



India Equities Telecom Infrastructure

Initiating Coverage

GTL Infra

BUY

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CMP	Rs 42.35
Target Price	Rs 65.00
Sensex	15572.18
Nifty	4627.80

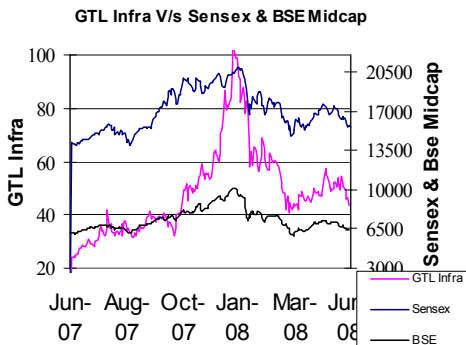
Stock Details

BSE Code	532775
NSE Code	GTLINFRA
Reuters Code	NA
Bloomberg Code	NA
Market Cap (Rs Crs)	3114
Beta (BSE mid-cap)	0.93
52 W High / Low (Rs)	106 / 16.45
Avg Daily Volume	20,35,525
Face Value (Rs)	10

Shareholding Pattern (%)

Promoters	49.1
MF/Banks/Indian FIs	10.7
FII / NRIs / OCBs	29.1
Indian Public	11.1

Price Chart



Investment Rationale

Pioneer in the shared infrastructure scene

High demand for towers

With the number of telecom towers set to double to more than 350,000 by FY10, GTL Infra (GIL) looks capable of exploiting its location planning and execution expertise to take advantage of the aggressive rollout plans of operators, both incumbent and new. We have assumed that occupancy ratio of its towers will reach 2.0 by FY15, which we believe is conservative enough to cover for any threat to GTLI from telco-backed tower alliances. We expect rentals to decline in the long term, but renting towers will still be increasingly attractive vis-à-vis owning them, assuring demand for GIL's towers. The stock price of GIL, carries an attractive upside of 54%, based on our Valuation-based target price of Rs 65.

Plans aggressive rollout of towers

GIL is looking to expand its number of towers from 6,010 at the end of FY08 to 23,700 at the end of FY11. It has entered into master service agreement with six national level and one regional level telecom operators. These are long term contracts of 10-15 year with built-in escalation of 2.5-3% on an annual basis.

Average tenancy to go up

GIL's average tower tenancy at the end of FY08 was 0.98, which it feels should improve significantly with faster rollout of operations by existing telecom companies and potential new entrants. Wimax and 3G will provide further opportunity for GIL. It is striving to reach a tenancy of 2-2.5 in the next 2-3 years. End of FY08, GIL's average tenancy was 0.98 and with respect to only occupied towers it was 1.3.

We estimate that India had 210,000 telecom towers at the end of March 2007 and expect the number to rise to 375,000 by March 2010. While the tower industry is likely to be dominated by Indus Towers and Reliance Infratel, we estimate that GIL's contribution, less than 10% of this incremental demand, would be absorbed easily, as GIL uses its RF planning expertise to complement telcos' rollouts.

Rising subscriber additions fuelling demand for telecom towers

At the current monthly rate of over eight million subscribers, wireless subscription is expected to easily increase to more than 450 million by FY10. With an average of approximately 1400 subscribers/GSM Base Transmitter Station (BTS) and 900 subscribers/CDMA BTS, there is demand for more than 4.5 lakh BTS. This, coupled with potential new entrants, would require towers in excess of three lakh, representing a CAGR of 64% over the next two years. We feel GIL is well placed to leverage this opportunity by rolling out towers aggressively pan-India in FY09 and FY10.



Demand for 3 lakh towers is expected by of 2010 with a subscriber base of 500 million

Tower sharing expected to reduce opex and capex and maintain profitability as operators fight for market share in rural India

Focus on the In-Building solutions (IBS)

In the coming years, almost 70% of mobile voice calls and a similar portion of mobile data usage in India are expected to originate inside the buildings. However, users are experiencing poor connectivity inside the buildings. We see this as a major opportunity and are likely to wire atleast 700 major buildings in metros by deploying In-Building solutions (IBS).

