaker compared with incumbent GSM operators, reflected by its revenue market share of 9.2% as of FY11 (versus subs market share of 16.7%).

Opportunities — 4

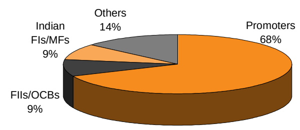
The company operates in India's telecom market, which remains under-penetrated with 48% active subs penetration. India's fixed wireless penetration is less than 1%, and wireless broadband (with launch of 3G services) offers significant growth opportunity for the company.

Threats — 2

Loss of CDMA mobile revenue owing to MNP and low barriers for subscribers to shift across technology. Unfavourable changes in licensing conditions (over spectrum pricing and allocation, spectrum re-farming, rollout obligation). Increase in competitive intensity in wireless broadband market.

Scoring range is 1-5 (high score is good)

Shareholding pattern



Source: BSE

Market data

Headquarters
H Block, 1st Floor, Dhirubhai Ambani Knowledge City, Navi Mumbai 400 071

Website
www.rcom.com

Shares in issue
2064.0m

Freefloat
32%

Majority shareholders
Promoter group (68%), LIC (7%), Ontario Teachers Pension Plan Board (2%)

Country view: India

The compression of multiples typically characteristic of a market undergoing the transition from growth to value continued to pressure Indian equities in the 2Q. While the economic deceleration is well under way, we continue to view the country as a major potential loser from higher costs of capital in quarters and perhaps even years ahead. Still, given the significant short-term relative underperformance and the expected decline in commodities prices, clearly a bounce is possible. Yet, as valuations are broadly unattractive and returns declining, we continue to consider the risk-reward trade-off as unattractive.

The country view is set in consultation with the relevant company analyst but is the ultimate responsibility of the Strategy Team.

Country rel to Asia Pacific

Competitive position

Average competitive score: 3+

Supplier power — 4+

2G equipment is largely commoditised, given the maturity of the technology. The rise of Chinese players intensified price competition and greatly reduced the pricing power of European suppliers.

Barriers to entry — 4+

During 2008, new licences were rewarded, removing barriers to entry. However, significant capital investment is required to compete with incumbent operators, acting as a barrier to entry.

Customer power — 2-

With 8-plus operators in most circles, tariffs in India are low. However, MNP has enabled CDMA subs base to shift across technologies with no barriers to shift.

Substitute products — 4+

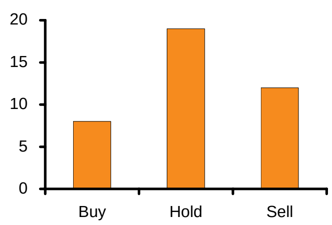
Mobile telephony tariffs in India are among the lowest worldwide and eat into the share of fixed-line telephony. Internet-based telephony has not had an impact, as PC penetration is very low.

Rivalry — 3+

We expect consolidation in the industry in FY13/FY14 as merger and acquisition guidelines, and spectrum sharing and spectrum trading guidelines are laid out in upcoming National Telecom Policy 2011.

Scoring range 1-5 (high score is good) Plus = getting better Minus = getting worse

Broker recommendations



Source: Bloomberg

Recommendation structure

Absolute performance, short term (trading) recommendation: A Trading Buy recommendation implies upside of 5% or more and a Trading Sell indicates downside of 5% or more. The trading recommendation time horizon is 0-60 days. For Australian coverage, a Trading Buy recommendation implies upside of 5% or more from the suggested entry price range, and a Trading Sell recommendation implies downside of 5% or more from the suggested entry price range. The trading recommendation time horizon is 0-60 days.

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and, except as follows, only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%. For UK-based Investment Funds research, the recommendation structure is not based on upside/downside to the target price. Rather it is the subjective view of the analyst based on an assessment of the resources and track record of the fund management company. For research on Australian listed property trusts (LPT) or real estate investment trusts (REIT), the recommendation is based upon total return, ie, the estimated total return of capital gain, dividends and distributions received for any particular stock over the investment horizon.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

Distribution of recommendations

The tables below show the distribution of recommendations (both long term and trading). The first column displays the distribution of recommendations globally and the second column shows the distribution for the region. Numbers in brackets show the percentage for each category where there is an investment banking relationship. These numbers include recommendations produced by third parties with which RBS has joint ventures or strategic alliances.

Long term recommendations (as at 03 Oct 2011)

	Global total (IB%)	Asia Pacific total (IB%)
Buy	853 (11)	553 (3)
Hold	408 (7)	224 (4)
Sell	87 (5)	48 (0)
Total (IB%)	1348 (9)	825 (3)

Source: RBS

Trading recommendations (as at 03 Oct 2011)

	Global total (IB%)	Asia Pacific total (IB%)
Trading Buy	1 (100)	1 (100)
Trading Sell	1 (0)	1 (0)
Total (IB%)	2 (50)	2 (50)

