Deutsche Bank
Markets Research

Asia
India

Telecommunications

Industry
Indian Telecom Sector

Date
06 December 2011

Forecast Change

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Cashflow cake in sight, but government demands a bigger slice

Policy is the key risk for Indian telcos
Indian telcos are forced to contend with significant policy flux in an improving competitive environment. We expect mobile revenues to grow at 15-16% YoY, aided by 3-4% growth in revenue/minute and 12-13% YoY growth in minutes. Higher tariffs should drive 200-400bps margin expansion by FY14E. However, we assume negative impact of policy shifts on incumbents as our base case. Based on strength of balance sheet, cash flows and relative impact of likely regulatory costs, our ladder of preference is Bharti, Idea and RCOM.

Bharti – Strong FCF and African operations would temper policy risk
Our Buy rating on Bharti reflects its strong competitive position and relative resilience to global factors. We highlight its improving business momentum in India, driven by tariff increases and 3G rollout, and solid progress in African operations. Our FY12E/13E/14E EPS estimates are Rs14.8/25/34.4. Key metrics to watch: India revenue growth (est: 15% YoY), FCF in African operations (est: $-500m). We maintain Buy (target price Rs420).

Idea – Robust performance but burden of regulatory costs could be onerous
Idea's operating performance has been the strongest among incumbents. It has increased its revenue share and improved its cost position relative to sector leader Bharti. The two concerns on Idea are that compared to its peers it has: a) relatively higher impact of likely regulatory costs and b) a weaker FCF profile over the next three years. Our FY12E/13E/14E EPS estimates are Rs1.5/3.9/5.4. We maintain Hold (target price Rs105).

RCOM – Stabilising operations but debt burden constrains valuations
RCOM's operations have stabilised, but it has been forced to constrain capex to generate cash. It is due to repay around $1.2bn in FCCBs in March 2012. While it is favourably placed with respect to policy issues, RCOM's key challenge is to build momentum in its wireless business, where its EBITDA has been stagnant for the last seven quarters. Maintaining Hold (target price Rs80).

Three key policy issues for the incumbents (Bharti, Idea, Vodafone)
The cost of 'excess spectrum' and licence extension and a government decision on intra-circle data roaming are key focus areas. The estimated cost of excess spectrum/licence extension is Rs43/57bn for Bharti and Rs19/46bn for Idea. We factored excess spectrum cost in the EPS estimates but the cost of the licence extension will impact FY15E/16E cashflows. The policy decision on intra-circle roaming will effect the 3G investment case for the incumbents.

Incumbents likely to be left out of sector consolidation
It is increasingly clear that the incumbents would not be able to meaningfully participate in an industry consolidation. Rather, consolidation would provide additional strategic options for well-funded players such as Reliance Industries (RIL) to enter the telecom market in a more significant manner. The proposed guidelines on spectrum trading, refarming and auction of new spectrum bands (700Mhz) are also unfavourable to incumbents.

Valuation and risks
This report changes estimates and target prices (pg 3 for details). Our sector valuation methodology is DCF. Key upside/downside risks include competition and policy.

Top Picks				
Bharti Airtel Limited (BRTI.BO),INR390.30				Buy
Companies Featured				
Bharti Airtel Limited (BRTI.BO),INR390.30				Buy
	2011A	2012E	2013E	
P/E (x)	19.5	26.3	15.6	
EV/EBITDA (x)	9.2	8.5	6.6	
Price/book (x)	2.8	2.8	2.4	
Idea Cellular Limited (IDEA.BO),INR97.25				Hold
	2011A	2012E	2013E	
P/E (x)	26.0	65.2	25.1	
EV/EBITDA (x)	9.3	9.3	6.4	
Price/book (x)	1.8	2.5	2.3	
Reliance Communications (RLCM.BO),INR77.55				Hold
	2011A	2012E	2013E	
P/E (x)	22.1	23.3	19.7	
EV/EBITDA (x)	7.9	7.4	6.1	
Price/book (x)	0.5	0.4	0.4	

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Key highlights

Valuations expected to remain lower than historical averages

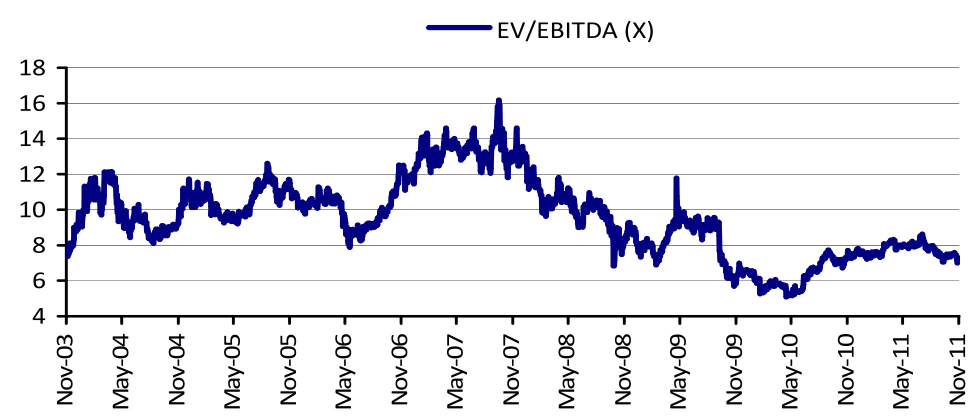
Figure 1: Key estimates and valuation

	Reco	Current Price (INR)	Target price (INR)	EPS			EV/EBITDA		P/E	
				FY12E	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
Bharti	Buy	390	420	14.8	25	34.4	6.5	5.1	15.6	11.3
Idea	Hold	96	105	1.5	3.9	5.4	5.9	4.7	22.2	15.9
RCOM	Hold	77	80	3.2	3.7	4.3	6.1	5.0	19.5	17.0
BSE Sensex		16,846							13.1	

Source: Deutsche Bank, Prices as of 2- Dec 2011

At our target prices, the implied valuation for Bharti (India business), Idea and RCOM would be at c20%, 10% and 40% discounts to their historical EV/EBITDA averages. We have focussed on EV/EBITDA, as the capital structure of all the companies has transformed significantly in the last three to four years. While the competitive environment in the medium term is likely to be better than in the previous three years, the pending resolution of key policy issues will cap valuations for Bharti and Idea. For RCOM, the valuations reflect its underperformance in the marketplace and our expectation of no significant improvement in its competitive position over the next two years.

Figure 2: Bharti – historical EV/EBITDA trend



Source: Bloomberg Finance LP, Deutsche Bank

Figure 3: Idea – historical EV/EBITDA trend

Source: Bloomberg Finance LP, Deutsche Bank

Figure 4: RCOM – historical EV/EBITDA trend

Source: Bloomberg Finance LP, Deutsche Bank

Indian telcos are trading at a premium to the BSE Sensex

On FY13E PE, Bharti, Idea and RCOM trade at 20%, 75% and 56% premiums to the BSE Sensex. Three factors one needs to consider in the context of the valuation premium are: a) higher revenue and EBITDA growth in the medium term compared to the Sensex, b) Indian telcos are just coming out of a highly competitive phase and hence near-term earnings are not a true reflection of a normalized level, and c) high financial leverage depresses EPS and magnifies the valuation premium

Indian telcos trading at premium to Asian averages on PE basis

Figure 5 gives the valuations of select Asian telcos, the Asian average and that of Indian telcos. The Asian average is for all the companies under Deutsche Bank coverage. On FY13 PE, Bharti currently trades at a 7% premium to the Asian average and would trade at a 20% premium on our target price. Idea and RCOM are at a significant premium of 75% and 56% to the regional peers. The higher leverage of the Indian telcos does impact the valuation premium. This is evident from the fact that Indian telcos are trading at a lower premium to the Asian average on FY13E EV/EBITDA.

Figure 5: Regional valuation comparison

Company	Reco	Current price	P/E		EV/EBITDA	
			CY11E/FY12E	CY12E/FY13E	CY11E/FY12E	CY12E/FY13E
Select Asian telcos						
China Mobile	Hold	HKD 74.65	9.7	9.7	4.3	4.0
China Telecom	Buy	HKD 4.57	17.7	17.0	4.3	4.0
China Unicom	Buy	HKD 16.18	52.5	26.6	5.7	4.7
Indosat	Hold	IDR 5100	29.1	13.7	5.1	4.3
Telkom	Buy	IDR 7150	12.3	11.4	4.3	4.0
Asian weighted mean (ex-India, ex-Japan)				14.1		5
Asian Median (ex-India, ex-Japan)				14.4		5.8
Bharti	Buy	INR 390	26.3	15.6	8.5	6.5
Idea	Hold	INR 96	64.4	24.8	8.5	5.9
RCOM	Hold	INR 77	23.1	19.5	7.4	6.1

Source: Deutsche Bank. Price data for Bharti, Idea and RCOM is as on 2nd Dec 2011. For other companies, the price data is for 29th Nov 2011

Deutsche Bank vs. consensus

We are below consensus on our estimates for Bharti and Idea

We have factored the impact of excess spectrum cost in our EPS estimates, which could be a possible reason for our below-consensus estimates. We note that Bharti's FY13E consensus EPS has reduced by 16% over the last six months. In the medium term, we believe clarity on policy impact will drive stock performance.

Figure 6: Difference from consensus

	FY12E			FY13E		
	DB est	Consensus	% diff	DB est	Consensus	% diff
Bharti	14.8	16.6	-10.70%	25	26.2	-4.50%
Idea	1.5	2.2	-33.60%	3.9	4.3	-10.10%
Rcom	3.2	4.6	-32.20%	3.7	6.5	-42.80%

Source: Bloomberg Finance LP, Deutsche Bank

Figure 7: Changes in target price and key estimates

	Target Price		FY13E		FY14E		
	Old	New	Old	New	Old	New	
Bharti							Reduction in EPS estimate factors the impact of excess spectrum payments and slower than forecast improvement in profitability. Our reduction in EBITDA is around 12-14%; however the impact is magnified at the EPS level due to operating leverage and Bharti's high financial leverage. The reduction in target price (DCF –based) is lower than reduction in EPS but largely in line with the fall in EBITDA. On a relative multiple basis, we are implying a rerating on PE basis but minimal change on EV/EBITDA basis
Target Price (INR)	460	420					
EPS (Rs)			38.6	25	45.3	34.4	
EBITDA (Rs m)			352.1	301.1	409	360.3	
Idea							Idea's operating performance has better than our expectation. However the positive impact is tempered by the excess spectrum charge which is factored in our estimates. Overall, Idea's EBITDA has increased by c20% which is lower than our increase in DCF-based target price. In summary, we are implying a rerating of Idea on EV/EBITDA and P/E basis reflecting the better operating performance and stronger competitive position.
Target Price (INR)	70	105					
EPS (Rs)			3.9	3.9	4.9	5.4	
EBITDA (Rs m)			57.4	66.5	65.6	77.7	
RCOM							Our reduction in RCOM's target price is significantly higher than the reduction in EBITDA. One reason is that RCOM's operating cashflows are weaker than fall in its EBITDA. Our new target price effectively implies a derating of RCOM on EV/EBITDA basis which we believe is justified given the leveraged balance sheet and weakening competitive position.
Target Price (INR)	150	80	7.9	3.7		4.3	
EPS (Rs)			85.5	73.9		86.2	
EBITDA (Rs m)							

Source: Deutsche Bank

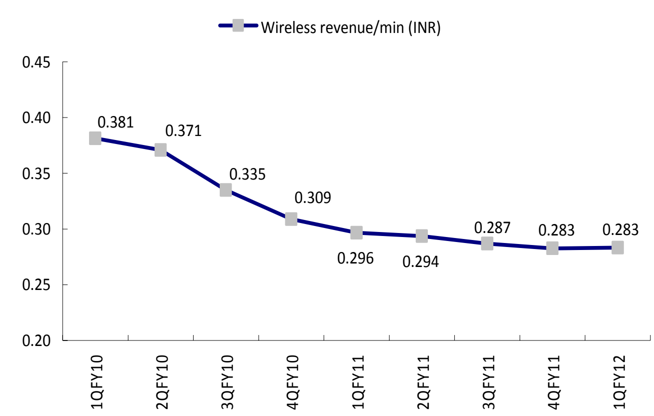
Report summary

Competitive landscape: changing rapidly for the better

Tariffs have stabilised and are poised to increase in the medium term

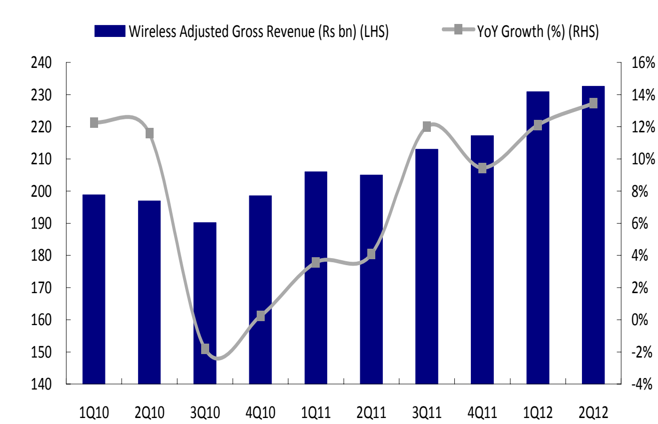
The Indian telecom sector has recently emerged from a bruising period of aggressive tariffs by challengers such as RCOM and Tata Teleservices, which were awarded GSM spectrum at historical costs. However, tariffs have now stabilised and a weakened competition has allowed incumbents to raise tariffs by 15-20%. Sector revenue growth is trending up and we forecast 15-16% YoY growth in the medium term.

Figure 8: Tariffs have stabilised …



Source: TRAI, Deutsche Bank

Figure 9: …and sector revenue growth is trending up



Source: TRAI, Deutsche Bank

Higher tariffs will lead to margin expansion driving EPS and FCF growth

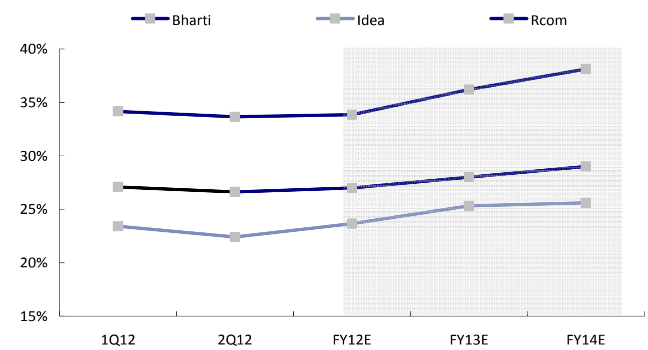
Higher tariffs will percolate to incumbents' subscriber bases over the next six months as the validity of the low promotional tariffs progressively expires. We believe this should drive margins up by 200-400bps over the next 24 months. A 5% increase in RPM leads to EPS increases of 14%, 40%, 35% for Bharti, Idea and RCOM. We expect Bharti (India biz), Idea and RCOM to generate cumulative FCF (FY13-14E) of Rs324bn/38bn/50bn.

Figure 10: Sensitivity to increase in mobile revenue per minute

	Change wireless RPM	Increase in EBITDA	Increase in EPS
Bharti	5%	6%	14%
Idea	5%	16%	40%
RCOM	5%	12%	30%

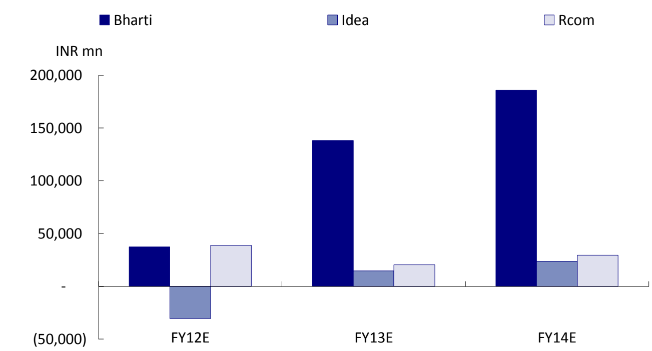
Source: Deutsche Bank

Figure 11: EBITDA margin comparison of incumbents



Source: Companies, Deutsche Bank

Figure 12: FCF comparison of incumbents



Source: Deutsche Bank

Funding constraints for challengers are significant

The prime reason for the pause in the tariff wars is the lack of funding to the challengers. We believe that none of the challengers except RCOM make cash profits and are dependent on equity or debt funding for both ongoing operations and network expansion. RCOM is forced to constrain capex and conserve cash as it has $1.2bn convertible due in March 2012. At this stage we believe most challengers are unable to access any long-term loan funds. While foreign partners could infuse capital, only Telenor has explicitly committed to invest further equity capital. Unfortunately, the recalcitrance of its Indian partner (Unitech) to subscribe to a rights issue in the joint venture (Unitech) would impair the JV's ability to borrow.

Policy environment: still in a flux but impact likely to be adverse for incumbents

We bifurcate the policy issues into two categories:

- Cost of 'excess spectrum' and licence extension – these have a cash flow impact; and
- M&A guidelines, intra-circle roaming, rules for spectrum sharing, refarming and eligibility for new spectrum auctions – this would impact the range of strategic options available to incumbents for business growth

Our base-case scenario is that policy developments would be adverse for incumbents on both counts. The guidelines are most favourable for well-funded entrants such as Reliance Industries and limit incumbents' options to play the role of a consolidator.

Cost of excess spectrum and licence extension

The regulator has deemed any spectrum held beyond 6.2Mhz in a market as 'excess spectrum'. It has levied a one-time fee based on a market-based value of spectrum for each market. For incumbents (Bharti/Idea), licences in key markets expire in FY15/16E.

Figure 13: Details of licence renewal

Company	Cost of excess spectrum (Rs m)	Potential cost of renewal (Rs m)	No of markets for renewal	% of Company's revenues impacted by renewal
Bharti	43,113	57,385	8	55%
Idea	18,995	45,574	9	80%
Vodafone	24,503	54,438	10	72%

Source: Telecom Regulatory Authority of India (TRAI), Deutsche Bank

Intra-circle data roaming – the current hot-button issue

The incumbents have entered bilateral roaming arrangements which allow them to provision 3G services for their entire subscriber base in all markets. Though individually the incumbents do not have 3G spectrum on a pan-India basis, collectively they have 3G spectrum for all the markets. The government believes that these roaming arrangements contravene license guidelines and is likely to ban the practice. We believe that the incumbents are likely to aggressively challenge any potential regulatory action.

Guidelines on spectrum refarming are adverse for incumbents

The regulator has suggested that:

- Operators with 800/900 MHz spectrum (i.e. the incumbents) be kept out of an auction for 700 MHz and
- Incumbents will be given the inferior 1800Mhz spectrum in lieu of 900Mhz spectrum when their licences are renewed.

For incumbents, an auction of a 700MHz spectrum prior to their licence renewal would be an extremely adverse scenario.

M&A and spectrum-sharing guidelines benefit challengers rather than incumbents

We understand that M&A would be prohibited if the revenue or subscriber share of the merged entity exceeds 35% – so incumbents (Bharti/Idea/Vodafone) would be unable to acquire any of the smaller players to gain more spectrum in their key markets due to high market shares. With respect to sharing, incumbents would be better off sharing spectrum with marginal operators rather than with their peers. However, for a marginal operator, a sell-off would be a superior outcome to sharing spectrum, which limits the strategic options for incumbents.

Stock recommendation: Bharti is our preferred sector pick

At this juncture, we believe that strength of cash flows and ability to manage policy risk should drive stock performance. The impact of rising tariffs is generally understood by investors and is likely to be largely factored into the stock prices. In other words, what matters is the (government's) slice of the pie rather than the size of the pie. It is in this context that we prefer Bharti.

- Its investment in Africa (25% of revenues, 20% of EBITDA) tempers India policy risk.
- It is the only telco with significant FCF (FY12-14E: Rs330bn), which gives it the ability to pay likely regulatory costs without straining its financials.
- It is the cost leader and has significant scale in the mobile business, which should act as a bulwark against the threat of entrants such as Reliance Industries.

Key catalysts/metrics to watch

- Policy outcomes – The recommendations of the sector regulator are currently under the consideration of the Telecom Commission, the highest policy-making body within the Department of Telecom. We expect a decision on the key issues before March 2012.
- India wireless revenue growth – 15% YoY.
- Africa FCF: We forecast Africa operations to be FCF negative by $800/500m in FY12E/13E.

Trading at 6.5xFY13E EV/EBITDA, a modest premium to Asian average

At the current price Bharti trades at 15.6x FY13E PE and 6.5x FY13E EV/EBITDA. On FY13 PE, Bharti currently trades at a 7% premium to the Asian average and would trade at a 20% premium on our target price. Our target price of Rs420 implies FY13E EV/EBITDA for the India business at 7.5x and Africa operations at 5x. Bharti could trade at a premium to its Asian peers due to robust growth in EBITDA and cashflow over the next two years.

