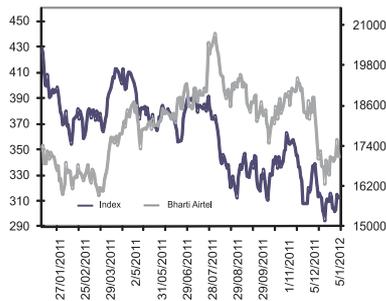


Sector Update

Indian Telecom Services

Bharti Airtel

Performance Chart

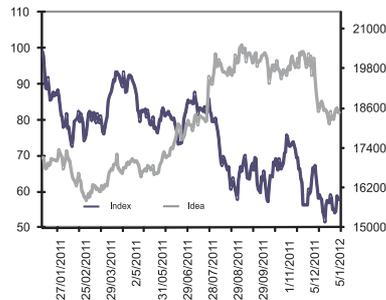


PRICE PERFORMANCE (%)

	3 M	6 M	12 M
Absolute	(6.2)	(9.8)	(1.6)
Relative	(6.6)	5.6	20.3

Idea Cellular

Performance Chart



PRICE PERFORMANCE (%)

	3 M	6 M	12 M
Absolute	(13.1)	6.7	18.3
Relative	(13.5)	22.1	40.2

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Delay in introduction of NTP is a major concern

- *Too much of regulatory flip-flop lately is damaging the investment climate in the Indian Telecom space; DoT's move to declare 3G roaming agreements between private operators as 'illegal' came as a shocker for the industry.*
- *Huge regulatory overhang remains for the sector; will wait for two more quarters to examine operational performance of the companies under our coverage before reviewing our call on the sector; maintain our 'Buy' rating on both Bharti Airtel and Idea Cellular*

After having spent huge amount in capex to acquire the 3G and Broadband Wireless Access (BWA) license and spectrum in Q2FY10, the highly competitive Indian telecom sector really banked on the new telecom policy (NTP) that was promised to be introduced by the end of CY11. The industry had spent a total of Rs 932.9 bn to acquire the 3G and BWA spectrum.

NTP promised structural changes for the industry through various pro-industry measures such as audit of spectrum usage and spectrum sharing, favorable proposals relating to merger & acquisition (M&A), lowering of license fee to a uniform 8% across all circles, as against the varying fee of 6-10%. We expected the implementation of NTP to be completed by end CY11 and believed that the favorable measures in it would revive the mood despite the overhang of 2G spectrum allocation scam. The one time spectrum charges that the operators had to pay for 2G spectrum held by them in excess of 6.2 MHz and the policy clarity on that front is another overhang.

We had initiated coverage on Bharti Airtel and Idea Cellular in September 2011 and besides the NTP we really banked on the operational improvement due to tariff increase. We expected Bharti Airtel's Africa operation turnaround to assist earnings growth while in Idea Cellular's case we believed the turn around to happen in the company's new circles and aggressive ramp-up of 3G operations to help earnings growth. Tariffs have improved while the subscriber acquisition continues to be strong for both Bharti Airtel and Idea Cellular (except that the 3G subscriber upgrade has been lower than expected). But the host of negative feeds from regulatory front has been disappointing during the past few weeks. Department of Telecom (DoT) seems to have gone overboard in auditing the sector and penalizing the errant operators.

Recent Policy action...

• Uniform license fee to be introduced

On the positive front the Telecom Commission has accepted the introduction of Uniform License Fee of 8% for telecom companies, from 6-10% variable in different circle at present. It has also accepted Telecom Regulatory Authority of India's (TRAI) proposals on M&A rules. TRAI had earlier proposed that in case of a merger between two telecom service providers, the combined entity should have a market share of less than 35%. Further, the merged entity's total spectrum holding should be less than 25% of the total airwaves available to telecom operators in a circle. In case the market share exceeds the 35% but remains less than 60%, TRAI will carry out detailed examination to ensure that there is no market dominance. Besides, they stipulate that the combined entity can retain 14.4 MHz and the remaining has to be surrendered to the government. This measure once adopted will help in significant consolidation in the 15 operator Indian Telecom space.

- **Show-cause notices for violation of MNP norms**

Bharti and Vodafone were recently issued show-cause notices recently for allegedly violation of the mobile number portability (MNP) norms, based on complaints from subscribers that their requests for MNP were rejected.

- **Imposition of penalty by DoT for violation of ILD license terms and conditions**

The Telecom Disputes Settlement & Appellate Tribunal recently directed Bharti Airtel and Tata Communications to pay 10% of the Rs 500 mn penalty each imposed on them by DoT for violation of ILD license terms and conditions.

