

January 25, 2012

## Telecom Industry

### Improving scenario – time to buy...

The telecom industry is coming out of the intense competition phase highlighted in declining net adds, withdrawal of unviable customer acquisition offers, emerging regulatory stability, price hikes by incumbents and upward tick in ARPMs. We believe this is a good time to buy into telecom stocks with a selective approach as companies are set for a rapid jump in profitability over the next two years, led by growth in revenue yielding traffic. Also, all telcos will witness declining capex intensity, debt repayment and reduced interest costs. With more clarity on NTP expected in a few months, the regulatory scenario seems to be more stable now than what it seemed about a year ago. Airtel would benefit from huge FCF to comfortably repay majority of its debt and improving margins in the African business. It remains our top pick in the sector with a target price of ₹ 450. We expect Idea's EBITDA to grow 1.9x by FY14E led by increasing revenue share and lower network operating costs. However, spectrum pricing may remain an overhang on the stock. We reiterate HOLD with a target price of ₹ 99. We rate RCom as SELL due to huge debt levels. However, our view may change if some of the several positive developments like higher external tenancy, monetisation of tower assets and possible listing of undersea cable business fructify.

#### Slowing net adds; stabilising ARPM coupled with steady increase in MoU

Net adds have fallen significantly in the past months as new operators cut down on capacity expansion. Incumbents would continue to witness steady growth in subscribers and traffic. Idea, with increasing penetration in new circles would witness fastest CAGR of 17.7% over FY11-14 to 591 billion minutes while Airtel (already the widest coverage) would be slower at CAGR of 7.9% to 995 billion minutes. RCom (to lose out on minutes share due to curtailed capex) would register minutes CAGR of 5.9% over FY11-14E to 445 billion minutes. Going forward, we expect the ARPM to rise marginally and stabilise at those levels in the near term.

#### Peak capex cycle over, debt to reduce

All the telcos are past their peak capex cycle with Bharti Airtel, Idea Cellular and RCom guiding for capex of about ₹ 10000 crore, ₹ 4000 crore and ₹ 1500 crore, respectively, in FY12E. We believe all three telcos would be generating free cash flow, going forward, to start repaying debt. This would result in a significant reduction in interest costs. However, significantly lower capex for RCom may impact network quality.

#### NTP – Overhang still remains but seems to be priced in...

Trai has come out with a New Telecom Policy, which has positives for both incumbents and subscribers. We expect implementation of a watered down version of the policy, which would impact industry players relatively less. Nonetheless, Idea is most sensitive to current policy recommendations. Per share impact for Airtel, Idea & RCom would be about ₹ 46.7 (10.4% of TP), ₹ 32.9 (33.2%) & ₹ 19.6 (23.3%), respectively.

#### Exhibit 1: Valuation matrix

Company	Target Price	Rating	EPS (₹)		PE		EV/EBITDA	
			FY12E	FY13E	FY12E	FY13E	FY12E	FY13E
Bharti Airtel	450	Buy	13.4	21.3	26.6	16.7	8.0	6.5
Idea Cellular	99	Hold	2.2	4.1	41.9	22.7	8.4	6.6
RCom	84	Sell	3.6	3.7	26.5	25.8	8.7	7.4

Source: Company, ICICIdirect.com Research

### Bharti Airtel BUY

CMP	₹	356
TP	₹	450
Upside	%	27%
Market Cap	Cr	170942

		FY11	FY12E	FY13E	FY14E
Revenue	₹ Cr	59467	71395	81293	89207
EBITDA	₹ Cr	19961	23914	28474	32015
EBITDA %	%	33.6	33.5	35.0	35.9
PAT	₹ Cr	6047	5081	8071	9758
EPS	₹	15.9	13.4	21.3	25.7
Growth	%	-33.6	-16.0	58.9	20.9

### Idea Cellular HOLD

CMP	₹	93
TP	₹	99
Upside	%	6%
Market Cap	Cr	32667

		FY11	FY12E	FY13E	FY14E
Revenue	₹ Cr	15438	19444	23113	25714
EBITDA	₹ Cr	3726	5195	6348	7130
EBITDA %	%	24.1	26.7	27.5	27.7
PAT	₹ Cr	899	735	1356	1820
EPS	₹	2.7	2.2	4.1	5.5
Growth	%	-5.9	-18.2	84.4	34.3

### RCom SELL

CMP	₹	95
TP	₹	84
Upside	%	-11%
Market Cap	Cr	17330

		FY11	FY12E	FY13E	FY14E
Revenue	₹ Cr	22430	19836	21558	22687
EBITDA	₹ Cr	8404	5817	6581	7234
EBITDA %	%	37.5	29.3	30.5	31.9
PAT	₹ Cr	1346	738	757	1085
EPS	₹	6.5	3.6	3.7	5.3
Growth	%	-71.1	-45.2	2.6	43.3

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## Industry overview

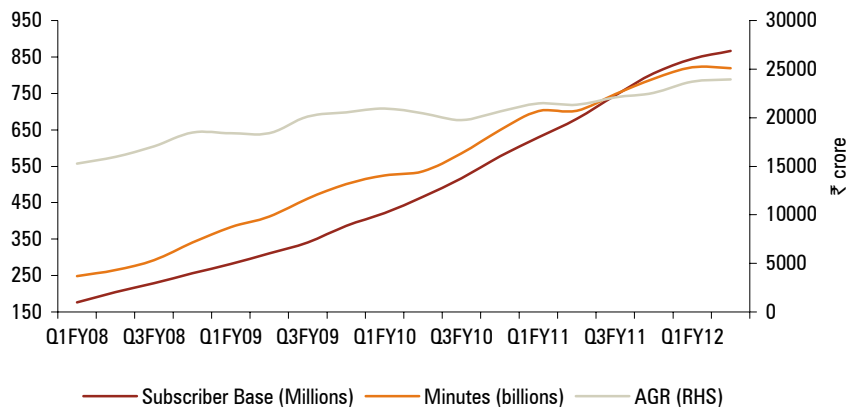
### Declining competitive intensity...

Hypercompetitive intensity is now on the decline, reflecting in decreasing net adds owing to withdrawal of unviable subscriber acquisition offers and reduction of free minutes, recent price hikes by telecom operators and stabilising ARPMs.

The past three years saw a disproportionate increase in subscriber addition while the adjusted gross revenue (AGR) of the industry increased only marginally in the first two years. However, with declining competitive intensity since late 2010, the AGR has started to increase. The industry AGR recorded CQGR of 1.9% over Q2FY09-Q2FY11 while it has grown by 2.9% over Q2FY11-Q2FY12.

**Exhibit 2: Subscriber base**

The subscriber base and minutes on the network have been growing at a CAGR of 46.4% and 31.8%, respectively, from FY09 to FY11 while AGR has grown at just 6.9%

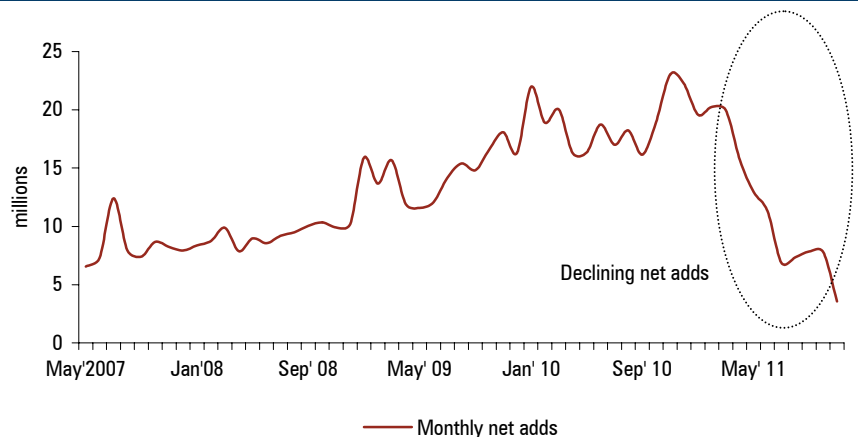


Source: TRAI, ICICIdirect.com Research

Declining competitive intensity is also visible in lower subscriber addition owing to scaling down of capex plans by new operators. Several new operators are finding it difficult to increase penetration as it is becoming increasingly unviable to operate at these price points in areas other than metros and A circles.

**Exhibit 3: Monthly net adds**

The monthly net adds have declined owing to operators refraining from lucrative offers to attract customers and the recent price hike taken by them. While the industry added 23.0 million subscribers in November 2010, it added only 3.6 million in November 2011

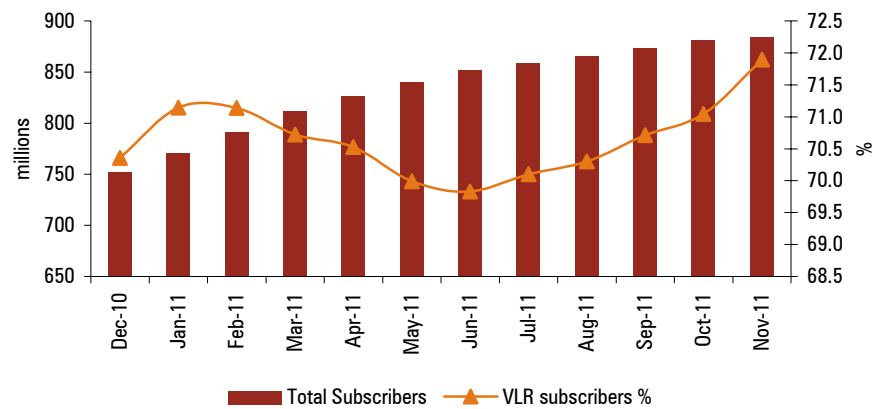


Source: TRAI, ICICIdirect.com Research

The net subscriber addition fell drastically in November 2011 primarily due to TTSL. The company saw its subscriber base decline by 4.4 million in November. Keeping TTSL aside, the industry witnessed net adds of 8.0 million, which is almost at the same level as that of October 2011.

The subscriber base of the industry grew from 176.6 million in Q1FY08 to 866.7 million in Q2FY12. After rising to a high of 23.0 million in November 2010, the net subscriber addition has been slowing down and it reached a 3.6 million in November 2011. Growth has been relatively lower in CY11 as compared to previous years. However, CY11 witnessed a steady improvement in the visitor location registry (VLR) subscribers as a percentage of total subscribers due to deactivation of inactive subscribers. The VLR subscribers percentage increased from 70.4% in December 2010 to 71.9% in November 2011 and is expected to improve going ahead as the dual SIM phenomena reduces further.

**Exhibit 4: Increasing VLR subscriber percentage with reducing net adds**

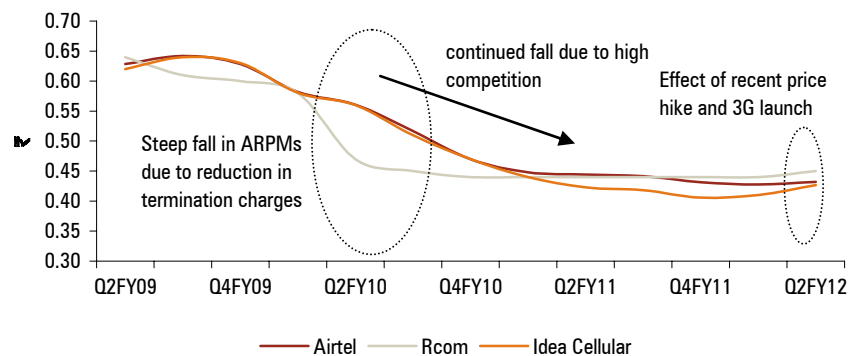


Source: TRAI, ICICIdirect.com Research

**ARPM to stabilise close to current levels**

The steep rise in traffic without a commensurate increase in revenue led to a rapid descent in ARPMS. However, over the past few quarters, telcos have witnessed stabilising ARPM. Also, in Q2FY12 most listed players saw an increase in ARPM owing to recent price hikes and 3G uptake.

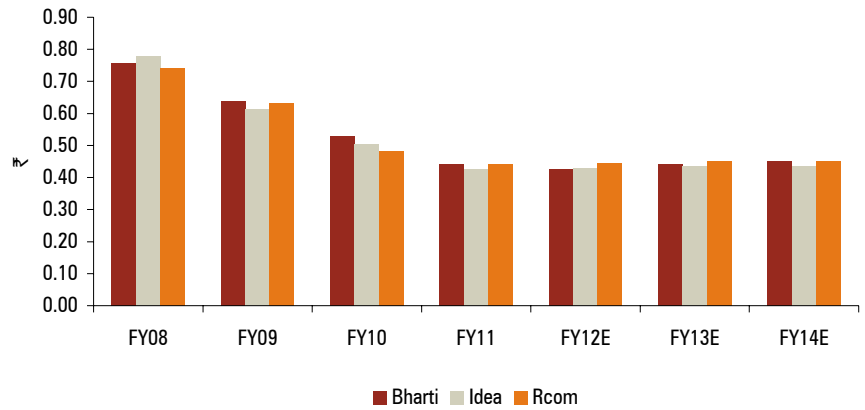
**Exhibit 5: Declining ARPMS**



Source: Company, ICICIdirect.com Research

Going forward, we expect the ARPM to rise marginally and stabilise at those levels in the near term as the full impact of recent price hikes is realised and 3G picks up further.

**Exhibit 6: ARPM to stabilise, going ahead**

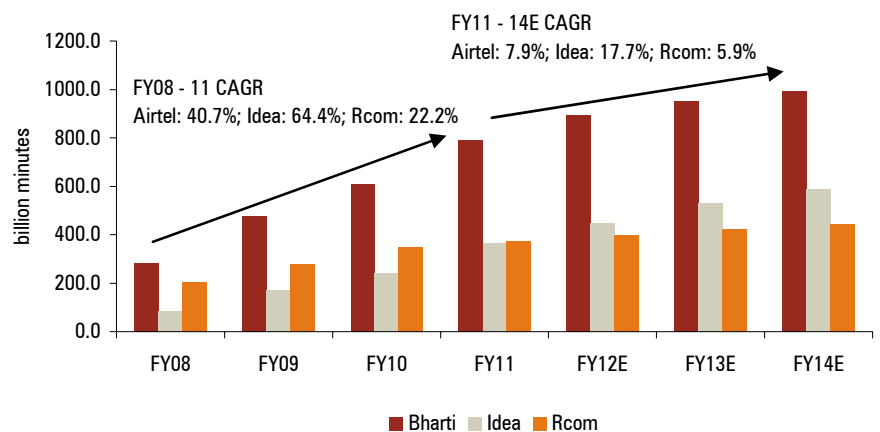


Source: Company, ICICIdirect.com Research

**MoU to grow, albeit at much lower pace**

Total traffic recorded a phenomenal CAGR (FY08-11) of 36.9% for the industry, 40.7% for Bharti Airtel, 61.4% for Idea Cellular and 22.2% for RCom. This was primarily due to huge subscriber addition coupled with cheap and free minutes on offer. Going ahead, as the telcos rationalise their offering and cut down on free minutes, we expect the minutes to grow at a relatively lower pace. Idea is expected to witness fastest CAGR of 17.7% over FY11-14 to 591 billion minutes with increasing penetration in newer geographies. Bharti Airtel, already having the widest coverage in terms of cell sites, would be slower at a CAGR of 7.9% to 995 billion minutes while RCom is expected to lose out on the minutes market share due to curtailed capex and slower network expansion. We expect RCom to register minutes CAGR of 5.9% over FY11-14E to 445 billion minutes.

**Exhibit 7: Overall traffic to continue growing, albeit at lower pace**



Source: Company, ICICIdirect.com Research

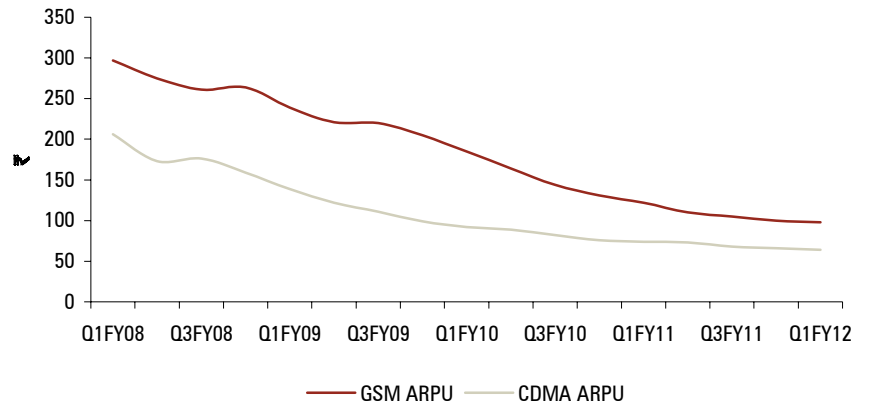
**ARPU to continue to decline...**

ARPU has declined very rapidly with a huge jump in subscriber addition. The ARPU for GSM operators fell from ₹ 297 in Q1FY08 to ₹ 98 in Q1FY12

whereas the ARPU for CDMA operators fell from ₹ 206 in Q1FY08 to ₹ 64 in Q1FY12.

The ARPU for GSM operators fell from ₹ 297 in Q1FY08 to ₹ 98 in Q1FY12 whereas the ARPU for CDMA operator fell from ₹ 206 in Q1FY08 to ₹ 64 in Q1FY12

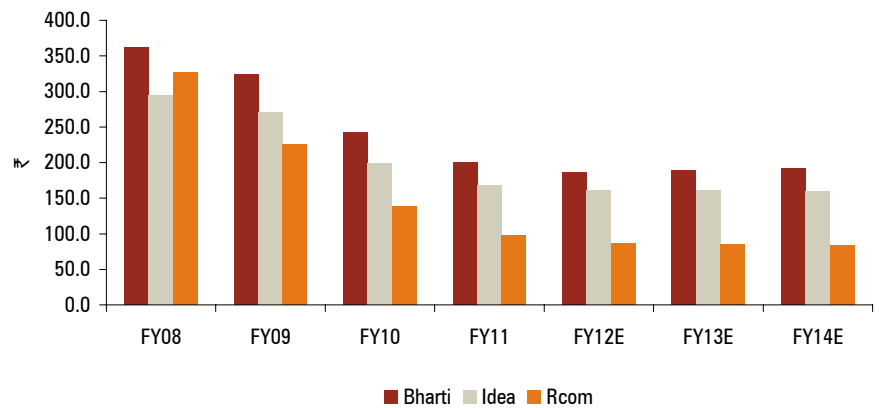
**Exhibit 8: Declining ARPUs**



Source: TRAI, ICICIdirect.com Research

Going forward, we expect the ARPU to continue to decline but at a lower pace. We expect Airtel’s ARPU to fall to ₹ 192 by FY14 from ₹ 201 in FY11 while that for Idea would fall from ₹ 168 to ₹ 160 and from ₹ 98 to ₹ 84 for RCom.

**Exhibit 9: Operator wise ARPU**

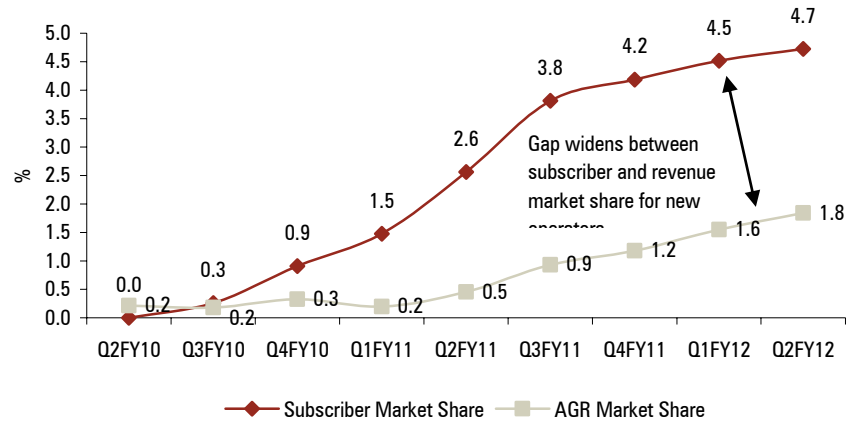


Source: Company, ICICIdirect.com Research

**Incumbents to continue to rule...**

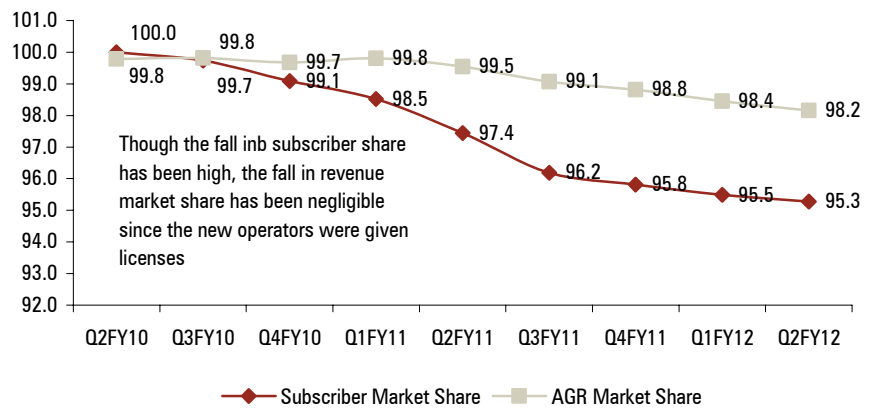
Since the launch in Q2FY10, new operators have managed to garner about 4.7% subscriber market share. However, the revenue share continues to be meek at 1.8% since most of the traffic on their network is low yield.

**Exhibit 10: New operators – Subscriber and revenue market share trend**



Source: TRAI, ICICIdirect.com Research

**Exhibit 11: Incumbents – Subscriber and revenue market share trend**



Source: TRAI, ICICIdirect.com Research

**Exhibit 12: Operator wise ARPU**

Operators	ARPU (₹)
Bharti Airtel	144.2
Reliance Communication	45.2
Vodafone Essar	117.4
BSNL	68.5
Idea Cellular	114.9
Tata Tele	80.5
Aircel Cellular	66.4
MTNL	94.3
BPL Mobile	152.8
HFCL	67.7
Shyam Telelink	64.7
Stel	23.5
Uninor	48.5
Videocon	14.9
DB Etilat	22.1

ARPU based on Q2FY12 AGR

Source: TRAI, ICICIdirect.com Research

Incumbents commanded a far higher ARPU compared to new operators in Q2FY12

Though the new operators have gained subscriber share through attractive offers, majority of the subscribers happen to be in urban areas. Further penetration into rural parts of the country may not be viable at these price points for new operators.

Uninor, even being the largest new operator in terms of subscribers and revenue has been unable to improve its financials over the last few quarters.

**Exhibit 13: Uninor's performance**

Uninor		Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12
Revenue	NOK in million	3	56	103	214	400	548	698	837
Operating Expense	NOK in million	758	1169	1426	1551	1672	1794	1904	1921
Operating Loss	NOK in million	-755	-1113	-1323	-1337	-1272	-1246	-1206	-1084
Subscribers	millions	1.2	4.3	6.0	11.3	18.5	22.8	26.3	29.7
Net Adds	millions	1.2	3.1	1.8	5.2	7.2	4.3	3.5	3.3
ARPU	NOK	NM	10	12	13	13	12	12	12
Capex	NOK in million	1196	712	364	198	350	320	186	196

Source: Company, ICICIdirect.com Research

We expect incumbents to slightly increase revenue market share, going ahead, as the full effect of the recent tariff hike is passed on and more subscribers migrate to 3G.

Uninor, even being the largest new operator in terms of subscribers and revenue, has been unable to make much improvement in its financials over the last few quarters

### 3G – Potential game changer

When the auction of the scarce 3G spectrum happened, it fetched the government a mammoth sum of ₹ 67,800 crore against the budgeted ₹ 35,000 crore and incumbents were found bidding aggressively in circles where they already had a significant presence. While Bharti and Vodafone went on a spree buying costly circles including the metros, Idea and Aircel adopted a selective approach of bidding heavily only in circles where they already had a strong 2G presence. RCom also went in for a selective approach by bagging spectrum in the top circles and bottom circles, thus managing to get licenses in Delhi and Mumbai and yet keeping a check on financial outgo. Tata Teleservices was the disappointing bidder as it won spectrums in only nine circles covering only ~49% of its subscriber base and ~42% of its revenue.

**Exhibit 14: Who's got what**

Circle	Bharti	Vodafone	Reliance	Idea	Aircel	TTSL	Stel
<b>Metro</b>							
Delhi	✓	✓	✓				
Mumbai	✓	✓	✓				
Kolkata		✓	✓		✓		
Chennai*	✓	✓			✓		
<b>A Circle</b>							
Maharashtra		✓		✓		✓	
Gujarat		✓		✓		✓	
A.P.	✓			✓	✓		
Karnataka	✓				✓	✓	
<b>B Circle</b>							
Kerala				✓	✓	✓	
Punjab			✓	✓	✓	✓	
Haryana		✓		✓		✓	
U.P.(E)		✓		✓	✓		
UP (W)	✓			✓		✓	
Rajasthan	✓		✓			✓	
MP			✓	✓		✓	
W B	✓	✓	✓		✓		
<b>C Circle</b>							
HP	✓		✓	✓			✓
Bihar	✓		✓		✓		✓
Orissa			✓		✓		✓
Assam	✓		✓		✓		
North East	✓		✓		✓		
J & K	✓		✓	✓	✓		

\* Includes Tamil Nadu

Source: TRAI, ICICIdirect.com Research

However, as it stands, the full effect of 3G has not yet been seen in the revenues, which is reflected by a low VAS share of revenues. Except for TTML, which has seen a good share of non-mobile revenue (due to data card services), all other telecom operators are still under penetrated as far as 3G uptake is concerned. VAS revenue accounted for ~15% of the total mobile revenue in March 2011 as against ~30% in China and the UK leaving huge room for growth.