Figure 14: Bharti – Key forecasts

Year ending 31-Mar	2011	2012E	2013E	2014E
India revenue	*464,445*	*529,799*	*615,567*	*702,468*
Africa revenue	*130,834*	*189,626*	*221,862*	*249,595*
Total revenue	595,279	719,425	837,429	952,063
India EBITDA	*171,078*	*192,483*	*235,219*	*280,830*
Africa EBITDA	*28,616*	*51,118*	*65,852*	*79,441*
Total EBITDA	199,694	243,602	301,072	360,272
EPS (Rs)	**16.4**	**14.8**	**25.0**	**34.4**
Cashflow from operations - India	*165,615*	*180,483*	*229,219*	*276,930*
Cashflow from operations - Africa	*13,907*	*31,050*	*47,184*	*61,140*
Total Cashflow from operations	179,522	211,533	276,403	338,070
India capex	*105,858*	*100,100*	*91,000*	*91,000*
Spectrum fees (3G, BWA, excess spectrum)	*156,000*	*43,000*		
Africa capex	*36,400*	*68,250*	*68,250*	*68,250*
Total capex	298,258	211,350	159,250	159,250
FCF from operations before WC changes- India	*-96,243*	*37,383*	*138,219*	*185,930*
FCF from operations before WC changes- Africa	*-22,493*	*-37,200*	*-21,066*	*-7,110*
Total Free cashflow from operations before WC changes	-118,736	183	117,153	178,820
(Inc)/Dec in Working capital		63,489	22,142	-13,779
Free cashflow from operations		63,672	139,295	165,041
India Net debt	147,171	75,388	-49,047	-173,493
Africa Net debt	452,994	490,194	511,261	518,371
Consolidated Net Debt	600,165	565,583	462,214	344,877
Net Debt/Equity	116%	100%	71%	44%

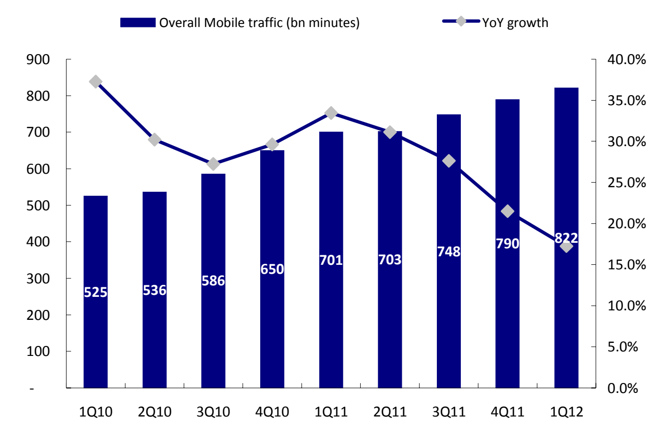
Source: Company, Deutsche Bank

Industry revenue and traffic trends

Industry wireless revenues have reverted to trend rate of 15% YoY

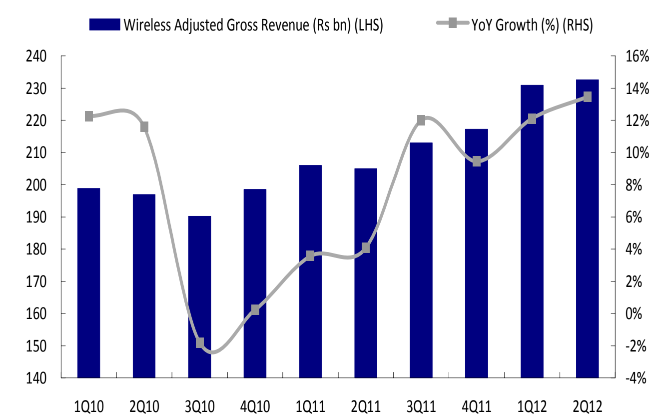
India wireless revenues are currently growing at 15% YoY, driven by 15-16% YoY growth in traffic and flat to improving revenue/minute. The tariff war precipitated by the entrants – namely RCOM and Tata Tele – in October 2009 resulted in a steep decline in industry revenue/min and disrupted revenue growth for two to three quarters. However, this had a positive impact on traffic growth as the incumbents responded swiftly to the price cuts.

Figure 15: Total industry minutes (bn) and growth



Source: Companies, TRAI, Deutsche Bank

Figure 16: Industry wireless revenues (AGR) and growth



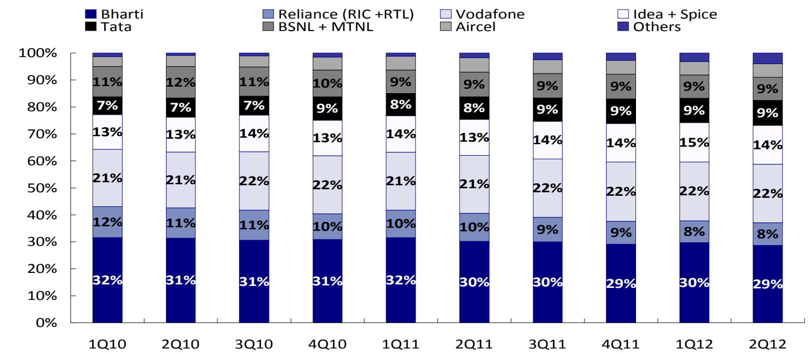
Source: Companies, TRAI, Deutsche Bank

Industry revenue growth over the last four quarters has been driven by strong traffic growth (25% YoY) as tariffs continued to be soft. Going forward, we expect industry wireless revenue growth to sustain at 15-16% YoY, driven by 3-4% growth in revenue/min, even as traffic growth moderates to 12-13% YoY.

Incumbents have strengthened their position during the revival

The tariff war did not have an impact on the structure of the industry. The combined revenue marketshare of the incumbents (Bharti/Idea/Vodafone) has remained constant at 65% since 2QFY10 (just before the tariff war). The biggest loser has been RCOM, whose market share has declined from 11% to 8.5% over the same period.

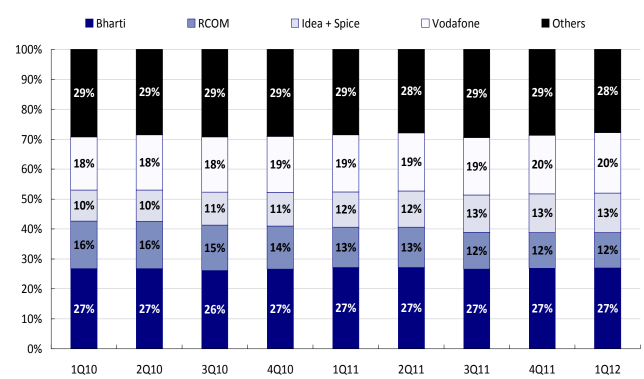
Figure 17: India wireless – revenue market share trends



Source: Telecom Regulatory Authority of India (TRAI)

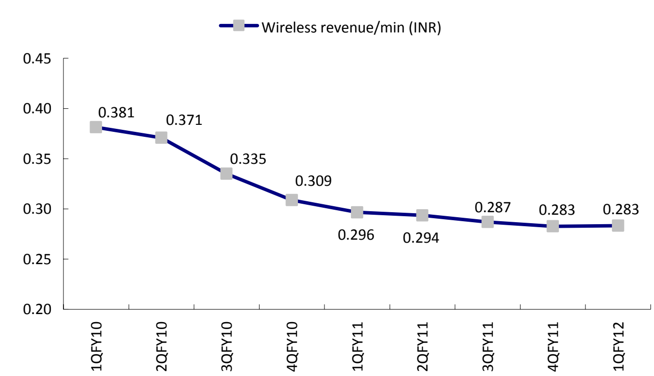
The incumbents' strength is underpinned by an improvement in traffic market share. The combined traffic share of Bharti/Idea/Vodafone increased from 55% in 2QFY10 to 60% in 2QFY12.

Figure 18: Industry traffic market share trends



Source: Companies, TRAI, Deutsche Bank

Figure 19: Industry revenue/min (Rs) trends



Source: TRAI, Deutsche Bank

Tariffs have bottomed; likely to increase by 5-7% in FY13E

Almost all operators recently increased their baseline tariffs by 15-20% for new customers. We estimate that the bulk of the existing subscribers will move to these new tariffs over the next six months. Revenue/min declined by 18% p.a. in FY10 and FY11 and we estimate growth of -1%/5%/3% in FY12E/13E/14E.

Idea's performance most creditable; Bharti has lost share in a few key markets

Idea's (including Spice) revenue marketshare has increased by 160bps to 14.5% over the last eight quarters as it has managed to protect its share in the legacy markets while ramping up in new circles (Bihar, Mumbai. UP East). Bharti's marketshare has declined by 290bps to 28.7% due to marketshare losses in its key circles (Bihar, Delhi, Karnataka and Tamil Nadu), which contribute 37% of its revenues. Interestingly, in most cases either Vodafone or Idea has gained at the expense of Bharti.

Cost analysis

Bharti remains the cost leader

We divide wireless-related costs into two categories – regulatory (licence fee and access charges) and operating (network, SG&A and employee). As is evident in Figure 20, Bharti's cost leadership across both these categories enables it to have a 20-50% higher EBITDA/min despite similar levels of rev/min.

Bharti's advantage on the regulatory costs side is driven by significantly lower access/interconnect costs. We believe that Bharti's national long distance (NLD) traffic is carried primarily through its captive NLD network. In addition, Bharti's large network of minutes (40% higher than the next operator) would likely result in a higher proportion of on-net calls compared to industry average. Both these factors limit interconnect costs, providing Bharti with a cost advantage relative to its peers. RCOM also has an expansive NLD network, but its on-net traffic is likely to be lower than that of Bharti.

Figure 20: Indian telecom sector – trend in costs

Operator		1Q2011	2Q2011	3Q2011	4Q2011	1Q2012	2Q2012
Idea	Minutes (m)	82,274	84,828	93,503	101,960	108,630	106,224
Bharti	Minutes (m)	190,396	190,767	199,146	211,822	221,560	217,408
RCOM	Minutes (m)	94,400	94,600	91,500	94,400	97,300	98,900
Idea	**Rev/min**	**0.441**	**0.426**	**0.420**	**0.409**	**0.412**	**0.430**
Bharti	**Rev/min**	**0.448**	**0.444**	**0.442**	**0.431**	**0.428**	**0.432**
RCOM	**Rev/min**	**0.440**	**0.440**	**0.444**	**0.445**	**0.445**	**0.447**
Idea	**Regulatory costs/min**	**0.122**	**0.118**	**0.116**	**0.114**	**0.114**	**0.122**
Bharti	**Regulatory costs/min**	**0.096**	**0.092**	**0.093**	**0.090**	**0.088**	**0.088**
RCOM	**Regulatory costs/min**	**0.143**	**0.140**	**0.144**	**0.138**	**0.135**	**0.123**
Idea	Employee cost/min	0.019	0.023	0.020	0.019	0.017	0.021
Bharti	Employee cost/min	0.017	0.018	0.016	0.015	0.016	0.015
RCOM	Employee cost/min	0.026	0.027	0.028	0.020	0.028	0.026
Idea	Network cost/min	0.141	0.139	0.125	0.115	0.120	0.126
Bharti	Network cost/min	0.101	0.103	0.100	0.105	0.104	0.108
RCOM	Network cost/min	0.083	0.088	0.082	0.097	0.103	0.104
Idea	SGA/min	0.069	0.064	0.076	0.076	0.067	0.068
Bharti	SGA/min	0.073	0.074	0.077	0.076	0.073	0.074
RCOM	SGA/min	0.054	0.048	0.051	0.061	0.052	0.061
Idea	**Non-regulatory costs/min**	**0.229**	**0.226**	**0.221**	**0.210**	**0.205**	**0.215**
Bharti	**Non-regulatory costs/min**	**0.190**	**0.195**	**0.193**	**0.196**	**0.192**	**0.198**
RCOM	**Non-regulatory costs/min**	**0.170**	**0.172**	**0.171**	**0.185**	**0.189**	**0.204**
Idea	**EBITDA/min**	**0.090**	**0.082**	**0.082**	**0.085**	**0.093**	**0.092**
Bharti	**EBITDA/min**	**0.162**	**0.158**	**0.156**	**0.145**	**0.147**	**0.147**
RCOM	**EBITDA/min**	**0.127**	**0.128**	**0.129**	**0.122**	**0.121**	**0.119**

Source: Companies, Deutsche Bank

Network costs: Capacity utilisation has bigger impact on network costs than the scale of the network

While Bharti has maintained its network cost advantage over Idea, the gap has narrowed over the last six quarters (1Q11-2Q12). Idea's network costs have been falling as the growth in minutes (29%) has led to improved capacity utilisation (as measured by the number of minutes per site per quarter).

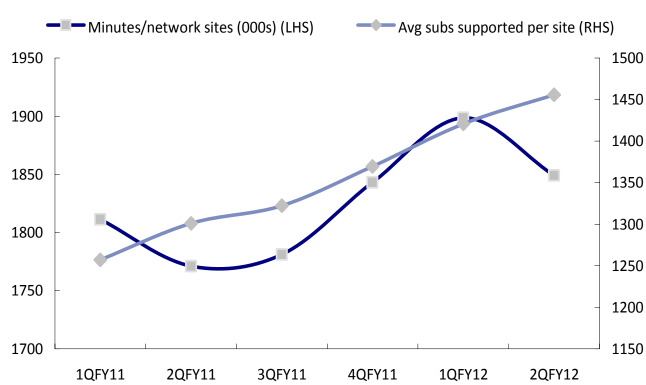
We estimate that Bharti's network cost per minute has largely remained constant despite a 14% increase in network minutes. Its capacity utilisation (proxied by number of minutes per site per quarter) has also remained largely constant during that period, reflecting a relatively congested network.

Figure 21: Impact of capacity utilisation and scale of network costs

		1Q2011	2Q2011	3Q2011	4Q2011	1Q2012	2Q2012
Idea	Minutes (m)	82,274	84,828	93,503	101,960	108,630	106,224
Bharti	Minutes (m)	190,396	190,767	199,146	211,822	221,560	217,408
Idea	Network cost/min	0.141	0.139	0.125	0.115	0.120	0.126
Bharti	Network cost/min	0.101	0.103	0.100	0.105	0.104	0.108
Idea	Minutes/cell site (000s)	1,238	1,259	1,353	1,417	1,449	1,374
Bharti	Minutes/cell site (000s)	1,811	1,771	1,781	1,843	1,899	1,849

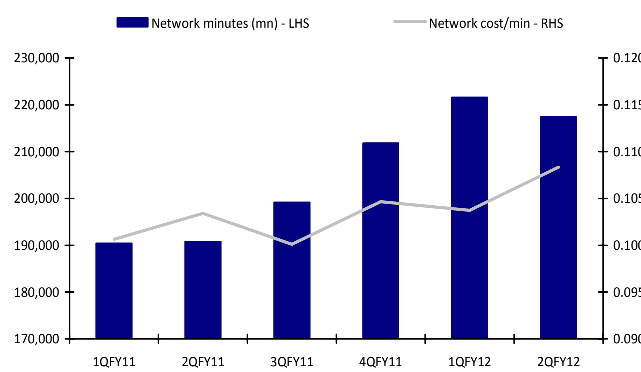
Source: Companies, Deutsche Bank

Figure 22: Bharti – network utilisation remains high



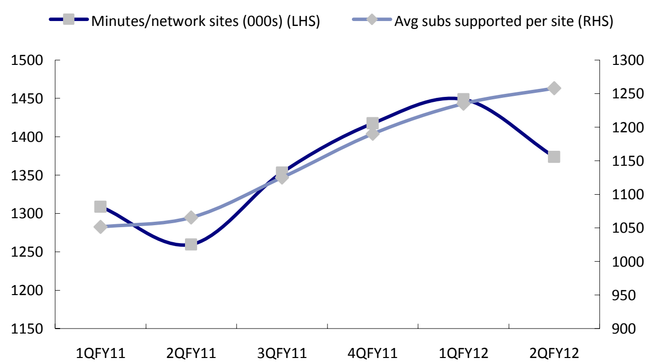
Source: Company, Deutsche Bank

Figure 23: Bharti – network minutes and cost/min



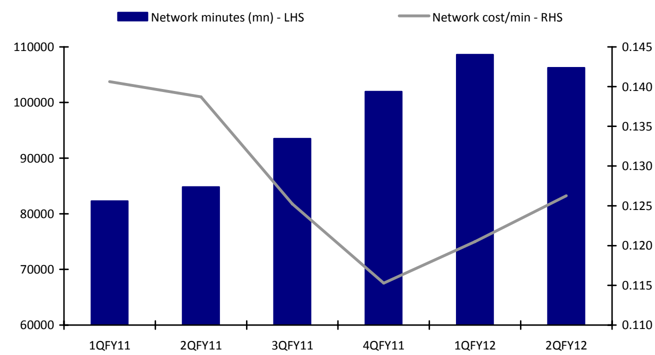
Source: Company, Deutsche Bank

Figure 24: Idea – network efficiency



Source: Company, Deutsche Bank

Figure 25: Idea – network minutes and cost/min



Source: Company, Deutsche Bank

SG&A costs

Bharti's scale does not translate into any advantage in SG&A costs. Bharti had an edge in these costs two years ago, as very few operators (including Idea and Vodafone) had a pan-India presence and their costs were spread over a lower revenue base. Moreover, a bulk of the incremental SG&A spend has been on "below-the-line" costs such as subscriber acquisition and dealer incentives.

RCOM's SG&A costs are lower, as it has held back on both advertising and distribution costs. We believe this is not sustainable as it has resulted in below-industry revenue growth.

Comparison of business returns

Industry returns poised to improve on the back of margin uptrend

The last tariff war resulted in margin compression and a decline in ROCEs for the incumbent operators. It also brought to the fore the relative capital efficiencies of the incumbents, which we believe is a sustainable competitive advantage. While profitability declined during the tariff war, capital turnover (the other determinant of ROCE) remained high for the incumbents. We believe the recent tariff hikes will result in margin expansion and an improvement in ROCEs.

Efficient execution, and not just margins, provides Bharti and Idea with the edge

Bharti's revenues in FY09 were Rs370bn on capital employed of Rs326bn, while RCOM's revenue at Rs222bn (60% of Bharti) was achieved by employing an asset base of Rs582bn (80% higher than Bharti). Hence, while RCOM's margins (23%) were moderately lower than Bharti's (28%), its ROCE was significantly lower. Similarly, Idea achieved revenue of Rs100bn (45% of RCOM) with one-fifth the capital base.

Figure 26: Bharti – industry-leading ROCE driven by capital efficiency and higher profitability

	FY09	FY10	FY11	FY12E	FY13E	FY14E
Average Core capital employed	326,494	401,334	751,892	1,090,003	1,089,434	1,087,116
Revenues	369,616	396,150	595,279	719,425	837,429	952,063
Capital turnover	1.13	0.99	0.79	0.66	0.77	0.88
EBIT margins	28.2	25.4	16.4	15.0	18.0	20.6
Core ROCE	31.9	25.1	13.0	9.9	13.8	18.0

Source: Company, Deutsche Bank, Core Capital Employed is defined as Net Fixed Assets (including intangibles)+ Net Working Capital

Figure 27: Idea – losses in new circles constrain margins and ROCE compared to Bharti

	FY09	FY10	FY11	FY12E	FY13E	FY14E
Average Core capital employed	115,680	154,145	192,278	234,683	251,617	247,785
Revenues	99,622	134,160	156,380	198,878	248,625	280,289
Capital turnover	0.86	0.87	0.81	0.85	0.99	1.13
EBIT margins	14.4	9.1	7.4	8.5	11.5	12.4
Core ROCE	12.4	7.9	6.0	7.2	11.3	14.0

Source: Company, Deutsche Bank

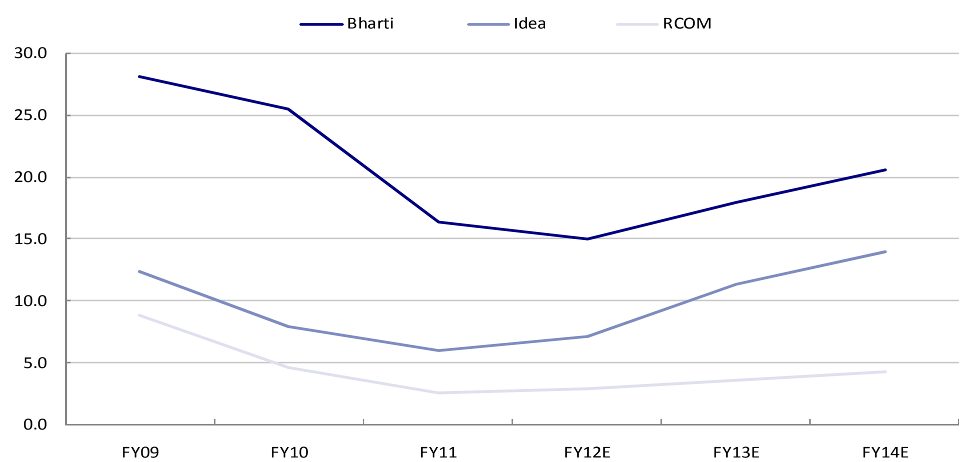
Figure 28: RCOM – capital inefficiencies result in lower ROCE

	FY09	FY10	FY11	FY12E	FY13E	FY14E
Average Core capital employed	581,905	698,660	720,904	738,618	719,411	706,571
Revenues	222,505	214,964	224,304	208,939	233,517	258,651
Capital turnover	0.38	0.31	0.31	0.28	0.32	0.37
EBIT margins	23.0	15.1	8.3	10.5	10.9	11.6
Core ROCE	8.8	4.6	2.6	3.0	3.5	4.3

Source: Company, Deutsche Bank

As margins improve over the next 12-18 months, we estimate that Bharti and Idea should be able to revert to their earlier ROCEs as they have maintained high capital turns throughout this period. Please note that Bharti's headline ROCE will be lower than it was in the past due to the acquisition of Zain's African assets.