New licensees to boost demand for shared infrastructure

The entry of new Operators will create an opportunity for us in the metros. The implementation of TRAI's (Telecom Regulatory Authority of India) recommendation on Mobile Number Portability (MNP) will force the existing Operators to focus more on improving quality of network and providing better connectivity to their existing customer base. This will add to the demand for Telecom Infrastructure in metros. Given the massive growth in the Telecom market, the operators are likely to outsource their Network Operating Center (NOC), Data Centers and Call Centers to focus on their core business. GIL can focus on leveraging this opportunity by providing Network Infrastructure on a shared basis to the Operators and Enterprises.

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Exhibit 1: Financial Summary

Particulars	FY2008	FY2009E	FY2010E	FY2011E
Net Sales (Rs cr)	124.58	413.96	831.62	1021.15
Total Income (Rs cr)	130.88	443.96	881.62	1081.15
PAT (Rs cr)	-59.48	-15.19	53.53	155.78
PAT Margin (%)	NA	NA	6%	15%
EBIDTA Margin (%)	51%	47	47	47
EPS (Rs)	-0.8	-0.22	0.76	2.26
P/E (x)	NA	NA	NA	31
P/BV (x)	2.57	2.77	2.4	2.8

Source: Company, Parsoli Research



India is the fastest growing and second largest telecom market in the world with 308 million subscribers (surpassed US in number of mobile subscribers in March 2008)

Net adds in India has accelerated to 8-9 million in recent months

Network quality concerns remain one of the primary reasons why customers switch operators and the churn remains an important cost driver for the operators.

Financials & outlook

For FY08, GIL has posted revenue of Rs1.24bn, up 149% yoy. EBIDTA grew by 94% to Rs0.6bn and margins stood at 51%. Ahead, we see GIL growing at a CAGR of 141% in revenue for the next two years, and expect average tenancy to rise from 0.98 to 1.5. But, the company is unlikely to post profits earlier than FY12. We remain upbeat on the tower portfolio business and see GIL consolidating its position further.

We expect GIL to have 11090 towers by 2009 which translates to an EV/tower of 0.46 crore. Reliance Communication recently sold 5% stake in its tower business for Rs1400cr, translating into an EV/tower of Rs0.52cr while Bharti Infratel's 10% stake sale at approximately Rs4500cr translates into an EV/tower of Rs0.5cr. We believe GIL valuations are inline with Bharti and Reliance tower business valuations. Based on our valuation methodologies we have arrived at a 24 month target price of Rs65.

Strengths

Rural India remains the key opportunity, with 3G an upside

With a rural tele-density of just over 10% and with urban markets, especially metros, reaching saturation, incumbent telcos as well as new competitors will target rural India. GIL's towers would enable operators to accelerate their rollouts without investment in tower capacity. This can be crucial, as towers can account for as much as 60% of total capex in wireless. On the other hand, we expect serious consolidation in the wireless industry over the next few years, and this would keep GIL's occupancy ratio below 2 in the long run. Migration to 3G would create demand for additional tower capacity, which will be an upside to our estimate.

Indus Towers is likely to be followed by more such telco-led alliances, which would affect GIL's business growth. Global capital market conditions may stay difficult, adversely affecting GIL's capital raising plans and rollout. Active infrastructure and spectrum-sharing are risks to demand for tower capacity. Lastly, improving range and capacity of wireless technologies such as WCDMA and LTE may enable coverage to be achieved with fewer towers in the long run.

Bidding for USO (Universal Services Obligation) tender

Under the USO tender, GIL has won 421 towers in 4 clusters mostly in Andhra Pradesh and UP and received a subsidy of Rs 8 crores. As per the USO tender the tower company shall not charge any rental from the tenant during five years of the contract. However operational expenses will be born by the tenant. The subsidy will be distributed in equal installments over a period of five years. This will help the company get guaranteed three tenants. The company is further expected to bid for more towers in Phase II of the tender process.



