India I Equities

Telecommunications

Sector Report

22 November 2008

India Wireless

Overweight

Referee playing spoilsport, but the game ain't over yet

Nifty/Sensex: 2553/8451

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- **Some air pockets on the way.** Despite prospects of strong volume/ revenue growth in the medium term and relative resilience to the ongoing macro slowdown, our near-term sector outlook is somewhat dampened by regulatory concerns. We initiate with a Buy on Bharti and RCOM and a Hold on Idea.

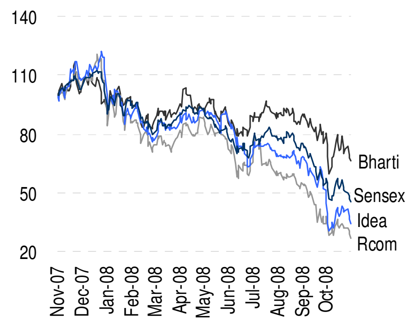
- **Subscriber growth, tower sharing are key positives.** Our 550m sub forecast (46.5% penetration) for Mar'11 implies 7.9m monthly net-adds from hereon vs 9.0m in 1HFY09. We expect rev growth to recover after a seasonally soft 2Q. New wireless entrants may pose long-term risks but they bode well for the tower companies.

- **Regulatory issues constrain optimism.** Key outstanding issues are: levy of a one-time 2G spectrum charge on GSM incumbents, 3G spectrum auctions and 3G spectrum usage fees. A potential 100-200bps hike in 2G spectrum usage fee would be offset by recently announced license-fee cut (linked to 95% coverage) over the medium term, but would impact margins in the short term.

- **Bharti is well placed to negotiate choppy waters,** thanks to its superior scale and balance sheet. Valuations are attractive at 1-yr forward PE of 11.6x (10% below the 5-yr trough) in the context of our 16% EPS CAGR (FY10-11) forecast. We believe RCOM stock offers an attractive reward/risk ratio, given prospects of operational recovery and undemanding valuations. Finally, we do see long-term value in Idea but our short-term outlook is constrained by losses from new circles/Spice consolidation and the stock's unappetizing valuations.

- **Key downside risks to our TPs are:** (1) irrational competition post RCOM's GSM expansion in 4QFY09, (2) excessive 3G spectrum bids and (3) a significant one-time levy for 2G spectrum on Bharti and Idea. Upside risks to our Idea TP are higher-than-expected revenue growth and a quicker turnaround of Spice.

Relative performance



Source: Anand Rathi Research

India wireless - Ratings and valuations

Year end 31 Mar	Rating	Price (Rs) (As on 20 Nov)	TP (Rs)	Upside (%)	PE (x) FY09e	PE (x) FY10e	EPS CAGR FY09e-11e	PE to Growth	EV/EBIT (x) FY09e	EV/EBIT (x) FY10e	EBIT CAGR FY09e-11e	EV/EBIT to Growth
Bharti	Buy	592	850	44	12.9	11.0	15.9	0.82	10.8	9.4	14.4	0.75
RCOM	Buy	182	275	51	6.5	7.8	(5.8)	(1.14)	10.7	10.1	9.9	1.08
Idea [a]	Hold	41	60	45	14.5	13.2	9.7	1.50	11.8	9.5	22.3	0.53
Average					**10.5**	**10.0**	**8.0**	**1.31**	**10.9**	**9.6**	**13.6**	**0.80**

Source: Anand Rathi Research. [a] Idea's EPS and EBIT CAGR excluding the impact of Spice merger are around 22% and 20%, respectively.