Figure 29: Comparison of company ROCEs



Source: Company, Deutsche Bank

We forecast that ROCEs for Bharti (adjusting for Africa) and Idea will revert to pre-tariff war levels. RCOM's ROCE gap with Bharti and RCOM will likely increase as its margins are expected to be significantly lower than in the past.

Competitive landscape

Spectrum allocation at sub-economic costs precipitates a tariff war

The tariff war in October 2009 was initiated by the challengers (mainly RCOM and Tata Tele). However, unlike the experience in some other countries, the incumbents were quick to match the lower tariffs. This swift response by incumbents did not allow challengers to benefit from the tariff war. Effectively, though the revenue pie shrank for two to three quarters, the incumbents did not lose traffic or revenue marketshare. In fact, the price cuts resulted in a revival in usage, which subsequently benefitted the incumbents.

The dust has settled now…and it feels the same

The tariff war did not result in any structural changes in the industry dynamics. The combined revenue marketshare of the incumbents (Bharti/Idea/Vodafone) has remained constant at 65% since 2QFY10 (just before the tariff war). The biggest loser has been RCOM, whose market share has declined from 11% to 8.5% over the same period. The incumbents' strength is further underpinned by an improvement in traffic marketshare. The combined traffic share of Bharti/Idea/Vodafone increased from 55% in 2QFY10 to 60% in 2QFY12. As a result, the challengers have not been able to fulfil the single most important objective of the tariff war – building a sizeable revenue base.

Financial constraints of key challengers limited the scope for sustained tariff cuts

The prime reason for the pause in the tariff wars is the lack of funding to the challengers. Most challengers have leveraged balance sheets, which puts a constraint on their ability to take operating risks such as aggressive tariff cuts. Given the low fixed asset base for a number of the challengers (except RCOM and Tata), banks have lent funds against the economic value of license/spectrum. The intense legal scrutiny into the issuance of the new licenses has likely made it difficult for these challengers to tap the financial institutions for further funding.

This has resulted in a significant reduction in competitive intensity in the past six months.

- RCOM is in the midst of efforts to strengthen its balance sheet. The company is currently constraining capex to conserve cash as it has $1.2bn convertible due in March 2012. Its current net debt/EBITDA is at 4.7x, which we forecast will be reduced to 3x only by FY14E.
- Tata-DoCoMo has fewer funding constraints given the likely equity support from DoCoMo. However, we understand that the stake sale to DoCoMo has imposed operating covenants with respect to subscribers, revenues, and profitability. Tata's performance has been the best among the challengers, and it has managed to improve its marketshare from 7% in 2QFY10 (before the tariff war) to 9.3% in 2QFY12.
- Uninor's partners (Telenor and Unitech) are having disagreements over the management and funding of the joint venture. While Telenor has explicitly committed to invest further equity capital, the recalcitrance of its Indian partner (Unitech) to subscribe to a rights issue would impair the JV's ability to borrow.
- Aircel has remained sub-scale despite a pan-India footprint and ownership of 3G spectrum in a few markets (marketshare has stagnated at 5% over the past six quarters).

Reliance Industries: The second coming

RIL: Secures pan-India spectrum for LTE

In June 2010, RIL secured 2x20Mhz unpaired spectrum in the 2.3Ghz band at Rs120bn. It has announced its intention to rollout LTE (FDD version). At this juncture, RIL has not made any announcements about its key equipment vendors or its strategy to source towers for the network rollout. We expect a service launch over the next 18 months.

Our assumptions for RIL's telecom foray:

- RIL would also need to provide voice services to build a viable business.
- LTE is both a boon (for data) and bane (for voice) – standards for provisioning voice over LTE have not crystallised.
- Headroom for disruptive pricing, especially on voice, is limited. However, we believe RIL would be impacted by data tariffs. RIL would be better placed than the incumbents to offer higher data speeds, which it is likely to leverage to drive down data pricing.
- RIL could acquire/merge with another player to gain access to GSM spectrum. The proposed M&A guidelines are favourable for such an outcome

We expect RIL to target and enter both voice and data markets

We believe it would be difficult to build a viable business only focussed on the data market. Assuming the Indian data market scales up to 20% of the total telecom revenues by FY16E, an optimistic estimate of the market size would be around Rs350-400bn. Assuming RIL corners a 20% marketshare (an optimistic estimate), its top line would be around Rs75-80bn. As a comparison, Idea's current top line is around Rs200bn. Given that RIL plans to invest around $5bn in telecom, a $1.6bn top line is likely to fall short of its ambitions.

RIL's ability to disrupt pricing, especially voice, would be limited

Our discussions with clients indicate that there is an expectation that RIL will focus on data and offer cheap (or free) voice calls on VoIP technology as a loss leader strategy to build a subscriber base. In addition, this would significantly impact the voice revenues of the incumbents.

While RIL can offer on-net calls at any rate, off-net calls will need to be priced at a minimum of the termination charge. As for VoIP calls, we note that they are not 'costless'. Hence we would surprised if RIL elects to provide free voice calls and use it as a loss leader strategy for an extended period.

Incumbents' strategies and tactics have evolved since RIL's last foray

During its first foray into telecom (as RCOM in 2003), RIL entered the market with disruptive voice pricing, which quickly helped build operating scale and volume of minutes. Ironically, incumbents such as Bharti recognised the value of this 'minutes factory' approach rather than their ARPU-based business model and re-jigged their operating strategy and business processes.

We believe RIL's ability to succeed with a similar approach this time is limited due to two factors: a) the headroom to cut prices is low as incumbents have significant scale and low-cost structure and b) incumbents have demonstrated a willingness to sacrifice margins to remain competitive on tariffs. In summary, we believe that RIL's entry could trigger a round of competitive tariff cuts, but these are unlikely to be sustained in the long run.

LTE – challenges abound

Deutsche Bank analyst Brian Modoff highlighted in a recent note (*Signals to Noise – LTE challenges,* 2 October 2011) the key challenges confronting carriers building out a LTE network. This includes: a) support for voice and legacy services and b) band support in handset radios.

- He notes that carriers are still struggling to find a way to support basis services such as voice and SMS. Voice Over LTE (VoLTE) has emerged as a preferred solution, but there are no clear-cut standards for designing VoLTE systems.
- Band support: The proliferation of bands proposed for LTE is a major challenge. Brian believes that there are around 44 different bands for LTE around the world, which is too broad a range to be addressed in a single chip. He sees radios in cell phones as major technical challenge for LTE. Put simply, RIL is likely to be hamstrung with a poor device ecosystem, and it would be a challenge to build a low-cost LTE ‘phone’.

Nevertheless, on a long-term basis RIL is well placed on its technology choice

Unlike the last time around when RIL was on a CDMA platform that had a truncated upgrade path, its current choice of LTE is the next upgrade for WCDMA (i.e. 3G) technologies being used by its key competitors. As the telecom market in India evolves to an increasing share of data, RIL would be better placed than competitors on the technology front.

Policy issues – taking a deeper look

Resolution of key policy issues will drive stock performance in the medium term.

Waiting for a Solomon

The announcement of the issuance of new licenses and spectrum at historical costs on a first-come-first-served basis precipitated a major controversy in the sector in October 2007. Triangulated by the courts, media and investigative agencies, the Indian telecom sector has hobbled in a policy vacuum. As an example, no additional spectrum has been allocated by the government to any operator over the past 24-30 months. News reports indicate that industry captains have recently met the prime minister and key policymakers and urged them to clear the present morass.

New policy framework is in the final stages of the approval process

Figure 30: Key policy issues

- Spectrum caps and pricing
- Spectrum refarming in the 700Mhz and 900Mhz bands
- Rules for spectrum sharing
- Conditions for extension of license
- Guidelines for M&A
- Intra-circle roaming for 3G data services

Source: Deutsche Bank

The sector regulator (TRAI) has proposed a new framework that covers the license extension, spectrum issues and guidelines for M&A. These recommendations are currently under consideration with the Telecom Commission, which is the penultimate stage before they become sector policy.

Impact on incumbents: material but manageable

The incumbents would need to pay a market-linked price for 'excess spectrum' held and the for license extension. For incumbents (Bharti & Idea) licenses in key markets expire in FY15/16E.

The cost impact of 'excess spectrum' is Rs43bn, Rs19bn, Rs24bn for Bharti, Idea and Vodafone, respectively; these estimates assume a start date of May 2008 (as recommended by Dept of Telecom) and prorates for the balance of the validity of the license period. Bharti, Idea and Vodafone face extensions of some licenses in their key markets between November 2014 and April 2016. The potential cost of licence extension (ten years) for Bharti/Idea/Vodafone is Rs58bn/46bn/55bn.

Figure 31: Details of licence renewal

Company	Cost of excess spectrum (Rs m)	Potential cost of renewal (Rs m)	No of markets for renewal	% of Company's revenues impacted by renewal
Bharti	43,113	57,385	8	55%
Idea	18,995	45,574	9	80%
Vodafone	24,503	54,438	10	72%

Source: Telecom Regulatory Authority of India (TRAI), Deutsche Bank

Decision on intra-circle data roaming arrangements is important for incumbents

The decision on intra-circle data roaming is critical as it would have an impact on business returns from 3G investments. In addition, the current guidelines for spectrum refarming and M&A and not favourable to incumbents. We believe the market does expect a negative outcome on these issues for the incumbents and a firm resolution would be positive for the stocks as it would remove uncertainty.

Details of the policy issues:

Excess spectrum and spectrum pricing

TRAI has determined that under the telecom license, the government is obligated to provide spectrum up to a maximum limit of 6.2Mhz. Spectrum held beyond this limit would need to be paid for at the 'current price', which would reflect the economic value of the spectrum. TRAI would annually determine the current price; however, if an auction takes place, the auction values would be the current price for the next 12 months. We note that TRAI has published the current price for all markets for 1800Mhz spectrum held for 20 years. This would be the basis to determine the value of the excess spectrum held by the Telcos (typically the incumbents). The start date for calculation is likely to be May 2008 and the excess spectrum cost will be pro-rated for the balance period of the license.

Conditions for extension of license:

- License would be extended for a period of ten years
- The operator would have to pay current price for its entire spectrum holding
- 900Mhz spectrum would be exchanged for equal amount of 1800Mhz spectrum. If the government is unable to provide 1800Mhz spectrum, the operator would pay 1.5x of the current price for 900Mhz spectrum.
- The government is also discontinuing to current practice of bundling spectrum with the operating license.

Refarming of spectrum in 900Mhz and 700Mhz bands

Use of 700Mhz spectrum for LTE/4G technologies

- In the current National Frequency allocation Plan (NFAP), spectrum in the 698-806Mhz band is allowed to be used with Broadband Wireless Access (BWA) and IMT technologies.
- TRAI has suggested the auction of spectrum in the 700Mhz band, which would enable the rollout of LTE. It believes that there is adequate spectrum that can be auctioned immediately.
- Operators holding spectrum in the 800Mhz (ie CDMA) and 900MHz (GSM) spectrum would be prohibited from participating in this auction.

Refarming of spectrum in 900Mhz band

- TRAI has suggested that on extension of licenses, the government should allocate an equal amount of spectrum in the 1800Mhz band to the incumbents in lieu of their spectrum in the 900Mhz band.

As it is evident that an auction of 700Mhz spectrum prior to the renewal of their licenses would be a materially adverse scenario for the incumbents.

Spectrum sharing

- Permitted for a period of five years with a possibility of extension for one more term of five years
- The total spectrum held by both operators is deemed to be shared – partial sharing is not allowed.
- Spectrum caps in line with that of M&A guidelines will apply
- The spectrum usage fees will be individually levied on each operator for the total quantum of shared spectrum.

M&A guidelines

- The resultant entity cannot have a revenue-share or subscriber-share in excess of 35%.
- The resultant entity cannot hold more than 25% of the allocated spectrum in the service area.
- The resultant entity would pay to current price for spectrum beyond 6.2Mhz.

Intra-circle roaming for 3G data services

We note that this has emerged as one of the most contentious issues for the government and the incumbents. In the 3G auction, none of the players managed to secure spectrum in all the markets. The incumbents focussed on winning 3G spectrum in their key markets. Though individually they do not have 3G spectrum on a pan-India basis, collectively they have 3G spectrum for all markets. In order to provide service to their existing subscriber base in markets where they do not have 3G spectrum (but have 2G spectrum), the incumbents have entered into bilateral roaming arrangements. Thus the subscriber accesses 2G services on the incumbent's spectrum but to access 3G services, the subscriber 'roams' on the 3G spectrum of the partner (even though the subscriber is in her home market). These arrangements have allowed the incumbents to provision 3G services for their entire subscriber base in all markets.

The government believes that these roaming arrangements are illegal and it could ban the practice. We believe the incumbents are likely to aggressively challenge any potential regulatory action. We note that the incumbents contend that the government has given explicit approval for such a possibility prior to the 3G auction.

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Rating
Buy

Asia
India

Telecommunications

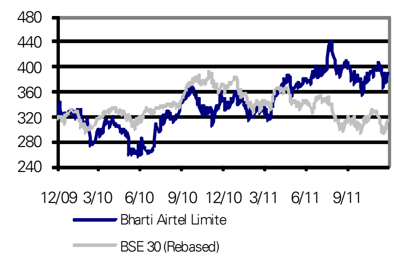
Company
Bharti Airtel Limited

Reuters	Bloomberg
BRTI.BO	BHARTI IN

Price at 5 Dec 2011 (INR)	390.30
Price target - 12mth (INR)	420.00
52-week range (INR)	440.25 - 314.20
BSE 30	16,847

Key changes			
Price target	460.00 to 420.00	↓	-8.7%
Sales (FYE)	747,909 to 719,425	↓	-3.8%
Op prof margin (FYE)	20.4 to 15.0	↓	-26.5%
Net profit (FYE)	100,695.2 to 51,298.7	↓	-49.1%

Price/price relative



Performance (%)	1m	3m	12m
Absolute	-1.9	-3.8	12.9
BSE 30	-4.1	0.8	-15.6

Stock Data	
Market cap (INRm)	1,482,359
Market cap (USDm)	28,952
Shares outstanding (m)	3,798.0
Major shareholders	Bharti Telecom (45.3%)
Free float (%)	32
Avg daily value traded (USDm)	43.9

Key Indicators (Fy1)	
ROE (%)	10.0
Net debt/equity (%)	100.5
Book value/share (INR)	140.74
Price/book (x)	2.8
Net interest cover (x)	3.4
Operating profit margin (%)	15.0

Thriving on the strength of scale

Strong FCF and African operations should temper India policy risk
Our Buy rating on Bharti reflects strong FCF generation (Rs368bn over FY12-14E) and relative resilience to global factors. We highlight improving business momentum in India driven by tariff increases and 3G rollout, and the solid progress in its African operations. However, these should be partially offset by negative impact of policy changes, which we factor in our estimates. We reduce our FY13E/FY14E EBITDA by 14%/12% and target price by 9% to Rs420. The EPS cut is higher (35%/24% in FY13E/14E) due to Bharti's operating and financial leverage.

India: steady progress but policy risk is material
We expect Bharti's Indian operations to generate FCF (before spectrum/license payments) of Rs80bn/138bn/186bn in FY12E/13E/14E. The impact of higher tariffs (c20%) should percolate through the subscriber base over the next six months, leading revenue growth to inch back to 15% YoY. Our estimates factor the likely cost of excess spectrum (around Rs43bn) but not the cost of extension of key licenses during FY15/16 (around Rs57bn). While the impact of regulatory costs is material, Bharti is better placed than its incumbent peers to absorb them.

Africa: we expect operations to close the cashflow gap by FY14E
Bharti's revenue and EBITDA run-rate in Africa stands at \$3.7bn/\$1bn. Margin has continued to improve (26.3% 2QFY12), and we forecast a level of 30%/32% in FY13/FY14. Bharti has increased its FY12E capex guidance to \$1.5bn and believes that its unit capex costs are lower than competition. Results commentary of its key competitors suggests that it has made aggressive tariff cuts in markets such as Ghana and Kenya but has been more restrained in Nigeria. We forecast FY13/FY14 EBITDA and FCF at \$1.4/\$1.7bn and \$350m/\$85m, respectively.

Target price of Rs420, trading at 6.5xFY13E EV/EBITDA and 7% FCF yield
We use DCF to value Bharti (details on pg 13). Our target price implies 7.8xFY13 EV/EBITDA for Indian ops assuming 5.0x for Africa. The reduction in target price is due to Indian operations (Rs460 vs Rs500 earlier); we continue imply African ops at equity value of Rs40/shr. Adverse policy outcome is the key risk.

Forecasts And Ratios

Year End Mar 31	2010A	2011A	**2012E**	2013E	2014E
Sales (INRm)	396,150.2	595,279.0	**719,425.0**	837,428.5	952,062.7
EBITDA (INRm)	161,241.6	199,693.8	**243,601.8**	301,071.6	360,271.6
Reported NPAT	91,023.2	60,519.0	**51,298.7**	95,075.4	130,725.4
Reported EPS	23.99	15.93	**13.51**	25.03	34.42
DB EPS FD(INR)	20.53	16.36	**14.82**	25.03	34.42
OLD DB EPS	20.53	16.33	**26.51**	38.62	45.27
% Change	0.0%	0.2%	**-44.1%**	-35.2%	-24.0%
DB EPS growth	-27.7	-20.3	**-9.4**	68.9	37.5
PER (x)	17.3	19.5	**26.3**	15.6	11.3
EV/EBITDA (x)	8.5	9.2	**8.5**	6.6	5.1

Source: Deutsche Bank estimates, company data

[1.] DB EPS is fully diluted and excludes non-recurring items; 2 Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close.

Model updated:02 December 2011

Running the numbers

Asia

India

Telecommunications

Bharti Airtel Limited

Reuters: BRTI.BO | Bloomberg: BHARTI IN

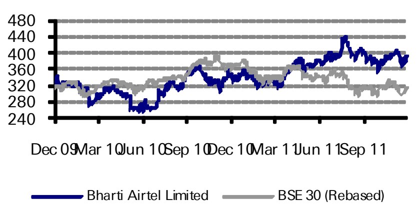
Buy

Price (5 Dec 11)	INR 390.30
Target Price	INR 420.00
52 Week range	INR 314.20 - 440.25
Market Cap (m)	INRm 1,482,359
	USDm 28,833

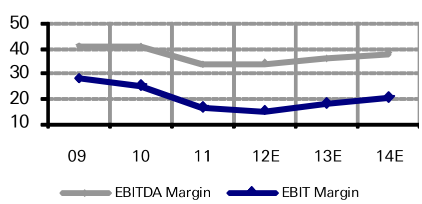
Company Profile

Bharti Airtel Limited provides cellular serivces in all the telecom circles in India. The company also provides fixed line phones services, Internet services, VAT services & network solutions.

