

3G roaming pact cancellation impact

Media reports cite Department of Telecom secretary R Chandrashekhar as saying that 3G roaming pacts between telecom operators are illegal and that all such pacts should be annulled. So far, the government has not imposed any penalty. If a decision to disqualify roaming pacts is taken, it will adversely affect Bharti, Idea, and Vodafone the most, as they were the first to launch such services under a roaming pact. They may have to spend more to acquire spectrum and licenses in the future.

Limited impact on topline: If the 3G pacts are cancelled, we do not expect any significant impact on revenues in FY12-13 as 3G's revenue share is currently less than 2% and we expect it to remain below 4% till FY14 at least. Bharti and Idea have 65% and 74% of their existing customers in 3G circles. (Exhibit 1)

Idea's margins to improve slightly in the short run: These are likely to improve in H1CY12 as roaming and access charges pertaining to 3G will go away. In Q2FY12, these charges had risen by almost 8% qoq (17% of revenue from 16%). A jump in new-circles EBITDA losses to Rs1.8bn in Q2FY12 from Rs1.4bn in Q3 was also due to 3G roaming fees. We do not expect much impact on Bharti's financials as Bharti already has a presence in all the metros where 3G usage is concentrated.

NTP-11 may provide relief: Draft NTP-11 talks of technology-neutral services delivery and spectrum sharing. If these provisions are implemented, any operator would be able to share spectrum to offer 3G/4G services. However, NTP-11 is still in the consultation phase and is not likely to become a reality before FY13.

Buying 3G spectrum will be expensive: If Bharti has to buy spectrum at the 2010 3G auction prices in its remaining 9 circles (where roaming was active), it will have to shell out Rs44.6bn. Idea will have to spend Rs109.8bn for its 11 circles (Exhibit 2).

Valuation and outlook: Bharti trades at 8x FY12 EV/EBITDA and 22x P/E. Maintain Buy with target price of Rs467 (40% upside). Idea trades at 8x EV/EBITDA and 42x P/E. Maintain Add with a price target of Rs100. We remain positive on telecom based on current players' ability to gain revenue market share despite weakness in subscriber market share, falling competition leading to higher tariffs, and more revenue from 3G. Implementing NTP-11 recommendations (final report expected early 2012) will offer a stable regulatory regime.

Sushil Sharma

+91 22 6636 0073

sushil.sharma@bricssecurities.com

Pranav Kshatriya

+91 22 6636 0093

pranav.kshatriya@bricssecurities.com

Peer valuation

(Rs mn)

Company	CMP (Rs)	Net sales		EBITDA		Net profit		EV/EBITDA (X)		P/E (X)		Rating
		FY12E	FY13E	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E	
Bharti Airtel	333	712,541	825,835	244,716	304,582	57,462	101,579	7.9	6.3	22.0	12.4	BUY
Idea Cellular	82	193,335	231,530	50,557	63,424	6,425	11,848	7.8	6.2	42.7	23.1	ADD

Source: BRICS Research

Exhibit 1: Impact of 3G roaming pact being cancelled

	No of Circles	License Fee (Rs bn)	Total Customers (mn)	Customers in circles with 3G coverage(mn)	3G circle customers proportion	Revenue in Q2FY12 from all circles (As per TRAI, Rsbn)	Revenue in Q2FY12 for 3G circles (As per TRAI, Rsbn)	3G circle revenue proportion
Bharti	13	123.0	174.7	113.2	65%	100.8	69.7	69%
Idea	11	57.7	104.0	77.0	74%	46.9	35.4	75%

Source: TRAI, BRICS Research

Exhibit 2: 3G spectrum at 2010 cost (Rs bn)

Company	Existing circles		Remaining circles	
	Nos	Amount	Nos	Amount
Bharti	13	123.0	9	44.6
Idea	11	57.7	11	109.8
Vodafone	9	116.2	13	51.3

Source: DoT, BRICS Research

BRICS RECOMMENDATION SCALE

BUY:	More than 15% upside
ADD:	Upside up to 15% (between 0% and 15%)
REDUCE:	Downside up to 15% (between 0% and -15%)
SELL:	More than 15% downside

Head Office: Sadhana House, 1st Floor, 570, P. B. Marg, Behind Mahindra Tower, Worli, Mumbai - 400 018. Tel: (91-22) 6636 0000

Disclaimer: This Report/Document has been prepared solely for your information. All reasonable care has been taken to ensure that the information contained herein is not misleading or untrue at the time of publication, but we make no representation as to its accuracy or completeness. All information is for private use of the person to whom it is provided and is not for public distribution and without any liability whatsoever on the part of BRICS Securities Limited, any associated company, or employee thereof (hereinafter collectively referred to as BRICS). This Report/Document shall not be copied, printed, distributed or re-distributed to any person. If you are not the intended recipient of this Report/Document, you should immediately send it to the sender. Nothing contained herein should be construed as an offer to buy or sell or a solicitation of an offer to buy or sell. The value of any investment may fall as well as rise. Past performance is no guide to the future. The rate of exchange between currencies may cause value of investment to increase or diminish; consequently investors may not get back full value of their original investment.

BRICS shall not be liable for any direct or indirect losses arising from action initiated by you on the basis of information provided in this Report/Document and BRICS accepts no responsibility for statements made or any other source of information received by you and you would be doing so at your own risk.

This Report/Document is not directed or intended for distribution to or use by any person or entity who is a US citizen or person resident in US or who is a citizen/resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject BRICS to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to a certain category of investors. Persons in whose possession this presentation may come are required to inform themselves of and to observe such restrictions.