Source: RBS

Valuation and risks to target price

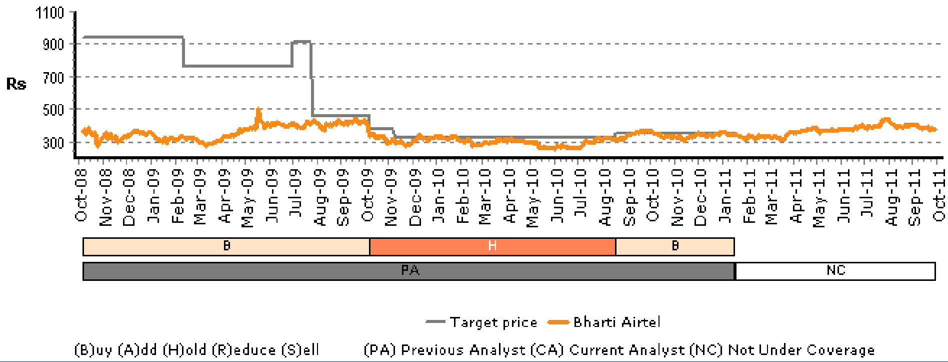
Bharti Airtel (RIC: BRTI.BO, Rec: Buy, CP: Rs378.00, TP: Rs475.00): Our target price is based on SOTP valuation methodology, comprising EV/EBITDA values for the core businesses. We discounted our SOTP-based FV of Mar-13 by six months to derive a 12-month target price (Sept-12). Key risks to our target price and rating: 1) higher-than-expected impact from one-time spectrum fees and spectrum renewal charges; 2) lower-than-expected tariffs; and 3) lower-than-expected minute market share performance.

Idea Cellular (RIC: IDEA.BO, Rec: Buy, CP: Rs98.50, TP: Rs121.00): Our target price is based on SOTP valuation methodology, comprising EV/EBITDA values for the core businesses. Idea's mobile business is valued at a slight discount to Bharti's India mobile business valuation multiple. Key downside risks: 1) a higher-than-expected impact from one-time spectrum fees and spectrum-renewal charges; 2) lower-than-expected tariffs; 3) lower-than-expected minute market share performance; and 4) higher-than-expected competitive intensity.

Reliance Communications (RIC: RLCM.BO, Rec: Hold, CP: Rs71.75, TP: Rs67.00): Our fair value estimate is based on a 25% discount to Bharti's India mobile business EV/EBITDA target valuation multiple. Key upside risks to our target price include: 1) if the company is able to de-leverage significantly by raising equity at higher-than-estimated fair value of the assets; 2) a higher-than-expected minute market share performance; and 3) higher-than-expected tariffs. Key downside risks: 1) lower-than-expected tariffs; and 2) lower-than-expected minute market share.

Bharti Airtel coverage data

Stock performance, recommendations and coverage (as at 3 Oct 2011)



Piyush Choudhary started covering this stock on 3 Oct 11. Moved to new recommendation structure between 1 November 2005 and 31 January 2006. Source: RBS

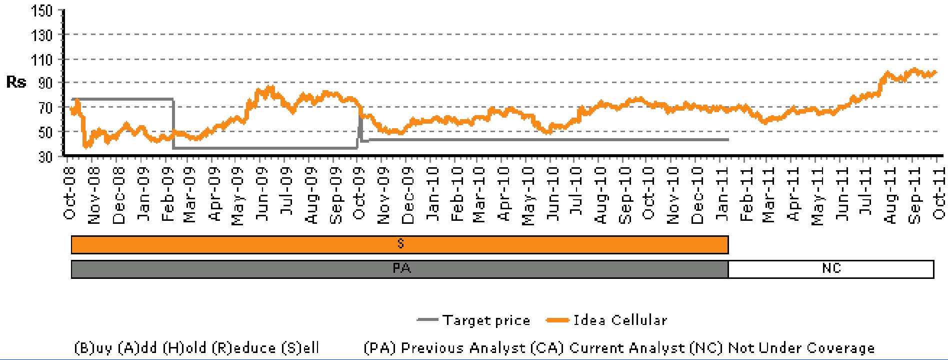
Trading recommendation history (as at 03 Oct 2011)

Date	Rec	Analyst
	n/a	

Source: RBS

Idea Cellular coverage data

Stock performance, recommendations and coverage (as at 3 Oct 2011)



Piyush Choudhary started covering this stock on 3 Oct 11. Moved to new recommendation structure between 1 November 2005 and 31 January 2006. Source: RBS

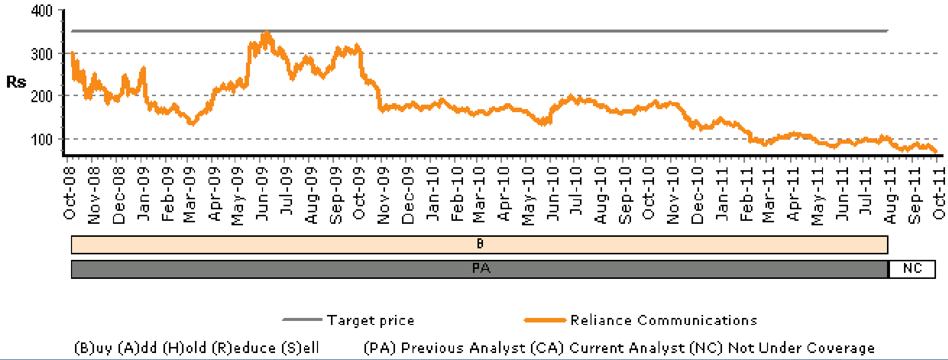
Trading recommendation history (as at 03 Oct 2011)

Date	Rec	Analyst
	n/a	

Source: RBS

Reliance Communications coverage data

Stock performance, recommendations and coverage (as at 3 Oct 2011)



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Trading recommendation history (as at 03 Oct 2011)

Date	Rec	Analyst
	n/a	

Source: RBS

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