**Exhibit 15: Non voice revenues as a percentage of total revenues**

	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12
Bharti	13%	14%	15%	15%	15%
Idea	12.9%	13.0%	12.1%	12.1%	13.2%
TTML	22%	24%	27%	30%	30%

Source: Company, ICICIdirect.com Research

While Bharti and Vodafone went on a spree buying costly circles, Idea and Aircel followed the strategy of applying for 3G licenses in circles where they already have a strong 2G presence. Tata Teleservices was the disappointing bidder as it won spectrum in only nine circles covering only ~49% of its subscriber base and ~42% of its revenue

Only TTML has seen a good traction in terms of VAS revenues due to Tata Indicom while there is still a long way to go for other operators

It is still early days for data services as 3G revenues have started showing in mobile revenues only in FY12. Going forward, with 3G enabled handsets becoming commonplace and cheap, we expect 3G revenues to grow considerably. We expect 3G subscribers to grow to 20.9 million for Bharti, 12.2 million for RCom and 12.5 million for Idea by FY16.

**Exhibit 16: 3G projections**

Bharti	Unit	FY12E	FY13E	FY14E	FY15E	FY16E
Total Subscribers	million	178.9	189.9	199.1	205.1	209.2
Total 2G Subs	million	175.4	182.3	187.2	188.7	188.3
Active 3G Subscribers	million	3.5	7.5	11.9	16.4	20.9
% of Total Subs	%	1.9%	4.0%	6.0%	8.0%	10.0%
Blended 2G ARPU	₹	184	185	181	178	176
Blended 3G ARPU	₹	467	436	403	389	382
Total Revenue	₹ crore	38,278	41,979	44,757	46,842	48,390
Revenue from 3G Subscribers	₹ crore	992	2,876	4,699	6,603	8,544
Net 3G Revenue	₹ crore	601	1,657	2,594	3,575	4,601
RCom	Unit	FY12E	FY13E	FY14E	FY15E	FY16E
Total Subscribers	million	153.0	164.0	172.4	177.6	181.1
Total 2G Subs	million	150.2	159.0	165.0	167.8	168.9
Active 3G Subscribers	million	2.8	5.0	7.4	9.8	12.2
% of Total Subs	%	1.8%	3.1%	4.3%	5.5%	6.7%
Blended 2G ARPU	₹	94	95	93	92	91
Blended 3G ARPU	₹	267	272	271	270	271
Total Revenue	₹ crore	17,798	19,150	20,070	21,092	21,861
Revenue from 3G Subscribers	₹ crore	698	1,283	2,018	2,787	3,573
Net 3G Revenue	₹ crore	453	834	1,326	1,842	2,380
Idea	Unit	FY12E	FY13E	FY14E	FY15E	FY16E
Total Subscribers	million	111.1	128.6	140.0	144.2	147.1
Total 2G Subs	million	108.3	123.5	132.3	134.1	134.6
Active 3G Subscribers	million	2.8	5.2	7.7	10.1	12.5
% of Total Subs	%	2.5%	4.0%	5.5%	7.0%	8.5%
Blended 2G ARPU	₹	155	147	153	151	149
Blended 3G ARPU	₹	371	365	360	351	346
Total Revenue	₹ crore	19,331	23,113	25,714	27,887	28,741
Revenue from 3G Subscribers	₹ crore	725	1,741	2,780	3,756	4,702
Net 3G Revenue	₹ crore	422	1,040	1,599	2,142	2,679

Source: Company, ICICIdirect.com Research

Bharti currently has the highest number of 3G subscribers in the industry. It has disproportionately higher revenue market share indicating cream of the subscribers, which would be the first ones to migrate to 3G and consume data services. We expect Bharti's 3G subscriber base to reach 11.9 million by FY14 and 3G revenue to reach ₹ 4699 crore.

Idea has 3G licenses in circles, which contribute 82.7% of its total revenue and 74.6% of its subscriber base. In these circles, Idea commands a far higher ARPU than in remaining circles. We expect Idea to leverage its strong presence in 2G circles to gain 3G revenues. We expect the company to generate ~ ₹ 2780 crore from 3G services by FY14 led by an ARPU of ₹ 360 and 3G subscriber base of 7.7 million.

RCom's 3G penetration may be lower given the relatively poor subscriber quality. We expect 6.7% of its subscribers to adapt to 3G by FY16E, with an ARPU of ₹ 271.

### MNP – Damp squib!

MNP has turned out to be a damp squib as by the end of August 2011, only 18.1 million subscribers have submitted their requests to different service providers for porting their mobile numbers. Considering a total subscriber base of 865.7 million at the end of August 2011, only 2.1% have requested to port their numbers. On the VLR subscriber base of 608.6 million, only 3.0% have requested to port their numbers.

Vodafone was the early beneficiary of MNP and was consistently the top operator to gain from MNP. However, Idea has overtaken Vodafone and currently is the top operator to gain from MNP by some distance. Bharti Airtel comes a close third. Among losers, RCom leads the way followed by BSNL and TTSL.

#### Exhibit 17: MNP - Top gainers

Operators	MNP In	MNP out	Net	Out/In ratio	Net/Subscriber ratio
Idea	1993684	1133886	859798	0.6	0.9%
Vodafone	2287179	1527269	759910	0.7	0.5%
Airtel	2407929	1737992	669937	0.7	0.4%
Aircel	601859	522672	79187	0.9	0.1%

Source: TRAI, ICICIdirect.com Research

#### Exhibit 18: MNP - Top losers

Operators	MNP In	MNP out	Net	Out/In ratio	Net/Subscriber ratio
Rcom	571821	1750522	-1178701	3.1	-0.8%
BSNL	359700	965270	-605570	2.7	-0.7%
TTSL	29007	476599	-447592	16.4	-0.5%

Source: TRAI, ICICIdirect.com Research

The ineffectiveness of MNP can be attributed to the fact that ~95% of the country's mobile customers are in the pre-paid category, which has a monthly churn rate of 4-5%. This indicates that the segment is insensitive to number retention. Other hassles like documentation, filling up forms, clearing dues and obtaining no objection certificate from departing operators also made MNP look less lucrative.

Even several marketing campaigns aimed at gaining subscribers through MNP along with offering lower tariffs and better services did not entice most of the subscribers to port their numbers.

#### Exhibit 19: Circle wise MNP requests

Zone 1		Zone 2	
Service Area	Number of Porting Requests	Service Area	Number of Porting Requests
Delhi	1009582	AP	1393726
Gujarat	1762683	Assam	47871
HP	74417	Bihar	417552
Haryana	971790	Karnataka	1401092
J&K	3772	Kerala	885555
Maharashtra	1477490	Kolkatta	441361
Mumbai	672998	MP	1159336
Punjab	792441	North East	12539
Rajasthan	1291842	Orissa	426497
UP East	854772	Tamil Nadu	1236094
UP West	1061858	West Bengal	664134
Total	9973645	Total	8085757
Total (Zone 1 + Zone 2)		18059402	

Source: TRAI, ICICIdirect.com Research

Idea is the highest gainer of MNP while RCom is the top loser

### New telecom policy

Trai has come up with a New Telecom Policy (NTP), which has something for both incumbents as well as subscribers to cheer about. While NTP has addressed the need for enhanced broadband penetration, increasing rural teledensity and the need for additional spectrum, it lacks clarity on the timeline for implementation of the same. Also, some of the issues like spectrum refarming, which could have a huge impact on incumbents as well as the government due to the huge cash outgo have a lot of ambiguity related to process and timeline of implementation.

Although some of the guidelines of the draft of the NTP (like one-time spectrum fees, spectrum renewal charges and higher spectrum usage charges) could hurt the profitability of the incumbents in the near future, provisions like liberal M&A norms and spectrum sharing will have a positive impact on the incumbents. Though there is still lack of clarity in the policy implementation, NTP would provide much needed stability to the sector. We expect a watered down version of the policy to be implemented, which would have relatively lesser outgo for the telcos.

### One-time spectrum fees

Trai has recommended that no extra charges be levied upon the incumbents who have spectrum up to 6.2 MHz in 1800 MHz band and up to 5 MHz for CDMA as long as their existing licenses are valid. However, for spectrum held in any circle beyond 6.2 MHz for GSM and 5 MHz for CDMA, the company will have to pay excess spectrum charges.

The companies that plan to exit the industry and surrender spectrum in 1800 MHz will be allowed to do so. The spectrum surrendered will be auctioned and the price would become the current price of the spectrum and will be used for any transactions on the spectrum. However, if no spectrum is surrendered then the spectrum in the 1800 MHz band will be charged as per the table given by Trai. The spectrum in 900 MHz will be 1.5x that of 1800 MHz.

**Exhibit 20: One time spectrum fees – according to Feb 2011 recommendations (₹ Crore)**

Service Area	Upto 6.2 MHz	Beyond 6.2 MHz
Delhi	149.78	249.73
Mumbai	101.11	157.34
Kolkata	49.48	47.6
Maharashtra	117.14	374.47
Gujarat	149.87	355.37
Andhra Pradesh	153.77	431.95
Karnataka	136.16	345.92
Tamil Nadu including Chennai	187.38	426.05
Kerala	73.98	232.16
Punjab	72.86	180.56
Haryana	14.5	107.9
U.P (West)	60.11	252.55
U.P (East)	151.76	318.76
Rajasthan	106.03	278.84
M.P	87.71	254.45
West Bengal	44.79	216.96
Himachal Pradesh	9.34	28.12
Bihar	51.04	153.69
Orissa	24.33	73.26
Assam	10.4	31.33
North East	10.61	31.95
J&K	7.6	22.89
<b>Total</b>	<b>1769.75</b>	<b>4571.85</b>

Source: TRAI, ICICIdirect.com Research

Airtel will have the highest impact of one-time spectrum fee as it holds excess spectrum above the contracted 6.2 MHz in 13 circles as against eight for Vodafone, six for Idea and just one for RCom. Based on pricing suggested by Trai, we expect Bharti to face an outgo of ₹ 4387.4 crore for holding excess spectrum as one-time spectrum fee, which corresponds to ₹ 11.6/share. Idea would have to face an outgo of ₹ 1768.1 crore, which corresponds to a per share impact of ₹ 5.4 whereas the impact on RCom will be minimal as it holds excess spectrum in just one circle.

**Exhibit 21: Bharti - one time spectrum fee**

Circle	I Spectrum (MHz)	900 MHz	1800 MHz	Outgo (₹crore)
Delhi	10.0	8.0	2.0	410.8
Mumbai	9.2	8.0	1.2	297.1
Kolkata	8.0	8.0	0.0	45.0
Maharashtra	8.2	8.2	0.0	560.3
Gujarat	6.2	0.0	6.2	0.0
Andhra Pradesh	10.0	7.8	2.2	786.1
Karnataka	10.0	7.8	2.2	629.6
Tamil Nadu including Chennai	9.2	6.2	3.0	501.0
Kerala	6.2	0.0	6.2	0.0
Punjab	7.8	7.8	0.0	151.7
Haryana	6.2	0.0	6.2	0.0
U.P (West)	6.2	6.2	0.0	0.0
U.P (East)	7.2	6.0	1.2	192.1
Rajasthan	8.2	6.0	2.2	201.0
M.P	8.0	0.0	8.0	221.8
West Bengal	6.2	4.4	1.8	0.0
Himachal Pradesh	6.2	6.2	0.0	0.0
Bihar	9.2	4.4	4.8	311.3
Orissa	8.0	6.2	1.8	79.5
Assam	6.2	1.8	4.4	0.0
North East	6.2	4.4	1.8	0.0
J&K	6.2	6.2	0.0	0.0
Total (₹ Crore)				4,387.4
Per Share (₹)				11.6

Source: TRAI, Company, ICICIdirect.com Research

Bharti is expected see an outgo of ₹ 4387.4 corresponding to a per share value of ₹ 11.6 while Vodafone is expected to see an outgo of ₹ 2135.3 crore

**Exhibit 22: Vodafone - One time spectrum fee**

Circle	I Spectrum (MHz)	900 MHz	1800 MHz	Outgo (₹crore)
Delhi	10.0	8.0	2.0	410.8
Mumbai	10.0	8.0	2.0	258.8
Chennai	8.0	0.0	8.0	0.0
Kolkata	9.8	8.0	1.8	84.0
Maharashtra	6.2	6.2	0.0	0.0
Gujarat	9.8	8.0	1.8	626.9
Andhra Pradesh	6.2	0.0	6.2	0.0
Karnataka	8.0	0.0	8.0	301.3
T.N	7.2	7.2	0.0	223.7
Kerala	6.2	6.2	0.0	0.0
Punjab	6.2	0.0	6.2	0.0
Haryana	6.2	6.2	0.0	0.0
U.P (West)	6.2	0.0	6.2	0.0
U.P (East)	8.2	6.2	2.0	229.8
Rajasthan	6.2	0.0	6.2	0.0
M.P	4.4	0.0	4.4	0.0
West Bengal	6.2	4.4	1.8	0.0
Himachal Pradesh	4.4	0.0	4.4	0.0
Bihar	4.4	0.0	4.4	0.0
Orissa	4.4	0.0	4.4	0.0
Assam	4.4	0.0	4.4	0.0
North East	4.4	0.0	4.4	0.0
J&K	4.4	0.0	4.4	0.0
Total (₹ Crore)				2,135.3

Source: TRAI, Company, ICICIdirect.com Research

**Exhibit 23: Idea - One time spectrum fee**

Circle	I Spectrum (MHz)	900 MHz	1800 MHz	Outgo (₹crore)
Delhi	8.0	0.0	8.0	218.1
Mumbai	4.4	0.0	4.4	0.0
Kolkata	4.4	0.0	4.4	0.0
Maharashtra	9.8	8.0	1.8	660.6
Gujarat	6.2	6.2	0.0	0.0
Andhra Pradesh	8.0	6.2	1.8	272.1
Karnataka	6.2	6.2	0.0	0.0
Tamil Nadu including Chennai	4.4	0.0	4.4	0.0
Kerala	8.0	6.0	2.0	146.3
Punjab	7.8	7.8	0.0	151.7
Haryana	6.2	6.2	0.0	0.0
U.P (West)	8.0	6.0	2.0	159.1
U.P (East)	6.2	0.0	6.2	0.0
Rajasthan	6.2	0.0	6.2	0.0
M.P	8.0	6.2	1.8	160.3
West Bengal	4.4	0.0	4.4	0.0
Himachal Pradesh	4.4	0.0	4.4	0.0
Bihar	4.4	0.0	4.4	0.0
Orissa	4.4	0.0	4.4	0.0
Assam	4.4	0.0	4.4	0.0
North East	4.4	0.0	4.4	0.0
J&K	4.4	0.0	4.4	0.0
Total (₹ Crore)				1,768.1
Per Share (₹)				5.4

Idea is expected to see an outgo of ₹ 1768.1 crore corresponding to a per share value of ₹ 5.4

Source: TRAI, Company, ICICIdirect.com Research

**Spectrum renewal fees**

Trai has recommended that the original holders of licenses pay two components of charges. One is a renewal fee, which will be ₹ 2 crore for Metro, ₹ 1 crore for B circle and ₹ 0.5 crore for C circles and the other, the value of the spectrum as determined by market prices. Trai has also recommended that the period of the renewed license be 10 years.

Bharti, Vodafone and Idea will be the most impacted as they have above 6.2 MHz in most of the circles where they have spectrum and they are up for renewal as early as 2015. Bharti and Idea each have five circles up for renewal by December 2015 leading to a cash outgo of ₹ 1116.7 crore and ₹ 8564.1 crore, respectively.

The present value of the outgo in the future for spectrum renewal as and when they are due for Bharti, is ₹ 13312.8 crore or a per share value of ₹ 35.1, for Idea it is ₹ 9097.1 crore or per share value of ₹ 27.5 and for RCom it is ₹ 3941.7 crore or a per share value of ₹ 19.1.

**Exhibit 24: Bharti - Spectrum renewal fees**

Circle	License			Amount Payable (₹ crore)
	Spectrum (MHz)	Issue Date	Renewal Date	
Delhi	10	Nov-94	Nov-14	2566.7
Mumbai	9.2	Sep-01	Sep-21	1553.9
Kolkata	8	Nov-94	Nov-14	588.7
Maharashtra	8.2	Sep-01	Sep-21	2246.5
Gujarat	6.2	Sep-01	Sep-21	929.2
Andhra Pradesh	10	Dec-95	Dec-15	3676.2
Karnataka	10	Feb-96	Feb-16	3065.1
Tamin Nadu	9.2	Nov-95	Nov-15	3174.2
Kerala	6.2	Sep-01	Sep-21	458.7
Punjab	7.8	Dec-95	Dec-15	1110.9
Haryana	6.2	Sep-01	Sep-21	89.9
U.P (West)	6.2	Sep-01	Sep-21	559.0
U.P (East)	7.2	Feb-04	Feb-24	1715.0
Rajasthan	8.2	Apr-96	Apr-16	1549.9
M.P	8	Sep-01	Sep-21	1001.8
West Bengal	6.2	Feb-04	Feb-24	376.2
Himachal Pradesh	6.2	Dec-95	Dec-15	86.9
Bihar	9.2	Feb-04	Feb-24	945.1
Orissa	8	Feb-04	Feb-24	358.1
Assam	6.2	Jul-04	Jul-24	73.8
North East	6.2	Dec-05	Dec-25	89.1
J&K	6.2	Feb-04	Feb-24	70.7
<b>Total</b>				<b>26285.7</b>
<b>NPV</b>				<b>13312.8</b>
<b>Per Share Value</b>				<b>35.1</b>

Bharti is expected to see an outgo of ₹ 26285.7 crore, with an NPV of ₹ 13312.8 crore with a per share value of ₹ 35.1

Source: TRAI, Company, ICICIdirect.com Research

**Exhibit 25: Idea - Spectrum renewal fees**

Circle	License			Amount Payable (₹ crore)
	Spectrum (MHz)	Issue Date	Renewal Date	
Delhi	8	Oct-01	Oct-21	1,378.2
Mumbai	4.4	Dec-06	Dec-26	444.9
Kolkata	4.4	Jan-08	Jan-28	217.7
Maharashtra	9.8	Dec-95	Dec-15	2,976.7
Gujarat	6.2	Dec-95	Dec-15	1,393.8
Andhra Pradesh	8	Dec-95	Dec-15	2,207.6
Karnataka	6.2	Apr-96	Apr-16	1,266.3
Tamin Nadu	4.4	Jan-08	Jan-28	824.5
Kerala	8	Dec-95	Dec-15	1,098.5
Punjab	7.8	Apr-96	Apr-16	1,110.9
Haryana	6.2	Dec-95	Dec-15	134.9
U.P (West)	8	Dec-95	Dec-15	1,007.6
U.P (East)	6.2	Oct-01	Oct-21	940.9
Rajasthan	6.2	Oct-01	Oct-21	657.4
M.P	8	Dec-95	Dec-15	1,273.7
West Bengal	4.4	Jan-08	Jan-28	197.1
Himachal Pradesh	4.4	Oct-01	Oct-21	41.1
Bihar	4.4	Dec-06	Dec-26	224.6
Orissa	4.4	Jan-08	Jan-28	107.1
Assam	4.4	Jan-08	Jan-28	45.8
North East	4.4	Jan-08	Jan-28	46.7
J&K	4.4	Jan-08	Jan-28	33.4
<b>Total</b>				<b>17,629.2</b>
<b>NPV</b>				<b>9097.1</b>
<b>Per Share Value</b>				<b>27.5</b>

Idea is expected to see an outgo of ₹ 17629.2 crore, with an NPV of ₹ 9097.1 crore with a per share value of ₹ 27.5

Source: TRAI, Company, ICICIdirect.com Research

**Exhibit 26: RCom - Spectrum renewal fees (GSM)**

Circle	License			Amount Payable (₹ crore)
	Spectrum (MHz)	Issue Date	Renewal Date	
Delhi	4.4	Jul-01	Jul-21	659.0
Mumbai	4.4	Jul-01	Jul-21	444.9
Kolkata	6.2	Sep-01	Sep-21	306.8
Maharashtra	4.4	Jul-01	Jul-21	515.4
Gujarat	4.4	Sep-97	Sep-17	659.4
Andhra Pradesh	4.4	Jul-01	Jul-21	676.6
Karnataka	4.4	Jul-01	Jul-21	824.5
Tamin Nadu	4.4	Sep-01	Sep-21	824.5
Kerala	4.4	Jul-01	Jul-21	325.5
Punjab	4.4	Jul-01	Jul-21	320.6
Haryana	4.4	Jul-01	Jul-21	63.8
U.P (West)	4.4	Jul-01	Jul-21	264.5
U.P (East)	4.4	Jul-01	Jul-21	667.7
Rajasthan	4.4	Jul-01	Jul-21	466.5
M.P	6.2	Dec-95	Dec-15	815.7
West Bengal	6.2	Dec-95	Dec-15	376.2
Himachal Pradesh	6.2	Dec-95	Dec-15	86.9
Bihar	8	Dec-95	Dec-15	751.3
Assam	6.2	Dec-95	Dec-15	96.7
North East	6.2	Dec-95	Dec-15	89.1
Orissa	6.2	Dec-95	Dec-15	226.3
J&K	4.4	Sep-04	Sep-24	33.4
<b>Total</b>				<b>9495.4</b>
<b>NPV</b>				<b>3941.7</b>
<b>Per Share Value</b>				<b>19.1</b>

RCom is expected to see an outgo of ₹ 9495.4 with an NPV of ₹ 3941.7 corresponding to a per share value of ₹ 19.1

Source: TRAI, Company, ICICIdirect.com Research

**Reduction in license fees**

With the intention of checking arbitrage among service providers, Trai had recommended uniform license fees of 6% for all telecom services provided. Trai had also recommended doing it over a four year period progressively. Some services will see an increase to 6% while others will see a decrease. Hence, Trai feels that the revenues of the government will not be affected due to this change.

While DoT agrees with the need for a uniform license fees, they feel that the uniform license fees should stand at 8.5% of AGR rather than the 6% recommended by Trai. However, the Telecom Commission has recommended a uniform license fee of 8%.

**Exhibit 27: Trai's earlier recommendations for uniform license fees**

Service Providers	FY13	FY14	FY15	FY16
UASL/CTMS in Metro	10%	9%	8%	6%
UASL/CTMS in 'A'	9%	8%	7%	6%
UASL/CTMS in 'B'	7%	6%	6%	6%
UASL/CTMS in 'C'	6%	6%	6%	6%
ISP	3%	4%	5%	6%
IP1	3%	4%	5%	6%

Source: TRAI, ICICIdirect.com Research

### Spectrum refarming

Trai has recommended that spectrum in 800 and 900 MHz bands should be refarmed at the time of renewal of the licenses. For holders of spectrum in 900 MHz band, substitute spectrum should only be assigned in 1800 MHz band and for license holders of 800 MHz, spectrum should be assigned in 450/1900 MHz. It will, however, carry out separate consultation process on issues involved in refarming of 800/900 MHz and come up with its recommendations before the licenses come up for renewal.

#### Exhibit 28: Base station densities across spectrum bands

Base Stations Per KM	UMTS 900	UMTS 1800	UMTS 2100
Sub Urban	0.017	0.027	0.037
Remote/Rural	0.008	0.013	0.018

Source: TRAI, ICICIdirect.com Research

UMTS 900 can effectively generate cost reductions of up to 40% in capex and 30% in overall costs when compared to a baseline case scenario of deployment using UMTS at 2100 MHz. These lower costs are primarily due to the radio propagation characteristics in the lower band that provide greater reach of UMTS 900 and improved in building coverage.

#### Exhibit 29: Percentage of 900 MHz spectrum in total spectrum

	Bharti Airtel		Vodafone		Idea Cellular	
	% spectrum in 900 MHz	Rev. dependence	% spectrum in 900 MHz	Rev. dependence	% spectrum in 900 MHz	Rev. dependence
Delhi	80.0	8.7	80.0	8.7	-	3.9
Mumbai	87.0	3.7	80.0	8.8	-	2.0
Kolkata	100.0	1.9	81.6	3.7	-	0.1
Maharashtra	100.0	4.4	100.0	8.7	81.6	17.6
Gujarat	-	2.5	81.6	11.4	100.0	7.8
A. P.	78.0	11.5	-	3.7	77.5	10.9
Karnataka	78.0	11.3	-	3.9	100.0	3.8
Tamil Nadu	67.4	9.8	100.0	9.9	-	0.3
Kerala	-	2.1	100.0	4.7	75.0	11.4
Punjab	100.0	4.5	-	2.7	100.0	5.5
Haryana	-	1.0	100.0	2.3	100.0	2.9
U. P. (W)	100.0	2.3	-	4.6	75.0	9.5
U. P. (E)	83.3	6.0	75.6	9.3	-	5.3
Rajasthan	73.2	7.2	-	5.0	-	3.0
M. P.	-	3.9	-	0.7	77.5	11.6
West Bengal	71.0	2.8	71.0	6.1	-	0.6
H. P.	100.0	1.0	-	0.2	-	0.2
Bihar	47.8	7.9	-	2.5	-	2.9
Orissa	77.5	2.6	-	1.1	-	0.3
Assam	29.0	1.9	-	1.1	-	0.2
North East	71.0	1.3	-	0.5	-	0.1
J & K	100.0	1.4	-	0.3	-	0.1

Source: TRAI, Company, ICICIdirect.com Research

Spectrum refarming is extremely capital intensive for those vacating the spectrum as well as for those using it. Thus, it will involve a huge outgo for both the incumbents as well as the government. Trai and DoT are currently not in agreement about the funding required, with DoT suggesting that the funding be made from the Consolidated Fund of India while Trai is demanding a separate fund containing 50% of the realisation from all proceeds from spectrum including auction proceeds as well as from spectrum usage charges specifically for the purpose of spectrum refarming. DoT has suggested that no support be given to private firms for the capital required from their part for refarming. Trai has suggested that no firm view be taken about that at this stage as the

Bharti is expected to see the highest outgo due to spectrum refarming followed by Vodafone and Idea as they hold maximum spectrum in 900 MHz band

recommendations from the consultations process with the telecom operators are not yet out.

### One nation – one license

Trai has recommended de-linking awarding of spectrum in future with licenses. All the original holders of licenses upon renewal will be free to apply for a unified license. The guidelines for such a license will be recommended by Trai after a consultation process with all the stakeholders before the end of December 2011. Such a move would mean the end of roaming charges. This will negatively affect all the telecom operators as revenues earned from roaming charges will be done away with, impacting the EBITDA by ~4-6%. Idea would be the most impacted. However, this could be compensated by increase in headline tariffs and increase in tariff.

### Spectrum usage charges

Trai has also recommended revising the spectrum usage charges. The spectrum usage charges were meant to be revised every two years and were last revised in February 2010, which came into effect from April 1, 2010. However, the matter is sub judice now. Once the matter is solved by the court, Trai's recommendations will be examined.