MOU is increasing (presently MOU is about 464 min/month) leading to an increase in capacity requirement for existing subscribers

Emergence of Data application technologies like 3G, EDGE and WiMAX will lead to uninterrupted high speed flow of data application while maintaining the voice quality services.

Industry Scenario and structure

Scenario

The Indian telecommunication industry has registered a growth of 46% over last year, to touch a subscriber base of 301mn by March 2008. Class B & C circles have contributed majorly to this growth. During the year, 5 new companies and 4 existing operators secured new licenses to offer telecom services. The first phase of roll out for the new players is likely to be in Metros and Class A Circles.

The mobile phone prices and tariffs are falling sharply, with prices for some models falling below US\$ 50. More and more players are being awarded with licenses for providing the Network Services. This has led to an increase in the number of subscribers in the rural and semi urban areas. We believe this trend is likely to continue even in future.

The industry is likely to experience the emergence of newer technologies like 3G and WiMAX. This would lead to growth in data traffic, leading to further increase in infrastructure requirements by the Operators.

The demand for Telecom Infrastructure is likely to stabilise after 2011-12. Hence the speed of rollout would be critical in order to meet the Operators' demand for infrastructure during this period. We believe that site acquisition, clearance from regulatory authorities, supply chain and logistics management will be the key challenges for the rollout of sites on Pan-India basis.

Structure

The telecom infrastructure consists of active (electronic) components such as microwave radio equipment, switches, backhaul connectivity, antennas, etc used for telecom signal processing and transmission; and passive (non-electronic) components including the tower, shelter, air-conditioning equipment, diesel electric generator, etc. Infrastructure sharing is viewed as an effective means of cutting costs and increasing coverage in unserved areas. Earlier TRAI regulations restricted active infrastructure sharing for telecom companies and allowed only passive infrastructure sharing. With passive infrastructure sharing each operator can save 15-20% on capex and 20-30% on operating expenditure as well.

The Department of Telecom's new guidelines, which permit sharing of active infrastructure among service and infrastructure providers, have given a major boost to telecom service providers. The new guidelines will not only help service providers (SPs) cut costs, but will also make consumers happy, as the savings will trickle down to them as cheaper tariffs. With the new infrastructure sharing guidelines, sharing of active infrastructure among service providers, based on mutual agreements, is permitted. Sharing of allocated spectrum, however, is not allowed as of now. Active sharing will help operators save at least 24% cost & and it will be approximately 50% and 35% in terms of capex and opex savings, respectively and will benefit the customers in terms of lower tariffs



DoT issued 121 Lols to 5 new and 4 existing Telecom players

BSNL's decision to allow only independent tower companies to partner it in its new rollouts will benefit independent tower companies

China 565 million mobile subscribers (highest globally) in total, or a 42.71% penetration rate, and adds 6 to 7 million subscribers per month

US currently has 256 mobile million subscribers (third highest), or a 84% penetration rate, and adds about 2 to 3 million subscribers every month

Exhibit 2: Indian teleocm market overview	
Parameter	Current status
Telecom subscribers (mn)-Apr 2008	308
Wireless subscribers (mn)-Apr 2008	269
Teledensity (%)	26.89
No.of circles	23
Average net adds per month	8.5
Subscriber growth rate (FY 07)	46.71
Average minutes of usage per user	464 mins/month
Average revenue per user (ARPU)	Rs.261/month
Average No. of operators per circle	6