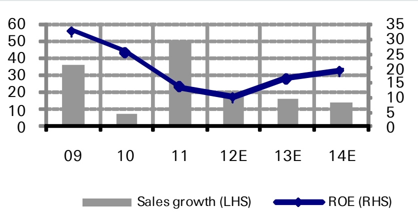
Price Performance



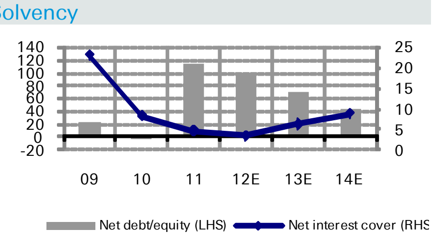
Margin Trends



Growth & Profitability



Solvency



Fiscal year end 31-Mar	2009	2010	2011	2012E	2013E	2014E
Financial Summary						
DB EPS (INR)	28.42	20.53	16.36	14.82	25.03	34.42
Reported EPS (INR)	22.33	23.99	15.93	13.51	25.03	34.42
DPS (INR)	1.00	1.00	1.00	1.00	1.00	1.00
BVPS (INR)	80.1	109.1	128.4	140.7	164.6	197.9
Weighted average shares (m)	3,792	3,793	3,798	3,798	3,798	3,798
Average market cap (INRm)	1,395,068	1,350,173	1,211,859	1,482,359	1,482,359	1,482,359
Enterprise value (INRm)	1,475,278	1,365,683	1,839,895	2,075,513	1,972,461	1,854,656
Valuation Metrics						
P/E (DB) (x)	12.9	17.3	19.5	26.3	15.6	11.3
P/E (Reported) (x)	16.5	14.8	20.0	28.9	15.6	11.3
P/BV (x)	3.90	2.86	2.78	2.77	2.37	1.97
FCF Yield (%)	nm	2.6	nm	3.0	7.3	8.2
Dividend Yield (%)	0.3	0.3	0.3	0.3	0.3	0.3
EV/Sales (x)	4.0	3.4	3.1	2.9	2.4	1.9
EV/EBITDA (x)	9.7	8.5	9.2	8.5	6.6	5.1
EV/EBIT (x)	14.2	13.6	18.9	19.3	13.1	9.5
Income Statement (INRm)						
Sales revenue	369,616	396,150	595,279	719,425	837,429	952,063
Gross profit	200,651	216,432	305,412	377,659	448,590	516,877
EBITDA	151,678	161,242	199,694	243,602	301,072	360,272
Depreciation	47,581	60,457	102,097	135,888	150,220	164,553
Amortisation	0	0	0	0	0	0
EBIT	104,098	100,785	97,597	107,714	150,851	195,719
Net interest income(expense)	-4,534	-12,434	-21,915	-32,069	-24,668	-22,201
Associates/affiliates	-713	292	0	0	0	0
Exceptionals/extraordinaries	-23,084	13,116	-1,629	-5,000	0	0
Other pre-tax income/(expense)	17,307	6,193	2,815	29	84	158
Profit before tax	93,074	107,952	76,868	70,674	126,267	173,676
Income tax expense	6,615	13,959	17,823	19,675	31,567	43,419
Minorities	1,759	2,970	-1,475	-300	-375	-469
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	84,700	91,023	60,519	51,299	95,075	130,725
DB adjustments (including dilution)	23,084	-13,116	1,629	5,000	0	0
DB Net profit	107,783	77,907	62,148	56,299	95,075	130,725
Cash Flow (INRm)						
Cash flow from operations	137,065	142,972	267,843	255,376	267,062	281,030
Net Capex	-143,420	-107,441	-298,258	-211,350	-159,250	-159,250
Free cash flow	-6,355	35,532	-30,415	44,026	107,812	121,780
Equity raised/(bought back)	1,895	23,640	-41,509	0	0	0
Dividends paid	-4,442	-4,443	-4,414	-4,444	-4,444	-4,444
Net inc/(dec) in borrowings	21,737	-54,182	552,090	0	0	0
Other investing/financing cash flows	9,816	-10,142	-538,216	0	0	0
Net cash flow	22,651	-9,596	-62,464	39,582	103,369	117,337
Change in working capital	*-16,976*	*10,118*	*128,010*	*63,489*	*22,142*	*-13,779*
Balance Sheet (INRm)						
Cash and other liquid assets	49,166	77,425	16,543	51,125	154,494	271,831
Tangible fixed assets	409,136	443,808	651,426	722,506	770,154	803,469
Goodwill/intangible assets	40,364	52,675	637,317	641,699	603,081	564,464
Associates/investments	128	172	0	0	0	0
Other assets	97,598	71,649	159,778	166,250	179,921	240,290
Total assets	596,391	645,729	1,465,064	1,581,580	1,707,650	1,880,053
Interest bearing debt	118,800	64,618	616,708	616,708	616,708	616,708
Other liabilities	162,942	138,923	332,125	402,086	437,899	484,489
Total liabilities	281,742	203,542	948,833	1,018,794	1,054,607	1,101,197
Shareholders' equity	303,945	413,699	487,668	534,523	625,155	751,437
Minorities	10,704	28,489	28,563	28,263	27,888	27,419
Total shareholders' equity	314,649	442,188	516,231	562,786	653,043	778,856
Net debt	*69,634*	*-12,807*	*600,165*	*565,583*	*462,214*	*344,877*
Key Company Metrics						
Sales growth (%)	36.8	7.2	50.3	20.9	16.4	13.7
DB EPS growth (%)	60.9	-27.7	-20.3	-9.4	68.9	37.5
EBITDA Margin (%)	41.0	40.7	33.5	33.9	36.0	37.8
EBIT Margin (%)	28.2	25.4	16.4	15.0	18.0	20.6
Payout ratio (%)	4.5	4.2	6.3	7.4	4.0	2.9
ROE (%)	32.5	25.4	13.4	10.0	16.4	19.0
Capex/sales (%)	38.8	27.1	50.1	29.4	19.0	16.7
Capex/depreciation (x)	3.0	1.8	2.9	1.6	1.1	1.0
Net debt/equity (%)	22.1	-2.9	116.3	100.5	70.8	44.3
Net interest cover (x)	23.0	8.1	4.5	3.4	6.1	8.8

Source: Company data, Deutsche Bank estimates

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Key highlights

Our estimates vs consensus

Our revenue and EBITDA estimates are broadly in line with consensus. We note that Bharti's FY13E consensus EPS has been reduced by 16% over the last six months.

Over the last six months, the visibility in terms of both the India businesses and the African operations has improved. We believe consensus now factors the impact of the recent tariff hikes and the improvement in African EBITDA margins.

Our estimates factor an amortisation charge for the excess spectrum fee payable by Bharti. This has probably resulted in lower than consensus EPS estimates.

Figure 32: Bharti – Deutsche Bank estimates vs. consensus

	FY12E			FY13E		
	DB est	Consensus	%diff	DB est	Consensus	%diff
Revenue (Rs m)	719,425	714,043	0.8%	837,429	822,317	1.8%
EBITDA (Rs m)	243,602	246,157	-1.0%	301,072	300,795	0.1%
EPS (Rs)	14.8	16.6	-10.7%	25.0	26.2	-4.5%

Source: Bloomberg Finance LP, Deutsche Bank

Changes in key estimates

Figure 33: Bharti – change in estimates

		FY12E	FY13E	FY14E	Comments
Revenues (Rs m)	New est	719,425	837,429	952,063	
	Old est	747,909	887,325	1,005,708	
	Change	-3.8%	-5.6%	-5.3%	
EBITDA (Rs m)	New est	243,602	301,072	360,272	Our reduction in EBITDA factors the likely impact of excess spectrum payments and slower-than-forecast improvement in profitability.
	Old est	276,841	352,101	409,016	
	Change	-12.0%	-14.5%	-11.9%	
EBITDA margin	New est	33.9%	36.0%	37.8%	The impact is magnified at the EPS level due to operating leverage and Bharti's high financial leverage.
	Old est	37.0%	39.7%	40.7%	
EPS (Rs)	New est	14.8	25.0	34.4	
	Old est	26.5	38.6	45.3	
	Change	-44.1%	-35.2%	-24.0%	
Capex (Rs m)	New est	168,350	159,250	159,250	The reduction in target price (DCF –based) is lower than the reduction in EPS but largely in line with the fall in EBITDA. On a relative multiple basis, we are implying a rerating on PE basis but minimal change on EV/EBITDA basis
	Old est	139,500	112,500	112,500	
Target price	New est	Rs420			
	Old est	Rs460			

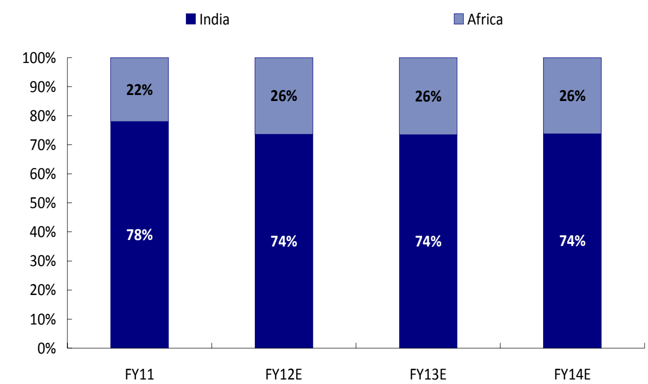
Source: Deutsche Bank

Business Overview

India remains the driver of Bharti's substantial FCF growth

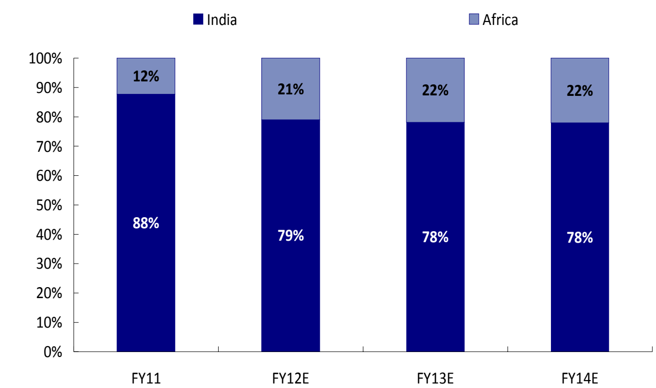
Bharti's debt-financed $9bn acquisition of Zain's African assets in June 2010 has altered its financials. The African operations currently account for 26% of revenues and 20% of EBITDA. However, the Indian operations will likely be the prime driver of FCF. The African ops are likely to be FCF negative to the tune of Rs37bn/21bn/7bn in FY12E/13E/14E.

Figure 34: Bharti –India and Africa revenue breakup



Source: Company, Deutsche Bank

Figure 35: Bharti – India and Africa EBITDA breakup



Source: Company, Deutsche Bank

Figure 36: Bharti – abridged consolidated financials (Rs m)

Year ending 31-March	2011	2012E	2013E	2014E
India revenue	464,445	529,799	615,567	702,468
Africa revenue	130,834	189,626	221,862	249,595
Total revenue	**595,279**	**719,425**	**837,429**	**952,063**
India EBITDA	171,078	192,483	235,219	280,830
Africa EBITDA	28,616	51,118	65,852	79,441
Total EBITDA	**199,694**	**243,602**	**301,072**	**360,272**
India interest cost	(5,463)	(12,000)	(6,000)	(3,900)
Africa Interest cost	(14,709)	(20,069)	(18,668)	(18,301)
Total interest cost	**(20,172)**	**(32,069)**	**(24,668)**	**(22,201)**
Cashflow from operations - India	165,615	180,483	229,219	276,930
Cashflow from operations - Africa	13,907	31,050	47,184	61,140
Total Cashflow from operations	**179,522**	**211,533**	**276,403**	**338,070**
India capex	105,858	100,100	91,000	91,000
Spectrum fees (3G, BWA, excess spectrum)	156,000	43,000		
Africa capex	36,400	68,250	68,250	68,250
Total capex	298,258	211,350	159,250	159,250
Free cash flows from operations before WC changes-India	(96,243)	37,383	138,219	185,930
Free cash flows from operations before WC changes-Africa	(22,493)	(37,200)	(21,066)	(7,110)
Total Free cashflow from operations before WC changes	**(118,736)**	**183**	**117,153**	**178,820**
(Inc)/Dec in Working capital		**63,489**	**22,142**	**(13,779)**
Free cashflow from operations		**63,672**	**139,295**	**165,041**
India Net debt	147,171	75,388	(49,047)	(173,493)
Africa Net debt	452,994	490,194	511,261	518,371
Consolidated Net Debt	**600,165**	**565,583**	**462,214**	**344,877**
Net Debt/Equity	116%	100%	71%	44%

Source: Company, Deutsche Bank

Mobile business - India

India business: mobile revenue growth is the key focus area

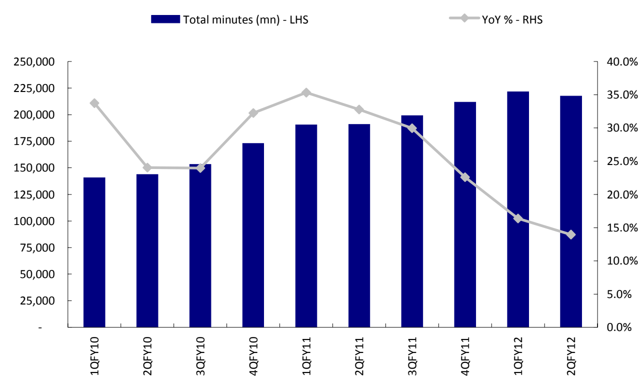
Bharti's mobile business accounts for c.70% of revenues and EBITDA and is the key driver for its FCF. Bharti has increased its headline tariffs by c.20% across all its markets for new subscribers, reflecting an improved competitive environment. This should percolate to the tariff plans of the existing subscriber base over the next six months. We note that to combat the aggressive tariffs of the challengers, Bharti and its incumbent peers made promotional offers with lower tariffs, which were typically valid for one year. As these offers expire, the impact of the new tariffs will kick in.

We expect mobile revenue growth to reach 14% over the next six months

Revenue per minute has stabilised at Rs0.432. We expect it to grow 1-2% QoQ over the next four quarters to reach a level of Rs0.46. Our forecasts imply an RPM increase of

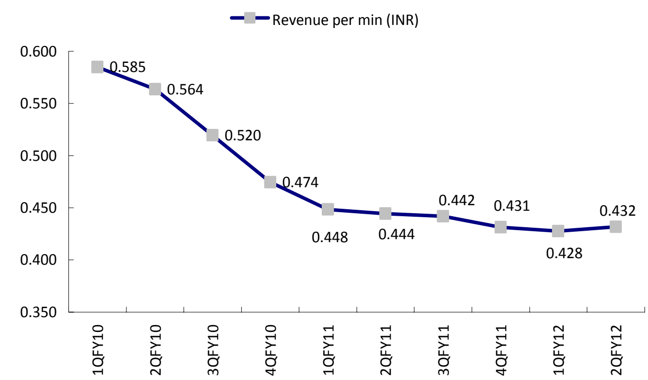
6%/2.5% in FY13E/14E. However, we expect the growth in minutes to moderate to a level of 10% YoY from the current level of around 15% YoY. Overall, we expect voice revenues to increase at a two-year CAGR (FY12-14E) of 14%.

Figure 37: Bharti – India minutes quarterly trends



Source: Company, Deutsche Bank

Figure 38: Bharti – RPM quarterly trends

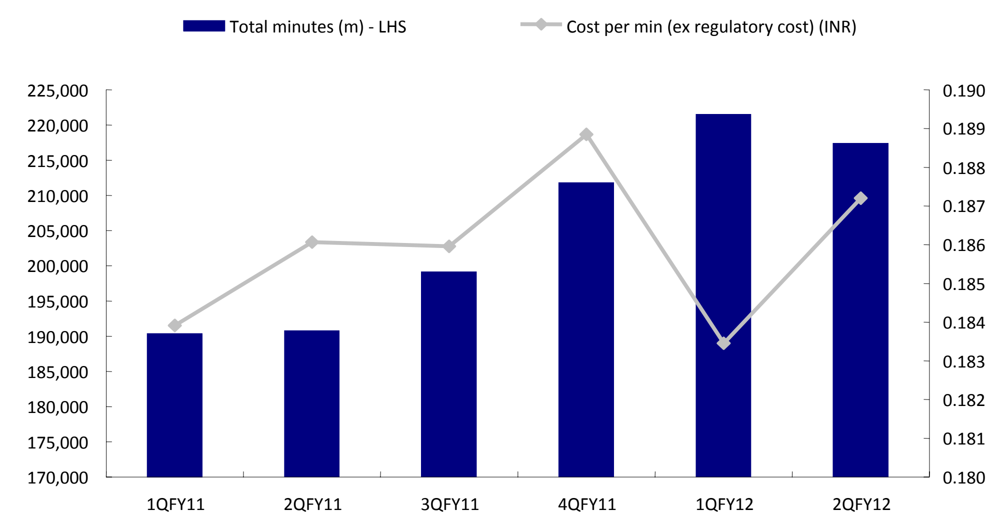


Source: Company, Deutsche Bank

Improving revenue per minute (RPM) should have a significant impact on margin

We estimate that a 5% increase in tariffs leads to a 6% increase in Bharti's consolidated EBITDA and a 14% increase in its consolidated EPS. Our analysis assumes that c.80% of the increase in RPM will flow to the EBITDA. We note that regulatory costs (license fees and spectrum charges) account for c.11% of revenues, and we further assume an additional 10% of costs would directly increase with tariffs. The improvement in RPM would lead to an expansion in the mobile EBITDA margin from 35% in FY12E to 36.4% and 37.5% in FY13E and FY14E, respectively. Over the last six quarters, Bharti's cost management has been exceptional – we estimate its cost per minute, excluding license fees and interconnect, has remained between Rs0.18 and Rs0.19 per minute.

Figure 39: Bharti – total minutes and semi-fixed cost per minute trends



Source: Company, Deutsche Bank

Mobile business: incumbent peers have done better than Bharti

Over the last six quarters, Bharti's revenue share of the Indian wireless market has decreased from 31.5% to 28.7%, and the primary gainers have been its incumbent peers, Vodafone and Idea. Bharti's top ten markets account for 65% of its revenues. The loss in revenue share has been primarily driven by key markets such as Karnataka and Bihar. At this stage we have assumed Bharti will largely maintain its revenue share at current levels.

Figure 40: Bharti – revenue contribution from top circles

Circle	Revenue (INR m)	Revenue market share	Share of Bharti's revenues
A.P.	853	41.8%	11.5%
Karnataka	837	48.7%	11.3%
Tamil Nadu	728	32.2%	9.8%
Delhi	644	36.7%	8.7%
Bihar	584	47.8%	7.9%
Rajasthan	530	46.6%	7.2%
U.P. (E)	441	28.1%	6.0%
Punjab	334	38.4%	4.5%
Maharashtra	326	17.4%	4.4%
M.P.	291	26.9%	3.9%

Source: TRAI, Deutsche Bank

Other businesses

Passive Infrastructure business: higher tenancy to drive revenues and profitability

Bharti's passive infrastructure business includes Bharti Infratel (86% subsidiary) and a 42% stake held in Indus towers, which is held through Bharti Infratel. Infratel owns 33,000 towers that have an average tenancy of 1.79. Indus operates 108,000 towers with an average tenancy of 1.89. We assume a minimal growth in towers, as operators will likely co-locate most of the new radio equipment. Our forecasts assume the tenancy of Infratel towers to increase to 1.9 and for Indus to reach 2.0 by FY14. We expect the EBITDA margin to remain stable, and hence we expect EBITDA to rise around 9% during FY12-14.

Figure 41: Passive Infrastructure – quarterly trends and annual forecasts

	1QFY11	2QFY11	3QFY11	4QFY11	1QFY12	2QFY12	FY12E	FY13E	FY14E
Bharti Infratel									
No. of towers	31,196	31,831	32,424	32,792	32,942	33,056	33,792	34,292	34,792
Tenancy ratio	1.65	1.65	1.68	1.73	1.77	1.79	1.79	1.85	1.9
Indus Towers									
No. of towers	104,901	106,438	107,789	108,586	108,922	108,998	110,086	112,086	113,586
Tenancy ratio	1.75	1.78	1.8	1.83	1.87	1.89	1.89	1.9	2.0
Passive Infrastructure (INR m)									
Revenue	20,412	21,161	21,972	22,010	22,767	23,766	96,739	104,324	114,461
EBITDA	7,240	7,858	8,486	8,153	8,585	8,902	36,259	39,252	42,705
EBITDA margin	*35.5%*	*37.1%*	*38.6%*	*37.0%*	*37.7%*	*37.5%*	*37.5%*	*37.6%*	*37.3%*

Source: Company, Deutsche Bank

Fixed line and enterprise: Minimal growth over FY12-14E

We have forecast Bharti's access and enterprise business to grow minimally over the next two years. We have assumed margins to remain relatively stable at 45% for access and 22% for the enterprise business.