Spectrum usage charges, as per TRAI recommendations, both for GSM and CDMA spectrum, will be at the rate of 0.5% for every MHz up to the contracted spectrum (6.2 MHz for GSM and 5.0 MHz for CDMA) at the rate of 1% for every MHz with respect to spectrum beyond the contracted quantity, subject to a limit of 10% in respect of GSM and 7% in respect of CDMA. Such a structure of spectrum usage charges will cost a higher percentage of AGR for Bharti, followed by Idea while RCom will have a minimum percentage of AGR charged.

#### Exhibit 30: Spectrum usage charges

Existing Guidelines (Feb 2010)			TRAI Recommendations			
GSM (MHz)	CDMA (MHz)	SUC*	GSM (MHz)	SUC*	CDMA (MHz)	SUC*
4.4	5	3%	4.4	2.2%	2.5	1.3%
6.2	6.25	4%	6.2	3.1%	3.75	1.9%
8.2	7.5	5%	8	4.9%	5	2.5%
10.2	10	6%	10	6.9%	6.25	3.8%
12.2	12.5	7%	12.4	9.3%	8.75	6.3%
15	15	8%	14.4	10.0%	10	7.0%

Source: TRAI, ICICIdirect.com Research

\* Spectrum usage charges as a % of AGR

Operators holding below 8 MHz (GSM) and 5MHz (CDMA) will benefit while those holding above it stand to lose should the revised spectrum usage charges come into effect

The spectrum available for allocation can receive a huge boost if Trai's recommendation of cancellation of licenses is accepted. Trai had recommended cancelling 38 licenses and legal examination of the feasibility of cancelling 31 more licenses in 1800 MHz (GSM) and 800 MHz (CDMA) bands in November 2012. Further, in December 2012, Trai recommended cancelling another five licenses in the 1800 MHz band.

**Exhibit 31: Spectrum above 8MHz - to be affected by revised spectrum usage charges**

Circle	Spectrum (MHz)		RCom
	Bharti	Idea	
Delhi	10.0	8.0	4.4
Mumbai	9.2	4.4	4.4
Kolkata	8.0	4.4	6.2
Maharashtra	8.2	9.8	4.4
Gujarat	6.2	6.2	4.4
Andhra Pradesh	10.0	8.0	4.4
Karnataka	10.0	6.2	4.4
Tamil Nadu including Chennai	9.2	4.4	4.4
Kerala	6.2	8.0	4.4
Punjab	7.8	7.8	4.4
Haryana	6.2	6.2	4.4
U.P (West)	6.2	8.0	4.4
U.P (East)	7.2	6.2	4.4
Rajasthan	8.2	6.2	4.4
M.P	8.0	8.0	6.2
West Bengal	6.2	4.4	6.2
Himachal Pradesh	6.2	4.4	6.2
Bihar	9.2	4.4	8.0
Orissa	8.0	4.4	6.2
Assam	6.2	4.4	6.2
North East	6.2	4.4	6.2
J&K	6.2	4.4	4.4

Bharti will be the most effected as it holds above 8 MHz in 13 circles, followed by Idea in seven circles while RCom will mostly benefit from revised spectrum usage charges

Source: TRAI, ICICIdirect.com Research

**Exhibit 32: Available spectrum after cancellation of licenses**

Circle	Available GSM spectrum MHz	Current Scenario			On Cancellation		
		No of operators	Spectrum already allocated MHz	Balance available spectrum MHz	No of operators	Spectrum already allocated MHz	Balance available spectrum MHz
Delhi	57.2	12	53.6	3.6	11	49.2	8.0
Mumbai	74.8	11	72.4	2.4	10	68.0	6.8
Kolkata	78.4	10	60.4	18.0	9	56.0	22.4
Maharashtra	69.4	12	69.4	0.0	8	51.8	17.6
Gujarat	60.4	11	60.4	0.0	8	47.2	13.2
AP	83.6	12	69.4	14.2	8	51.8	31.8
Karnataka	79.2	12	69.4	9.8	8	51.8	27.4
Tamil Nadu	87.0	11	67.0	20.0	9	58.2	28.8
Kerala	89.2	11	61.2	28.0	9	52.4	36.8
Punjab	63.2	12	63.2	0.0	7	41.2	22.0
Harayana	63.8	12	63.8	0.0	7	41.8	22.0
UP - West	61.2	11	61.2	0.0	8	48.0	13.2
UP - East	62.4	11	62.4	0.0	8	49.2	13.2
Rajasthan	63.8	12	63.8	0.0	7	41.8	22.0
M.P.	93.6	11	63.0	30.6	7	45.4	48.2
West Bengal	57.4	10	53.0	4.4	8	44.2	13.2
H.P.	57.6	11	57.6	0.0	8	44.4	13.2
Bihar	71.2	12	66.8	4.4	9	53.6	17.6
Orissa	77.4	11	59.4	18.0	9	50.6	26.8
Assam	59.4	10	55.0	4.4	8	46.2	13.2
North East	57.6	10	53.2	4.4	8	44.4	13.2
J&K	49.4	10	49.4	0.0	8	40.6	8.8
<b>Total</b>	<b>1,517.2</b>		<b>1,355.0</b>	<b>162.2</b>		<b>1,077.8</b>	<b>439.4</b>

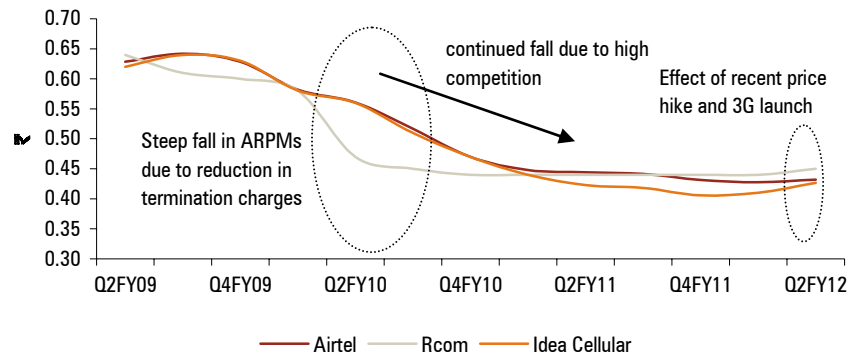
Source: TRAI, ICICIdirect.com Research

**Call termination charges**

Trai has recently suggested reducing call termination charges from 20 paisa to 10 paisa a minute from January 2012 and doing away with it by January 2014. Such a move will bring down the tariffs further as it will lead to lowering of costs for new operators who could pass it on to subscribers in order to gain subscriber market share. Bharti Airtel and Vodafone would be the most impacted as they are currently net earners of call termination charges. The impact on Idea will be minimal as Idea is more or less neutral on call termination charges. However, all other operators tend to gain as they are currently net payers of call termination charges.

Call termination charges were reduced from 30 paisa to 20 paisa in Q3FY10. As expected, it led to a further reduction of mobile tariffs and resulted in a significant drop in the ARPMS of operators.

**Exhibit 33: Effect of reducing call termination charges**



Source: Company, ICICIdirect.com Research

**IP 1 Category to be brought under licensing regime**

Trai has recommended bringing the IP 1 category into the licensing regime as well. The reasons given for such a move is to enable the IP1 category to provide both passive as well as active infrastructure, independent of the service providers, faster roll out and reduced capex on the part of service providers. Currently, tower providers are facing restrictions from different local bodies and are facing non uniform local regulations. By bringing them into the license regime such problems will be solved. Also, arbitrage is expected to be significantly reduced.

IP 1 category will be expected to take the unified license from the moment it comes into existence. Trai is working on preparing detailed guidelines for a unified license, which will cover the infrastructure providers also and is expected to come up with them before the end of December 2011. The license fee for IP 1 category, as recommended by Trai, is expected to be 3% in FY13, 4% in FY14, 5% in FY15 and 6% from FY16 and onwards.

**Exhibit 34: Impact of license fee on IP 1 Industry**

₹ Crore	FY12	FY13	FY14	FY15	FY16
AGR ( IP 1 )	26,436.0	29,457.0	32,823.2	36,574.3	40,753.7
License Fees	0.0	2,356.6	2,625.9	2,925.9	3,260.3

Source: TRAI , ICICIdirect.com Research,

IP1 industry will be heavily impacted due to license fee as they will see an outgo of ~ ₹ 2356 crore in FY13 as compared to no outgo in FY12

Our estimates for the external revenue of Bharti from its passive infrastructure business assume external tenancy of 2.0x and internal tenancy of 1.2x in FY13, is ₹ 2653.8 crore. Considering an 8% license fees charge, we get an impact of ₹ 212.3 crore for FY13. For Idea, our revenue estimates for FY13 stands at ₹ 620.0 crore. An 8% license fee would correspond to ₹ 49.6 crore outlay for Idea in FY13.

The license fee for Bharti on account of passive infrastructure would be ₹ 212.3 crore while for Idea it would be ₹ 49.6 crore

**Exhibit 35: License Charge (8%) Impact**

(₹ Crore)	FY13 Revenue	License Charge @8%
Bharti Infratel Consolidated	2653.8	212.3
Idea (Through Indus)	620	49.6

Source: ICICIdirect.com Research

### Liberal M&A norms

Trai has found the consolidation of spectrum to be the need of the hour. As on Q1FY12, the seven major players in the telecom sector had a revenue market share of 93.8% while the six new players had a market share of just 6.2%.

Previously, the norms said that the market share of the merged entity cannot be greater than 40% in a particular circle. DoT had wanted it to be reduced to 35% to prevent any kind of monopoly happening in the market. However, Trai has recommended that when the market share of the merged entity is below 35% of the subscriber base as well as AGR, the merger can happen. However, if it is above 35% and below 60%, then the case will be looked upon by the government after recommendations from Trai. Cases where the market share of the merged entity goes beyond 60% will not be entertained. The total spectrum held by the resultant entity also cannot exceed 25% of the spectrum assigned in that circle.

These M&A norms, if implemented, will certainly help consolidation in the industry. The cap recommended by Trai for service providers is 10 MHz for Delhi and Mumbai and 8 MHz in all other areas. The only way a service provider can have more than the above-mentioned spectrum is in the open market either by M&A or through auction of spectrum.

Trai may also recommend an exit policy for the licensees who want to exit from the provisioning of telecom services under a license after consultations with the stakeholders. In such a case the spectrum held by the licensee will be surrendered and auctioned by the government in the open market.

These norms will enable the small operators to either get merged or acquired or quit the industry by taking the exit policy. In any case, the industry is set for consolidation with small operators leaving the industry. The return of pricing power to incumbents will also help the pace of consolidation.

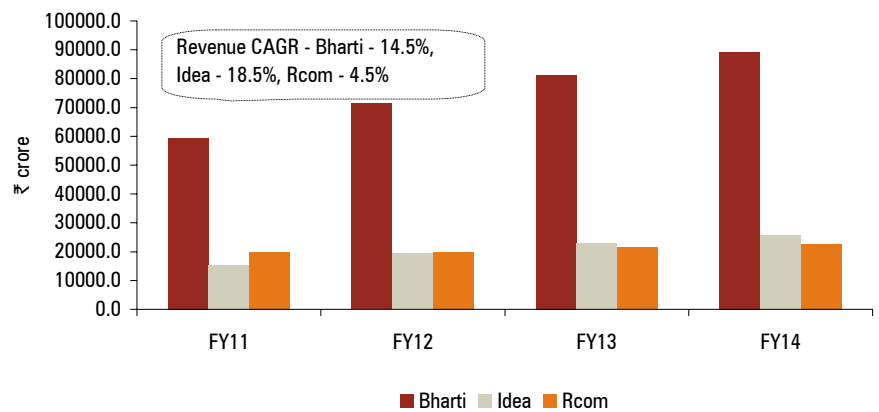
## Financials

### Revenue to grow led by traffic growth and stable ARPMs

Bharti Airtel and Idea are expected to see a CAGR of 9.0% and 18.5% from FY11 to FY14E in their mobility revenue on the back of increasing traffic at a stable ARPM. For Bharti, traffic is expected to see 7.9% CAGR to ~995 billion minutes in FY14E from 792.1 billion minutes in FY11 while Idea is expected to witness a 17.7% CAGR to ~ 591 billion minutes. The ARPMs for both Bharti and Idea are expected to increase marginally to 45 paisa and 44 paisa respectively. Overall revenue for Bharti Airtel is expected to increase at a CAGR of 14.5%. RCom, which has been struggling with the KPIs and subscriber quality, is expected to grow at 4.5% CAGR over FY11 to FY14E driven by a 5.9% CAGR in traffic to 445.4 billion minutes and a stable ARPM of ~ 45 paisa.

Revenue will also be driven by higher traction in 3G. We expect revenue from 3G subscribers to reach ₹ 4699, ₹ 2780 and ₹ 2018 for Bharti, Idea and Rcom, respectively, by FY14E. Bharti's revenue will also be helped by African revenues expected to grow at 30.9% CAGR from FY11 to FY14 on the back of 16.7% and 10.9% CAGR in subscribers and ARPU, respectively, over the same period.

**Exhibit 36: Revenue growth trend**



*Normalized revenue for Rcom in FY11*

*Source: Company, ICICIdirect.com Research*

### EBITDA margins to expand

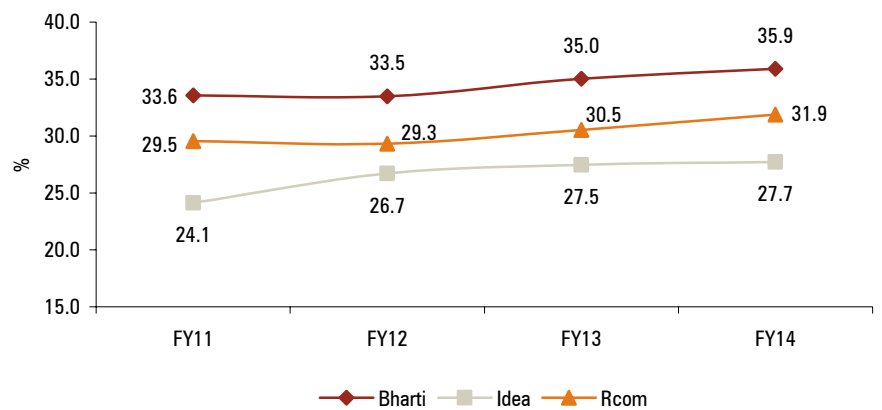
EBITDA margin across telecom operators are expected to improve on account of reduced network rollout expenses as the capex intensity declines and lower marketing and promotional expenses with lower subscriber addition.

For Bharti Airtel, African operations are expected to see a significant margin expansion from 25.0% to 30.9% due to various cost saving initiatives like BPO, IT and network management outsourcing, passive infrastructure sharing, etc. undertaken by the company. The consolidated EBITDA margin is expected to improve from 33.6% in FY11 to 35.9% in FY14. EBITDA would grow 1.6x by FY14 from FY11 levels recording a CAGR of 17.1%.

For Idea Cellular, EBITDA margins are expected to improve to 24.1% in FY14 from 27.7% in FY11, primarily on the back of higher network utilisation. The company already has a 2G cell site base of 78,367 as on September 2011, which has increased from 24,793 in March 2008. We believe incremental rollout would not be as aggressive as in the recent past. This would help the company to save on network operating cost. The EBITDA is expected to increase to 1.9x FY14E to ₹ 7130.3 from ₹ 3725.8 in FY11.

We expect the EBITDA margin for Reliance Communication to improve to 31.9% in FY14 from 29.5% in FY11 on account of reduced network rollout costs. The EBITDA is expected to grow at a CAGR of 7.2% from ₹ 5874.3 crore to ₹ 7233.9 crore in FY14.

**Exhibit 37: EBITDA margin trend**



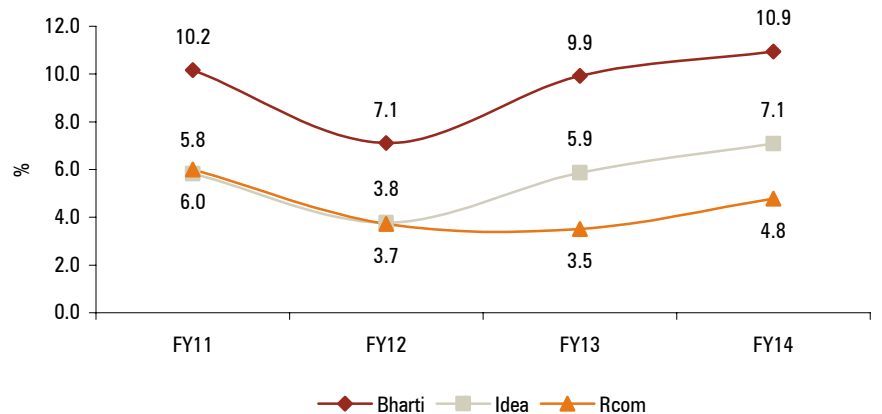
EBITDA margins across all players are expected to increase – from 33.6% to 35.9% for Bharti; from 29.5% to 31.9% for RCom and 24.1% to 27.7% for RCom from FY11 to FY14

*Normalized EBITDA margin for Rcom in FY11*  
Source: Company, ICICIdirect.com Research

**PAT margins to improve FY12E onwards...**

We expect the PAT margins to grow at a much faster rate for Idea and Bharti aided by debt repayment and reduced interest expenses. While Bharti is expected to see an expansion in the PAT margins from 7.1% in FY12E to 10.9% in FY14E, Idea would see an expansion from 3.8% to 7.1%. RCom’s margin would improve from 3.7% in FY12E to 4.8% in FY14E, but would still be lower than in FY11.

**Exhibit 38: PAT margin trend**



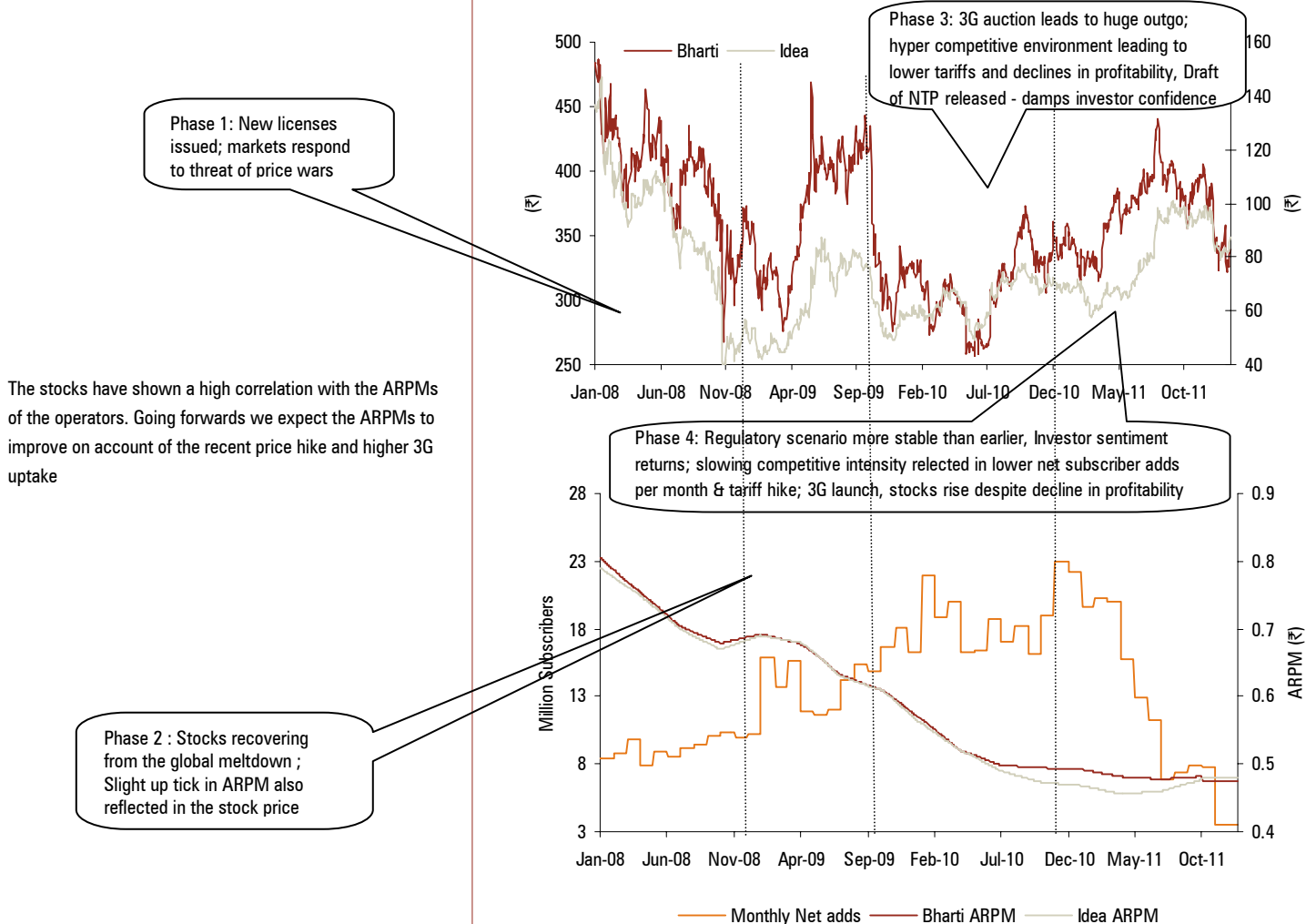
While Bharti and Idea are expected to see a PAT margin expansion from 10.2% to 10.9% and 5.8% to 7.1% respectively, RCom would see a contraction from 6.0% to 4.8% from FY11 to FY14

Source: Company, ICICIdirect.com Research

## Valuations

Telecom sector stocks have outperformed the Sensex in the last year, in spite of the continuous downgrade of their EPS (due to higher interest and amortisation cost relating to 3G related debt). This has been primarily due to a new telecom minister assuming office and improving regulatory scenario which helped bring back investor confidence in the sector.

**Exhibit 39: Telecom performance thus far...**



Source: Reuters, ICICIdirect.com Research

Going forward, we expect the ARPMs to increase on account of the price hike taken recently, the full effect of which is yet to reflect in the ARPMs and a higher 3G uptake.

Although some of the guidelines of the draft of the NTP 2011 (like one time spectrum fees, spectrum renewal charges, and higher spectrum usage charges) could hurt the profitability of the incumbents in the near term, provisions like liberal M&A norms and spectrum sharing will have a positive bearing on the stocks.

Moreover, all the incumbents are already past their peak capex cycle and are expected to generate free cash flow in subsequent years. We expect Bharti Airtel to generate sufficient cash flow to repay its debt comfortably in the coming years, resulting in huge savings in terms of interest outgo.

### Bharti Airtel (Buy); Target Price: ₹ 450/ share

The stock has been de-rated due to the dual impact of regulatory overhang and hyper-intensive competition in the domestic market. We expect Airtel's valuation multiples to expand on account of reducing regulatory uncertainty, improving key metrics and profitability. We expect a higher EPS CAGR of 17.3% over FY11-14E against revenue CAGR of 14.5% over the same period primarily due to repayment of debt.

Assuming revenue CAGR of 10.8% over FY11-FY20E and terminal growth of 3% thereon, we have arrived at a target price of ₹ 450/share for Bharti Airtel. Our target price discounts FY12E and FY13E EPS of ₹ 13.4 and ₹ 21.3 by 33.6x and 21.2x, respectively. The stock is currently trading at ₹ 356. Our target price implies an upside potential of 27%. We reiterate our **BUY** rating on Bharti Airtel.

Key risks to our target price are unfavourable regulatory outcomes and slower than expected improvement in African operations.

#### Exhibit 40: Valuation table - Bharti Airtel

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY11	59467.2	50.1	15.9	-33.6	22.3	9.8	12.4	8.6
FY12E	71394.8	20.1	13.4	-16.0	26.6	8.0	9.5	9.6
FY13E	81292.5	13.9	21.3	58.9	16.7	6.5	13.2	12.2
FY14E	89207.0	9.7	25.7	20.9	13.8	5.3	13.9	14.2

Source: Company, ICICIdirect.com Research

### Idea Cellular (Hold); Target Price: ₹ 99/ share

The company is the fastest growing player in the domestic industry. Idea has gained maximum revenue share in the past few years. With reducing network rollout intensity and 3G uptake, margins are expected to go northwards for the company. However, Trai recommendations related to spectrum pricing, if implemented in their current form, would have a greater impact on Idea Cellular. This remains a near term overhang on the stock.

Using the DCF methodology and assuming revenue CAGR of 12.6% over FY11-20E and terminal growth of 3% thereon, we have arrived at a target price of ₹ 80/ share for the core business. We have valued the Indus contribution at ₹ 19/ share to arrive at a target price of ₹ 99/ share. We maintain **HOLD** rating the stock.

#### Exhibit 41: Valuation table - Idea Cellular

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY11	15,438.4	24.5	2.7	(5.9)	34.3	11.4	7.3	5.5
FY12E	19,443.7	25.9	2.2	(18.2)	41.9	8.4	5.6	8.4
FY13E	23,113.4	18.9	4.1	84.4	22.7	6.6	9.4	11.6
FY14E	25,713.6	11.2	5.5	34.3	16.9	5.6	11.2	13.7

Source: Company, ICICIdirect.com Research

### Reliance Communication (Sell); Target Price: ₹ 84/ share

RCom has been struggling with its KPIs with a lesser proportion of active subscribers in its subscriber base as compared to its peers and declining traffic growth. To add to its woes, a huge debt remains a concern. This has caused its capex guidance to be just ₹ 1500 crore, which is way lower than industry standards. However, if the company is able to strike a tower deal, it will help address the huge debt concern.

At the CMP of ₹ 95, the stock is trading at 26.5x FY12E EPS of ₹ 3.6 and 25.8x FY13E EPS of ₹ 3.7. We have valued the stock using the DCF methodology and arrived at a target price of ₹ 84/share, assuming 4.8% CAGR in revenue over FY11-FY20E and terminal growth rate of 3%. We maintain our **SELL** rating on the stock.