- **Penalty for under-reporting of mobile revenues**

The DoT raised a demand of over Rs 15.9 bn from five telecom firms, Tatas, Vodafone, Reliance Communications, Bharti Airtel and Idea Cellular for under-reporting revenues, as per a special audit conducted by DoT, for the assessment years starting from 2006 to 2008. Based on the report Reliance Communication has to pay a penalty of Rs 5.5 bn, while Tata Communication & Tata Teleservices and Vodafone will have to pay Rs 3.93 bn and Rs 2.45 bn respectively. Bharti Airtel and Idea Cellular will have to shell out Rs 2.92 bn and Rs 1.13 bn as penalty.

- **DoT to terminate six Idea Cellular licenses; may impose fresh Rs 300 crore penalty**

The Telecom Ministry is likely to terminate the licenses of Idea Cellular in six circles and impose an additional Rs 300 crore penalty on the company for violating roll-out obligations. The Department of Telecom will soon send notice to Idea Cellular asking them to stop their services in six service areas in Karnataka, Punjab, Maharashtra, Haryana, Andhra Pradesh and Delhi.

- **3G roaming agreement**

In a major setback to Bharti Airtel, Vodafone and Idea Cellular, the DoT has ordered them to immediately stop 3G services in telecom circles where they do not have spectrum. The three operators have roaming pacts and offer pan-India 3G mobile services without having spectrum in several circles. DoT says that the 3G roaming deals are in violation of the terms and conditions of the license. According to DoT an operator can be fined Rs 500 mn per circle for violation of license conditions.

Our take

The recent DoT's notice to mobile operators declaring 3G roaming agreements between private operators as 'illegal' came as a shocker for the industry. DoT further asked telecom operators to stop their 3G roaming pact with immediate effect. Although the issue is pending with the Telecom Disputes Settlement and Appellate Tribunal (TDSAT) that would hear the case on 9th January, we believe that the damage is already done. We do not expect any favorable verdict from TDSAT and the matter may perhaps go to the Supreme Court.

None of the operators had bid for pan India 3G license while only Reliance Industries owned Infotel Broadband have pan India BWA spectrum. Thus it is imperative for the operator to enter into roaming arrangement with others for service launch in circles where they do not have 3G licenses. ***It was well known even before the 3G auction that the major operators may not go for bidding for the entire 22 circles; rather they would selectively bid for circles to consolidate their leadership in their 2G markets. The operators had taken specific clarification from the DoT that roaming policy is applicable on a license basis and has nothing to do with the spectrum band.***

Pretty obvious, why would a Bharti Airtel or Idea Cellular or any other operator bid for select few circles and risk losing their 2G subscribers to competition in the circles where they do not have 3G, if they know that the 3G roaming arrangement is not possible. Thus we do not see any err on the part of operators in this case and we believe that the DoT is being unfair. The DoT says that the operators have entered into agreement with each other to offer 3G services in the name of inter-circle roaming, thereby avoiding any spectrum usage charge or license fee to the government. **We believe that if the outcome of the TDSAT order support 3G roaming ban, the major beneficiary would be Reliance Industry's Infotel Broadband as it is the only player who has a Pan India 4G license. On the other hand in case of Gol the 3G ban is expected to pave the way for another round of 3G spectrum auction.**

In another disappointing development, which is expected to delay the NTP further the department of telecom (DoT) has sought the law ministry's opinion on implementing policy decisions related to pricing of airwaves. This will delay the unveiling of the new telecom policy to H2CY12 or perhaps even beyond.

Huge regulatory overhang continues to remain for the sector and we are really concerned about it right now. The sooner the 3G roaming arrangement issue is sorted, the better it is for the Industry. We will wait for two more quarters to examine operational performance of the companies under our coverage before reviewing our call on the sector; maintain our 'Buy' rating on both Bharti Airtel and Idea Cellular. We maintain our revenue and earning forecast for both Bharti Airtel and Idea Cellular.

Comparative valuation

Company	Year End	CMP	Rating	Total Revenue (bn Rs.)		Net Profit (bn Rs.)		EPS (Rs.)		EPS Growth	Sales Growth	EBIDTA Margin	ROE	ROCE	P/E (x)		EV/EBITDA (x)		P/BV (x)		
				FY12E	FY13E	FY12E	FY13E	FY12E	FY13E	(13/12E)	(13/12E)	%	%	%	%	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E
Bharti Airtel	Mar	332	Buy	698.58	792.95	50.14	88.06	13.2	23.2	75.6	13.5	34.1	9.8	6.3	25.1	14.3	7.7	6.3	2.3	2.0	
Idea Cellular	Mar	82	Buy	190.85	242.17	7.67	16.53	2.3	5.0	115.6	26.9	26.7	6.0	5.9	35.3	16.4	8.0	5.4	2.1	1.7	
Rcom	Mar	72	NR	211.63	233.65	9.38	12.61	4.4	6.1	38.3	10.4	32.2	2.5	1.5	16.4	11.8	7.3	6.4	0.4	0.4	

*NR (Not Rated)

Source: Company, FQ Research, Bloomberg

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More than 10% return

HOLD

Between 5-10% return

SELL

Less than 5% return