Figure 42: Fixed line and enterprise business – quarterly trends and annual forecasts (INR m)

	1QFY11	2QFY11	3QFY11	4QFY11	1QFY12	2QFY12	FY12E	FY13E	FY14E
Access business									
Revenue	8,960	9,118	9,068	9,178	9,457	9,528	38,578	40,712	42,554
EBITDA	3,938	4,200	4,045	4,147	4,304	4,213	17,360	18,320	19,149
EBITDA margin	44.0%	46.1%	44.6%	45.2%	45.5%	44.2%	45.0%	45.0%	45.0%
Enterprise business									
Revenue	10,186	10,424	10,503	10,179	10,410	11,042	42,118	43,803	45,555
EBITDA	2,497	2,571	2,260	2,619	2,303	2,371	9,266	9,637	10,022
EBITDA margin	*24.5%*	*24.7%*	*21.5%*	*25.7%*	*22.1%*	*21.5%*	*22.0%*	*22.0%*	*22.0%*

Source: Company, Deutsche Bank

Africa: Bharti has made steady progress

Capex boost signals increased confidence

Bharti bought Zain's African operations in 2010 for $10.7bn. Bharti's Africa foray is premised on the economic growth prospects of the continent in the next decade and a high-tariff/low-MoU market structure that provides headroom for it to execute its 'minutes factory' business model. Since the acquisition, Bharti has increased revenues from an annualised run-rate of $3.3bn to $4.0bn. EBITDA margins have increased from 23% to 26%. We have forecast FY14 revenues and EBITDA at $5.5bn and $1.7bn, respectively.

Bharti recently increased its FY12E capex guidance for its Africa operations from $1bn to $1.5bn. We view this development positively, as we believe it signals Bharti's increased confidence in the momentum of its African operations. We note that Bharti believes its unit capex costs are lower than its competitors. Our channel checks indicate that this is likely, given that Bharti has continued to partner with its existing network vendors such as Ericsson.

Figure 43: Bharti Africa business – quarterly trends and annual forecasts (in $ m)

	1QFY11	2QFY11	3QFY11	4QFY11	1QFY12	2QFY12	FY12E	FY13E	FY14E
Revenue	205	838	911	924	979	1,030	4,171	4,880	5,490
EBITDA	37	194	174	225	246	270	1,124	1,448	1,747
EBITDA margin	17.9%	23.1%	19.1%	24.3%	25.2%	26.2%	27.0%	29.7%	31.8%

Source: Company, Deutsche Bank

Managing the FCF gap should be key to the valuation impact of African operations

From a Bharti shareholder's perspective, the African transaction is an LBO (leveraged buyout), as it was completely debt-funded. If Bharti is able to limit the cash flow gap in Africa, the dependence on free cash flows from India would be minimal. If the African operations are able to substantially shoulder the burden of interest and principal repayment of the acquisition debt, the transaction would have a significant positive impact on the long-term ROE.

Competitor commentary throws light on Bharti's Africa strategy

Bharti does not provide a country-wise breakup of its African metrics. Hence, we look into the commentary from its competitors such as Vodacom, Safaricom, Millicom and MTN, which also have operations in some of the same markets as Bharti.

We believe Bharti has followed a calibrated strategy in various markets based on two factors – the overall market potential and its contribution to Bharti's financials. In markets such as Ghana and Kenya, which are large telecom markets but have minimally contributed to Bharti's revenue and EBITDA in the past, it appears to have been aggressive with tariff cuts.

Ghana: Both MTN and Millicom, the two key players in the market, reported significant price competition primarily driven by cuts in off-net tariffs. While MTN's revenues grew 12% YoY (in local currency) in 1HCY11, EBITDA margin contracted 140bps to 38.5%. Deutsche Bank analyst Nik Kershaw believes the contraction in margins was due to a sharp increase in interconnection costs (65.2%), driven by lower off-net tariffs resulting in higher off-net traffic. In its recent 3QCY11 results, Millicom indicated that due to the severe price competition, it has decided to eliminate its price-premium in order to retain its market position. While Millicom's overall African revenues increased 7.8% in local currency, excluding Ghana and Senegal (network issues), it rose 16% YoY.

Kenya: Safaricom, which is the market leader, has been significantly affected by aggressive tariffs. For 1HFY12 (end-September), voice revenues fell 5.5% YoY, driven by an 80% decline in voice tariffs. Safaricom also saw a 50% increase in interconnect costs.

Nigeria: Bharti appears to have been more restrained here, given that this market accounts for an estimated 35% of its African revenues. For 1HCY11, MTN Nigeria EBITDA margin increased 200bps to 63.3%.

Tower –sharing starts to gain traction in Africa

We note that African operators are increasing focus on defraying network costs through tower sharing deals. Millicom has initiated the process for the sale of its towers in Ghana, Tanzania, and DRC. We note that MTN has also transferred its towers in Ghana to an external tower company. Bharti has indicated that it is keen to share its towers in Africa, and it has already formed separate tower companies in its operating markets.

Policy impact – Rs43bn for excess spectrum and Rs57bn for license extension

The sector regulator (TRAI) has made many recommendations with respect to spectrum allocation and pricing. These are in the penultimate stages of being accepted by the government, after which the recommendations would be sector policy. As discussed elsewhere in this report, the impact of policy changes is on two counts:

- Likely cash outflow on account of 'excess spectrum' and the cost of license extension in key markets
- Guidelines relating spectrum sharing and M&A, which would affect the range and efficacy of the strategic options available to Bharti in the future

The regulator has deemed any spectrum held beyond 6.2Mhz in a market as 'excess spectrum.' It has levied a one-time fee based on a market-based value of spectrum for each market. The impact on this count is around Rs43bn for Bharti. In addition, Bharti's licenses in its key markets expire in FY15-16E. At the current value, the cost of a license extension for ten years would amount to around Rs57bn for Bharti. We note the regulator has suggested that on the extension of a license, the government should exchange Bharti's holding in 900Mhz spectrum for the inferior 1800MHz spectrum. Our calculations assume the same; however, we have not factored in the likely increase in capex due to the shift in spectrum.

M&A and spectrum sharing guidelines – Bharti likely to be negatively affected

We expect M&A policy to have a negative impact on Bharti. As a dominant player in the key markets, Bharti will unlikely be in an advantageous position to act as a consolidator. The current guidelines suggest a revenue-share cap of 35% for the merged entity. We believe the guidelines are most beneficial to challengers such as RCOM/Tata Teleservices or well-funded entrants such as Reliance Industries. With respect to sharing, we believe Bharti would be better off sharing spectrum with marginal operators rather than incumbent peers. However, for a marginal operator, a sell-off is a superior option to sharing spectrum. Thus Bharti's strategic options would depend on strategies adopted by the challengers and entrants.

Financial analysis

Revenue growth to accelerate both in India and Africa

We forecast Bharti's consolidated revenues at a CAGR (FY11-14E) of 17%, driven by 15% and 24% p.a. growth in the India and Africa businesses, respectively. We expect the recent tariff hikes and the rollout of 3G to sustain the current revenue growth momentum in India. In Africa, we are forecasting robust traffic growth (30% p.a.).

We forecast consolidated EBITDA at a 22% CAGR (FY11-14E) and EBITDA margins to improve from 33.5% in FY11 to 37.8% by FY14E. We expect Indian margins to improve on falling competitive intensity and the incremental positive impact of 3G roll-out on voice network costs. We expect margins in the African operations to improve on cost efficiencies especially on SG&A costs.

Figure 44: Bharti – abridged financials (Rs m)

Year ending 31-Mar	FY11	FY12E	FY13E	FY14E
Revenues	**595,279**	**719,425**	**837,429**	**952,063**
India (incl 3G)	464,445	529,799	615,567	702,468
Africa	130,834	189,626	221,862	249,595
EBITDA	**199,694**	**243,602**	**301,072**	**360,272**
India (incl 3G)	171,078	192,483	235,219	280,830
Africa	28,616	51,118	65,852	79,441
EBITDA margin	33.5%	33.9%	36.0%	37.8%
Depreciation	102,097	135,888	150,220	164,553
Interest	20,172	32,069	24,668	22,201
Recurring PAT	62,148	56,299	95,075	130,725
EPS	**16.4**	**14.8**	**25.0**	**34.4**
FCFF before WC changes	**(118,736)**	**183**	**117,153**	**178,820**
India	(96,243)	37,383	138,219	185,930
Africa	(22,493)	(37,200)	(21,066)	(7,110)

Source: Company, Deutsche Bank

India wireless revenues at a CAGR (FY11-14E) of 16%

We expect India wireless minutes to increase at a CAGR (FY11-14E) of 11% and revenue per minute to rise by 2% per year, leading to a base-case revenue growth of 14%. In addition, we expect 3G data revenues to ramp up from Rs7.8bn (2% of revenues) in FY12E to Rs39bn (7% of revenues) by FY14E. We estimate the India non-wireless businesses to grow at a CAGR (FY11-14E) of 9%, leading to overall India revenue growth of 15% p.a.

Africa revenues to reach $5.5bn by FY14E

We estimate Africa revenues to expand at a CAGR (FY11-14E) of 24%, which would result in its share increasing from 22% (FY11) to 26% (FY14E) of consolidated revenues. We have assumed Bharti's Africa minutes to grow at rates of 30% and 25% in FY13E and FY14E, respectively, led by selective price cuts (revenue per minute expected to decline by 10% p.a.) and its aggressive network rollout (capex guidance increased from $1.0-1.2bn to $1.5bn).

India EBITDA margins to expand due to tariff hikes

We forecast India base-case wireless EBITDA margins to improve from 35.8% in FY11 to 37.5% by FY14 as a result of 2% p.a growth in revenue/min. Between FY08-11, revenue/min fell 16% p.a. resulting in EBITDA/min declining by 19% p.a. over the same period. We expect EBITDA/min to increase by 4% p.a. over FY11-14E.

In addition, we believe 3G should be margin-accretive at the EBITDA level primarily due to lack of handset subsidies. We expect overall India EBITDA margins to expand from 36.8% in FY11 to 40% by FY14, leading to an EBITDA CAGR (FY11-14) of 18%.

EBITDA margin in Africa to be driven by cost efficiencies

In Africa, we expect EBITDA margins to improve from 22% in FY11 to 32% by FY14. We have already begun to witness an improvement due to better management of SG&A costs. Furthermore, we expect the network integration efforts of Bharti should result in significant cost savings. Overall, we estimate FY14 African EBITDA at $1.7bn (Rs79bn), which would constitute 22% of Bharti's consolidated EBITDA (Rs362bn) compared to 21% in FY12E.

Net profit to double over FY11-14E

We forecast Bharti's net profit to double from Rs62bn in FY11 to Rs131bn by FY14. The fall in net debt should result in a lower interest burden relative to operating cash flows, leading to higher growth than EBITDA.

Debt level likely to fall due to significant free cash generation in India

Bharti's consolidated net debt was at Rs600bn at the end of FY11. We expect Bharti to spend total capex (including spectrum costs) of $11bn ($6.5bn in India plus $4.5bn in Africa) over FY12-14. Over the same period, we expect Bharti to generate operating cash flows (post-interest cost) of $18bn (Rs825bn). We expect Bharti to generate FCF of $8bn (Rs370bn) over the same period, resulting in net debt falling from $13bn (Rs600bn) at the end of FY11 to $7.5bn (Rs345bn) by FY14. The net debt-to-equity ratio should reach a comfortable level of 0.4x by FY14.

Figure 45: Bharti – abridged consolidated financials (Rs m)

Year ending 31-Mar	2011	2012E	2013E	2014E
India revenue	464,445	529,799	615,567	702,468
Africa revenue	130,834	189,626	221,862	249,595
Total revenue	**595,279**	**719,425**	**837,429**	**952,063**
India EBITDA	171,078	192,483	235,219	280,830
Africa EBITDA	28,616	51,118	65,852	79,441
Total EBITDA	**199,694**	**243,602**	**301,072**	**360,272**
India interest cost	(5,463)	(12,000)	(6,000)	(3,900)
Africa Interest cost	(14,709)	(20,069)	(18,668)	(18,301)
Total interest cost	**(20,172)**	**(32,069)**	**(24,668)**	**(22,201)**
Cashflow from operations - India	165,615	180,483	229,219	276,930
Cashflow from operations - Africa	13,907	31,050	47,184	61,140
Total Cashflow from operations	**179,522**	**211,533**	**276,403**	**338,070**
India capex	105,858	100,100	91,000	91,000
Spectrum fees (3G, BWA, excess spectrum)	156,000	43,000		
Africa capex	36,400	68,250	68,250	68,250
Total capex	**298,258**	**211,350**	**159,250**	**159,250**
Free cash flows from operations before WC changes- India	(96,243)	37,383	138,219	185,930
Free cash flows from operations before WC changes- Africa	(22,493)	(37,200)	(21,066)	(7,110)
Total Free cashflow from operations before WC changes	**(118,736)**	**183**	**117,153**	**178,820**
(Inc)/Dec in Working capital	**63,489**	**22,142**	**(13,779)**	
Free cashflow from operations	**63,672**	**139,295**	**165,041**	
India Net debt	147,171	75,388	(49,047)	(173,493)
Africa Net debt	452,994	490,194	511,261	518,371
Consolidated Net Debt	**600,165**	**565,583**	**462,214**	**344,877**
Net Debt/Equity	116%	100%	71%	44%

Source: Company, Deutsche Bank

Impact of FX

A key investor concern about Bharti is the impact of FX movements on its financials. 75% of Bharti's consolidated debt is USD–denominated, which would result in significant translation losses due to the INR depreciation. However, the impact on finance costs and recurring profit should be minimal, in our view. Hedging translational gains and losses is unnecessary, as they arise out of the consolidation of accounts rather than an economic impact on operations.

The cash flow impact of the acquisition debt should be minimal. The acquisition debt is serviced out of the Indian cash flows as the African operations have a marginally negative FCF (EBITDA-capex). The principal payments on the acquisition debt are due in year three, four, five, and six at respective rates of 10%, 20%, 30%, and 40% of the total loan amount. The first installment would fall due around June 2013.

We estimate the interest cost of the acquisition debt at around $200m per year. The INR depreciation would have a negative impact on the cost of servicing the acquisition debt. In addition, the finance cost includes the impact of the exchange gains and losses on FX liabilities of the various operating companies.

Valuation and risks

Valuation methodology

We value Bharti at Rs420 per share based on a DCF methodology. We have consolidated the financial operations of Bharti's African portfolio with its Indian operations (including a 42% stake in Indus).

DCF – assumptions and valuation

We have used a 15-year period for our DCF forecasts. We assume revenue growth will trend down over our forecast period and settle at 6%. The capex-to-sales ratio should remain at 15%, as the company will likely continue to invest in creating capacities in both India and Africa. Our DCF assumptions are as follows: we derive our overall WACC of 13.6% using a weighted average of the cost of equity of India and Africa.

For India, our assumptions are: a risk-free rate of 6%, a risk premium of 8.5%, beta at 0.9x, and cost of debt of 8%. Our resultant India CoE is 13.7%, and we assume the CoE for Africa at 17.6%. Our weighted cost of debt is at 11.5% (assuming Africa cost of debt is at 12%). Our resultant WACC for the consolidated entity is 13.6%, and we assume a 2% terminal growth rate.

Figure 46: Bharti – DCF value and assumptions

Assumptions								
WACC	13.6%							
Terminal growth rate of cashflow	2%							
Terminal value	2,841,630			Terminal growth rate				
PV of terminal value	417,974			0.0%	2.0%	4.0%	6.0%	
Enterprise value	2,158,576		11.6%	511	543	593	678	
TV as % of Total	19%	WACC	12.6%	452	476	511	568	
Net debt	565,583		13.6%	402	420	445	484	
Equity value	1,592,993		14.6%	358	372	391	418	
Equity Value per share (Rs)	420		15.6%	321	331	345	365	

Source: Deutsche Bank

SOTP valuation implies Indian operations at 7.8x FY13E EV/EBITDA

On an SOTP basis, our target price implies a valuation of 7.8x FY13E EV/EBITDA for Bharti's Indian operations if we assume 5x FY13E EV/EBITDA for its African operations. We note that Bharti's African peers such as MTN, Safaricom, and Vodacom are currently trading at c.4.5-5.5x.

Our SOTP implies an equity value of Rs463/share for India and (Rs42) for African operations. The implied multiple of 7.8xEV/EBITDA is broadly in line with Bharti's historical valuations. On a consolidated basis, our target price implies FY13E EV/EBITDA of 7.2x and P/E of 17x.

Figure 47: Bharti – SOTP valuation

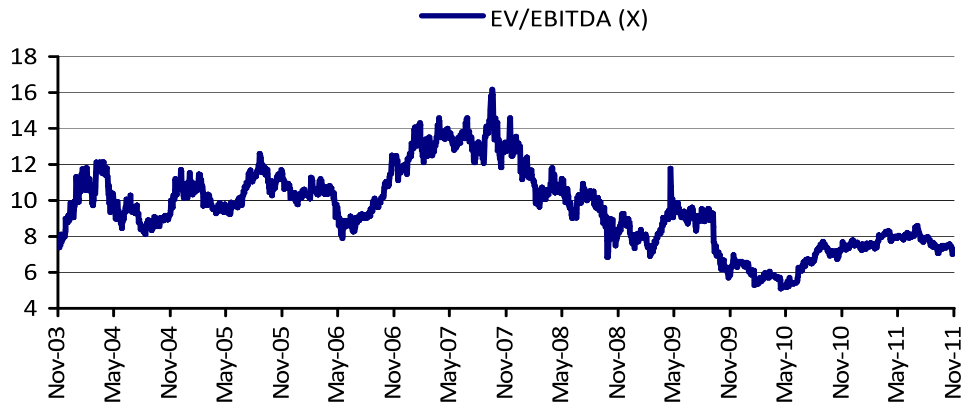
Rs m	FY12E	Comment
EV/EBITDA (x)		
India	7.8	The implied multiple for the India business is based on our target price
Africa	5.0	In line with its major African peer – MTN
Implied total EV/EBITDA	7.2	
India EBITDA	235,219	
Africa EBITDA	65,852	
Total EBITDA	**301,072**	
India EV	1,834,711	
Africa EV	329,261	
Total EV	**2,163,972**	
India debt	75,388	
Africa debt	490,194	
India equity value	1,759,323	
Africa equity value	(160,933)	
Total equity value	**1,598,389**	
India equity value (Rs/sh)	463	
Africa equity value (Rs/sh)	(42)	Our SOTP implies a negative equity value for African operations.
Share price	421	

Source: Deutsche Bank

Bharti would trade at a modest discount to historical valuations

Our target price implies a 15-20% to historical EV/EBITDA for Bharti. Bharti's historical valuations were driven by the strong growth witnessed in the Indian voice market between FY03-FY10 (75% CAGR). We believe the potential for wireless data in India is as promising as the voice opportunity in the last decade which should ideally result in valuations reverting to historical levels. However, we believe the overhang of a) adverse impact of domestic telecom policy decisions and b) market concerns on negative free cashflows in African operations could result in valuations settling at a lower level in the medium term.

Figure 48: Bharti – historical EV/EBITDA trend



Source: Bloomberg Finance LP, Deutsche Bank

Risks

Adverse outcomes from policy decisions

The recent policy-related recommendations of the regulator are likely to have a negative impact on the incumbents' cash flows in the immediate term and their ability to compete in the medium and long term. Our current estimates and valuations factor in the likely charges for excess spectrum and the renewal of licenses. The other policy decisions that are pending and could have a negative impact on valuations are: a) the refarming of 900MHz spectrum and giving 1800Mhz to incumbents at the time of license renewal and b) disallowing of 3G intra-circle roaming agreements.

Resumption of tariff wars in India

The wireless pricing environment has been quite benign over the last quarter, and we expect industry tariffs to increase by a respective 5% and 3% in FY13 and FY14. However, if the new entrants try once more to acquire subscribers by providing lower rates, there could be a downside risk to our revenue and margin estimates.

Slower-than-expected increase in 3G subscribers

We have assumed a meaningful increase in the proportion of subscribers that will have 3G enabled handsets over the next three years. If the penetration of 3G-enabled handsets does not increase as projected, there could be downside to our estimates.

Increased competition in Africa

Bharti currently has low market shares in the larger markets of Africa, and we have assumed that its competitive position would not deteriorate over the next three years. If the larger competitors in Africa – namely MTN, Vodacom, and Safaricom – are able to increase their market share further, it would have a negative impact on our Africa estimates.