**Exhibit 42: Valuation table - Reliance Communication**

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY11	22430.4	4.3	6.5	-71.1	14.5	6.4	3.3	2.4
FY12E	19835.9	-11.6	3.6	-45.2	26.5	8.7	1.8	2.0
FY13E	21557.6	8.7	3.7	2.6	25.8	7.4	1.8	2.8
FY14E	22686.8	5.2	5.3	43.3	18.0	6.4	2.5	3.4

Source: Company, ICICIdirect.com Research

January 25, 2012

## Bharti Airtel (BHATE)

₹ 356

### Fundamental strength to pay off...

Bharti Airtel is the market leader in telecom with ~30.9% revenue market share and strongest fundamentals in the industry. Falling capex intensity, repayment of debt and reduced interest expense thereon, margin expansion in African business and high quality subscribers (first takers of 3G) led uptake in 3G services would drive EPS CAGR of 17.3% over FY11-14E. Spectrum pricing and other regulatory overhang may remain in the near term but it seems to be already priced in. We reiterate our BUY rating on Bharti Airtel with a target price of ₹ 450 per share.

#### 3G revenue to drive growth

Bharti Airtel has the highest number of 3G subscribers in the industry. The company has disproportionately higher revenue market share indicating cream of the subscribers, who would be the first ones to migrate to 3G and consume data services. We expect Bharti's 3G subscriber base to increase to 6% of total subscribers by FY14E and 10% by FY16E.

#### Debt repayment resulting in higher EPS growth

Bharti Airtel is expected to generate free cash flow of ~ ₹ 34986 crore over the next three years, which would be utilised to repay debt. On account of reduction in debt of about ₹ 24,000 from current levels, we expect interest expenses to decline by 42.8% by FY14E. This coupled with margin expansion would aid higher profitability growth. We expect EBITDA and PAT CAGR of 17.1% and 17.3%, respectively, over FY11-14E.

#### Margin expansion in Africa

Airtel's foray into the African market with relatively less penetration give it further room for growth. Initiatives like BPO, IT and network management outsourcing and passive infrastructure sharing would help expand the margins in the long run. Going forward, we expect African revenues and EBITDA to grow to ₹ 29,372.7 crore and ₹ 9,063.1 by FY14 at a CAGR of 30.9% and 40.4%, respectively, over FY11-14E.

### Valuations

Assuming revenue CAGR of 10.8% over FY11-FY20E and terminal growth of 3% thereon, we have arrived at a target price of ₹ 450/ share for Bharti Airtel. Our target price discounts FY12E and FY13E EPS of ₹ 13.4 and ₹ 21.3 by 33.6x and 21.2x, respectively. The stock is currently trading at ₹ 356. Our target price implies an upside potential of 27%. We reiterate BUY rating on Bharti Airtel.

#### Exhibit 43: Key Financials

(Year-end March)	FY10	FY11	FY12E	FY13E	FY14E
Net Sales (₹ crore)	39,615.0	59,467.2	71,394.8	81,292.5	89,207.0
EBITDA (₹ crore)	16,026.6	19,960.8	23,914.3	28,474.5	32,015.2
Net Profit (₹ crore)	9,102.5	6,046.8	5,080.7	8,071.2	9,757.9
EPS (₹)	24.0	15.9	13.4	21.3	25.7
P/E (x)	14.8	22.3	26.6	16.7	13.8
Price / Book (x)	3.3	2.8	2.5	2.2	1.9
EV/EBITDA (x)	8.3	9.8	8.0	6.5	5.3
RoCE (%)	19.7	8.6	9.6	12.2	14.2
RoE (%)	22.0	12.4	9.5	13.2	13.9

Source: Company, ICICIdirect.com Research; Sales includes other operating income

## Company Update

### Rating Matrix

Rating	: Buy
Target	: ₹ 450
Target Period	: 12 months
Potential Upside	: 27%

### YoY Growth (%)

(YoY Growth)	FY11	FY12E	FY13E	FY14E
Net Sales	50.1	20.1	13.9	9.7
EBITDA	24.5	19.8	19.1	12.4
Net Profit	(33.6)	(16.0)	58.9	20.9
EPS	(33.6)	(16.0)	58.9	20.9

### Valuation Summary

	FY11	FY12E	FY13E	FY14E
P/E	22.3	26.6	16.7	13.8
Target P/E	28.3	33.6	21.2	17.5
EV / EBITDA	9.8	8.0	6.5	5.3
P/BV	2.8	2.5	2.2	1.9
RoNW (%)	12.4	9.5	13.2	13.9
RoCE (%)	8.6	9.6	12.2	14.2

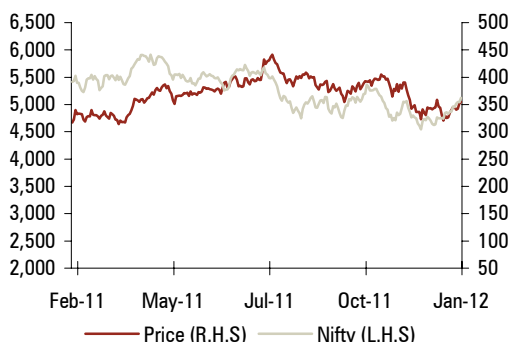
### Stock Data

Market Capitalization (₹ Crore)	135,059.8
Total Debt (FY11) (₹ Crore)	61,670.8
Cash and Investments (FY11) (₹ Crore)	1,579.9
EV (₹ Crore)	195,150.6
52 week H/L	441 / 314
Equity capital	₹ 1898.2 Crore
Face value	₹ 5
MF Holding (%)	8.2
FII Holding (%)	17.6

### Comparative return matrix (%)

	1M	3M	6M	12M
Bharti Airtel	6.6	-6.8	-14.3	4.7
RCOM	36.8	23.6	-1.9	-32.5
Idea	10.9	-4.4	2.5	27.4

### Price movement

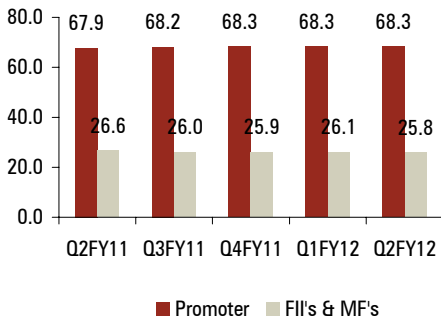


### Analyst's name

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Promoter and FII & MFs holding trend (%)

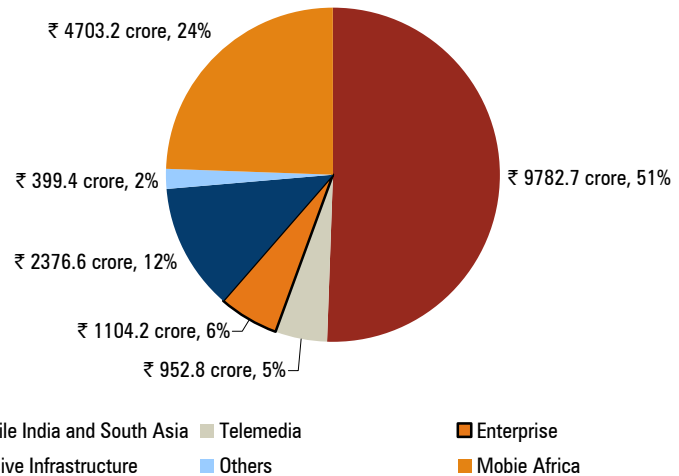


### Company background

Bharti Airtel is one of the world’s leading providers of telecommunication services with a significant presence in India, 16 countries of Africa, Sri Lanka and Bangladesh. As of September 2011, Airtel served an aggregate 237 million customers. The services they provide include telecommunication services under wireless and fixed line technology, integrated suite of telecom solutions to enterprise customers and provision of long distance connectivity both nationally and internationally. They also offer digital TV and IPTV services. All these services are rendered under a unified brand Airtel. The company also manages passive infrastructure pertaining to telecom operations through its subsidiary and joint venture entity.

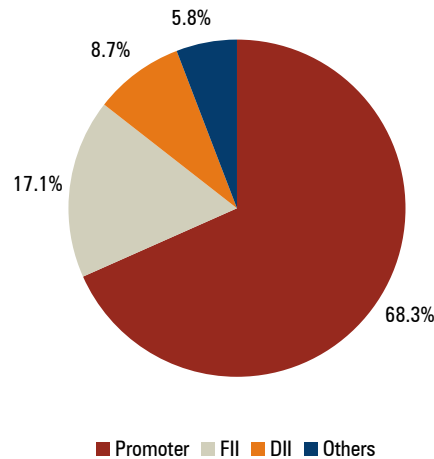
Bharti earns 75% of its revenues from mobile services. Out of this, 51% is contributed by the Asian operations whereas the remaining 24% is contributed by African mobile operations. Passive infrastructure forms 12% of Bharti’s revenue. Telemedia and enterprise contribute 5% and 6%, respectively while the DTH business along with others contributes 2%.

Exhibit 44: Revenue contribution as of Q2FY12



Source: Company, ICICIdirect.com Research

Exhibit 45: Bharti Airtel - Shareholding pattern as on Q2FY12



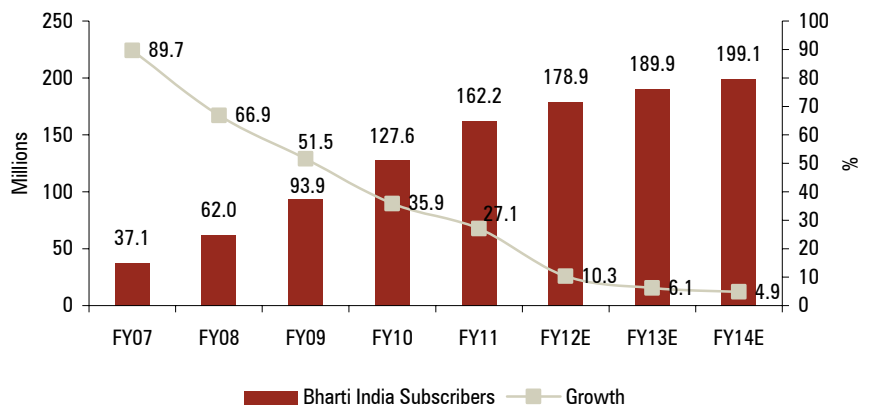
Source: Company, ICICIdirect.com Research

## Investment Rationale

### Dominant player in domestic market

Bharti Airtel is the largest player in the domestic industry both in terms of subscriber and revenue market share. The company has a subscriber base of 174.7 million as on November 2011 indicating a subscriber market share of 19.9%. An 88.9% visitor location register (VLR) subscriber base against ~70% for the overall industry implies an active subscriber share of 25.3%.

**Exhibit 46: Bharti - India subscribers and growth**



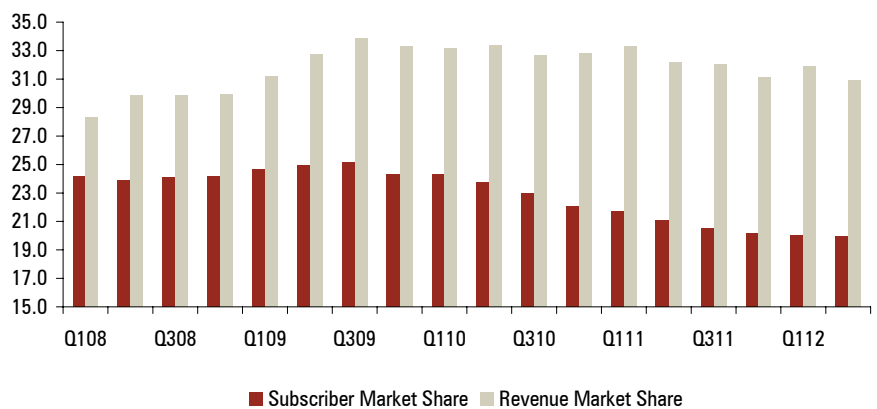
We expect the mobile subscriber base for Bharti Airtel in the domestic market to grow at a CAGR of 7.1% (FY11-14E) to 199.1 million

Source: Company, ICICIdirect.com Research

We expect the mobile subscriber base for Bharti Airtel in the domestic market to grow at a CAGR of 7.1% (FY11-14E) to 199.1 million.

Though the company has lost subscriber share with lower share in net adds since the onslaught of new players, it has fared much better in the revenue market share. The revenue market share has declined only by 4.2% points over Q1FY08-Q2FY12

**Exhibit 47: Bharti - Subscriber & revenue market share trend**



Though the company has lost subscriber share with lower share in net adds since the onslaught of new players, it has fared much better in the revenue market share. The revenue market share has declined only by 4.2 percentage points (pps) over Q1FY08-Q2FY12

Source: Company, ICICIdirect.com Research

**Superior key metrics**

The company commands superior key metrics compared to its peers in the industry. Though the ARPU has declined by 4.4% CQGR from ₹ 390 in Q1FY08 to ₹ 190 in Q2FY12, it is far lesser than the decline in industry GSM ARPU, which has declined by 6.7% CQGR from ₹ 297 to ₹ 98 over the same period.

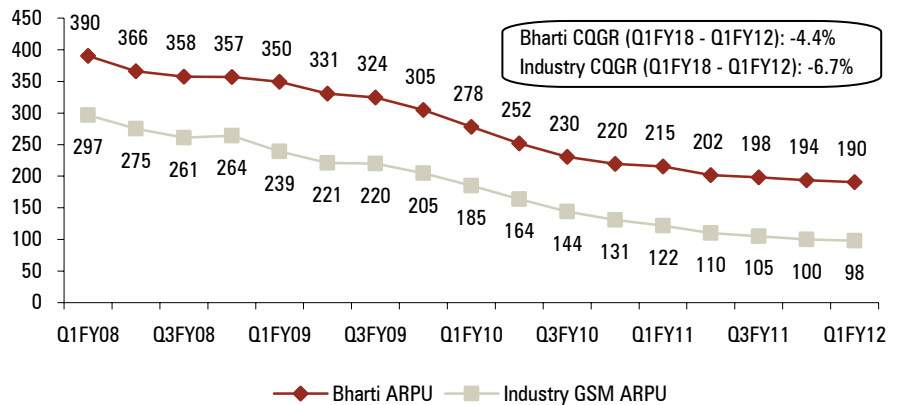
Bharti ranks No. 1 across the industry in all the KPIs except for ARPM, in which RCom currently leads

**Exhibit 48: Superior key metrics**

Data as in Q2FY12	Unit	Bharti	Idea	Rcom	Bharti Rank
ARPU	₹	183	155	101	1
MOU	minutes	423	364	227	1
ARPM	₹	0.43	0.43	0.45	2
EBITDA Margin	%	33.7	26.7	28.3	1
Subscribers	million	172.8	100.2	146.0	1
Subscriber Market Share	%	19.9	11.6	16.8	1
Revenue Market Share	%	30.9	14.1	8.2	1

Source: Company, ICICIdirect.com Research

**Exhibit 49: Bharti & Industry ARPU trend**



Bharti's ARPU has been declining at a CQGR of 4.4% while the industry's ARPU has been declining at 6.7%

Source: Company, TRAI, ICICIdirect.com Research

Recently, the company took a price hike increasing the off net call charges by ~20% in six circles and subsequently increased the ISD charges by 10%. We expect the ARPM to increase by ~2 paise in FY12E, led by recent price hikes and uptake in 3G services.

**Exhibit 50: Domestic Wireless business - key metrics**

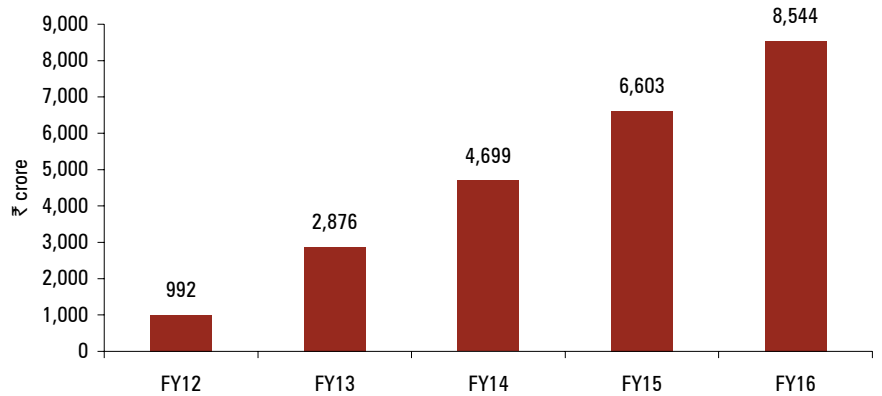
Bharti Airtel	Unit	FY11	FY12	FY13	FY14
Subscribers	millions	162	179	190	199
ARPU	₹	201	187	190	192
MOU	minutes	456	438	431	426
ARPM	Paisa	44.1	42.7	44.1	45.0

Source: Company, ICICIdirect.com Research

**3G to be future growth driver**

Airtel has the highest 3G subscribers in the industry. The company has disproportionately higher revenue market share indicating the cream of the subscribers, who would be the first ones to migrate to 3G and consume data services. We expect Bharti's 3G subscriber base to reach 11.9 million by FY14.

**Exhibit 51: Revenue from 3G subscribers**



We expect the company to earn ~ ₹ 8544 as 3G revenues by FY16 on the back of an ARPU of 382 and a subscriber base of 20.9 million

Source: Company, ICICIdirect.com Research

**Exhibit 52: Key Assumptions for 3G**

Unit	FY12	FY13	FY14	FY15	FY16
3G subscriber base: Million	3.5	7.5	11.9	16.4	20.9
3G ARPU ₹	467	436	403	389	382

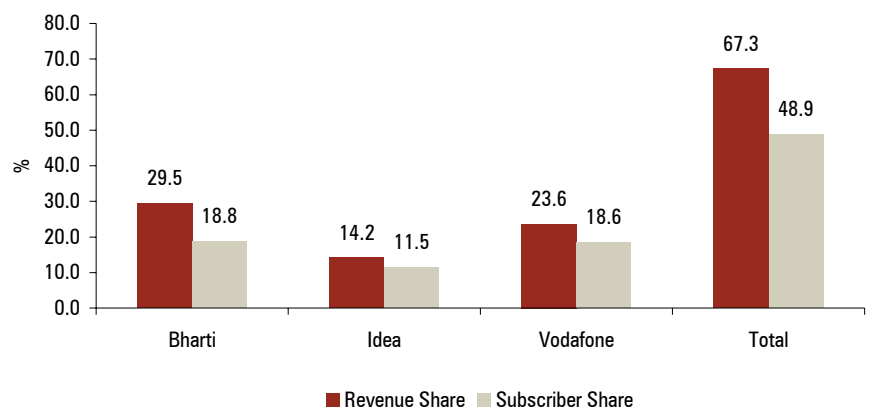
Source: Company, ICICIdirect.com Research

**Tower business**

Bharti Airtel holds 85% stake in Bharti Infratel, which owns 33,056 towers with a tenancy of 1.8x as on September 2011 and Bharti Infratel holds a 42% stake in Indus Towers, which owns 1,08,998 towers with a tenancy of 1.9x.

Indus Towers has the largest and best tower portfolio in the country in terms of the three anchor tenants (Bharti Airtel, Vodafone and Idea Cellular), the largest in the industry with a combined revenue and subscriber market share of 67.3% and 48.9%, respectively. These three companies collectively have 67.3% and 48.9% revenue and subscriber market share, respectively, in the 15 circles, Indus Towers operates in. This also insulates Indus Towers from the risk arising from consolidation in telecom service providers, since the anchor tenants are the three largest players.

**Exhibit 53: Market shares of Bharti, Vodafone and Idea in Indus circles**



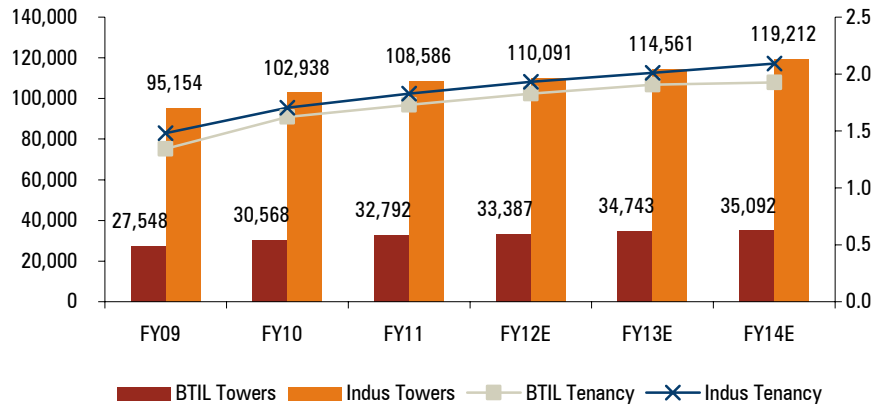
Source: TRAI, ICICIdirect.com Research

Bharti Infratel’s tower concentration is more in the C Circles, providing it more room for growth since most of the Metro and A circles are more or less saturated in terms of 2G subscriber growth. Revenues in the C circle grew at a CAGR of 18.0% over FY08–11 as compared to 5.9% in Metros and A circles over the same period.

**Exhibit 54: BTIL and Indus Towers and tenancy**

We expect Bharti Infratel’s standalone revenue to grow at a CAGR of 10.7% over FY11-14E to ₹ 3232.9 crore backed by a tower base of 35,092 with tenancy of 1.9x by FY14

Indus Towers is expected to increase its tower base to 1,19,212 with a tenancy of 2.1x in FY14 from 1,08,586 towers and tenancy of 1.8x in FY11, resulting in a revenue CAGR of 10.4% over the same period



Source: Company, ICICIdirect.com Research

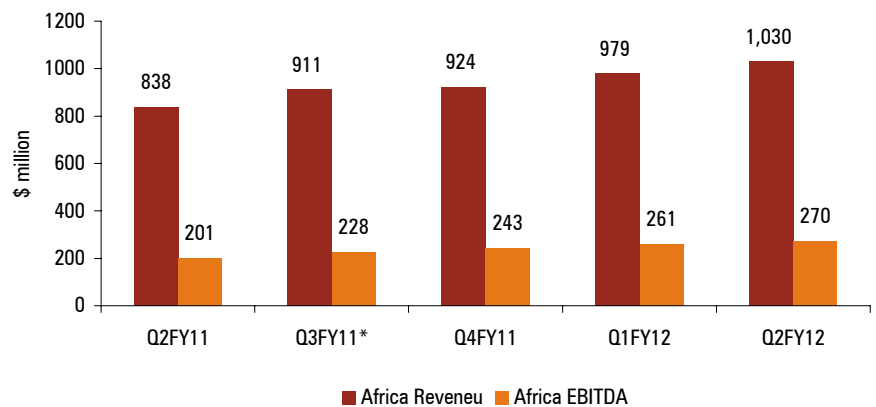
We expect Bharti Infratel’s standalone revenue to grow at a CAGR of 10.7% over FY11-14E to ₹ 3232.9 crore backed by a tower base of 35,092 with tenancy of 1.9x by FY14. Indus Towers is expected to increase its tower base to 1,19,212 with a tenancy of 2.1x in FY14 from 1,08,586 towers and tenancy of 1.8x in FY11, resulting in a revenue CAGR of 10.4% over the same period.

**African operations**

Airtel’s foray into the African market with relatively less penetration give it further room for growth. The revenue has grown from \$838.0 million in Q2F11 to \$1030.2 million in Q2FY12 while EBITDA has grown from \$201 million to \$270.4 million implying a CQGR of 5.3% and 7.7%, respectively.

**Exhibit 55: Africa - Revenue & EBITDA**

The revenue has grown from \$838.0 million in Q2F11 to \$1030.2 million in Q2FY12 while EBITDA has grown from \$201 million to \$270.4 million implying a CQGR of 5.3% and 7.7%, respectively



\* Normalised EBITDA, excluding one time re-branding cost  
Source: Company, ICICIdirect.com Research

This was led by 8.9% CQGR in traffic in the African market, from 12.8 billion minutes in Q2FY10 to 17.9 billion minutes in Q2FY12.

**Exhibit 56: Trend in key metrics of African operations**

	Unit	Q1FY11*	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12
Subscribers	Mn	36.4	40.1	42.1	44.2	46.3	48.4
Total traffic	Bn Minutes	3.7	12.8	14.9	14.9	16.3	17.9
ARPU	\$	7.4	7.4	7.3	7.2	7.3	7.3
MOU	Minutes	103	112	120	115	121	128
ARPM	Cents	7.2	6.6	6.1	6.2	6.0	5.7

\* Q1FY11 data only for 23 days

Source: Company, ICICIdirect.com Research

Though the management's target of \$5 billion revenue and \$2 billion EBITDA by 2013 may seem a little far fetched, the overall scenario in Africa is improving for Bharti Airtel. Initiatives like BPO, IT and network management outsourcing and passive infrastructure sharing would help expand the margins in the long run.

Going forward, we expect the African revenue and EBITDA to grow to ₹ 29372.7 crore and ₹ 9063.1 by FY14 at a CAGR of 30.9% and 40.4%, respectively, over FY11-14E, led by 16.7% and 10.9% CAGR in subscribers and ARPU, respectively, over the same period. The EBITDA margin is expected to expand to 30.9% by FY14 from 25.0% in FY11.

**Exhibit 57: Africa KPIs - assumptions**

	Unit	FY11	FY12E	FY13E	FY14E
Subscribers	Million	44.2	53.4	61.9	70.3
ARPU	\$	7.3	7.3	7.3	7.4
MOU	Minutes	113	130	147	162
ARPM	Cents	6.2	5.6	5.0	4.6

Source: Company, ICICIdirect.com Research

## Financials

### Revenue to grow at 14.5% CAGR in FY11-14E

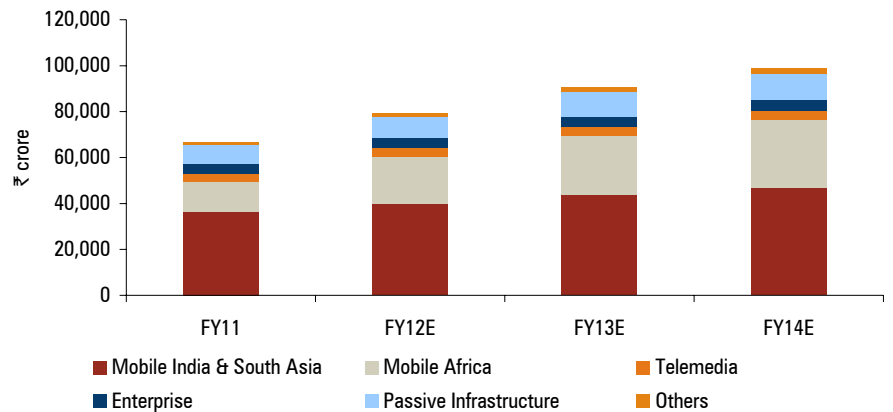
We expect domestic revenues to grow at 9.1% CAGR over FY11-14E on the back of 9.0% CAGR in the mobility business and 9.2% CAGR in other businesses over the same period.

