

11 Jan 2011

Telecom

Q3FY11 Preview

Overweight

Margins likely to be under pressure

We expect improvements in telecom companies' revenue growth on a QoQ basis in Q3FY11 due to the seasonality factor (the industry registers more minutes contribution during H2 than H1) and a recovery in subscriber addition during the quarter. However, we expect increased pressure on operating margins due to higher SG&A expenses incurred on account of mobile number portability (MNP) and 3G services (increased ad spend relating to MNP opportunity, 3G services and Bharti Airtel's launch of 'Airtel' brand in Africa). Net profit is expected to see a decline due to higher interest and depreciation expenses.

- **Sequential revenue growth to re-emerge:** We expect revenue to grow by 2-10% QoQ, on the back of minutes growth and lower fall in revenue per minute. Q3FY11 witnessed bounce back in subscriber growth.
- **EBITDA margins to be under pressure:** We expect EBITDA margins to remain low on a QoQ basis, as we see the higher SG&A expenses on account of MNP, 3G services related marketing spend. Bharti is likely to see a decline in EBITDA margin it launched its 'Airtel' brand across African countries.
- **PAT likely to fall:** We expect telcos to register a decline in net profit on higher interest and depreciation expenses. We expect net debt to rise for companies this quarter on higher capex. We have not factored in forex gain/loss in our estimates.
- **Bharti Airtel remains our top pick:** Bharti Airtel continues to be our best pick in the sector on account of improvement in the competitive pressure in the domestic market, potential of volume growth with stable pricing scenario, growth prospects in the Africa regions and highest return ratios among peers. Further, the company is not going to get impacted from regulatory stand-point and current 2G license/spectrum related issues.

Price Performance (%)

	1M	6M	1Yr
Bharti Airtel	3.9	11.4	4.5
Idea Cellular	(3.7)	0.7	8.3
RCom	11.0	(27.7)	(23.2)
Tulip Telecom	(1.9)	(3.7)	(19.9)
NIFTY	(1.8)	7.5	9.6

Source: Bloomberg, Centrum Research
*as on 11 January 2011

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Summary Estimates

Y/E Mar (Rsmn)	Net Sales (Rsmn)				EBITDA (Rsmn)				EBITDA Margin (%)		Adj. PAT (Rsmn)			
	Q3FY11E	YoY (%)	QoQ (%)	FY11E	Q3FY11E	YoY (%)	QoQ (%)	FY11E	Q3FY11E	Q3FY10	Q3FY11E	YoY (%)	QoQ (%)	FY11E
Bharti Airtel	154,402	49.8	1.5	583,999	50,454	23.6	(1.5)	196,160	32.7	39.6	16,181	(26.3)	(2.6)	59,753
Idea Cellular	39,855	27.1	9.6	158,989	8,952	11.8	4.5	37,817	22.5	25.5	1,273	(25.2)	(29.2)	8,548
RCom	52,590	(1.0)	2.7	208,607	17,087	(5.7)	3.0	67,772	32.5	34.1	2,341	(78.9)	(47.5)	13,402
Tulip Telecom	5,689	13.6	(2.8)	22,483	1,570	16.3	(3.9)	6,097	27.6	27.0	760	10.8	(2.6)	2,829

Source: Company, Centrum Research Estimates

Please refer to important disclosures/disclaimers in Appendix A

Bharti Airtel (Buy; Target Price: Rs424)

- We expect Bharti to register 12.9% YoY (and 2.8% QoQ) revenue growth to Rs154bn in Q3FY11 on the back of an increase in minutes growth
- We expect average revenue per user (ARPU) to amount to Rs197 vs Rs202 in Q2FY11 for the domestic market
- We expect the company to report an operating margin of 32.7% at the consolidated level, as the Africa business would take time to show improvement in operating profit margin. Further, the launch of its 'Airtel' brand in Africa would restrict margin expansion
- We expect net profit to decline 2.6% QoQ to Rs16bn on the back of lower operating margin, higher depreciation and interest expense

Idea Cellular (Buy; Target Price: Rs92)

- We expect net sales to grow 27.1 YoY (and 9.6% QoQ) to Rs39.8bn, driven by growth in minutes of usage. During the quarter, the company witnessed a bounce back in subscriber additions
- We expect EBIDTA margin to be lower at 22.5% (vs 25.5% in Q3FY10) on account of higher SG&A expenses. The company is trying to benefit from MNP implementation
- We expect net profit to decline by 25.2% YoY (29.2% QoQ) to Rs1.3bn on the back of higher interest expenses. Also, we have assumed a higher tax rate of 27.7%, vs 7.4% in Q2FY11

Reliance Communications (Buy; Target Price: Rs167)

- We expect RCom's Q3FY11 revenue to decline 1% YoY (and 2.7% QoQ). Post the clean-up of free minutes from the system in the last quarter, along with slower fall in revenue per minute, we believe that revenue growth would be more aligned to minute growth
- We expect operating profit margin to remain flat at 32.5% as we expect the benefits of scale getting negated by higher operating expenses
- We expect net profit to decline by 78.9% YoY (and 47.5% QoQ) to Rs2.3bn on the back of flat operating margin, higher depreciation and interest expenses

Tulip Telecom (Buy; Target Price: Rs206)

- We expect net sales to register 13.6% YoY growth in revenue, backed by growth in fibre-based revenue. Based on strong traction in the business, we see a possibility of upward revision in our estimates for FY11E
- A change in sales mix in favor of fibre would help expand operating profit margin to 27.6% from 27% in Q3FY10
- We expect net profit to grow 10.8% YoY to Rs760mn on the back of higher sales and expansion in operating profit margin

Summary valuations

Y/E March	Rating	Target Price (Rs)	CMP* (Rs)	Mkt Cap (Rsbn)	EPS (Rs)			P/E (x)			P/BV (x)			EV/EBITDA (x)		
					FY10A	FY11E	FY12E	FY10A	FY11E	FY12E	FY10A	FY11E	FY12E	FY10A	FY11E	FY12E
Bharti Airtel	Buy	424	339	1,289	18.5	19.7	26.2	18.3	17.2	12.9	2.7	2.3	2	10.4	8	6.4
Idea Cellular	Buy	92	67	222	2.6	1.8	3.4	26.1	37.4	19.7	1.8	1.7	1.6	9.3	7.2	5.9
Reliance Comm.	Buy	167	139	287	5.8	6.4	12.9	24.1	21.6	10.8	0.7	0.7	0.7	9.4	7.5	5.7
Tulip Telecom	Buy	206	174	25	17.4	20.1	21.6	10.3	8.9	8.3	2.2	1.8	1.4	6.1	5.2	4.5

Note: *CMP as on 10 Jan 2011

Source: Company, Centrum Research Estimates

Appendix A

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