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Rating
Hold

Asia
India

Telecommunications
Wireless

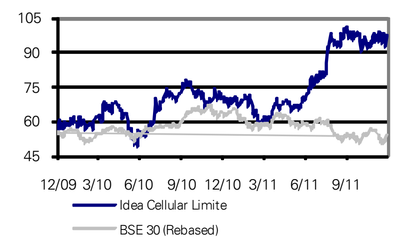
Company
Idea Cellular Limited

Reuters	Bloomberg
IDEA.BO	IDEA IN

Price at 5 Dec 2011 (INR)	97.25
Price target - 12mth (INR)	105.00
52-week range (INR)	100.95 - 57.50
BSE 30	16,847

Key changes			
Price target	70.00 to 105.00	↑	50.0%
Sales (FYE)	192,607 to 198,878	↑	3.3%
Op prof margin (FYE)	10.4 to 8.5	↓	-18.9%
Net profit (FYE)	8,881.5 to 4,925.2	↓	-44.5%

Price/price relative



Performance (%)	1m	3m	12m
Absolute	-0.6	-3.7	38.5
BSE 30	-4.1	0.8	-15.6

Stock Data	
Market cap (INRm)	321,270
Market cap (USDm)	6,275
Shares outstanding (m)	3,303.5
Major shareholders	Aditya Birla group (46.96%)
Free float (%)	34
Avg daily value traded (USDm)	13.1

Key Indicators (Fy1)	
ROE (%)	3.9
Net debt/equity (%)	95.7
Book value/share (INR)	38.60
Price/book (x)	2.5
Net interest cover (x)	1.7
Operating profit margin (%)	8.5

Tight execution but low FCF cushion to shield policy impact

Strong performance but weak FCF; target price Rs105, maintaining Hold
Idea's operating performance has been the strongest among its incumbent peers. It has creditably defended its revenue-share in legacy markets and managed to improve its cost competitiveness relative to the sector leader, Bharti. We have increased FY13E/14E EBITDA by 16%/18%, EPS by 0%/10% and target price by 50% implying a rerating which reflects its competitive position. The two concerns are a) relatively higher impact of likely regulatory costs and b) weaker FCF profile compared to its peers. Our EPS factors the cost of excess spectrum.

Closing the cost gap with sector leader Bharti
Over the last eight quarters, Idea has maintained its revenue-share in its legacy markets at c.21% despite dramatic changes in competitive dynamics. More recently (last 2 quarters), it has improved EBITDA margin in these markets by c.150bps to 29.4%, driven by improving revenue per minute. We estimate that Idea has largely closed the gap with Bharti on network and SG&A cost/min and its lower EBITDA per minute (Rs0.09 vs Rs0.15 for Bharti) is primarily due to higher regulatory and interconnect costs.

Regulatory costs and FCF are the key concerns
We estimate Idea's cost for 'excess spectrum' and license extension at Rs19bn and Rs46bn. While the excess spectrum cost is factored in our EPS estimates, the cost of extension should be incurred in FY15/16. Though Idea's debt/EBITDA at 2.5x is manageable, its FCF in FY12E/13E/14E of Rs-30/15/24bn is low relative to its likely cost of license extension. We note that Idea could monetise its stake in Indus towers (valued at Rs32bn) to bridge cashflow gaps.

Three-year EBITDA CAGR (FY11-13E) of 33%, trading at 6xFY13E EV/EBITDA
We value Idea on a sum-of-the-parts (SoTP) basis by valuing the core telecom business using DCF. Our DCF-based target price is Rs105/share: Rs95/share for core operations and Rs10/share for its 13.5% effective stake in Indus Towers. Our DCF assumptions are RFR of 6%, risk premium of 8.5%, WACC of 13.5%/10.8% for Idea/Indus and terminal growth rate of 2%. Upside risks include lower-than-expected spectrum and license extension costs. Adverse policy decisions are key downside risks.

Forecasts And Ratios

Year End Mar 31	2010A	2011A	2012E	2013E	2014E
Sales (INRm)	134,160.2	156,380.0	198,878.4	248,624.6	280,288.8
EBITDA (INRm)	32,276.3	33,263.0	47,597.2	66,526.3	77,744.8
Reported NPAT	8,281.9	8,379.0	4,925.2	12,805.8	17,854.0
Reported EPS	2.51	2.54	1.49	3.88	5.40
DB EPS FD(INR)	2.45	2.54	1.49	3.88	5.40
DB EPS growth	-22.2	3.6	-41.2	160.0	39.4
PER (x)	26.9	26.0	65.2	25.1	18.0
EV/EBITDA (x)	8.3	9.3	9.3	6.4	5.2

Source: Deutsche Bank estimates, company data

[1]. DB EPS is fully diluted and excludes non-recurring items; 2 Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close and future years, except P/B which uses the year end close.

Model updated:29 November 2011

Running the numbers

Asia

India

Wireless

Idea Cellular Limited

Reuters: IDEA.BO Bloomberg: IDEA IN

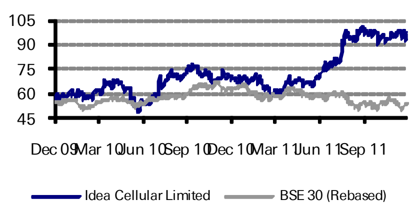
Hold

Price (5 Dec 11)	INR 97.25
Target Price	INR 105.00
52 Week range	INR 57.50 - 100.95
Market Cap (m)	INRm 321,270
	USDm 6,249

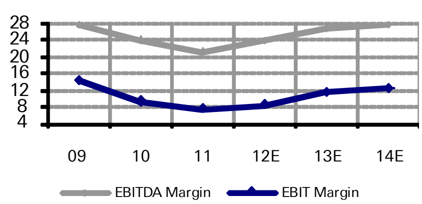
Company Profile

Idea cellular is a leading Indian mobile services company with operations in 11 license areas with a subscriber marketshare of 9% as of November 2007.

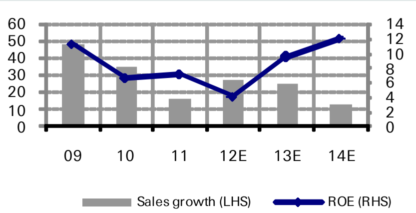
Price Performance



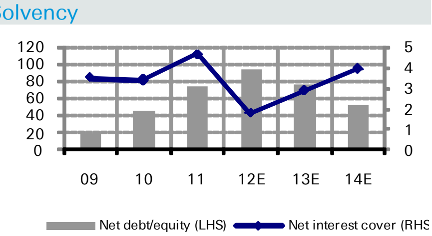
Margin Trends



Growth & Profitability



Solvency



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Fiscal year end 31-Mar	2009	2010	2011	2012E	2013E	2014E
Financial Summary						
DB EPS (INR)	3.15	2.45	2.54	1.49	3.88	5.40
Reported EPS (INR)	3.15	2.51	2.54	1.49	3.88	5.40
DPS (INR)	0.00	0.00	0.00	0.00	0.00	0.00
BVPS (INR)	44.8	34.6	37.1	38.6	42.5	47.9
Weighted average shares (m)	3,100	3,299	3,304	3,304	3,304	3,304
Average market cap (INRm)	224,611	217,071	218,007	321,270	321,270	321,270
Enterprise value (INRm)	230,586	268,330	309,419	443,273	428,719	404,847
Valuation Metrics						
P/E (DB) (x)	23.0	26.9	26.0	65.2	25.1	18.0
P/E (Reported) (x)	23.0	26.2	26.0	65.2	25.1	18.0
P/BV (x)	1.12	1.89	1.82	2.52	2.29	2.03
FCF Yield (%)	nm	1.0	8.0	nm	4.5	7.4
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0	0.0
EV/Sales (x)	2.3	2.0	2.0	2.2	1.7	1.4
EV/EBITDA (x)	8.4	8.3	9.3	9.3	6.4	5.2
EV/EBIT (x)	16.1	21.9	26.8	26.4	15.1	11.7
Income Statement (INRm)						
Sales revenue	99,622	134,160	156,380	198,878	248,625	280,289
Gross profit	44,531	54,201	58,799	83,927	104,920	118,282
EBITDA	27,537	32,276	33,263	47,597	66,526	77,745
Depreciation	12,112	18,948	20,262	23,108	30,391	35,394
Amortisation	1,100	1,100	1,465	7,667	7,667	7,667
EBIT	14,325	12,229	11,536	16,822	28,468	34,683
Net interest income(expense)	-4,069	-3,590	-2,489	-9,684	-9,909	-8,808
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinaries	0	205	0	0	0	0
Other pre-tax income/(expense)	0	663	0	0	0	0
Profit before tax	10,256	9,507	9,047	7,138	18,559	25,875
Income tax expense	501	1,225	668	2,213	5,753	8,021
Minorities	0	0	0	0	0	0
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	9,755	8,282	8,379	4,925	12,806	17,854
DB adjustments (including dilution)	0	-205	0	0	0	0
DB Net profit	9,755	8,077	8,379	4,925	12,806	17,854
Cash Flow (INRm)						
Cash flow from operations	9,073	30,911	53,197	28,358	54,504	63,821
Net Capex	-47,890	-28,830	-35,732	-40,000	-40,000	-40,000
Free cash flow	-38,817	2,081	17,465	-11,642	14,504	23,821
Equity raised/(bought back)	-16,228	2,259	69	50	50	51
Dividends paid	0	0	0	0	0	0
Net inc/(dec) in borrowings	12,477	-12,367	39,834	20,000	0	0
Other investing/financing cash flows	-22,856	7,690	-57,686	-19,000	0	0
Net cash flow	-65,424	-337	-317	-10,592	14,554	23,872
Change in working capital	*-8,854*	*-3,889*	*22,447*	*-7,343*	*3,640*	*2,905*
Balance Sheet (INRm)						
Cash and other liquid assets	49,614	14,005	13,687	3,095	17,649	41,521
Tangible fixed assets	125,048	134,930	150,400	167,291	176,900	181,506
Goodwill/intangible assets	23,228	36,480	92,701	104,034	96,367	88,700
Associates/investments	22,042	0	0	0	0	0
Other assets	30,007	34,420	33,731	35,081	36,835	38,676
Total assets	249,939	219,835	290,519	309,501	327,751	350,402
Interest bearing debt	77,631	65,264	105,098	125,098	125,098	125,098
Other liabilities	33,271	40,470	62,873	56,880	62,274	67,020
Total liabilities	110,902	105,734	167,971	181,978	187,372	192,118
Shareholders' equity	139,038	114,100	122,548	127,523	140,379	158,284
Minorities	0	0	0	0	0	0
Total shareholders' equity	139,038	114,100	122,548	127,523	140,379	158,284
Net debt	*28,017*	*51,259*	*91,411*	*122,003*	*107,449*	*83,577*
Key Company Metrics						
Sales growth (%)	48.2	34.7	16.6	27.2	25.0	12.7
DB EPS growth (%)	-16.1	-22.2	3.6	-41.2	160.0	39.4
EBITDA Margin (%)	27.6	24.1	21.3	23.9	26.8	27.7
EBIT Margin (%)	14.4	9.1	7.4	8.5	11.5	12.4
Payout ratio (%)	0.0	0.0	0.0	0.0	0.0	0.0
ROE (%)	11.2	6.5	7.1	3.9	9.6	12.0
Capex/sales (%)	48.1	21.5	22.8	20.1	16.1	14.3
Capex/depreciation (x)	3.6	1.4	1.6	1.3	1.1	0.9
Net debt/equity (%)	20.2	44.9	74.6	95.7	76.5	52.8
Net interest cover (x)	3.5	3.4	4.6	1.7	2.9	3.9

Source: Company data, Deutsche Bank estimates

Key highlights

Our estimates vs consensus

We are marginally above consensus on our FY13 estimates revenue and EBITDA estimate for Idea. However, we are significantly below consensus on EPS estimates. This is likely on account of the impact of 'excess spectrum charges' that we have factored in our EPS estimates. We note that Idea's FY13E EPS estimates have increased by 7% over the last six months.

Figure 49: Idea – Deutsche Bank vs. consensus

	FY12E			FY13E		
	DB est	Consensus	%diff	DB est	Consensus	%diff
Revenue (Rs mn)	198,878	192,374	3.4%	248,625	229,376	8.4%
EBITDA (Rs mn)	47,597	50,438	-5.6%	66,526	63,532	4.7%
EPS (Rs)	1.5	2.2	-33.6%	3.9	4.3	-10.1%

Source: Bloomberg Finance LP, Deutsche Bank

Changes in key estimates

Figure 50: Idea – change in estimates

		FY12E	FY13E	FY14E	Comments
Revenues (Rs m)	New est	198,878	248,625	280,289	We are increasing our revenues and EBITDA estimates to factor Idea's better than expected operating performance. We also note that Idea's financials are most sensitive to tariffs among its peers. A 5% increase in RPM leads to a 16% increase in EBITDA and 40% increase in EPS
	Old est	192,607	225,902	257,521	
	change	3.3%	10.1%	8.8%	
EBITDA (Rs m)	New est	47,597	66,526	77,745	
	Old est	46,448	57,405	65,625	
	change	2.5%	15.9%	18.5%	
EBITDA margin	New est	23.9%	26.8%	27.7%	
	Old est	24.1%	25.4%	25.5%	
	change	-19bps	+135bps	+226bps	
EPS (Rs)	New est	1.5	3.9	5.4	We have factored the amortisation impact of the excess spectrum fees, which would be payable by Idea and hence the changes in our EPS changes are not commensurate with the EBITDA changes.
	Old est	2.7	3.9	4.9	
	change	-44.6%	-0.3%	9.5%	
Capex (Rs m)	New est	40,000	40,000	40,000	Our DCF based target prices increases more than the increase in our EBITDA estimate. In summary, we are implying a re-rating of Idea on EV/EBITDA and P/E basis reflecting the better operating performance and stronger competitive position
	Old est	40,000	35,000	35,000	
Target price	New est	Rs 105			
	Old est	Rs 70			

Source: Deutsche Bank

Business overview

While Idea has a pan-India presence, it is an incumbent in 13 markets (legacy business) and an entrant in the ten other markets. Over the last six quarters, Idea's performance has been the strongest among incumbents with respect to growth in traffic and revenues. It has increased its revenue share by 160bps to14.5% over the last eight quarters.

Figure 51: Minutes and RPM quarterly trends

	1QFY11	2QFY11	3QFY11	4QFY11	1QFY12	2QFY12
Total minutes growth (YoY) %						
Bharti	35.3%	32.8%	30.0%	22.6%	16.4%	14.0%
Idea	51.1%	51.3%	45.7%	40.0%	32.0%	25.2%
RCOM	13.3%	12.0%	2.8%	1.0%	3.1%	4.5%
RPM growth (QoQ)%						
Bharti	-5.5%	-0.9%	-0.6%	-2.4%	-0.9%	1.0%
Idea	-6.0%	-3.4%	-1.2%	-2.9%	1.0%	4.1%
RCOM	0.0%	0.0%	0.0%	0.0%	0.0%	2.3%

Source: Company, Deutsche Bank

Idea is best placed to benefit from tariff hikes

We estimate a 5% increase in tariffs to lead to a 16% increase in EBITDA and 40% increase in EPS. On an overall basis, we forecast Idea's revenues to expand at two-year CAGR (FY12-14) of 17% and EBITDA margin to reach 25.6% from current level of 22.4%.

Legacy markets – stable revenue share and improving profitability

These markets account for 90% of revenues and contribute the entire EBITDA. Idea's 20% revenue share in the legacy market has remained steady despite turbulent industry conditions. The improvement in the competitive environment has helped Idea to increase tariffs. This has led to RPM growth of c.2.3% QoQ growth to Rs0.43 over the last two quarters. EBITDA margin in the legacy markets has improved 150bps to 29.4% in 1HFY12. We forecast legacy market revenues to expand at a two-year CAGR (FY12E-14E) of 14%. We expect EBITDA margins in legacy markets to improve to 32% by FY14E.

New markets – idea would need to limit its losses

Idea's revenues in the new markets have reached an annualised run rate of Rs20-22bn. However, these markets continue to lose money. We forecast revenues in new markets to increase at a two-year CAGR (FY12E-14E) of 35% but EBITDA losses to remain at a level of around Rs5.5-6bn over the next two years. While investors have been relatively unconcerned about the losses, we note that they have trended up in over the last two quarters. At our target price of Rs105 for Idea's mobile business, assuming 6.5x FY13E EV/EBITDA for Idea's legacy business, we are implying a negative value of new business at Rs11/share.

Figure 52: Idea – performance of legacy markets and new circles (Rs m)

	1QFY11	2QFY11	3QFY11	4QFY11	1QFY12	2QFY12	FY12E	FY13E	FY14E
Revenue	**36,896**	**36,891**	**39,901**	**42,691**	**45,560**	**46,554**	**193,906**	**236,193**	**263,471**
Legacy circles	33,833	33,507	35,941	38,298	40,746	41,579	173,700	206,705	226,541
New circles	3,063	3,384	3,960	4,393	4,814	4,975	20,206	29,489	36,930
EBITDA	**7,936**	**7,618**	**8,213**	**9,494**	**10,667**	**10,436**	**45,867**	**59,777**	**67,442**
Legacy circles	9,337	9,047	9,597	10,667	12,064	12,212	51,827	65,675	72,982
New circles	(1,401)	(1,429)	(1,384)	(1,173)	(1,397)	(1,776)	(5,961)	(5,898)	(5,540)
EBITDA margin	**21.5%**	**20.7%**	**20.6%**	**22.2%**	**23.4%**	**22.4%**	**23.7%**	**25.3%**	**25.6%**
Legacy circles	27.6%	27.0%	26.7%	27.9%	29.6%	29.4%	29.8%	31.8%	32.2%
New circles	-45.7%	-42.2%	-34.9%	-26.7%	-29.0%	-35.7%	-29.5%	-20.0%	-15.0%

Source: Company, Deutsche Bank

Cost analysis – improving competitive position

Idea cost position relative to its peers (such as Bharti) has been affected by its lower scale of operations. While its RPM of Rs0.43 is in line with Bharti, its EBITDA/min at Rs0.092 is 38% below that of Bharti. Our analysis suggests that Idea's lower EBITDA/minute is largely on account of higher interconnect costs. We estimate that Idea has closed the gap with Bharti on network and SG&A costs.

Figure 53: Cost analysis of Idea vs Bharti

		1Q2011	2Q2011	3Q2011	4Q2011	1Q2012	2Q2012
Idea	Minutes (mn)	82,274	84,828	93,503	101,960	108,630	106,224
Bharti	Minutes (mn)	190,396	190,767	199,146	211,822	221,560	217,408
Idea	Rev/min	0.441	0.426	0.420	0.409	0.412	0.430
Bharti	Rev/min	0.448	0.444	0.442	0.431	0.428	0.432
Idea	**Regulatory charges per min**	**0.122**	**0.118**	**0.116**	**0.114**	**0.114**	**0.122**
Bharti	**Regulatory charges per min**	**0.096**	**0.092**	**0.093**	**0.090**	**0.088**	**0.088**
Idea	Employee cost/min	0.019	0.023	0.020	0.019	0.017	0.021
Bharti	Employee cost/min	0.017	0.018	0.016	0.015	0.016	0.015
Idea	Network cost/min	0.141	0.139	0.125	0.115	0.120	0.126
Bharti	Network cost/min	0.101	0.103	0.100	0.105	0.104	0.108
Idea	SGA/min	0.069	0.064	0.076	0.076	0.067	0.068
Bharti	SGA/min	0.073	0.074	0.077	0.076	0.073	0.074
Idea	Total cost (excl reg charges)/min	0.229	0.226	0.221	0.210	0.205	0.215
Bharti	Total cost (excl reg charges)/min	0.190	0.195	0.193	0.196	0.192	0.198
Idea	**EBITDA/min**	**0.090**	**0.082**	**0.082**	**0.085**	**0.093**	**0.092**
Bharti	**EBITDA/min**	**0.162**	**0.158**	**0.156**	**0.145**	**0.147**	**0.147**

Source: Companies, Deutsche Bank

Policy impact – Rs19bn for excess spectrum and Rs46bn for license extension

The sector regulator (TRAI) has made many recommendations with respect to additional spectrum allocation and pricing. These are in the penultimate stages of being accepted by the government, after which the recommendations would be sector policy. As discussed in this report, the impact of policy changes is on two counts:

- Likely cash-outflow on account of 'excess spectrum' and the cost of license extension in key markets
- Guidelines relating spectrum sharing and M&A, which will impact the range and efficacy of the strategic options available to Idea in future

Figure 54: Idea – cost of excess spectrum

Circle	Spectrum (Mhz)	TRAI reco price per MHz beyond 6.2	Payout based on reco (Rs m)
Delhi	8	2,497	3,001
Maharashtra	9.8	3,745	6,346
Andhra Pradesh	8	4,320	2,935
Kerala	8	2,322	1,574
Punjab	7.8	1,806	1,703
UP- West	8	2,526	1,712
Madhya Pradesh	8	2,545	1,725
Total			18,995

Source: TRAI, Deutsche Bank

We have factored the cost of excess spectrum in our EPS estimates. We have assumed 50% of the cost to be amortised over the next three years. We note that current news reports indicate that the excess spectrum holding cost would be calculated from May 2008. Hence, we have assumed 50% of the payment to be adjusted as a prior-period cost and the balance to be amortised over the remaining life of the licenses (which is approximately three to four years).