Growth in the mobility business would be led by growth at 7.9% CAGR in overall traffic to ~ 995 billion minutes in FY14E from 792.1 billion minutes in FY11 while the ARPM is expected to improve to 45 paisa. The domestic subscriber base is expected to increase from 162.2 billion in FY11 to 199.1 million by FY14E.

African operations would post superior CAGR of 30.9% over the same period led by 16.7% increase in the subscriber base resulting in volume growth of 40.4% from 46.3 billion minutes in FY11 to 128.2 billion minutes in FY14E.

Consolidated revenues for Bharti Airtel are expected to post a CAGR of 14.5% over FY11-14E.

**Exhibit 58: Bharti segment wise revenue assumptions**



Source: Company, ICICIdirect.com Research

**Exhibit 59: Bharti - Expected revenue growth**

(₹ Crore)	FY10*	FY11	FY12E	FY13E	FY14E	CAGR %(11 - 14E)
Mobile	32,487.2	49,352.3	60,166.6	69,306.7	76,344.4	15.7
Telemedia	3,415.4	3,632.4	3,829.1	3,978.7	4,140.6	4.5
Enterprise	8,394.8	4,129.2	4,386.8	4,619.3	4,806.9	5.2
Others	582.5	1,031.7	1,616.2	1,880.6	2,150.4	27.7
Passive Infra	3,542.5	8,555.5	9,559.8	10,621.0	11,521.3	10.4
Gross revenue	48,422.4	66,701.1	79,558.5	90,406.4	98,963.6	14.1
Elimination	8,807.4	7,233.9	8,163.7	9,113.9	9,756.6	
Net Revenue	39,615.0	59,467.2	71,394.8	81,292.5	89,207.0	14.5

Source: Company, ICICIdirect.com Research

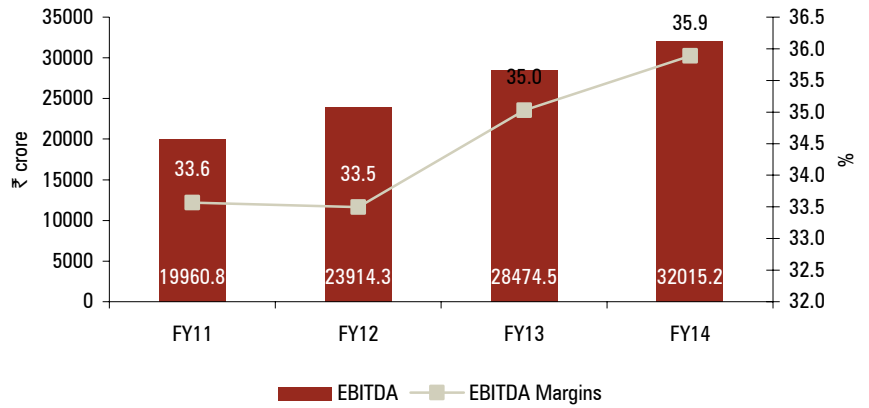
### EBITDA margins to improve

We expect the EBITDA margin of the domestic business to improve significantly to 39.0% in FY14 from 36.8% in FY11 on account of reduced network rollout costs. Even African operations are expected to see

We expect domestic revenues to grow at 9.1% CAGR over FY11-14E on the back of 9.0% CAGR in the mobility business and 9.2% CAGR in other businesses over the same period

significant margin expansion from 25.0% to 30.9% due to various cost saving initiatives like BPO, IT and network management outsourcing, passive infrastructure sharing, etc. undertaken by the company. The consolidated EBITDA margin is expected to improve from 33.6% in FY11 to 35.7% in FY14. The EBITDA would grow 1.6x by FY14 from FY11 levels recording a CAGR of 17.1%.

**Exhibit 60: EBITDA and EBITDA margins trend**

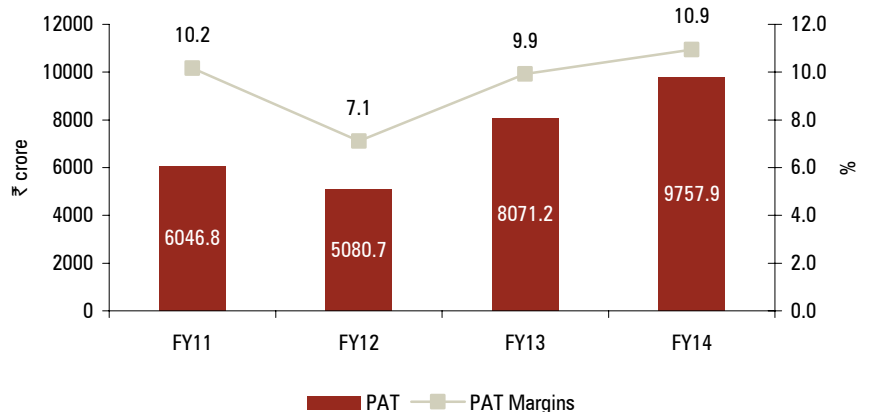


The consolidated EBITDA margin is expected to improve from 33.6% in FY11 to 35.7% in FY14. The EBITDA would grow 1.6x by FY14 from FY11 levels recording a CAGR of 16.8%

Source: Company, ICICIdirect.com Research

PAT would grow at a much faster rate than revenue and EBITDA, recording a CAGR of 17.3% over FY11-14E, aided by debt repayment and reduced interest expenses. The EPS is expected to grow from ₹ 15.9 in FY11 to ₹ 25.7 by FY14E.

**Exhibit 61: Trends in net profit & net profit margins**



PAT would grow at a much faster rate than revenue and EBITDA, recording a CAGR of 17.3% over FY11-14E, aided by debt repayment and reduced interest expenses. The EPS is expected to grow from ₹ 15.9 in FY11 to ₹ 25.7 by FY14E

Source: Company, ICICIdirect.com Research

**Return ratios to improve**

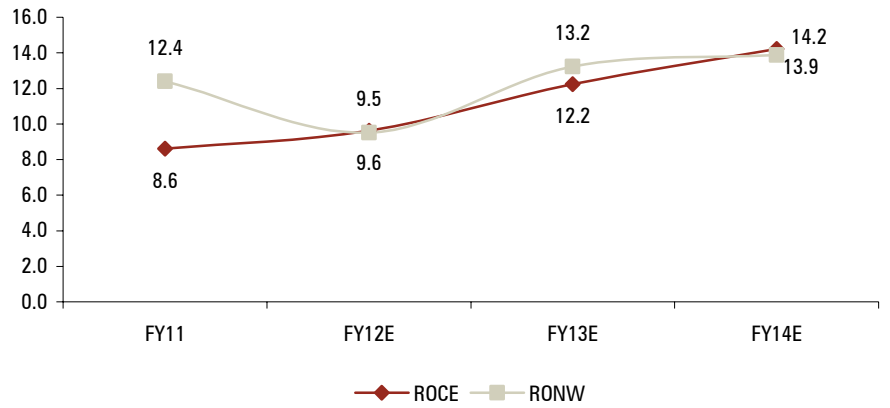
Return ratios are expected to improve significantly over the next three years led by increasing profitability in the domestic and international business (EPS CAGR of 19.4% over FY11-14E). Also, the company has passed the peak capex cycle with the capex requirement declining to ₹ 15,000 crore by FY14 from ₹ 93,109.7 crore in FY11 and capex intensity declining from 1.6 in FY11 to 0.2 in FY14E.

The company would also witness reduction in net debt and interest expense on account of repayment of ~ ₹ 24000 crore in the next three

years. We expect the net debt for Bharti Airtel to reduce from ₹ 60,090.9 crore in FY11 to ~ ₹ 36,084.4 crore in FY14E.

**Exhibit 62: Return ratios to improve significantly**

Return ratios are expected to improve significantly on the back of increasing profitability, reducing capital intensity and repayment of debt



Source: Company, ICICIdirect.com Research

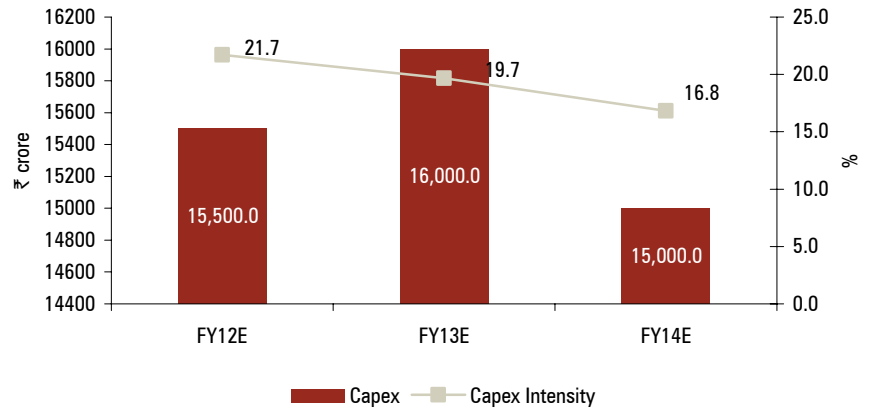
**Exhibit 63: Bharti generating huge FCF to repay debt**

(₹ Crore)	FY11	FY12E	FY13E	FY14E
NOPAT	7975.2	8936.7	11065.9	11868.9
Net Investment	82903.1	2544.0	1422.2	-1268.4
Change in Working Capital	-11101.2	-1613.6	-2061.0	-2137.8
FCF	-63826.6	8006.3	11704.8	15275.1

Source: Company, ICICIdirect.com Research

**Exhibit 64: Capex intensity to decline**

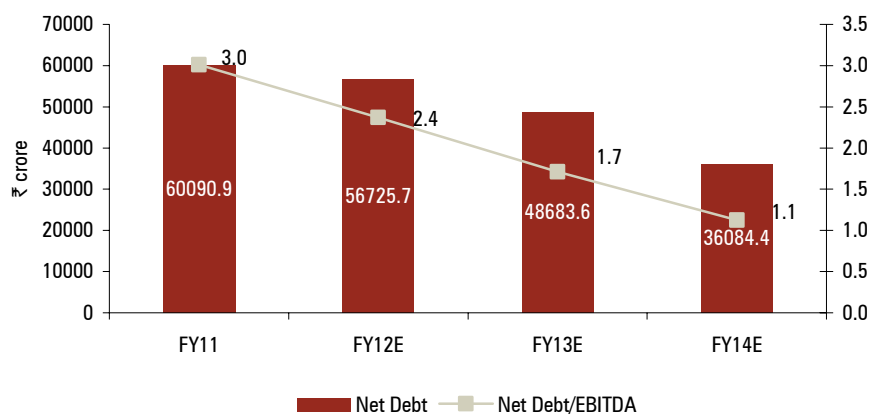
Capex intensity is expected to reduce from 21.7% to 16.8% from FY12 to FY14.



Source: Company, ICICIdirect.com Research

**Exhibit 65: Debt burden to reduce**

As the company pays off its debt, the net debt/EBITDA ratio is expected to decrease from 3.0x to 1.1x



Source: Company, ICICIdirect.com Research

## Valuation

### DCF based target price of ₹ 450/ share

The stock has been de-rated due to the dual impact of regulatory overhang and hyper-intensive competition in the domestic market. We expect Airtel's valuation multiples to expand on account of reducing regulatory uncertainty, improving key metrics and profitability. We expect a higher EPS CAGR of 17.3% over FY11-14E against revenue CAGR of 14.5% over the same period primarily due to repayment of debt.

Assuming revenue CAGR of 10.8% over FY11-FY20E and terminal growth of 3% thereon, we have arrived at a target price of ₹ 450/ share for Bharti Airtel. Our target price discounts FY12E and FY13E EPS of ₹ 13.4 and ₹ 21.3 by 33.6x and 21.2x, respectively. The stock is currently trading at ₹ 356. Our target price implies an upside potential of 27%. We reiterate our BUY rating on Bharti Airtel.

Key risks to our target price are unfavourable regulatory outcomes and slower than expected improvement in African operations.

#### Exhibit 66: DCF assumptions

₹ in Crore	
WACC	10.7%
Revenue CAGR over FY11-20E	10.8%
Present Value of Cash Flow till FY20E	41,820.9
Terminal Growth	3.0%
Present Value of terminal cash flow	190,791.9
PV of firm	232,612.8
Less: Current Debt	61,670.8
Total present value of the Equity	170,942.0
Number of Equity Shares outstanding	379.6
DCF - Target price (₹)	450

Source: Company, ICICIdirect.com Research

#### Exhibit 67: One-year forward PE graph



Source: Company, ICICIdirect.com Research

## Financial summary

### Profit and loss statement

	(₹ Crore)			
(Year-end March)	FY11	FY12E	FY13E	FY14E
Total operating Income	59,467.2	71,394.8	81,292.5	89,207.0
Growth (%)	50.1	20.1	13.9	9.7
Employee Expenses	3,280.3	3,744.8	4,192.0	4,486.7
Marketing Expenses	10,780.7	12,280.2	13,313.5	13,600.5
Access Charges	7,476.4	9,748.2	11,271.9	12,691.4
Network Operating	12,753.1	15,449.7	16,888.6	18,244.5
License Fee	5,173.0	6,017.7	6,660.7	7,612.3
Other Costs	42.9	239.9	491.2	556.3
Total Operating Expenditure	39,506.4	47,480.4	52,818.0	57,191.8
EBITDA	19,960.8	23,914.3	28,474.5	32,015.2
Growth (%)	24.5	19.8	19.1	12.4
Depreciation	10,206.6	12,956.0	14,577.8	16,268.4
Interest	2,181.3	3,948.8	3,129.3	2,260.2
Other Income	136.3	66.5	120.0	120.0
Non Operating Expenses	23.6	-	-	-
PBT	7,685.6	7,076.0	10,887.4	13,606.6
MI / Profit from associates	-140.2	-26.4	-14.5	-29.2
Total Tax	1,779.0	2,021.6	2,830.7	3,877.9
PAT	6,046.8	5,080.7	8,071.2	9,757.9
Growth (%)	-33.6	-16.0	58.9	20.9
EPS (₹)	15.9	13.4	21.3	25.7

Source: Company, ICICIdirect.com Research

### Balance sheet

	(₹ Crore)			
(Year-end March)	FY11	FY12E	FY13E	FY14E
<b>Liabilities</b>				
Equity Capital	1,898.8	1,898.8	1,898.8	1,898.8
Reserve and Surplus	46,868.0	51,504.6	59,131.5	68,445.2
Total Shareholders funds	48,766.8	53,403.4	61,030.3	70,344.0
Total Debt	61,670.8	57,670.8	49,670.8	37,670.8
Deferred Tax Liability	1,248.7	1,248.7	1,248.7	1,248.7
Others	6,272.6	6,246.2	6,231.8	6,202.6
<b>Total Liabilities</b>	<b>117,958.9</b>	<b>118,569.1</b>	<b>118,181.6</b>	<b>115,466.1</b>
<b>Assets</b>				
Gross Block	160,391.0	175,891.0	191,891.0	206,891.0
Less: Acc Depreciation	31,516.7	44,472.7	59,050.6	75,319.0
Net Block	128,874.3	131,418.3	132,840.4	131,572.0
Capital WIP	0.0	0.0	0.0	0.0
Total Fixed Assets	128,874.3	131,418.3	132,840.4	131,572.0
Investments	1,415.4	1,415.4	1,415.4	1,415.4
Inventory	213.9	236.0	276.3	285.9
Debtors	5,492.9	5,852.0	6,174.8	7,022.9
Loans and Advances	3,050.4	3,375.1	3,941.2	4,087.4
Other Current Assets	870.6	985.7	1,127.9	1,191.5
Cash	957.5	322.7	364.8	964.0
Total Current Assets	10,585.3	10,771.5	11,885.0	13,551.7
Creditors	23,968.4	25,323.3	28,129.3	30,527.4
Provisions	118.0	124.7	138.5	150.3
Other Current Liabilities	4,461.1	5,534.2	5,846.8	6,642.2
Total Current Liabilities	28,547.5	30,982.2	34,114.6	37,319.9
Net Current Assets	-17,962.2	-20,210.6	-22,229.6	-23,768.2
Others Assets	5,631.4	5,946.0	6,155.3	6,246.8
<b>Application of Funds</b>	<b>117,958.9</b>	<b>118,569.1</b>	<b>118,181.6</b>	<b>115,466.1</b>

Source: Company, ICICIdirect.com Research

### Cash flow statement

	(₹ Crore)			
(Year-end March)	FY11	FY12E	FY13E	FY14E
Profit after Tax	6,046.8	5,080.7	8,071.2	9,757.9
Add: Depreciation	10,206.6	12,956.0	14,577.8	16,268.4
(Inc)/dec in Current Assets	-4,418.4	-821.1	-1,071.3	-1,067.5
Inc/(dec) in CL and Provisions	15,519.6	2,434.7	3,132.4	3,205.3
Others				
<b>CF from operating activities</b>	<b>27,354.6</b>	<b>19,650.4</b>	<b>24,710.0</b>	<b>28,164.1</b>
(Inc)/dec in Investments	2,601.6	0.0	0.0	0.0
(Inc)/dec in Fixed Assets	-93,109.7	-15,500.0	-16,000.0	-15,000.0
Others	6,142.1	-341.0	-223.7	-120.7
<b>CF from investing activities</b>	<b>-84,365.9</b>	<b>-15,841.0</b>	<b>-16,223.7</b>	<b>-15,120.7</b>
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0
Inc/(dec) in loan funds	55,209.0	-4,000.0	-8,000.0	-12,000.0
Dividend paid & dividend tax	-442.8	-444.2	-444.2	-444.2
Inc/(dec) in Sec. premium	0.0	0.0	0.0	0.0
Others	1,773.2	0.0	0.0	0.0
<b>CF from financing activities</b>	<b>56,539.4</b>	<b>-4,444.2</b>	<b>-8,444.2</b>	<b>-12,444.2</b>
Net Cash flow	-471.9	-634.8	42.1	599.2
Opening Cash	1,429.4	957.5	322.7	364.8
Closing Cash	957.5	322.7	364.8	964.0

Source: Company, ICICIdirect.com Research

### Key ratios

(Year-end March)	FY11	FY12E	FY13E	FY14E
<b>Per share data (₹)</b>				
EPS	15.9	13.4	21.3	25.7
Cash EPS	42.8	47.5	59.7	68.6
BV	128.5	140.7	160.8	185.3
DPS	1.0	1.0	1.0	1.0
Cash Per Share	2.5	0.8	1.0	2.5
<b>Operating Ratios</b>				
EBITDA Margin (%)	33.6	33.5	35.0	35.9
PBT Margin (%)	12.9	9.9	13.4	15.3
PAT Margin (%)	10.2	7.1	9.9	10.9
Inventory days	0.8	1.2	1.2	1.2
Debtor days	21.1	29.0	27.0	27.0
Creditor days	113.2	126.0	120.0	120.0
<b>Return Ratios (%)</b>				
RoE	12.4	9.5	13.2	13.9
RoCE	8.6	9.6	12.2	14.2
RoIC	8.2	9.8	12.4	14.5
<b>Valuation Ratios (x)</b>				
P/E	22.3	26.6	16.7	13.8
EV / EBITDA	9.8	8.0	6.5	5.3
EV / Net Sales	3.3	2.7	2.3	1.9
Market Cap / Sales	2.3	1.9	1.7	1.5
Price to Book Value	2.8	2.5	2.2	1.9
<b>Solvency Ratios</b>				
Debt/EBITDA	3.1	2.4	1.7	1.2
Debt / Equity	1.3	1.1	0.8	0.5
Current Ratio	0.4	0.3	0.3	0.4
Quick Ratio	0.3	0.3	0.3	0.3

Source: Company, ICICIdirect.com Research

**Exhibit 68: Recommendation History**



Source: Reuters, ICICIdirect.com Research

**Exhibit 69: Recent Releases**

Date	Event	CMP	Target Price	Rating
8-Apr-11	Q4FY11 Preview	357	398	BUY
6-May-11	Q4FY11 Result Update	357	398	BUY
5-Jul-11	Q1FY12 Result Preview	382	398	HOLD
4-Aug-11	Q1FY12 Result Update	422	450	HOLD
5-Oct-11	Q2FY12 Result Preview	370	450	BUY
4-Nov-11	Q2FY12 Result Update	398	450	BUY
6-Jan-12	Q3FY12 Result Preview	344	450	BUY

Source: Reuters, ICICIdirect.com Research

# Idea Cellular (IDECEL)

₹ 93

## Company Update

### Rating Matrix

Rating	:	<b>Hold</b>
Target	:	₹ 99
Target Period	:	12 months
Potential Upside	:	6%

### YoY Growth (%)

(YoY Growth)	FY11	FY12E	FY13E	FY14E
Net Sales	24.5	25.9	18.9	11.2
EBITDA	11.0	39.4	22.2	12.3
Net Profit	(5.8)	(18.2)	84.4	34.3
EPS	(5.9)	(18.2)	84.4	34.3

### Valuation Summary

	FY11	FY12E	FY13E	FY14E
P/E	34.3	41.9	22.7	16.9
Target P/E	36.3	44.4	24.1	17.9
EV / EBITDA	11.4	8.4	6.6	5.6
P/BV	2.5	2.4	2.1	1.9
RoNW (%)	7.3	5.6	9.4	11.2
RoCE (%)	5.5	8.4	11.6	13.7

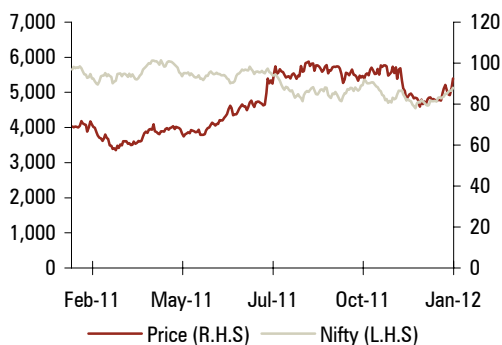
### Stock Data

Market Capitalization (₹ Crore)	30,836.0
Total Debt (FY11) (₹ Crore)	12,070.5
Cash and Investments (FY11) (₹ Crore)	457.7
EV (₹ Crore)	42,448.8
52 week H/L	101 / 58
Equity capital	3,303.3
Face value	₹ 10
MF Holding (%)	7.6
FII Holding (%)	13.4

### Comparative return matrix (%)

	1M	3M	6M	12M
Bharti Airtel	6.6	-6.8	-14.3	4.7
RCOM	36.8	23.6	-1.9	-32.5
Idea	10.9	-4.4	2.5	27.4

### Price movement



### Analyst's name

Karan Mittal  
karan.mittal@icicisecurities.com

Anil Shenoy  
anil.shenoy@icicisecurities.com

## Fastest growing domestic player...

Idea is the fastest growing player and has gained maximum revenue share, which has increased from 9.3% in Q2FY08 to 14.1% in Q2FY12. With 74.6% of its subscribers and 82.7% of its revenue coming from 3G circles, Idea is best positioned to leverage its strong and superior subscriber base in these circles to generate higher yields from 3G spectrum. With pricing stability, 3G uptake and reduction in network rollout intensity we expect EBITDA margins to expand to 27.7% by FY14. Idea would post revenue and PAT CAGR of 18.5% and 26.5% over FY11-14E. However, Trai recommendations related to spectrum pricing, if implemented, would have a greater impact on Idea Cellular. We maintain Hold on Idea with a target price of ₹ 99.

### Growth on fast track

Idea has witnessed the fastest revenue growth in the industry among listed peers. The company has been gaining revenue market share on the back of rapid high quality subscriber addition. We expect revenues to grow at 18.5% CAGR over FY11-14E to ₹ 25714 crore on the back of 17.7% CAGR in the traffic and an improvement of ARPM by ~ 1 paisa to 44 paisa. The subscriber base is expected to increase from 89.5 million in FY11 to 140 million in FY14 at a CAGR of 16.1%.

### 3G presence in established circles to drive 3G revenues

Idea has won 3G licenses in circles that contribute 82.7% to its revenue and 74.6% to its subscriber base. Their strong presence in these 2G circles is expected to help drive the 3G revenues. We expect the company to generate ~ ₹ 2780 crore from 3G services by FY14 led by an ARPU of ₹ 360 and 3G subscriber base of 7.7 million.

### High sensitivity to regulatory policy

The sensitivity of the company to regulatory policy remains a concern. Should Trai's recommendations be accepted in current form, Idea could face an impact of ~ ₹ 33 per share.

## Valuations

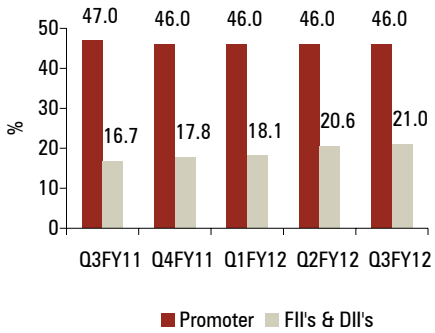
Reducing network rollout intensity and higher 3G uptake margins are expected to help the margins expand, though spectrum pricing would remain near term overhang. Assuming revenue CAGR of 12.6% over FY11-FY20E and terminal growth of 3% thereon, we have arrived at a target price of ₹ 80/ share for the core business. We have valued the Indus contribution at ₹ 19/ share to arrive at a target price of ₹ 99/ share.