Issue of overlapping licenses is yet to be resolved

On 5 July 2011, the Delhi High Court ruled in favour of Dept of Telecom (DoT) in a case relating to overlapping licenses and spectrum in six markets (circles). This situation arose due to the proposed amalgamation of Idea Cellular with Spice.

Idea acquired the promoter stake in Spice in June 2008 and completed the remaining acquisition through a share swap. The amalgamation was sanctioned by the High Court effective from 1 March 2010. As per the latest ruling, the six overlapping licenses including the important (operating) licenses in Karnataka and Punjab markets will now revert to DoT. Spice is approx 6% of Idea's EBITDA. Idea (through Spice) has a 7% revenue-share in Karnataka and 21% revenue share in Punjab.

Idea has already filed an appeal against the judgement.

Financial analysis

Three-year revenue CAGR (FY11-14E) of 22%, new circles continue to ramp up

We estimate Idea's base-case wireless revenues to expand at a CAGR (FY11-14E) of 19% driven by wireless minutes growth of 16% p.a. and 2% p.a. growth in revenue per minute. The legacy circles (including Spice) are likely to grow at 17% p.a., while the newer circles are likely to grow faster at 38% p.a.

Moreover, we estimate 3G revenues to ramp up to Rs17bn (6% of revenues) by FY14E, leading to overall revenue CAGR (FY11-14E) of 22%.

Tariff growth and 3G roll-out would aid margin expansion

We forecast Idea's EBITDA margins (excluding 3G) to improve from 21.3% in FY11 to 25.6% in FY14, due to higher tariffs and stabilization of losses in the newer circles. Including 3G, we expect EBITDA margins to expand to 27.7%, leading to an overall EBITDA CAGR (FY11-14) of 33%.

Profits, capex and cashflows

Our forecasts include the impact of excess spectrum fees that Idea could have to pay. We have assumed that the entire Rs19bn of excess spectrum fees is payable in FY12. We have also assumed that 50% of this fee would have to be charged as a prior period item while the remaining would be amortised equally over FY12/13/14. As a result, our FY12 PAT at Rs4.9bn implies a 41% decline over FY11. We forecast PAT to grow to Rs17.9bn by FY14 due to lower incidence of depreciation and interest costs.

We forecast Idea to generate operating cash flows of Rs139bn over FY12-14. The company will need to spend Rs101bn for capex and excess spectrum over the same period, resulting in a marginal free cash flow generation of Rs7.7bn. This would result in net debt/equity reducing to 0.5x in FY14 (1x in FY12). However, we note that Idea would have to pay Rs46bn in FY15/16 to renew its key licences, which could result in an increase in leverage.

Figure 55: Idea – capex and cash flows (Rs m)

Year ending March	2009	2010	2011	2012E	2013E	2014E
Cash profit	23,367	29,360	30,750	35,701	50,864	60,916
Change in WC	8,854	3,889	(22,447)	7,343	(3,640)	(2,905)
Cash from operations	14,513	25,471	53,197	28,358	54,504	63,821
Capital expenditure	47,890	28,830	35,732	40,000	40,000	40,000
3G spectrum/excess spectrum fee			57,686	19,000		
Free cash from Operations	(33,377)	(3,359)	(40,221)	(30,642)	14,504	23,821

Source: Company, Deutsche Bank

Valuation and risks

Valuation methodology

We value Idea on a sum-of-the-parts (SoTP) basis by valuing the core telecom business using DCF and ascribing a value to its 13.5% effective stake in Indus Towers. Our DCF value for Idea's core telecom business is Rs95/share, and we value Idea's stake in Indus at Rs10/share, resulting in a target price of Rs105.

DCF – assumptions and valuation

We have used a 15-year period for our DCF forecasts. We have assumed revenue growth to trend down during our forecast period and settle at 8%. We expect capex/sales to remain stable at 14-15%. Our DCF assumptions are as follows: risk-free rate (6%), risk premium (8.5%), beta (1.0), cost of debt (8%), and terminal growth rate of cash flow (2%). Our resultant WACC is 13.5%.

Figure 56: Idea – DCF value and assumptions

Assumptions							
WACC	13.5%						
Terminal growth rate of cash flow	2%						
Terminal value	603,967			Terminal growth rate			
PV of terminal value	90,421			0.0%	2.0%	4.0%	6.0%
Enterprise value	441,618	WACC	11.5%	120	128	140	162
TV as % of Total	20%		12.5%	105	111	120	134
Net debt	122,003		13.5%	92	97	103	113
Equity value	319,614		14.5%	81	85	90	96
Equity Value per share (Rs)	**97**		15.5%	72	75	78	83

Source: Deutsche Bank

Our DCF value implies 6.5xFY13E EV/EBITDA for the legacy circles

At a target valuation of Rs95/share, if we assume 6.5xFY13E EV/EBITDA (15% discount to Bharti) for Idea's legacy circles, it implies a negative EV of Rs35bn for the start-up circles. Idea's start-up circles are currently loss-making and we have assumed that these losses will continue over our forecast period (FY14). On an overall basis, our target price implies FY13 EV/EBITDA of 6.6x and P/E of 24x.

Figure 57: Idea – historical EV/EBITDA trend

Source: Bloomberg Finance LP, Deutsche Bank

Our valuations are in line with Idea's trading range over the last three years. Idea's valuations were quite elevated for the year following its listing (March 2007). However, the stock de-rated significantly after that due to an increase in the competitive intensity and policy actions favouring new entrants. The increase in competitive intensity had a significant impact on its newer roll-outs where EBITDA losses expanded from Rs723m in FY08 to Rs 4.2bn in FY10. We believe Idea would continue to trade in a range as the positive revenue and EBITDA impact of 3G would be offset by the overhang of adverse impact from regulatory and policy decisions.

Indus Towers valued at $5bn

We value Indus Tower (passive infrastructure JV between Bharti, Vodafone and Idea) at Rs228bn ($5bn), based on DCF. We have used a 15-year DCF to value Indus Towers. We have assumed rentals to grow at the rate of inflation and EBITDA margins to initially rise and then trend downwards over our DCF period. Our DCF assumptions are: risk-free rate (6%), risk premium (8.5%), beta (0.9), cost of debt (8%) and terminal growth rate of cash flows (2%). Our resultant WACC is 10.8%.

Figure 58: Indus Towers – DCF value and assumptions

Assumptions							
WACC	10.8%						
Terminal growth rate of cash flow	2%			**Terminal growth rate**			
Terminal value	610,622			0%	2%	4%	6%
PV of terminal value	130,679	WACC	9%	300,354	354,045	452,246	689,492
Enterprise value	318,310		10%	245,777	282,784	345,203	472,898
TV as % of Total	41%		10.8%	202,077	228,310	269,917	346,018
Net debt	90,000		12%	166,429	185,451	214,195	262,678
Equity value (Rs m)	**228,310**		13%	136,897	150,950	171,372	203,763

Source: Deutsche Bank

Risks

Upside risks

- Faster-than-expected turnaround in the newer circles – we have assumed that the losses in the new circles would stabilize and not increase further. If Idea is able to decrease these losses materially over the next two to three years, it would have a positive impact on our margin assumptions.
- Lower-than-expected spectrum and renewal costs – we have factored the excess spectrum charge of Rs19bn and licence renewal cost of Rs46bn in our

cashflows and valuations. However, if these charges are lower, it could have a positive impact on our valuations.

Downside risks

- Adverse outcomes from policy decisions – recent policy-related recommendations of the regulator are likely to have a negative impact on the incumbents' cashflows in the immediate term and their ability to compete in the medium and long term. Our current estimates and valuations factor the likely charges for excess spectrum and renewal of licences. The other policy decisions that are pending and could have a negative impact on valuations are a) refarming of 900MHz spectrum and giving 1800Mhz to incumbents at the time of licence renewal, and b) disallowing of 3G intra-circle roaming agreements.
- Resumption of tariff wars in India – the wireless pricing environment has been quite benign over the last quarter and we expect industry tariffs to increase by 5%/3% in FY13/14. However, if the new entrants try once more to acquire subscribers by providing lower rates, there could be a downside risk to our revenue and margin estimates.
- Slower-than-expected increase in 3G subscribers – we have assumed a meaningful increase in the proportion of subscribers that will have 3G enabled handsets over the next three years. If the penetration of 3G-enabled handsets does not increase as projected, there could be downside to our estimates.

Rating
Hold

Asia
India

Telecommunications
Wireless

Company
Reliance Communications

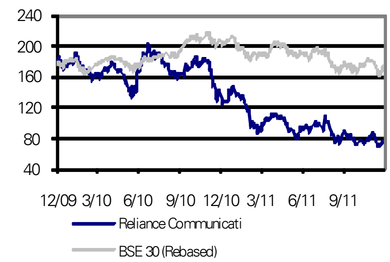
Reuters	Bloomberg
RLCM.BO	RCOM IN

Price at 5 Dec 2011 (INR)	77.55
Price target - 12mth (INR)	80.00
52-week range (INR)	147.90 - 69.55
BSE 30	16,847

Key changes

Price target	150.00 to 80.00	↓	-46.7%
Sales (FYE)	239,541 to 208,939	↓	-12.8%
Op prof margin (FYE)	13.7 to 10.5	↓	-23.5%
Net profit (FYE)	14,963.3 to 6,867.9	↓	-54.1%

Price/price relative



Performance (%)	1m	3m	12m
Absolute	-6.8	-11.8	-44.4
BSE 30	-4.1	0.8	-15.6

Stock Data

Market cap (INRm)	160,065
Market cap (USDm)	3,126
Shares outstanding (m)	2,064.0
Major shareholders	ADAG Group (67.2%)
Free float (%)	33
Avg daily value traded (USDm)	15.1

Key Indicators (Fy1)

ROE (%)	1.7
Net debt/equity (%)	71.9
Book value/share (INR)	198.17
Price/book (x)	0.4
Net interest cover (x)	1.3
Operating profit margin (%)	10.5

Cashflows are crucial and growth is the only option

Stabilising operations but debt burden constrains valuations

RCOM's key challenge is to build momentum in its wireless business and generate sufficient cashflows to reduce its debt burden (current net debt to EBITDA 4.7x). Over the last six quarters, revenue/min has been stable, but mobile EBITDA has stagnated. Weak cashflows have forced RCOM to constrain capex to generate sufficient cash to repay around $1.2bn in FCCBs maturing in March 2012. We are reducing our FY13E EPS and target price by c.50% to reflect RCOM's operating and financial challenges. Maintaining Hold (target price Rs80).

Wireless business – growth is critical, but could be harder to achieve

Over the last ten quarters, RCOM's wireless revenue-share fell from 12% to 8%. We believe it could be challenging for RCOM to maintain market share; we forecast FY13/14 revenue growth of 13%/11% (below sector growth of 15% p.a.). Margins should improve by 200bps to 29% by FY14 as RCOM has also raised tariffs following hikes by incumbents. Unlike in the past, we believe RCOM's ability to precipitate a tariff war is limited due to its leveraged balance sheet.

Debt burden a key concern, economic cost of debt difficult to estimate

At end-2QFY12, RCOM's net debt stood at Rs319bn, which includes a recent drawdown of $1.3bn out of a $1.93bn loan facility extended by a consortium of Chinese banks. Cash flows in 1HFY12 have also been weak, likely on account of payments to capex creditors. While we forecast cumulative FCF (FY12-14) of Rs88bn, our FY14 net debt to EBITDA remains at an elevated level of 3x. RCOM's interest costs are hard to fathom from its quarterly disclosures. However, we note that its convertible, due in March 2012, is trading at YTM of around 27%.

High leverage relative to peers results in a valuation discount

Our DCF-based target price for RCOM is Rs80/share, implying 6.3x FY13E EV/EBITDA (20% discount to Bharti's implied valuation). Our DCF assumptions: RFR of 6%, risk premium of 8.5%, CoE of 17%, Kd of 10.5%, WACC of 13.1% and terminal growth rate of 2%. A reversal in market share losses would be a key upside risk. A resumption of the tariff war would be a downside risk.

Forecasts And Ratios

Year End Mar 31	2010A	2011A	2012E	2013E	2014E
Sales (INRm)	214,963.8	224,303.5	**208,939.3**	233,516.9	258,650.8
EBITDA (INRm)	69,890.7	83,690.4	**63,811.5**	73,895.5	86,168.8
Reported NPAT	18,925.9	14,125.2	**6,867.9**	8,144.5	9,351.8
Reported EPS	9.17	6.84	**3.33**	3.95	4.53
DB EPS FD(INR)	8.99	6.90	**3.33**	3.95	4.53
OLD DB EPS	8.52	5.04	**6.87**	7.86	–
% Change	5.5%	37.0%	**-51.6%**	-49.8%	–
DB EPS growth	-60.1	-23.2	**-51.8**	18.6	14.8
PER (x)	25.4	22.1	**23.3**	19.7	17.1
EV/EBITDA (x)	10.4	7.9	**7.4**	6.1	5.0

Source: Deutsche Bank estimates, company data

[1] DB EPS is fully diluted and excludes non-recurring items; 2 Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end closeand future years, except P/B which uses the year end closeand future years, except P/B which uses the year end close.

Model updated:30 November 2011

Running the numbers

Asia

India

Wireless

Reliance Communications

Reuters: RLCM.BO Bloomberg: RCOM IN

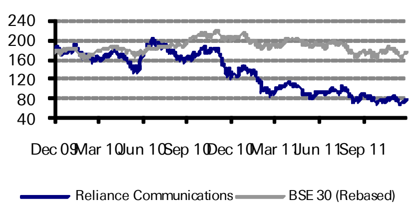
Hold

Price (5 Dec 11)	INR 77.55
Target Price	INR 80.00
52 Week range	INR 69.55 - 147.90
Market Cap (m)	INRm 160,065
	USDm 3,113

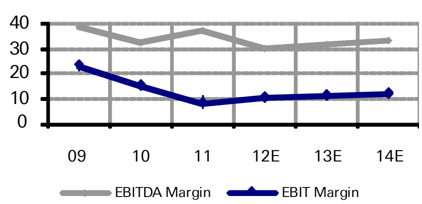
Company Profile

Reliance Communications is an integrated telecom services company with a nation-wide CDMA network and 7-province GSM network and 85,000 km fiber optic network. It also owns FLAG & FALCON, a 65,000 km global sub-sea cable system.

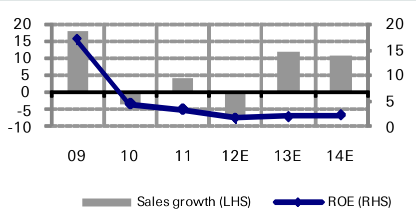
Price Performance



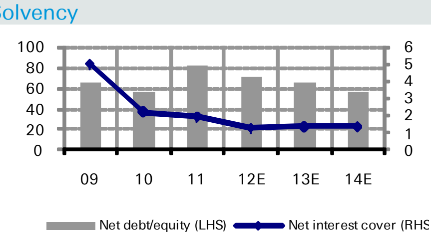
Margin Trends



Growth & Profitability



Solvency



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Fiscal year end 31-Mar	2009	2010	2011	2012E	2013E	2014E
Financial Summary						
DB EPS (INR)	22.53	8.99	6.90	3.33	3.95	4.53
Reported EPS (INR)	29.29	9.17	6.84	3.33	3.95	4.53
DPS (INR)	0.80	0.85	0.50	0.25	0.31	0.39
BVPS (INR)	204.8	210.1	196.2	198.2	201.8	205.9
Weighted average shares (m)	2,064	2,064	2,064	2,064	2,064	2,064
Average market cap (INRm)	705,041	471,897	315,052	160,065	160,065	160,065
Enterprise value (INRm)	990,727	725,851	659,649	470,604	453,090	426,943
Valuation Metrics						
P/E (DB) (x)	15.2	25.4	22.1	23.3	19.7	17.1
P/E (Reported) (x)	11.7	24.9	22.3	23.3	19.7	17.1
P/BV (x)	0.85	0.81	0.55	0.39	0.38	0.38
FCF Yield (%)	nm	8.6	nm	24.2	12.7	18.4
Dividend Yield (%)	0.2	0.4	0.3	0.3	0.4	0.5
EV/Sales (x)	4.5	3.4	2.9	2.3	1.9	1.7
EV/EBITDA (x)	11.3	10.4	7.9	7.4	6.1	5.0
EV/EBIT (x)	19.3	22.4	35.4	21.5	17.8	14.2
Income Statement (INRm)						
Sales revenue	222,505	214,964	224,304	208,939	233,517	258,651
Gross profit	125,895	107,180	116,783	99,246	113,256	-133,205
EBITDA	87,307	69,891	83,690	63,812	73,895	86,169
Depreciation	36,077	37,465	65,038	41,958	48,400	56,085
Amortisation	0	0	0	0	0	0
EBIT	51,230	32,426	18,652	21,854	25,495	30,084
Net interest income(expense)	-10,191	-14,587	-9,558	-16,837	-18,743	-21,691
Associates/affiliates	16	0	0	0	0	0
Exceptionals/extraordinaries	13,949	375	-121	0	0	0
Other pre-tax income/(expense)	6,979	6,359	6,773	4,000	4,400	4,840
Profit before tax	61,983	24,572	15,746	9,017	11,153	13,233
Income tax expense	-518	4,454	118	271	781	1,323
Minorities	2,052	1,193	1,503	1,878	2,228	2,558
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	60,449	18,926	14,125	6,868	8,144	9,352
DB adjustments (including dilution)	-13,949	-375	121	0	0	0
DB Net profit	46,500	18,551	14,246	6,868	8,144	9,352
Cash Flow (INRm)						
Cash flow from operations	50,624	61,384	33,125	54,241	63,747	72,943
Net Capex	-256,565	-20,711	-79,406	-15,482	-43,360	-43,432
Free cash flow	-205,942	40,672	-46,280	38,759	20,387	29,511
Equity raised/(bought back)	0	0	0	0	0	0
Dividends paid	-1,932	-2,046	-1,203	-604	-755	-943
Net inc/(dec) in borrowings	133,406	-94,468	93,560	-83,742	0	0
Other investing/financing cash flows	-7,051	-5,241	562	298	298	298
Net cash flow	-81,518	-61,082	46,638	-45,288	19,930	28,866
Change in working capital	*-33,243*	*3,466*	*-50,340*	*2,803*	*4,094*	*3,892*
Balance Sheet (INRm)						
Cash and other liquid assets	109,671	48,585	53,272	5,467	25,209	53,914
Tangible fixed assets	779,268	762,515	776,882	750,405	745,365	732,713
Goodwill/intangible assets	0	0	0	0	0	0
Associates/investments	2,815	1,200	1,089	1,089	1,089	1,089
Other assets	130,316	113,388	115,984	111,844	115,046	118,716
Total assets	1,022,070	925,686	947,227	868,806	886,709	906,432
Interest bearing debt	391,623	297,154	390,714	306,972	306,972	306,972
Other liabilities	201,095	188,342	143,277	142,673	150,850	159,469
Total liabilities	592,718	485,496	533,990	449,645	457,822	466,440
Shareholders' equity	422,803	433,606	404,992	409,038	416,537	425,083
Minorities	6,549	6,584	8,245	10,123	12,351	14,908
Total shareholders' equity	429,352	440,190	413,237	419,161	428,888	439,991
Net debt	*281,951*	*248,569*	*337,442*	*301,505*	*281,763*	*253,058*
Key Company Metrics						
Sales growth (%)	18.2	-3.4	4.3	-6.8	11.8	10.8
DB EPS growth (%)	29.2	-60.1	-23.2	-51.8	18.6	14.8
EBITDA Margin (%)	39.2	32.5	37.3	30.5	31.6	33.3
EBIT Margin (%)	23.0	15.1	8.3	10.5	10.9	11.6
Payout ratio (%)	2.7	9.3	7.3	7.5	7.9	8.6
ROE (%)	17.0	4.4	3.4	1.7	2.0	2.2
Capex/sales (%)	115.3	9.6	35.4	7.4	18.6	16.8
Capex/depreciation (x)	7.1	0.6	1.2	0.4	0.9	0.8
Net debt/equity (%)	65.7	56.5	81.7	71.9	65.7	57.5
Net interest cover (x)	5.0	2.2	2.0	1.3	1.4	1.4

Source: Company data, Deutsche Bank estimates

Key highlights

We are below consensus on EPS estimates

We are in line with consensus on revenue estimates, 5-7% below consensus EBITDA estimates and 30-45% below consensus on EPS estimates. One likely reason for lower-than-consensus EPS estimates is interest cost. We note that RCOM's interest costs are volatile on a quarterly basis and it does not breakout the FX impact, so it is difficult to estimate the recurring and economic cost of debt. Hence, there is likely to be significant divergence in analyst estimates on this count. We note that RCOM FY13E consensus EPS estimates have fallen by 32% in the last six months.

Figure 59: RCOM – Deutsche Bank vs. consensus

	FY12E			FY13E		
	DB est	Consensus	*%diff*	DB est	Consensus	*%diff*
Revenue (Rs m)	208,939	214,019	-2.4%	233,517	236,864	-1.4%
EBITDA (Rs m)	63,812	69,075	-7.6%	73,895	78,392	-5.7%
EPS (Rs)	3.2	4.6	-31.2%	3.7	6.6	-43.7%

Source: Bloomberg Finance LP, Deutsche Bank

Figure 60: RCOM – change in estimates

		FY12E	FY13E	FY14E	Comments
Revenues (Rs m)	New est	208,939	233,517	258,651	RCOM's performance has been lower than expectations – it has been unable to gain revenue share despite following a challenger strategy
	Old est	239,541	264,256		
	change	-12.8%	-11.6%		
EBITDA (Rs m)	New est	63,812	73,896	86,169	RCOM's challenge has been to improve margins in the wireless business. The lack of growth in the wireless revenues has constrained margin expansion.
	Old est	75,452	85,497		
	change	-15.4%	-13.6%		
EBITDA margin	New est	30.5%	31.6%	33.3%	
	Old est	31.5%	32.4%		
	change	-96bps	-71bps		
EPS (Rs)	New est	3.2	3.7	4.3	The fall in EPS is magnified due to the operating and financial leverage of RCOM.
	Old est	6.9	7.9		
	change	-54.1%	-52.4%		
Capex (Rs m)	New est	15,482	43,360	43,432	We have reduced FY12 capex in line with company guidance. However, we believe RCOM would need to increase its capex to a more normalised level in FY13/14E to remain competitive in the marketplace.
	Old est	30,351	33,135		
	change	*-48.9%*	*+30.8%*		

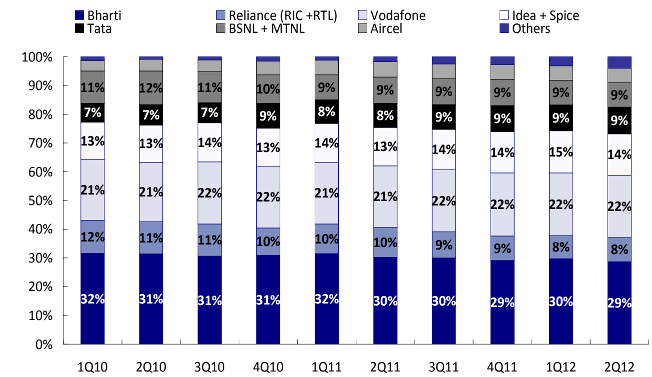
Source: Deutsche Bank

Business overview

Challenger strategy has not worked for the company

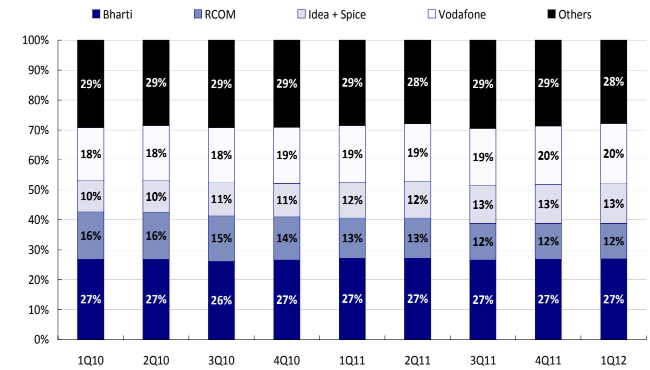
RCOM was one of the major aggressors (along with Tata Tele) to precipitate the tariff war in October 2009. However, the company was not able to capitalize on the lower tariffs, as it subsequently lost traffic and revenue market share. RCOM's traffic and revenue market share fell from 12%/16% in 1QFY10 to 8%/12% in 2QFY12.

Figure 61: RCOM's revenue market share has been declining …



Source: Telecom Regulatory Authority of India (TRAI)

Figure 62: … as it has continued to lose traffic share in the market place



Source: Companies, TRAI, Deutsche Bank

Stability in wireless business but growth has been elusive

RCOM's wireless business has consolidated over the last three quarters, which is reflected in the company's stable revenue per minute at Rs0.45 and modest uptrend in network traffic. However, in 1HFY12, RCOM's traffic and revenue growth at 4%/5% YoY lagged its peers (Bharti, Idea, Vodafone) whose revenues have grown at 11-20% YoY. Wireless EBITDA margins have continued to decline for RCOM and are currently at 27% compared to 29% in FY11.

It is imperative for RCOM to scale up its revenue and EBITDA base, which remain below the level it enjoyed prior to the launch of its GSM network.

Figure 63: RCOM – revenue and traffic continue to lag peers

	1QFY11	2QFY11	3QFY11	4QFY11	1QFY12	2QFY12
Total minutes growth (YoY) %						
Bharti	35.3%	32.8%	30.0%	22.6%	16.4%	14.0%
Idea	51.1%	51.3%	45.7%	40.0%	32.0%	25.2%
RCOM	13.3%	12.0%	2.8%	1.0%	3.1%	4.5%
Revenue growth (YoY) %						
Bharti	4.7%	6.2%	13.1%	14.2%	11.5%	11.1%
Idea	27.7%	27.6%	30.4%	33.4%	23.5%	26.2%
RCOM	-13.4%	3.8%	1.0%	2.6%	4.2%	6.1%

Source: Company, Deutsche Bank

Elevated leverage is impacting operations and valuation

RCOM must constrain capex to generate cash to meet its debt repayments. Its current net debt/EBITDA at 4.7x is the highest among its peers (Bharti – 2.3x, Idea – 2.6x). RCOM has guided for a capex of Rs15bn ($300m) for FY12E compared to Rs100bn ($2bn) guided by Bharti and Rs 40bn ($800m) by Idea.

At end-2QFY12, RCOM's net debt stood at Rs319bn, which includes a recent $1.3bn drawdown of a $1.9bn loan facility extended by a consortium of Chinese banks. RCOM has two FCCBs worth $1.3bn (face value), outstanding and repayable within FY12E. The drawdown helped the company repay the first FCCB amounting to $350m (face value) in May 2011. The amount outstanding on the second FCCB, which matures in March 2012, is around $925m (face value). Including the accrued interest, we estimate RCOM's liability at $1.2bn (Rs60bn). RCOM presently has a cash balance of Rs18bn and we estimate it will generate FCF of Rs25bn in 2HFY12. This implies that RCOM would have to refinance at least Rs15-20bn of its debt liability in the medium term.

Over the long-term, we forecast RCOM could reduce it net debt to Rs253bn by FY14 through FCF generation of Rs89bn over FY12-14. However, its net debt/EBITDA would remain at an elevated level of 3x in FY14 compared to around 1x for both Bharti and Idea. Our FCF estimates for RCOM factor a normalization of capex in FY13/14.

Figure 64: RCOM – leverage continues to be high

Year-end Mar, Rs m	FY10	FY11	FY12E	FY13E	FY14E
Net debt	248,569	337,442	301,505	281,763	253,058
Net debt/EBITDA (x)	3.6	4.0	4.7	3.8	2.9
Capex*	41,620	128,807	15,482	43,360	43,432
FCF	19,764	(95,682)	38,759	20,387	29,511

*Source: Company, Deutsche Bank estimates.: * Capex for FY2011E includes 3G license fee paid of Rs85,850m.*

Around 80% of RCOM's debt is FX-denominated, which includes the $925m FCCB maturing in March 2012.

Figure 65: RCOM – trend in debt profile

	FY08	FY09	FY10	FY11	1QFY12	2QFY12	FY12E	FY13E	FY14E
Foreign currency loan	174,117	243,075	236,197	270,470	258,421	261,838	186,728	186,728	186,728
Secured	-	-	-	186,728			186,728	186,728	186,728
Unsecured	174,117	243,075	236,197	83,742			-	-	-
INR Loan	84,100	148,547	60,957	120,244	73,158	75,157	120,244	120,244	120,244
Secured	9,500	30,000	30,000	30,200					
Unsecured	74,600	118,547	30,957	90,044					
Gross Debt	258,217	391,623	297,154	390,714	331,579	336,995	306,972	306,972	306,972
Cash and equivalents	117,430	109,671	48,585	53,272	11,825	17,959	5,467	25,209	53,914
Net Debt	**140,787**	**281,951**	**248,569**	**337,442**	**319,754**	**319,036**	**301,505**	**281,763**	**253,058**
Share of FX debt	67.4%	62.1%	79.5%	69.2%	77.9%	77.7%	60.8%	60.8%	60.8%

Source: Company, Deutsche Bank

Financial analysis

Revenues – three year CAGR (FY11-14E) of 5%

We forecast RCOM's wireless revenues to expand at a CAGR (FY11-14) of 12% driven by 9% p.a. growth in minutes and 2% p.a. growth in revenue/min. We forecast non-wireless revenues to fall 55% in FY12 due to a) a change in accounting policy in FY11, which resulted in upfront recognition of all outstanding IRU contracts and b) a slowdown in enterprise and other businesses. On a like-to like basis, non-wireless revenues should decline by 5% in FY12. Over the next two years, we expect non-wireless revenues to grow at 7% p.a.

Margins to improve as a result of higher tariffs

We are focusing on EBIT margins instead of EBITDA margins as EBITDA is not comparable with FY11 due to the change in accounting policy that resulted in an over-statement of EBITDA. EBIT margins are likely to improve from 8.3% in FY11 to 11.6% by FY14 leading to EBIT CAGR (FY11-14) of 17%.

Positive FCF should aid in paying down maturing FCCBs

At the end of FY11, RCOM had two FCCBs worth $1.3bn (face value) outstanding and repayable within FY12E. The company has already repaid one tranche by re-financing it through the China Development Bank. The company has to repay the remaining tranche worth $1.2bn (Rs60bn, including redemption premium) in March 2012. RCOM presently has a cash balance of Rs18bn and we estimate it will generate FCF of Rs25bn in 2HFY12. This implies that RCOM would have to refinance at least Rs15-20bn of its debt liability in the medium term.

Over FY12-14, we expect RCOM to generate operating cashflows of Rs191bn and spend Rs102bn towards capex. Overall, we expect RCOM to generate FCF of Rs89bn over this period. As a result, net debt is likely to come down from Rs337bn in FY11 to 253bn by FY14. However, we expect interest cost to increase from Rs9.5bn in FY11 to Rs22bn by FY14 as its low cost debt (FCCBs) would be replaced by higher cost borrowings. Overall, we expect net profit to fall 50% in FY12 to Rs6.9bn and grow 17% p.a. to Rs9.3bn by FY14.

Figure 66: RCOM – capex and cash flows

Year-end March (Rs m)	2009	2010	2011	2012E	2013E	2014E
Cash profit	83,866	57,918	83,465	51,438	59,652	69,051
Change in WC	33,243	(3,466)	50,340	(2,803)	(4,094)	(3,892)
Operating cash flow	50,624	61,384	33,125	54,241	63,747	72,943
Capex*	194,166	41,620	128,807	15,482	43,360	43,432
FCFF	**(143,542)**	**19,764**	**(95,682)**	**38,759**	**20,387**	**29,511**
Net debt	281,951	248,569	337,442	301,505	281,763	253,058

*Source: Company, Deutsche Bank estimates. * Capex for FY2011E includes 3G license fee paid of Rs85,850m.*

Valuation and risks

Valuation methodology and target price

We value RCOM on a DCF basis at Rs80/share. Our DCF assumptions are a risk-free rate of 6%, risk premium of 8.5%, beta of 1.3, CoE at 17% and cost of debt at 10.5%. Our resultant WACC of 13.1% and our terminal growth rate assumption is 2%.

We have used a 15-year period for our DCF forecasts. We assume revenue growth should initially rise to 12% and then trend downwards over our forecast period to 6%. Capex/sales should increase to 17-18% initially and then settle at 14-15%.

Figure 67: RCOM – DCF value and assumptions

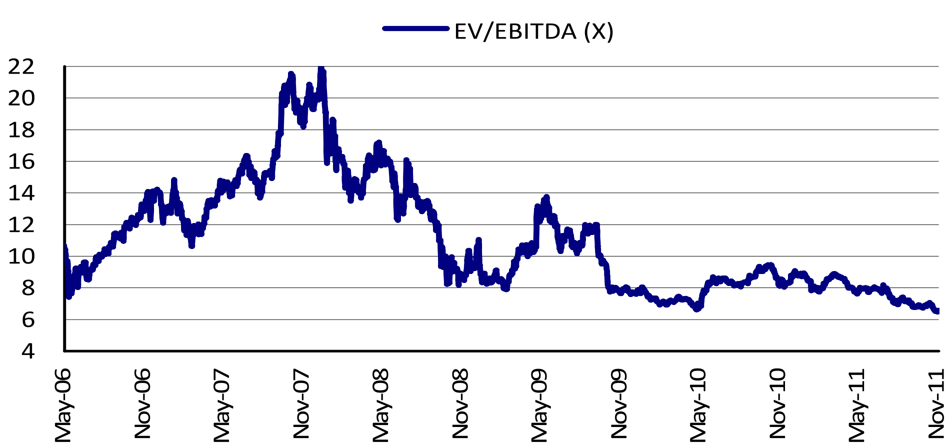
Assumptions, Rs m							
WACC	13.1%						
Terminal growth rate of cash flow	2%						
Terminal value	486,192				Terminal growth rate		
PV of terminal value	77,178		80	0.0%	2.0%	4.0%	6.0%
Enterprise value	476,419		11.1%	113	124	141	173
TV as % of Total	16%		12.1%	92	100	112	132
Net debt	301,505	WACC	13.1%	74	80	89	103
Equity value	174,914		14.1%	59	64	70	79
Equity Value per share (Rs)	**80**		15.1%	46	49	54	61

Source: Deutsche Bank estimates

Our target price implies a discount to our valuation of Bharti's India business

Our target price of Rs80/share implies FY13E EV/EBITDA of 6.3x, which is a 20% discount to our implied valuation for the India business of Bharti (7.8x). Our implied valuations are also at the lower end of RCOM's historical valuations. We believe valuations should remain subdued given the high leverage compared to Bharti and Idea. RCOM's net debt/EBITDA at 4.7x is significantly higher compared to Bharti (2.3x) and Idea (2.6x).

Figure 68: RCOM – one- year forward EV/EBITDA



Source: Bloomberg Finance LP, Deutsche Bank

Our valuations for RCOM are also at a 30-40% discount to its historical trading range. This is a reflection of the deterioration in the competitive position of the company. RCOM's revenue market share has declined from 12% in 1QFY10 to 8% in 2QFY12 despite it being the aggressor in the tariff war. Even now, RCOM's traffic growth continues to lag the industry.

Risks

Upside risks

- Revival in revenue market share – RCOM has lost significant revenue market share over the last eight quarters due to lower-than-industry traffic growth. We have assumed that going forward, RCOM would grow in line with industry and hence we are not building any improvement in market share.
- Higher-than-expected increase in tariffs – we have assumed industry revenue/min to increase by 5%/3% in FY13E/14. However, if the operators are able to increase tariffs even higher, they could have a positive impact on industry (as well as RCOM's) revenue growth and margins.

Downside risks

- Resumption of tariff wars in India - the wireless pricing environment has been quite benign over the last quarter and we expect industry tariffs to increase by 5%/3% in FY13/14. However, if the new entrants try once more to acquire subscribers by providing lower rates, there could be a downside risk to our revenue and margin estimates.
- Further loss in market share – RCOM's traffic growth still lags that of the industry. If RCOM's traffic continues to grow at a slower rate than the industry, it would have an adverse impact on our estimates.

The author of this report wishes to acknowledge the contribution made by Balajee Tirupati, employee of Irevna, a division of CRISIL Limited, a third-party provider to Deutsche Bank of offshore research support services.

Appendix 1

Important Disclosures

Additional information available upon request

Disclosure checklist

Company	Ticker	Recent price*	Disclosure
Bharti Airtel Limited	BRTI.BO	390.30 (INR) 5 Dec 11	4,14,17
Idea Cellular Limited	IDEA.BO	97.25 (INR) 5 Dec 11	
Reliance Communications	RLCM.BO	77.55 (INR) 5 Dec 11	4

*Prices are sourced from local exchanges via Reuters, Bloomberg and other vendors. Data is sourced from Deutsche Bank and subject companies

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The views expressed in this report accurately reflect the personal views of the undersigned lead analyst about the subject issuers and the securities of those issuers. In addition, the undersigned lead analyst has not and will not receive any compensation for providing a specific recommendation or view in this report. Srinivas Rao

Historical recommendations and target price: Bharti Airtel Limited (BRTI.BO)

(as of 12/5/2011)

Previous Recommendations

Strong Buy
Buy
Market Perform
Underperform
Not Rated
Suspended Rating

Current Recommendations

Buy
Hold
Sell
Not Rated
Suspended Rating

*New Recommendation Structure as of September 9,2002

1. 24/09/2010: Buy, Target Price Change INR460.00

Historical recommendations and target price: Idea Cellular Limited (IDEA.BO)

(as of 12/5/2011)

Previous Recommendations

Strong Buy
Buy
Market Perform
Underperform
Not Rated
Suspended Rating

Current Recommendations

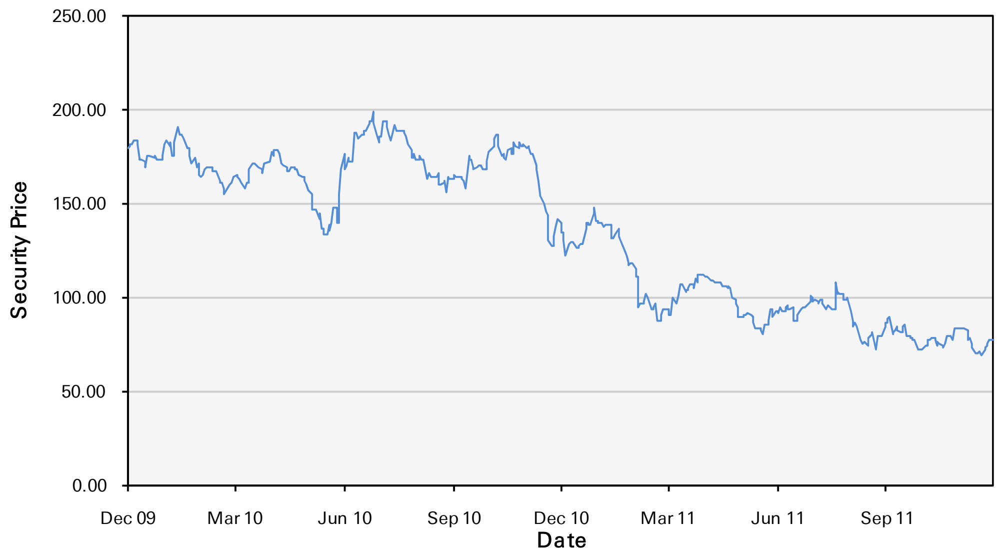
Buy
Hold
Sell
Not Rated
Suspended Rating

*New Recommendation Structure as of September 9,2002

1. 27/01/2011: Hold, Target Price Change INR70.00

Historical recommendations and target price: Reliance Communications (RLCM.BO)

(as of 12/5/2011)



Previous Recommendations

Strong Buy
Buy
Market Perform
Underperform
Not Rated
Suspended Rating

Current Recommendations

Buy
Hold
Sell
Not Rated
Suspended Rating

*New Recommendation Structure as of September 9,2002

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Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield) , we recommend that investors buy the stock.
Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock
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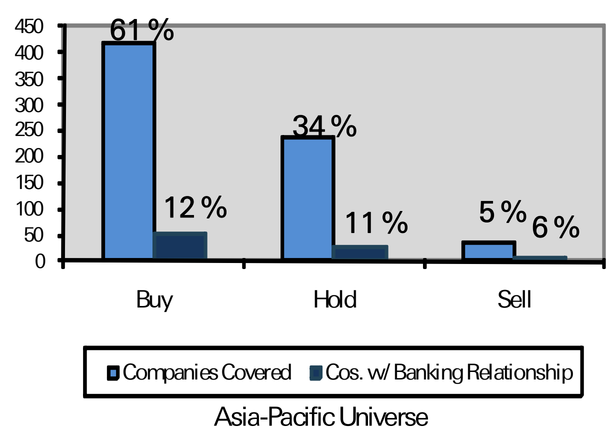
Sell: Expected total return (including dividends) of -10% or worse over a 12-month period

Equity rating dispersion and banking relationships



Regulatory Disclosures

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GRCM2011PROD024154