### Exhibit 70: Key Financials

(Year-end March)	FY10	FY11	FY12E	FY13E	FY14E
Net Sales (₹ crore)	12,397.9	15,438.4	19,443.7	23,113.4	25,713.6
EBITDA (₹ crore)	3,358.0	3,725.8	5,195.0	6,347.7	7,130.3
Net Profit (₹ crore)	953.9	898.7	735.3	1,355.5	1,820.3
EPS (₹)	2.9	2.7	2.2	4.1	5.5
P/E (x)	32.3	34.3	41.9	22.7	16.9
Price / Book (x)	2.7	2.5	2.4	2.1	1.9
EV/EBITDA (x)	11.4	11.4	8.4	6.6	5.6
RoCE (%)	7.0	5.5	8.4	11.6	13.7
RoE (%)	8.4	7.3	5.6	9.4	11.2

Source: Company, ICICIdirect.com Research; Sales includes other operating income

Promoters and FII & MFs holding trend (%)



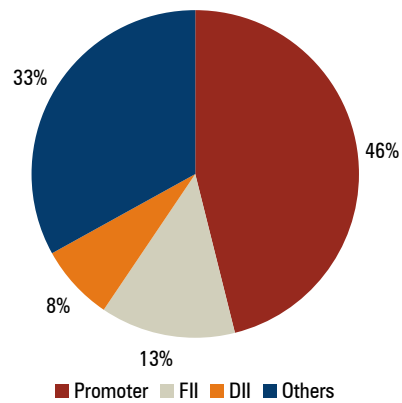
### Company background

Idea Cellular is the third largest mobile services operator in India with a subscriber base of over 104 million subscribers, as of November 2011. Idea is a pan-India integrated GSM operator and has its own NLD and ILD operations and ISP licenses. The company operates across all 22 service areas with 2G services and 3G services are being progressively rolled out to cover over 3,000 towns by FY12.

Idea has a network of over 70,000 cell sites, over 3,000 service centres servicing Idea subscribers across the country including 450 special Experience Zones for 3G promotion. Idea's service delivery platform is ISO 9001:2008 certified, making it the only operator in the country to have this standard certification for all 22 service areas and the corporate office.

Idea has deep penetration in the non-urban and rural market. It boasts of the highest share of rural subscribers as a percentage of total subscribers among GSM players.

Exhibit 71: Idea Cellular - Shareholding pattern as on Q3FY12 (%)



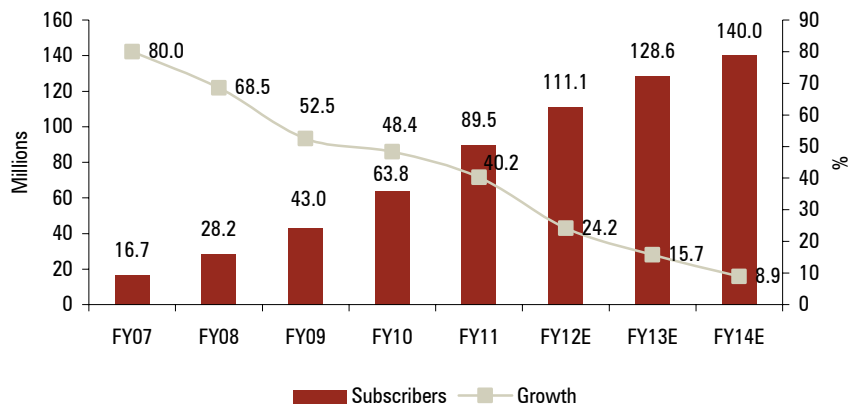
Source: Company, ICICIdirect.com Research

## Investment Rationale

### Fastest growing domestic player

Idea Cellular has exhibited the fastest growth in the domestic arena among listed peers in the recent past, led by its expansion into new circles. The overall subscriber base has grown at a CAGR of 52.1% over FY07-11, resulting in traffic CAGR of 67.6% over the same period. We expect the company to add 50.5 million subscribers from FY11 to FY14E to reach a subscriber base of 140.0 million.

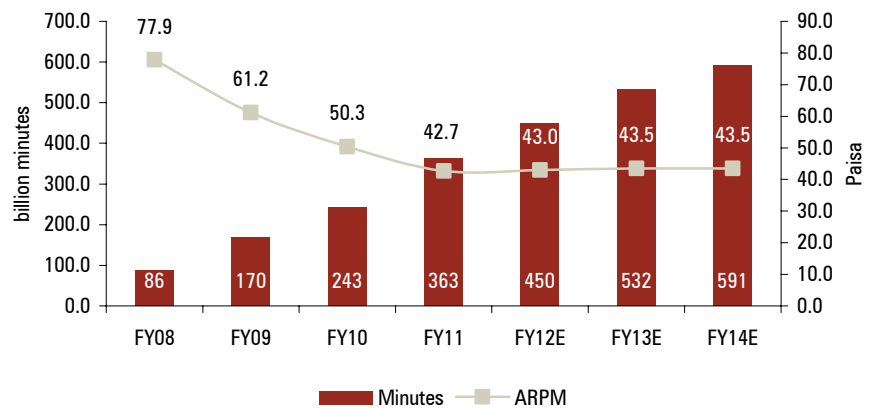
**Exhibit 72: Idea – Subscriber base and growth**



Continuing the trend of fast growth, the subscriber base is expected to grow at a CAGR of 16.1% from FY11 to FY14 to reach 140.0 million

Source: Company, ICICIdirect.com Research

**Exhibit 73: Highest minutes growth**



The traffic is expected to grow at a CAGR of 17.7% to reach 590.7 billion minutes in FY14 from FY11 while the ARPM is expected to improve marginally to 44 paisa

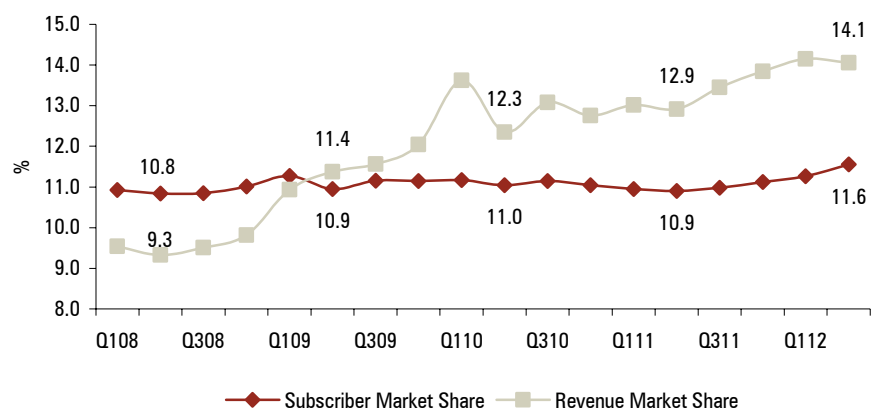
Source: Company, ICICIdirect.com Research

Among listed peers, Idea has witnessed highest traffic growth from FY08 to FY11. The total minutes grew from 86.2 billion minutes in FY08 to 362.6 billion minutes in FY11 at a CAGR of 61.4%. The traffic growth has come on the back of increasing penetration in the new circles resulting in high subscriber addition. In November 2011, Idea added 2.2 million subscribers, which is the highest in the industry with a share in net adds of 32.5% as compared to 14.4% of Bharti and 13.9% of Vodafone. We expect the traffic to grow from 363.1 billion minutes in FY11 to 590.7 billion minutes in FY14 at a CAGR of 17.7%.

### Gaining revenue market share

The company has gained the maximum revenue market share in the past few years. With the focus on revenues yielding high quality subscribers, the revenue share of Idea Cellular has increased from 9.5% in Q1FY08 to 14.1% by Q2FY12 even in a scenario of hyper intensive competition. The subscriber share has increased only marginally from 10.9% to 11.6%.

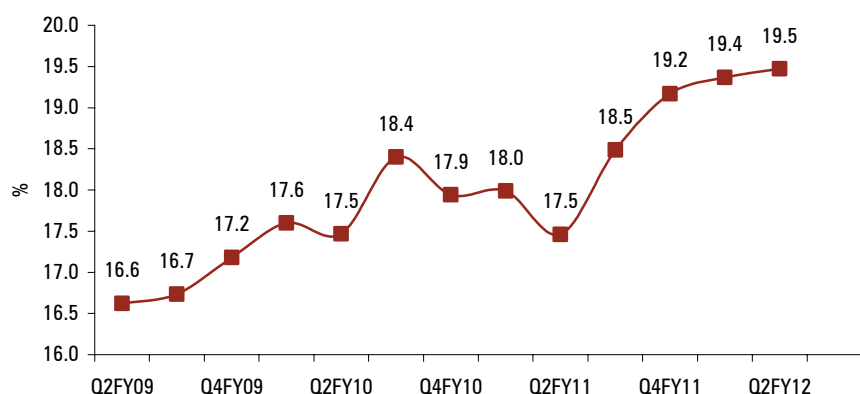
**Exhibit 74: Idea - Subscriber & Revenue market share**



Source: Company, ICICIdirect.com Research

Idea has been increasing its foothold in established circles with the revenue share increasing from 16.6% in Q2FY09 to 19.5% in Q2FY12. Currently, Idea is in the top position in terms of revenue share in four of its 13 established circles while it is in the top three in nine of its 13 established circles.

**Exhibit 75: Rapid gain in revenue share in established circles**



Source: Company, ICICIdirect.com Research

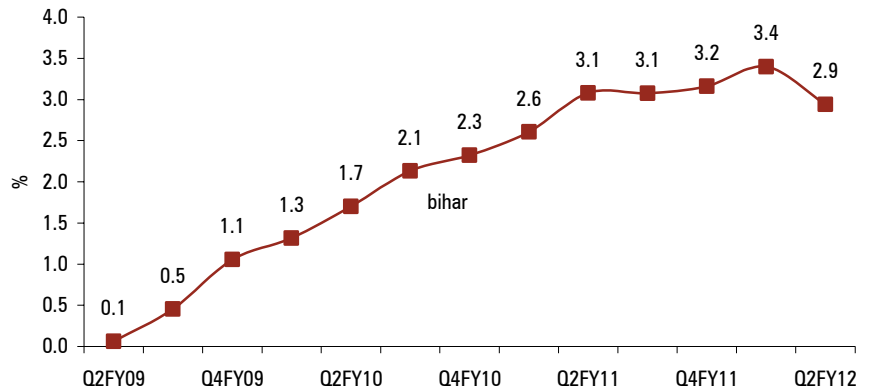
The company has also witnessed strong traction in new circles where it launched services post 2008. The revenue share in new circles has increased from 0.1% in Q2FY09 to 2.9% in Q2FY12. The traction seen in Bihar and Mumbai, Idea's first two new circles, suggests that the company will leverage its brand presence in other new circles as well subsequently. There has been a dip in Idea's revenue share in Q2FY12 but it is too early to form an opinion based on data from just one quarter.

The subscriber market share has grown from 10.9% to 11.6% from Q1FY08 to Q2FY12 while the revenue market share has grown from 9.5% to 14.1% during the same period

In its established circles, Idea's revenue market share has grown from 16.6% in Q2FY09 to 19.5% in Q2FY12

**Exhibit 76: Idea – New circles revenue market share**

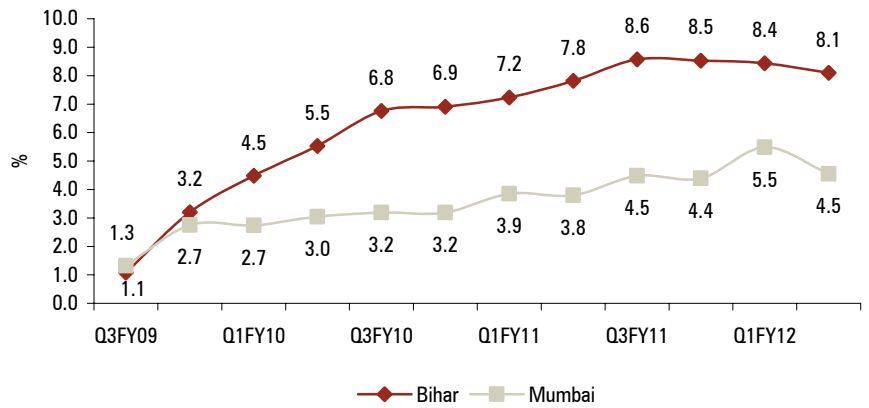
In the new circles, after starting services in Q2FY09, Idea has gained a revenue market share of 2.9% in Q2FY12



Source: Company, ICICIdirect.com Research

**Exhibit 77: Idea's revenue share in Bihar and Mumbai**

In Bihar and Mumbai, which were the earliest of the new circles, revenue market share has grown to 8.1% and 4.5%, respectively, in Q2FY12

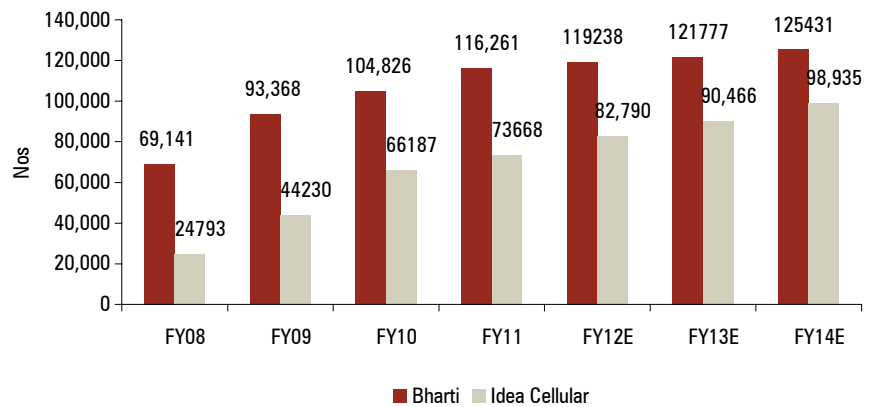


Source: Company, ICICIdirect.com Research

The cell sites of the company have increased from 21,197 in Q3FY08 to 78,367 in Q2FY12. Taking cues from Bharti, which saw its subscriber per site increase from 914 in Q1FY09, when it had almost the same number of cell sites as Idea currently has, to 1,513 in Q2FY12, we expect Idea to witness an increase in its subscriber per site (1,278 in Q2FY12). This would result in increased network utilisation and lower cell sites addition subsequently.

**Exhibit 78: Increasing network reach**

The number of cell sites is expected to grow slower, henceforth, due to lower subscriber addition. The numbers of cell sites of Idea are expected to grow from 73,668 in FY11 to 98,935 in FY14E



Source: Company, ICICIdirect.com Research

### 3G coverage

Idea Cellular had won 3G licenses in circles, which contribute about 82.7% of its total revenue and 74.6% of its total subscribers (as on September 2011). Also, the company has far higher ARPU in these circles and is either first or second largest operator by revenue in most of these circles. Idea's ARPU in the circles that it has won a 3G license in stands at ₹ 126.9 while in other circles, it stands at ₹ 88.4. The overall ARPU for Idea is ₹ 116.0 as of Q2FY12 (based on AGR data).

#### Exhibit 79: 3G circles - Revenue share

Idea 3G Circles	Idea's Revenue Share	Rank	Leader/Closet Competitor (Revenue Share %)	Circle's share in total Industry revenue
AP	17.9	2	Bharti Airtel (41.8)	8.5
Gujarat	19.4	2	Vodafone (42.7)	5.6
Haryana	22.1	2	Vodafone (26.6)	1.8
HP	4.6	6	Bharti Airtel (43.6)	0.7
J&K	1.1	7	Bharti Airtel (38.0)	1.2
Kerala	35.3	1	Vodafone (21.7)	4.6
Maharashtra	31.6	1	Vodafone (23.4)	7.8
MP	36.1	1	Bharti Airtel (26.9)	4.5
Punjab	21.2	2	Bharti Airtel (38.4)	3.6
UP (E)	11.5	4	Vodafone (30.2)	6.5
UP(W)	30.1	1	Vodafone (21.8)	4.4

Source: Company, ICICIdirect.com Research

#### Exhibit 80: ARPU in 3G and non 3G circles

Idea 3G Circles	ARPU (₹)*
AP	141.3
Gujarat	119.5
Haryana	94.4
HP	67.2
J&K	71.1
Kerala	179.2
Maharashtra	143.7
MP	107.6
Punjab	136.9
UP (E)	92.3
UP(W)	114.1
Blended ARPU in 3G circles	126.9
Blended ARPU in non 3G circles	88.4
Blended ARPU	116.0

\* ARPU based on Q2FY12 AGR data

Source: Company, ICICIdirect.com Research

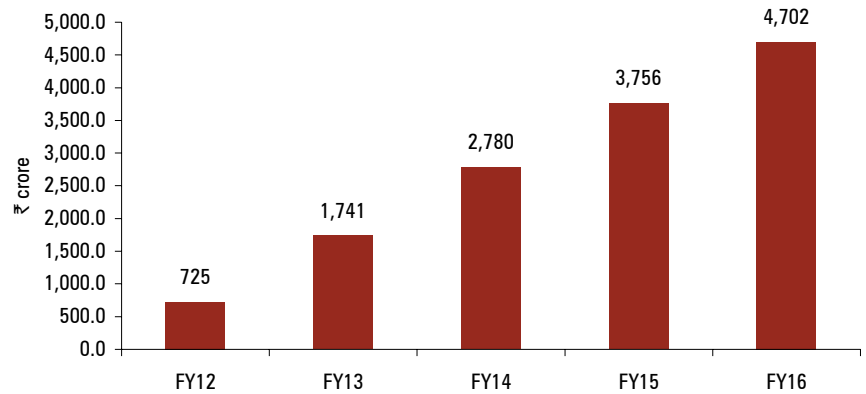
It would be relatively better placed in its stronger circles as the affluent class would be the first takers of 3G. The company would also be able to leverage its strong and superior subscriber base in these circles to generate higher yields from 3G spectrum.

We expect the company to generate ~ ₹ 2780 crore from 3G services by FY14 led by an ARPU of ₹ 360 and 3G subscriber base of 7.7 million.

Idea's 3G licenses are in circles, which contribute about 82.7% of its total revenue and 74.6% of its total subscribers (as on September 2011). In eight of its 11 circles where it has won a 3G license, it is among the top two in terms of revenue market share

Idea's ARPU in the circles that it has won a 3G license in stands at ₹ 124.1 while in other circles, it stands at ₹ 76.3. The overall ARPU for Idea is ₹ 112.0 as of Q2FY12

We expect the company to generate ~ ₹ 2780 crore from 3G services by FY14 led by an ARPU of ₹ 360 and 3G subscriber base of 7.7 million

**Exhibit 81: Revenue from 3G subscribers**


Source: Company, ICICIdirect.com Research

**Exhibit 82: Idea - Key Assumptions for 3G**

	Unit	FY12	FY13	FY14	FY15	FY16
3G subscribers	Million	2.8	5.2	7.7	10.1	12.5
3G ARPU	₹	371	365	360	351	346

Source: Company, ICICIdirect.com Research

### High sensitivity to regulatory policy

Idea Cellular is most susceptible to regulatory risk since the company would have the highest payout ratio in comparison to its peers, if the spectrum pricing norms are accepted in their current form.

**Exhibit 83: Per share impact of some of NTP guideline on Idea Cellular**

NTP Guideline	NPV	Per share Impact	% of CMP
One Time Spectrum Fees	1,768.1	-5.4	5.7
Spectrum Renewal Fees	9,097.1	-27.5	29.5
Total	10,865.2	-32.9	35.2

Source: TRAI, ICICIdirect.com Research

NPV of one-time spectrum fees and spectrum renewal fees comes to ₹ 10865.2 crore for Idea Cellular. The company has nine licenses coming up for renewal by FY17E.

**Exhibit 84: Idea – circles with licenses expiring by FY17**

Circles	Renewal Year	Amount Payable (₹ crore)	NPV (As on FY12) ₹ crore
Maharashtra	FY16	2976.7	1891.8
Gujarat	FY16	1393.8	885.8
Andhra Pradesh	FY16	2207.6	1403.0
Karnataka	FY17	1266.3	718.5
Kerala	FY16	1098.5	698.1
Punjab	FY17	1110.9	630.4
Haryana	FY16	134.9	85.7
U.P (West)	FY16	1007.6	640.3
M.P	FY16	1273.7	809.5

Source: Company, ICICIdirect.com Research

NPV of one-time spectrum fees and spectrum renewal fees comes to ₹ 9517.2 crore for Idea Cellular. The company has nine licenses coming up for renewal by FY17E

**Exhibit 85: Idea circles with spectrum in 900 MHz band – Candidate for spectrum refarming**

Circles with 900 Mhz spectrum	% of spectrum in 900 MHz	Revenue dependence (Q2FY12) (%)
Maharashtra	81.6	17.6
Gujarat	100.0	7.8
A. P.	77.5	10.9
Kerala	75.0	11.4
Haryana	100.0	2.9
U. P. (W)	75.0	9.5
M. P.	77.5	11.6

Source: TRAI, ICICIdirect.com Research

Idea has spectrum in 900 MHz in seven circles making it a candidate for spectrum refarming, should Trai's recommendations be accepted

However, we believe the recommendations may not be implemented in their current form. The ministry has taken cognizance of concerns faced by operators holding spectrum in 900 MHz and has already announced that it will separately initiating a consultation process on spectrum refarming. Also, if some of the new operators surrender their license or the government cancels some licenses, there would be enough availability of spectrum and it may not require incumbents to surrender excess spectrum.

The government has also suggested that all future spectrum may be granted only through the auction mode, in which case the current pricing would no longer hold true. We believe the current pricing mechanism, as proposed by Trai and DoT, values the spectrum much higher than the price that may be discovered through an auction given the current economic scenario and genuine demand by operators.

In addition to this, the current draft on new telecom policy also suggests allowing spectrum sharing and trading, which would be a big positive for incumbent players like Idea Cellular.

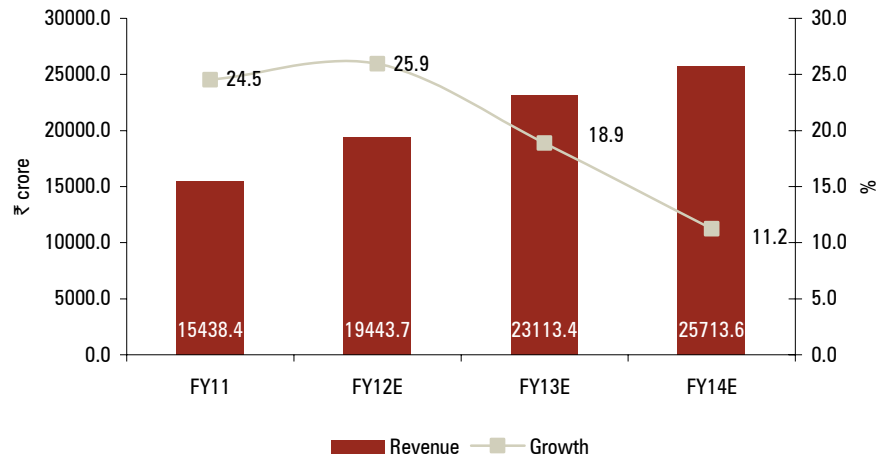
## Financials

### Revenue to grow at 18.5% CAGR in FY11-14E

We expect revenues to grow at 18.5% CAGR over FY11-14E to ₹ 25,714 crore on the back of 17.7% CAGR in traffic and an improvement of ARPM by ~ 1 paisa to 44 paisa. The subscriber base is expected to increase from 89.5 million in FY11 to 140 million in FY14 at a CAGR of 16.1%.

We expect revenues to grow at 18.5% CAGR over FY11-14E to ₹ 25714 crore on the back of 17.7% CAGR in the traffic and an improvement of ARPM by ~ 1 paisa to 44 paisa

**Exhibit 86: Idea – Revenue & growth**



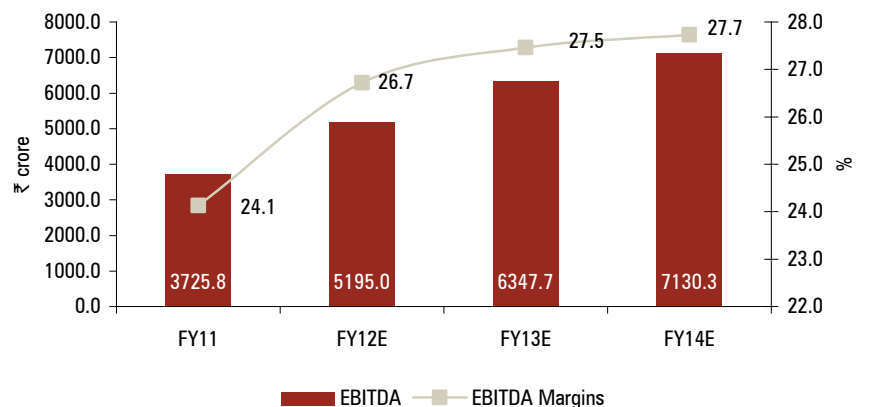
Source: Company, ICICIdirect.com Research

### EBITDA margins to be around 28%

EBITDA margins of the company are expected to improve to 27.7% in FY14 from 24.1% in FY11, primarily on the back of higher network utilisation. The company already has a 2G cell site base of 78,367 as on September 2011, which has increased from 24,793 in March 2008. We believe incremental rollout would not be as aggressive as in the recent past. This would help the company save on network operating cost. The EBITDA is expected to increase to 1.9x FY14E to ₹ 7130.0 from ₹ 3725.8 in FY11.

The EBITDA margins of the company are expected to improve to 27.7% in FY14 from 24.1% in FY11, primarily on the back of higher network utilisation

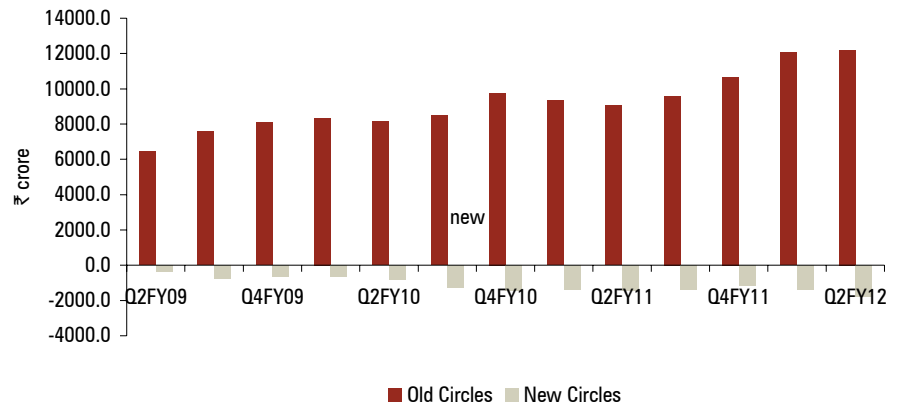
**Exhibit 87: EBITDA and EBITDA margin trend**



Source: Company, ICICIdirect.com Research

**Exhibit 88: EBITDA movement in established and new circles**

The EBITDA in new circles has been negative since revenue growth lags network rollout. We expect losses in new circles to contract on account of recent price hikes and better network utilisation



Source: Company, ICICIdirect.com Research

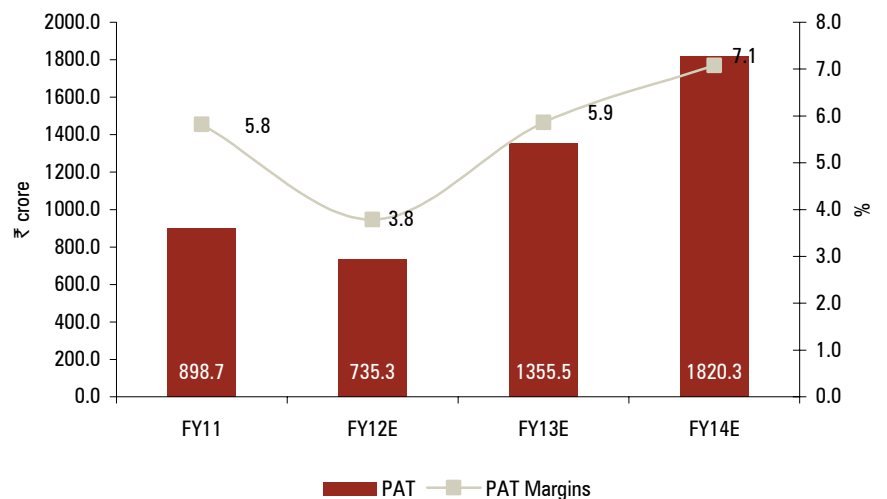
Also, the EBITDA in new circles has been negative since revenue growth lags network rollout. We expect losses in new circles to contract on account of recent price hikes and better network utilisation. This would help the overall margin expansion for the company. We expect the company to post EBITDA CAGR of 24.2% over FY11-14E.

**PAT growth**

The PAT margin would expand marginally, led by a better operating performance and lower interest cost on account of debt repayment. However, higher taxes due to running out of tax holidays would partly offset higher PBT. We expect PAT CAGR of 26.5% over FY11-14E.

**Exhibit 89: Trends in net profit & net profit margins**

PAT margins are expected to improve from 5.8% to 7.1% on the back of a better operating performance and lower interest cost on account of debt repayment



Source: Company, ICICIdirect.com Research

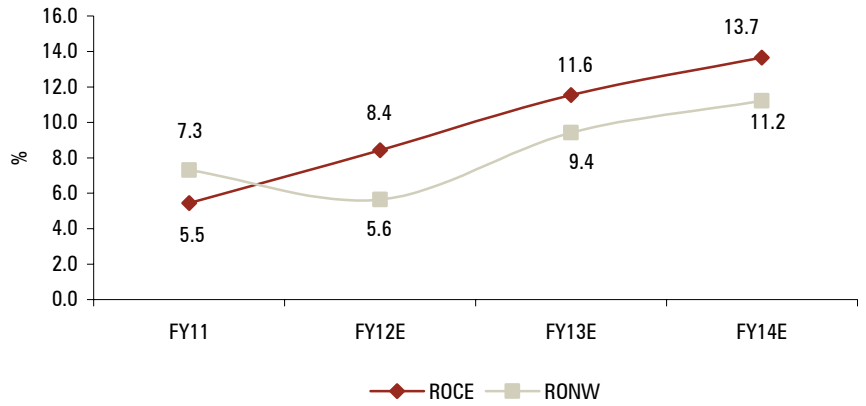
**Return ratios to remain subdued...**

Return ratios of Idea Cellular would not witness a huge expansion in the near future due to front loading of capex. The company has undertaken a capex of ₹ 14680.4 crore in the last two years. We expect the RoE and RoCE to improve from 7.3% and 5.7% in FY11 to 11.2% and 13.7%,

respectively, by FY14E on account of reduced capex spending, higher network utilisation and reduction in debt.

**Exhibit 90: Return ratios to improve**

Return ratios of Idea Cellular would not witness huge expansion in the near future due to front loading of capex



Source: Company, ICICIdirect.com Research

## Valuation

### SOTP based target price of ₹ 99/ share

The company is the fastest growing player in the domestic industry. Idea has gained maximum revenue share in the past few years. With reducing network rollout intensity and 3G uptake, margins are expected to go northwards for the company. However, Trai recommendations related to spectrum pricing, if implemented in their current form, would have a greater impact on Idea Cellular. This remains a near term overhang on the stock.

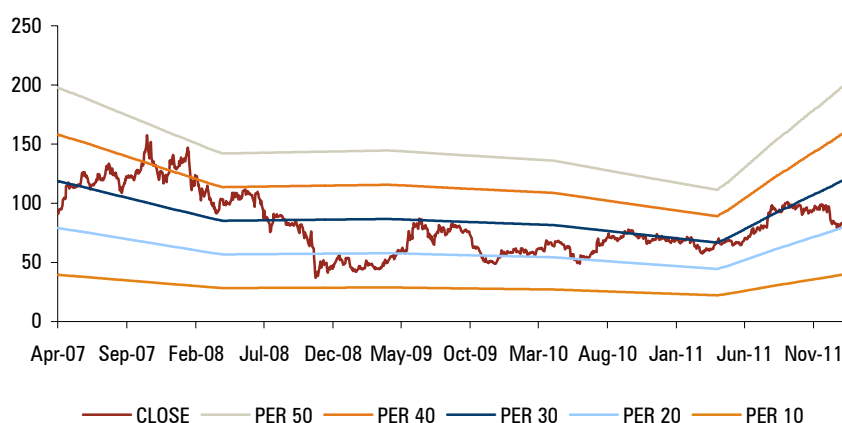
Using the DCF methodology and assuming revenue CAGR of 12.6% over FY11–20E and terminal growth of 3% thereon, we have arrived at a target price of ₹ 80/ share for the core business. We have valued the Indus contribution at ₹ 19/ share to arrive at a target price of ₹ 99/ share. We maintain HOLD rating the stock.

#### Exhibit 91: DCF Assumptions

₹ in Crore	
WACC	11.4%
Revenue CAGR over FY11-20E	12.6%
Present Value of Cash Flow till FY20E	13,366.0
Terminal Growth	3.0%
Present Value of terminal cash flow	24,698.9
PV of firm	38,065.0
Less: Current Debt	12,070.5
Total present value of the Equity (excluding current cash)	25,994.5
Number of Equity Shares outstanding	330.3
Per Share Value (excluding current cash)	78.7
Add Current Cash Per Share	1.4
DCF - Target price (₹)	80

Source: Company, ICICIdirect.com Research

#### Exhibit 92: One-year forward PE Graph



Source: Company, ICICIdirect.com Research

## Financial summary

### Profit and loss statement

	(₹ Crore)			
(Year-end March)	FY11	FY12E	FY13E	FY14E
Total operating Income	15,438.4	19,443.7	23,113.4	25,713.6
Growth (%)	24.5	25.9	18.9	11.2
Employee Expenses	805.6	958.6	1,221.7	1,408.5
Roaming & Access Charges	2,475.4	3,267.1	3,952.4	4,371.3
Network operating expenditure	4,013.1	4,613.2	5,251.1	5,883.0
License and WPC Charges	1,772.8	2,173.8	2,577.1	2,867.1
SG&A Expenses	1,016.0	3,136.8	3,721.3	4,011.3
Other Costs	1,629.7	99.3	42.1	42.1
Total Operating Expenditure	11,712.6	14,248.8	16,765.7	18,583.3
EBITDA	3,725.8	5,195.0	6,347.7	7,130.3
Growth (%)	11.0	39.4	22.2	12.3
Depreciation	2,397.3	2,996.1	3,349.0	3,607.9
Interest	396.5	1,116.3	983.5	813.5
Other Income	64.8	2.5	8.0	8.0
Non Operating Expenses	-	-	-	-
PBT	996.9	1,085.1	2,023.2	2,716.9
MI/ Profit from associates	0.0	0.0	0.0	0.0
Total Tax	98.2	349.8	667.7	896.6
PAT	898.7	735.3	1,355.5	1,820.3
Growth (%)	-5.8	-18.2	84.4	34.3
EPS (₹)	2.7	2.2	4.1	5.5

Source: Company, ICICIdirect.com Research

### Balance sheet

	(₹ Crore)			
(Year-end March)	FY11	FY12E	FY13E	FY14E
<b>Liabilities</b>				
Equity Capital	3,303.3	3,303.3	3,303.3	3,303.3
Reserve and Surplus	8,946.9	9,682.2	11,037.8	12,858.1
Others	49.7	49.7	49.7	49.7
Total Shareholders funds	12,299.9	13,035.2	14,390.8	16,211.1
Total Debt	12,070.5	13,070.5	11,570.5	9,570.5
Deferred Tax Liability	309.9	309.9	309.9	309.9
Others	0.0	0.0	0.0	0.0
Total Liabilities	24,680.4	26,415.7	26,271.2	26,091.5
<b>Assets</b>				
Gross Block	33,697.7	40,694.4	43,894.4	47,308.4
Less: Acc Depreciation	11,212.8	14,208.9	17,557.9	21,165.9
Net Block	22,484.9	26,485.5	26,336.4	26,142.5
Capital WIP	3,646.7	1,200.0	1,200.0	1,200.0
Total Fixed Assets	26,131.6	27,685.5	27,536.4	27,342.5
Investments	1,026.1	1,026.1	1,026.1	1,026.1
Inventory	65.9	72.6	73.1	84.0
Debtors	478.9	533.2	669.9	668.6
Loans and Advances	1,975.6	2,496.5	2,357.4	2,528.2
Other Current Assets	77.6	77.9	83.9	96.1
Cash	457.7	244.8	240.2	622.1
Total Current Assets	3,055.8	3,425.0	3,424.4	3,999.1
Creditors	5,355.5	5,511.7	5,506.8	6,046.8
Provisions	177.7	209.2	209.0	229.5
Other Current Liabilities	-	-	-	-
Total Current Liabilities	5,533.1	5,720.9	5,715.7	6,276.2
Net Current Assets	-2,477.3	-2,295.9	-2,291.3	-2,277.1
Application of Funds	24,680.4	26,415.7	26,271.2	26,091.5

Source: Company, ICICIdirect.com Research

### Cash flow statement

	(₹ Crore)			
(Year-end March)	FY11	FY12E	FY13E	FY14E
Profit after Tax	898.7	735.3	1,355.5	1,820.3
Add: Depreciation	2,397.3	2,996.1	3,349.0	3,607.9
(Inc)/dec in Current Assets	775.0	-582.2	-4.0	-192.8
Inc/(dec) in CL and Provisions	1,465.2	187.7	-5.1	560.5
Others	0.0	0.0	0.0	0.0
CF from operating activities	5,536.2	3,337.0	4,695.4	5,795.9
(Inc)/dec in Investments	110.4	0.0	0.0	0.0
(Inc)/dec in Fixed Assets	-9,814.6	-4,550.0	-3,200.0	-3,414.0
Others	95.7	0.0	0.0	0.0
CF from investing activities	-9,608.5	-4,550.0	-3,200.0	-3,414.0
Issue/(Buy back) of Equity	6.8	0.0	0.0	0.0
Inc/(dec) in loan funds	4,211.2	1,000.0	-1,500.0	-2,000.0
Dividend paid & dividend tax	0.0	0.0	0.0	0.0
Inc/(dec) in Sec. premium	22.1	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0
CF from financing activities	4,240.1	1,000.0	-1,500.0	-2,000.0
Net Cash flow	167.8	-213.0	-4.6	381.9
Opening Cash	290.0	457.7	244.8	240.2
Closing Cash	457.7	244.8	240.2	622.1

Source: Company, ICICIdirect.com Research

### Key ratios

(Year-end March)	FY11	FY12E	FY13E	FY14E
<b>Per share data (₹)</b>				
EPS	2.7	2.2	4.1	5.5
Cash EPS	10.0	11.3	14.2	16.4
BV	37.2	39.5	43.6	49.1
DPS	0.0	0.0	0.0	0.0
Cash Per Share	1.4	0.7	0.7	1.9
<b>Operating Ratios</b>				
EBITDA Margin (%)	24.1	26.7	27.5	27.7
PBT Margin (%)	6.5	5.6	8.8	10.6
PAT Margin (%)	5.8	3.8	5.9	7.1
Inventory days	1.4	1.3	1.2	1.1
Debtor days	11.2	9.5	9.5	9.5
Creditor days	108.8	102.0	87.0	82.0
<b>Return Ratios (%)</b>				
RoE	7.3	5.6	9.4	11.2
RoCE	5.5	8.4	11.6	13.7
RoIC	4.9	5.7	7.7	9.3
<b>Valuation Ratios (x)</b>				
P/E	34.3	41.9	22.7	16.9
EV / EBITDA	11.4	8.4	6.6	5.6
EV / Net Sales	2.7	2.2	1.8	1.5
Market Cap / Sales	2.0	1.6	1.3	1.2
Price to Book Value	2.5	2.4	2.1	1.9
<b>Solvency Ratios</b>				
Debt/EBITDA	3.2	2.5	1.8	1.3
Debt / Equity	1.0	1.0	0.8	0.6
Current Ratio	0.6	0.6	0.6	0.6
Quick Ratio	0.5	0.6	0.6	0.5

Source: Company, ICICIdirect.com Research

**Exhibit 93: Recommendation history**

Source: Reuters, ICICIdirect.com Research

**Exhibit 94: Recent releases**

Date	Event	CMP	Target Price	Rating
8-Apr-11	Q4FY11 Preview	66	73	BUY
25-May-11	Q4FY11 Result Update	73	73	HOLD
5-Jul-11	Q1FY12 Result Preview	79	73	HOLD
1-Aug-11	Q1FY12 Result Update	94	104	BUY
5-Oct-11	Q2FY12 Result Preview	97	104	HOLD
24-Oct-11	Q2FY12 Result Update	91	99	HOLD
6-Jan-12	Q3FY12 Result Preview	82	99	BUY
24-Jan-12	Q3FY12 Result Update	93	99	HOLD

Source: Company, ICICIdirect.com Research

## Reliance Communication (RELCOM)

₹ 95

### Huge debt! Still a concern...

RCom with the second highest subscriber base has very low VLR subscribers resulting in huge diversification in subscribers (16.8%) and revenue (8.2%) market share. The company is in the process of cutting down free minutes on the network resulting in lower MoU growth than peers. Also, huge net debt levels of 5.8x FY11 normalised EBITDA are a huge concern for RCom. Interest costs would rise, going ahead, as RCom replaces its FCCB with higher coupon debt. Several attempts to monetise tower assets have been unsuccessful while the current market scenario and regulatory overhang would make it all the more difficult to get desired valuations. The only silver lining is increase in external tenancy on RCom's towers backed by RIL's BWA rollout. We have not factored in any revenue from external tenancy till a formal announcement is made. We rate RCom as SELL with a target price of ₹ 84.

### Huge debt remains a concern

RCom has a huge debt of about ₹ 33699.5 crore as on September 2011. The normalised net debt/EBITDA stood at 5.8x in FY11 as compared to 3.0x and 3.1x for Bharti Airtel and Idea Cellular, respectively. Though the company has refinanced some of its debt through cheaper Chinese debt with longer maturity, the long term issue still remains. Also, it impacts the company's network rollout capex. With capex guidance much lower than its peers, we believe RCom may lose out on network depth and quality.

### Tower deal – A ray of hope

The company has also been looking at diluting its stake in the tower business to repay its debt. However, we believe given the market scenario it would be difficult to get the desired valuations for Reliance Infratel while the regulatory uncertainty would make equity dilution in the parent company more difficult. Increase in external tenancy would be a game changer for RCom. The company has announced it is in talks with Reliance Industries for renting out towers for the latter's LTE roll out.

### Valuations

At the CMP of ₹ 95, the stock is trading at 26.5x FY12E EPS of ₹ 3.6 and 25.8x FY13E EPS of ₹ 3.7. We have valued the stock using the DCF methodology and arrived at a target price of ₹ 84/share, assuming 4.8% CAGR in revenue over FY11-FY20E and terminal growth rate of 3%. We maintain our SELL rating on the stock.

#### Exhibit 95: Valuation Metrics

(Year-end March)	FY10	FY11	FY12E	FY13E	FY14E
Net Sales (₹ crore)	21,496.4	22,430.4	19,835.9	21,557.6	22,686.8
EBITDA (₹ crore)	7,184.6	8,404.3	5,817.2	6,580.7	7,233.9
Net Profit (₹ crore)	4,655.0	1,345.7	737.8	757.0	1,085.0
EPS (₹)	22.6	6.5	3.6	3.7	5.3
P/E (x)	4.2	14.5	26.5	25.8	18.0
Price / Book (x)	0.5	0.5	0.5	0.5	0.5
EV/EBITDA (x)	6.7	6.4	8.7	7.4	6.4
RoCE (%)	2.2	2.4	2.0	2.8	3.4
RoE (%)	10.7	3.3	1.8	1.8	2.5

Source: Company, ICICIdirect.com Research; Sales includes other operating income

#### Rating Matrix

Rating	: Sell
Target	: ₹ 84
Target Period	: 12 months
Potential Upside	: -11%

#### YoY Growth (%)

(YoY Growth)	FY11	FY12E	FY13E	FY14E
Net Sales	4.3	(11.6)	8.7	5.2
EBITDA	17.0	(30.8)	13.1	9.9
Net Profit	(71.1)	(45.2)	2.6	43.3
EPS	(71.1)	(45.2)	2.6	43.3

#### Valuation Summary

	FY11	FY12E	FY13E	FY14E
P/E	14.5	26.5	25.8	18.0
Target P/E	12.9	23.5	22.9	16.0
EV / EBITDA	6.4	8.7	7.4	6.4
Price / BV	0.5	0.5	0.5	0.5
RoNW (%)	3.3	1.8	1.8	2.5
RoCE (%)	2.4	2.0	2.8	3.4

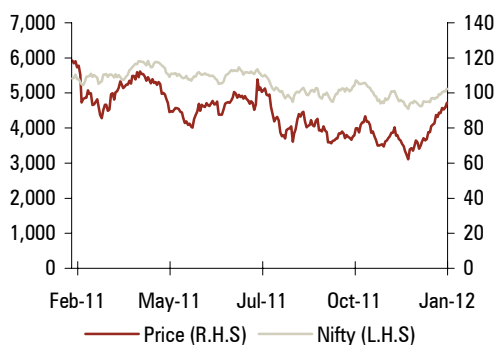
#### Stock Data

Market Capitalization (₹ Crore)	19,546.3
Total Debt (FY11) (₹ Crore)	39,071.4
Cash and Investments (FY11) (₹ Crore)	4,866.2
EV (₹ Crore)	53,751.4
52 week H/L	119 / 62
Equity capital	1,032.0
Face value	₹ 5
MF Holding (%)	9.0
FII Holding (%)	7.9

#### Comparative return matrix (%)

	1M	3M	6M	12M
Bharti Airtel	6.6	-6.8	-14.3	4.7
RCOM	36.8	23.6	-1.9	-32.5
Idea	10.9	-4.4	2.5	27.4

#### Price movement

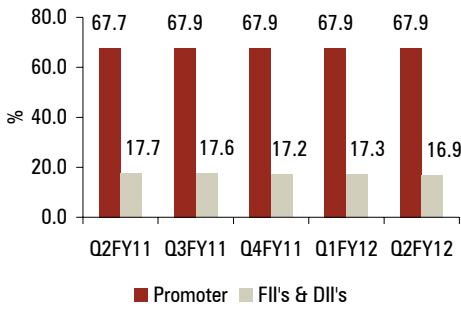


#### Analyst's name

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Anil Shenoy  
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Promoters and FII & MFs holding trend (%)

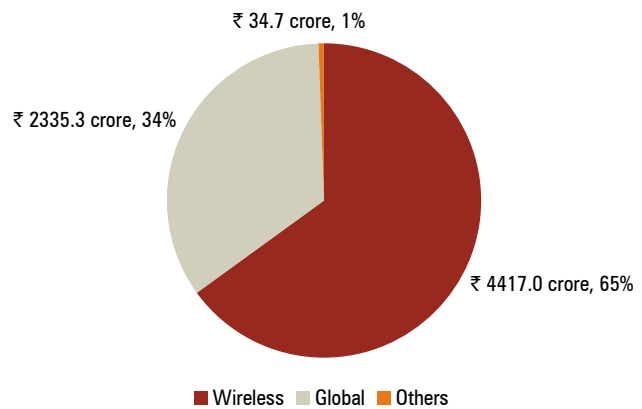


### Company background

Reliance Communications is one of the India’s largest integrated communications service providers with over 150 million individual, enterprise and carrier customers.

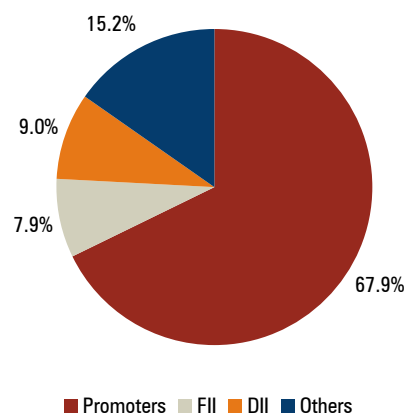
RCom offers CDMA and GSM based wireless services on a nationwide basis. Recently, the company started 3G services in all 13 circles where it had won spectrum. RCom provides a gamut of services in mobile and fixed wireless voice, data, and value added services for individual consumers and enterprises. The Global Enterprise Business Unit offers a whole portfolio of Enterprise, IT infrastructure, National and international long distance voice, video and data network services on an integrated and highly scalable platform. The company’s business segments comprise Carrier, Enterprise and Consumer business units. The company’s DTH business has moved into its third full year of operations. Reliance Digital TV is available at more than 100,000 outlets across 8,100 towns in the country. The retail and distribution reach as well as other elements of infrastructure established for their wireless network, have been leveraged to expand their DTH presence.

Exhibit 96: Revenue contribution as of Q2FY12



Source: Company, ICICIdirect.com Research

Exhibit 97: RCom - Shareholding pattern as on Q2FY12



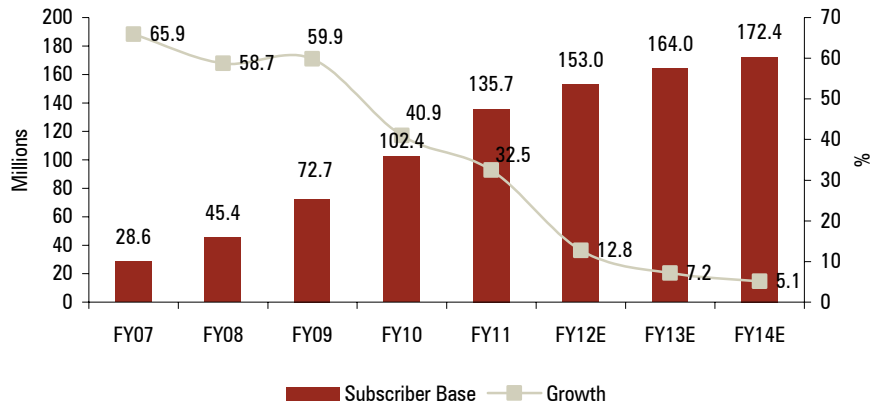
Source: Company, ICICIdirect.com Research

### Investment Rationale

#### Relatively poor subscriber quality...

RCom had the second highest subscriber base in the domestic industry at 148.0 million as of November 2011, growing 417.5% from 28.6 million in FY07. However, the VLR subscriber base stands at 92.5 million only. Also, the ARPU of RCom is much lower than its peers, indicating relatively poor subscriber quality.

**Exhibit 98: RCom subscribers and growth**



RCom has the second highest subscriber base in the industry at 135.7 million in FY11 but with a low VLR subscriber base. We expect its total subscriber base to reach 172.4 million by FY14E

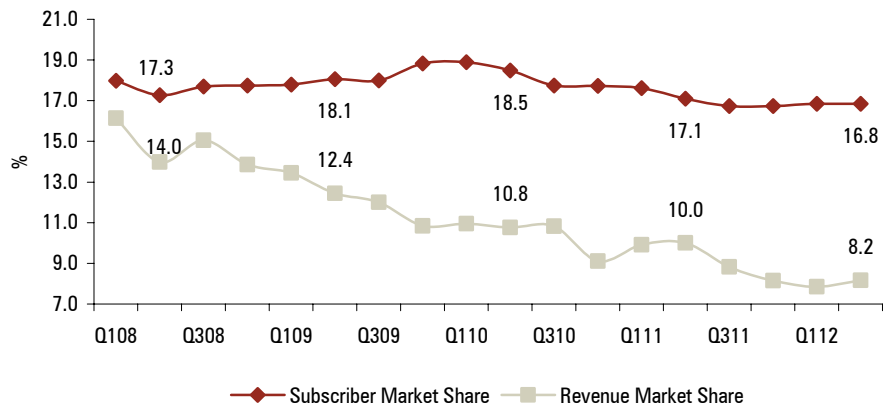
Source: Company, ICICIdirect.com Research

**Exhibit 99: Wireless business - assumptions**

Rcom	Unit	FY11	FY12	FY13	FY14
Subscribers	Millions	135.7	153.0	164.0	172.4
ARPU	₹	98.0	86.3	85.2	84.1
MoU	minutes	262.3	230.1	223.5	220.7
ARPM	₹	44.2	44.6	45.0	45.1

Source: Company, ICICIdirect.com Research

**Exhibit 100: RCom - Revenue and subscriber share movement**



The subscriber market share for RCom has marginally decreased from 18.0% in Q1FY08 to 16.8% in Q2FY12 while the revenue market share has declined from 16.1% to 8.2% over the same period, indicating waning subscriber quality

Source: TRAI, Company, ICICIdirect.com Research

The subscriber market share for RCom has marginally decreased from 18.0% in Q1FY08 to 16.8% in Q2FY12 while the revenue market share has declined from 16.1% to 8.2% over the same period, indicating waning

subscriber quality. We expect the subscriber base to post a CAGR of 8.3% from FY11 to FY14 to ~172 million by FY14E. However, the wireless business would post a revenue CAGR of only 6.6%.

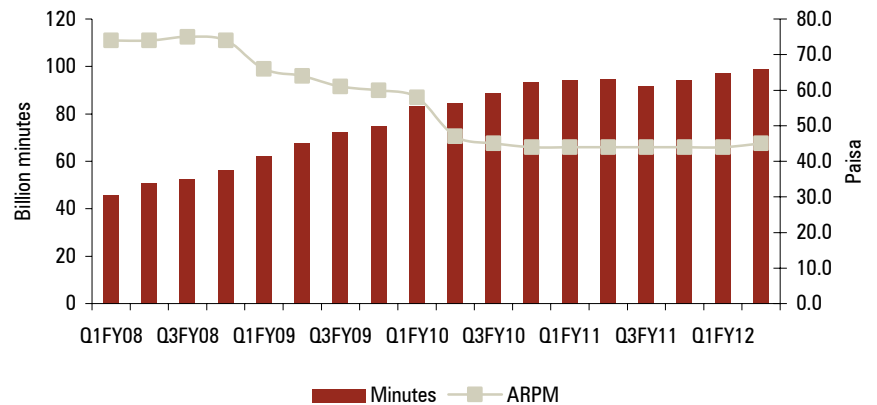
The company did manage to increase its revenue share in Q2FY12. However, this could be due to its seasonality factor in rural India, from where, some of the larger operators derive higher share of their revenue.

**Declining minutes growth...**

RCom had flooded the market with lots of attractive offers resulting in huge minutes growth since the launch of GSM operations in 2008. However, with declining key metrics, the company adopted a strategy to cut down on non revenue yielding minutes. This is also reflected in very low growth/de-growth in total minutes while those of its peers continued to grow at a stable pace. On the brighter side though, the company did well to stabilise its ARPM at ~ 44 paisa while that of its peers witnessed a steady decline. Also, the company managed to increase its traffic in the last quarter while other operators witnessed a decline (partly due to seasonality in the second quarter).

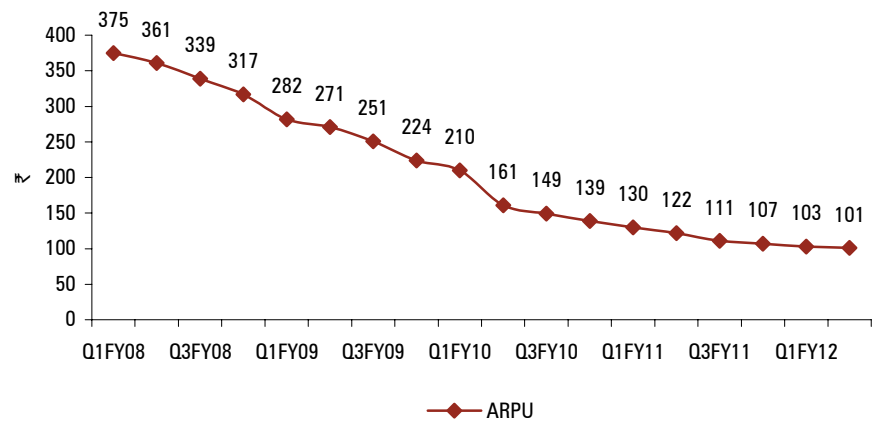
After struggling with low ARPMs due to attractive offers made by the company, RCom adopted a strategy to cut down its non revenue yielding minutes resulting in a stable ARPM of ~ 44 paisa

**Exhibit 101: Minutes growth and ARPM**



Source: Company, ICICIdirect.com Research

**Exhibit 102: ARPU trend**



ARPU for RCom has fallen continuously from ₹ 375 in Q1FY08 to ₹ 101 in Q2FY12

Source: Company, ICICIdirect.com Research

ARPU for RCom has fallen continuously from ₹ 375 in Q1FY08 to ₹ 101 in Q2FY12. We expect ARPU to continue with the downward trend and post a 5.0% decline over FY11–FY14 to ~ ₹ 84 while MoU is also expected to decline 5.6% to ~ 221 minutes. ARPM, however, is expected to increase marginally to 45 paisa.

**Huge debt a concern...**

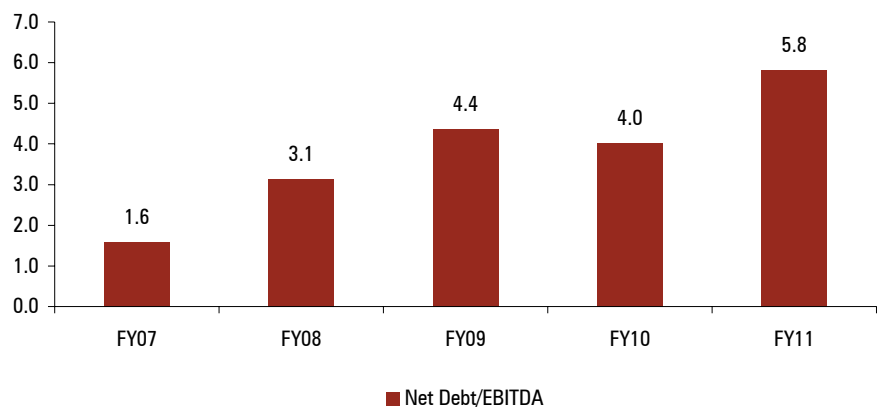
RCom has a huge debt of about ₹ 33699.5 crore as on September 2011. The normalised net debt/EBITDA stood at 5.8x in FY11 as compared to 3.0x and 3.1x for Bharti Airtel and Idea Cellular, respectively.

The company redeemed the entire outstanding amount of its first FCCB of \$0.5 billion in May 2011 at a premium of 25.84% while the outstanding amount from the second tranche stands at \$925 million due for conversion in February 2012. The company has recently raised debt of \$1.2 billion from Chinese banks to repay the second tranche of FCCBs due on March 31 2012.

RCom has been trying several ways to address the debt concern. It has refinanced high cost rupee debt by \$1.9 billion debt from China Development Bank, which, according to the management, would result in annual saving of ₹ 500 crore in terms of interest payment. Nonetheless, it has reduced its gross debt by about ₹ 3676.2 crore in H1FY12.

The company has also been looking at diluting its stake in the tower business to repay its debt. However, we believe, given the market scenario it would be difficult to get the desired valuations for Reliance Infratel while the regulatory uncertainty would make equity dilution in the parent company more difficult.

**Exhibit 103: Net debt/EBITDA trend**



RCom currently has the highest net debt/EBITDA ratio at 5.8x as compared to 3.0x and 3.1x for Bharti and Idea

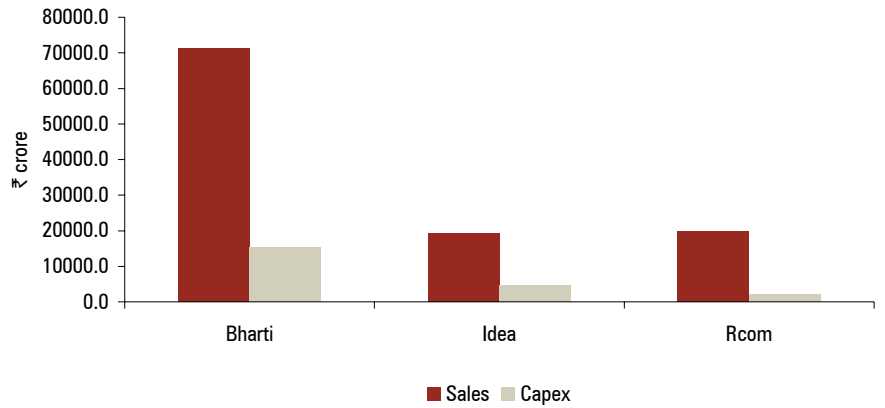
Source: Company, ICICIdirect.com Research

**Lower capex guidance – may hamper network depth...**

RCom has guided for a capex of ~₹ 1500 crore for FY12, significantly lower than that of its peers (₹ 4000 crore for Idea Cellular and ₹ 10,000 crore for Bharti Airtel India and South Asia). The company may have limited options for aggressive network expansion due to its bulging debt. The capex intensity for FY12 stands at 10.1% for RCom as compared to 21.7% and 23.4% for both Bharti Airtel and Idea Cellular, respectively.

We believe this may affect the network depth and reach of Reliance Communication and it may further lose revenue market share to its peers.

**Exhibit 104: RCom's revenue estimates and capex guidance for FY12 versus its peers**



Due to its huge debt, RCom has guided a capex of ₹ 1500 crore, significantly lower than that of Bharti at ₹ 10,000 crore and Idea at ₹ 4,000 crore

Source: Company, ICICIdirect.com Research

**External tenancy on tower business to help...**

RCom has a tower portfolio of about 50,000 towers with a tenancy of about 1.8x. However, there are very few external tenants on its towers, which have BTS of both GSM and CDMA operations of the company itself.

Increase in external tenancy would be a game changer for RCom. The company has announced it is in talks with Reliance Industries for renting out towers for the latter's LTE roll out.

## Financials

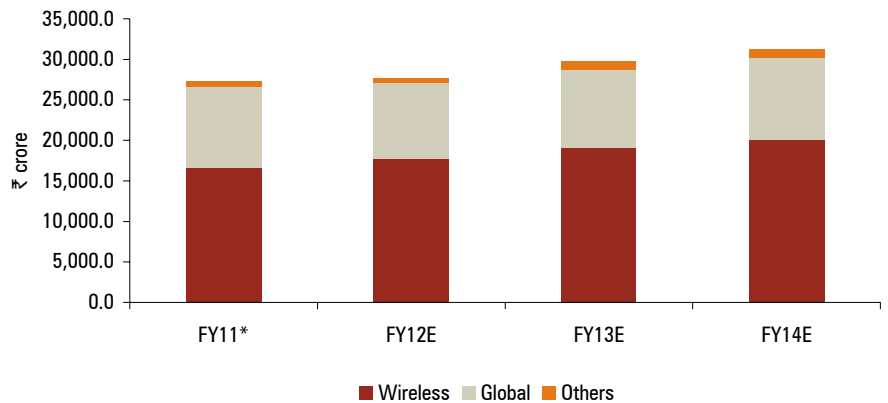
### Revenue to grow at 4.5% CAGR in FY11-14E

We expect domestic revenues to grow at 4.5% CAGR over FY11-14E on the back of 6.6% CAGR in the wireless business and 1.5% CAGR in other businesses over the same period.

The growth in the mobility business would be led by growth at 5.9% CAGR in overall traffic to ~445 billion minutes in FY14E from 374.9 billion minutes in FY11. ARPM is expected to increase marginally to 45 paisa during the same period. The domestic subscriber base is expected to increase from 135.7 billion in FY11 to ~172 million by FY14E.

We expect domestic revenues to grow at 4.5% CAGR over FY11-14E on the back of 6.6% CAGR in the wireless business and 1.5% CAGR in other businesses over the same period

**Exhibit 105: RCom segment wise revenue assumptions**



\* FY11 Normalised revenue

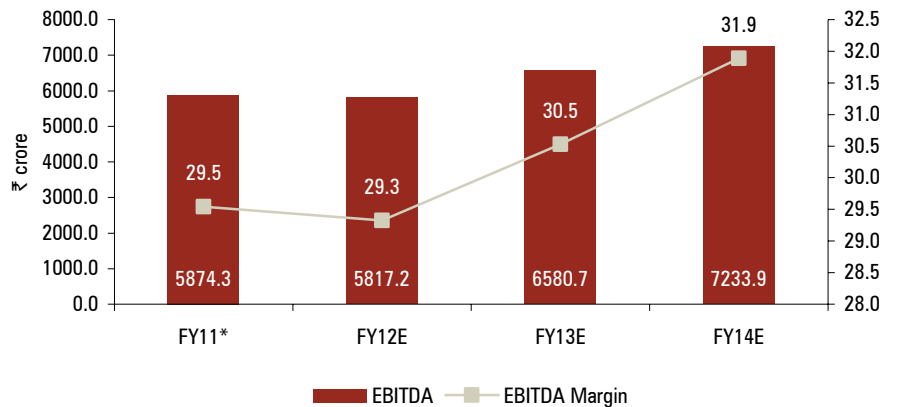
Source: Company, ICICIdirect.com Research

### EBITDA margin to be around 32%

We expect the EBITDA margin to improve to 31.9% in FY14 from a normalised EBITDA margin of 29.5% in FY11 on account of reduced network rollout costs. The EBITDA is expected to grow at a CAGR of 7.2% from ₹ 5874.3 crore to ₹ 7233.9 crore in FY14.

We expect the EBITDA margin of the domestic business to improve to 31.9% in FY14 from a normalised EBITDA margin of 29.5% in FY11 on account of reduced network rollout costs

**Exhibit 106: EBITDA and EBITDA margin trend**

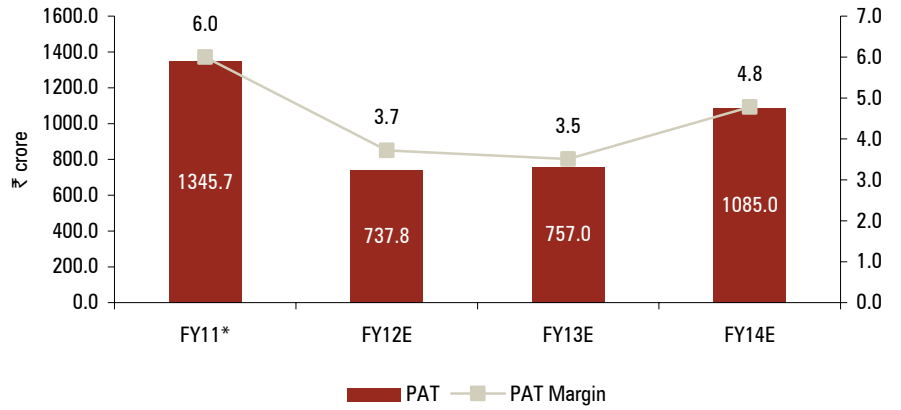


\* - Normalised EBITDA margin

Source: Company, ICICIdirect.com Research

PAT is expected to decline at a CAGR of 6.9% from FY11 to FY14 to ₹ 1085.0 crore from ₹ 1345.7 crore on the back of higher amortisation and interest cost. The depreciation cost is expected to increase from ₹ 5874.3 crore in FY11 to ₹ 6351.0 crore in FY14 while the interest cost is expected to increase from ₹ 1072.2 crore to ₹ 1202.9 crore over the same period.

**Exhibit 107: Trends in net profit & net profit margins**



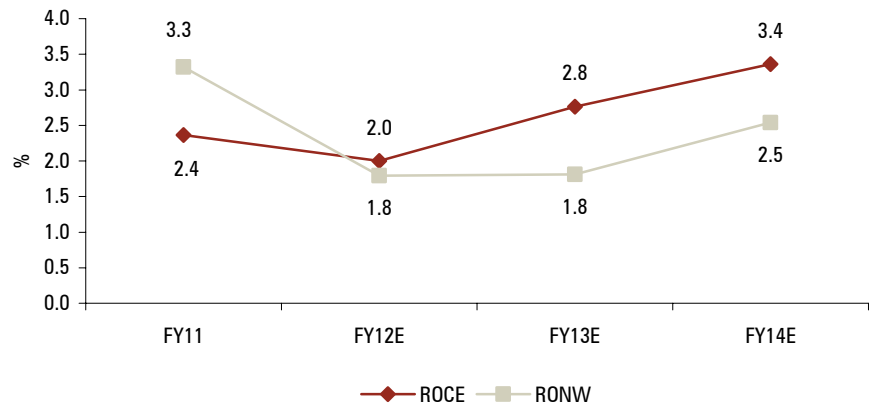
PAT is expected to decline at a CAGR of 6.9% from FY11 to FY14 to ₹ 1085 crore from ₹ 1345.7 crore on the back of higher amortisation and interest cost

Source: Company, ICICIdirect.com Research

**Return ratios to remain subdued**

Return ratios for RCom would remain subdued in the near future due to lower PAT growth and high debt levels.

**Exhibit 108: Return ratios to improve significantly**



Source: Company, ICICIdirect.com Research

## Valuation

RCom has been struggling with its KPIs with a lesser proportion of active subscribers in its subscriber base as compared to its peers and declining traffic growth. To add to its woes, a huge debt remains a concern. This has caused its capex guidance to be just ₹ 1500 crore, which is way lower than industry standards. However, if the company is able to strike a tower deal, it will help address the huge debt concern.

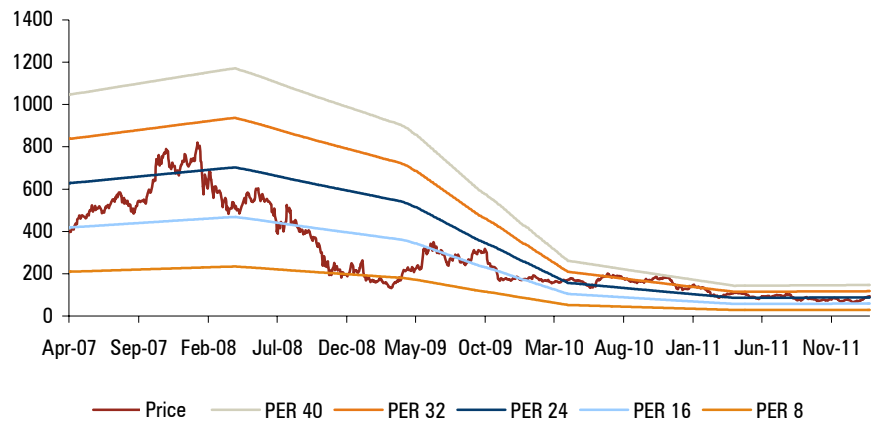
At the CMP of ₹ 95, the stock is trading at 26.5x FY12E EPS of ₹ 3.6 and 25.8x FY13E EPS of ₹ 3.7. We have valued the stock using the DCF methodology and arrived at a target price of ₹ 84/share, assuming 4.8% CAGR in revenue over FY11-FY20E and terminal growth rate of 3%. We maintain our SELL rating on the stock.

### Exhibit 109: DCF Assumptions

₹ in Crore	
WACC	11.4%
Revenue CAGR over FY11E-20E	4.8%
Present Value of Cash Flow till FY20E	56,401.6
Terminal Growth	3.0%
Present Value of terminal cash flow	35,596.9
PV of firm	56,401.6
Less: Current Debt	39,071.4
Total present value of the Equity (excluding current cash)	17,330.2
Number of Equity Shares outstanding	206.4
DCF - Target price (₹)	84.0

Source: Company, ICICIdirect.com Research

### Exhibit 110: One-year forward PE Graph



Source: Company, ICICIdirect.com Research

## Financial summary

### Profit and loss statement

	(₹ Crore)			
(Year-end March)	FY11	FY12E	FY13E	FY14E
Total operating Income	22,430.4	19,835.9	21,557.6	22,686.8
Growth (%)	4.3	-11.6	8.7	5.2
Employee Expenses	1,475.7	1,369.3	1,488.8	1,504.6
Administrative Expenses	3,274.0	3,179.7	3,155.7	3,071.6
Access Charges	9,276.4	2,730.2	3,126.5	3,291.3
License Fee	0.0	1,137.7	1,250.6	1,316.5
Network Expenses	0.0	5,601.8	5,955.2	6,269.1
Total Operating Expenditure	14,026.1	14,018.7	14,976.9	15,453.0
EBITDA	8,404.3	5,817.2	6,580.7	7,233.9
Growth (%)	17.0	-30.8	13.1	9.9
Depreciation	6,503.8	4,251.0	4,477.5	4,736.4
Interest	1,072.2	1,083.3	1,322.9	1,202.9
Other Income	677.3	539.0	320.0	320.0
Extraordinary Expense	(12.1)	1.3	-	-
PBT	1,517.6	1,020.6	1,100.3	1,614.6
MI/PAT from associates	160.2	217.0	189.3	271.3
Total Tax	11.8	65.8	154.0	258.3
PAT	1,345.7	737.8	757.0	1,085.0
Growth (%)	-71.1	-45.2	2.6	43.3
EPS (₹)	6.5	3.6	3.7	5.3

Source: Company, ICICIdirect.com Research

### Balance sheet

	(₹ Crore)			
(Year-end March)	FY11	FY12E	FY13E	FY14E
<b>Liabilities</b>				
Equity Capital	1,032.0	1,032.0	1,032.0	1,032.0
Reserve and Surplus	39,467.0	40,084.1	40,720.4	41,684.7
Total Shareholders funds	40,499.1	41,116.1	41,752.4	42,716.7
Total Debt	39,071.4	36,071.4	33,071.4	30,071.4
Deferred Tax Liability	366.8	366.8	366.8	366.8
Minority Interest	824.5	1,041.4	1,230.7	1,502.0
Total Liabilities	80,761.7	78,595.8	76,421.3	74,656.8
<b>Assets</b>				
Gross Block	82,090.2	96,781.4	102,781.4	107,281.4
Less: Acc Depreciation	27,340.6	31,591.6	36,069.1	40,805.5
Net Block	54,749.6	65,189.8	66,712.3	66,475.9
Capital WIP	18,191.2	5,500.0	3,000.0	2,000.0
Total Fixed Assets	72,940.9	70,689.8	69,712.3	68,475.9
Investments	569.8	569.8	569.8	569.8
Inventory	517.2	537.1	585.0	620.8
Debtors	3,984.0	4,167.7	4,337.2	4,364.6
Loans and Advances	5,086.3	5,228.4	5,766.0	6,031.2
Other Current Assets	2,011.0	2,352.9	2,562.2	2,746.5
Cash	4,866.2	4,967.3	3,809.2	3,354.3
Total Current Assets	16,464.6	17,253.5	17,059.6	17,117.4
Creditors	10,601.8	11,136.2	11,897.9	12,342.8
Provisions	3,359.1	3,528.4	3,769.8	3,910.7
Other Current Liabilities	-	-	-	-
Total Current Liabilities	13,960.8	14,664.6	15,667.7	16,253.5
Net Current Assets	2,503.8	2,588.9	1,391.9	863.8
Goodwill	4,747.3	4,747.3	4,747.3	4,747.3
Application of Funds	80,761.7	78,595.8	76,421.3	74,656.8

Source: Company, ICICIdirect.com Research

### Cash flow statement

	(₹ Crore)			
(Year-end March)	FY11	FY12E	FY13E	FY14E
Profit after Tax	1,345.7	737.8	757.0	1,085.0
Add: Depreciation	6,503.8	4,251.0	4,477.5	4,736.4
(Inc)/dec in Current Assets	-259.7	-687.7	-964.2	-512.7
Inc/(dec) in CL and Provisions	-4,774.3	703.8	1,003.1	585.9
Others	0.0	0.0	0.0	0.0
CF from operating activities	2,815.5	5,004.9	5,273.4	5,894.6
(Inc)/dec in Investments	3,590.1	0.0	0.0	0.0
(Inc)/dec in Fixed Assets	-8,190.8	-2,000.0	-3,500.0	-3,500.0
Others	684.1	217.0	189.3	271.3
CF from investing activities	-3,916.6	-1,783.0	-3,310.7	-3,228.7
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0
Inc/(dec) in loan funds	9,356.0	-3,000.0	-3,000.0	-3,000.0
Dividend paid & dividend tax	-120.3	-120.7	-120.7	-120.7
Inc/(dec) in Sec. premium	-301.1	0.0	0.0	0.0
Others	-3,785.7	0.0	0.0	0.0
CF from financing activities	5,148.9	-3,120.7	-3,120.7	-3,120.7
Net Cash flow	4,047.8	101.1	-1,158.1	-454.9
Opening Cash	818.4	4,866.2	4,967.3	3,809.2
Closing Cash	4,866.2	4,967.3	3,809.2	3,354.3

Source: Company, ICICIdirect.com Research

### Key ratios

(Year-end March)	FY10	FY11	FY12E	FY13E
<b>Per share data (₹)</b>				
EPS	6.5	3.6	3.7	5.3
Cash EPS	38.0	24.2	25.4	28.2
BV	196.2	199.2	202.3	207.0
DPS	0.5	0.5	0.5	0.5
Cash Per Share	23.6	24.1	18.5	16.3
<b>Operating Ratios</b>				
EBITDA Margin (%)	37.5	29.3	30.5	31.9
PBT Margin (%)	6.8	5.1	5.1	7.1
PAT Margin (%)	6.0	3.7	3.5	4.8
Inventory days	8.6	9.7	9.5	9.7
Debtor days	64.8	75.0	72.0	70.0
Creditor days	172.5	200.0	195.0	195.0
<b>Return Ratios (%)</b>				
RoE	3.3	1.8	1.8	2.5
RoCE	2.4	2.0	2.8	3.4
RoIC	2.5	2.3	3.1	3.8
<b>Valuation Ratios (x)</b>				
P/E	14.5	26.5	25.8	18.0
EV / EBITDA	6.4	8.7	7.4	6.4
EV / Net Sales	2.4	2.6	2.3	2.0
Market Cap / Sales	0.9	1.0	0.9	0.9
Price to Book Value	0.5	0.5	0.5	0.5
<b>Solvency Ratios</b>				
Debt/EBITDA	4.6	6.2	5.0	4.2
Debt / Equity	1.0	0.9	0.8	0.7
Current Ratio	1.2	1.2	1.1	1.1
Quick Ratio	0.8	0.8	0.8	0.8

Source: Company, ICICIdirect.com Research

**Exhibit 111: Recommendation History**



Source: Reuters, ICICIdirect.com Research

**Exhibit 112: Recent Releases**

Date	Event	CMP	Target Price	Rating
8-Apr-11	Q4FY11 Preview	111	110	HOLD
1-Jun-11	Q4FY11 Result Update	89	90	HOLD
5-Jul-11	Q1FY12 Result Preview	101	90	HOLD
17-Aug-11	Q1FY12 Result Update	77	84	HOLD
5-Jul-11	Q2FY12 Result Preview	71	84	HOLD
14-Nov-11	Q2FY12 Result Update	82	84	BUY
6-Jan-12	Q3FY12 Result Preview	74	84	BUY

Source: Reuters, ICICIdirect.com Research

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Sell: -10% or more;

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