Source: Company, TRAI

Exhibit 3: Drivers for sharing passive infrastructure	
Burgeoning subscriber base	The exponential growth of the subscriber base leading to increasing wireless traffic.
Emerging technology	High investment requirements in technologies like EDGE and 3G.
Sharply rising site rentals	Along with real-estate prices, site rentals have also seen a sharp increase. Site owners are aware of relatively large number of players desiring to rollout in urban or semi urban areas. Hence the demand for tower sites and rentals are expected to increase sharply.
Need for denser coverage due to spectrum constraints	According to the spectrum allocation criteria operators get only 10 MHz spectrum for as many as 2mn Subscribers. Hence operators need to have much denser tower locations to ensure minimum quality standards.
Regulatory and planning authorities	Installation of cell sites has become a cumbersome process as there are a number of clearances required and involves labour-intensive micro management. Passive infrastructures will speed up the process and trim time to market.
New Tower Restrictions	Both the urban planning ministries and municipal corporations are now starting to place restrictions on new tower construction on the grounds that they pose a health hazard and congest the skyline.



Project execution mainly done by GTL, GIL's parent company and a preferred deployer of sites

GTL (parent) is amongst the top five Network services players, globally

35,000 dedicated personnel deployed

GIL aim's to deploy one cell site per circle per day

Exhibit 4: Cost savings due to tower sharing	
	Rs / month
Owned tower	
Opex	20,500
Interest 9%	25,000
Depreciation 6%	17,000
Total cost per tower (A)	62,500
Rented tower	
Monthly rent (B)	*33,000
Savings	29,500
ARPU	261
Subscribers/tower (Numbers)	800
Revenue	208,800
Savings as % of revenue	14.13%

Source: Company, Parsoli research

The Indian Telecom sector, is consistently adding more than eight million monthly subscribers, is well on its way to reaching the 500-million subscriber mark by the end of the decade. To maintain the pace of this booming growth, operators need to invest towards network expansion and improved coverage in an effort to acquire newer subscribers. According to the Indian regulator, the country in order to reach its targets would need over 300,000 telecom towers, which is almost twice as many as those that exist today.

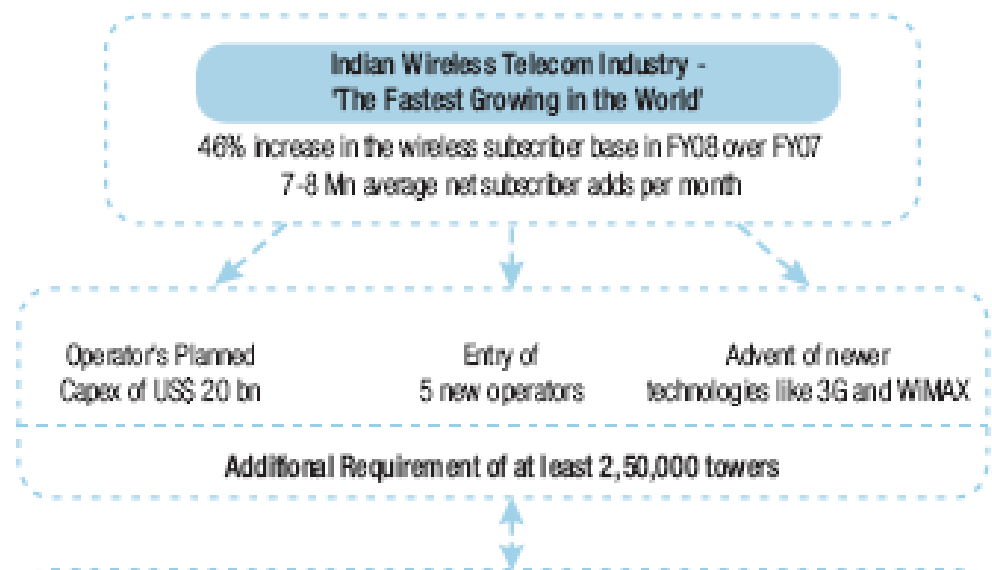
Therefore, assuming a 550mn mobile subscriber base by 2012, an average tenancy of 1.8 per telecom tower, and an average cost of \$62,500 (Rs2.5mn) per tower, sharing arrangements can help the industry save a whopping \$8.4bn (Rs33,516cr) in capital expenditures. Apart from the lower capex, the savings on operating expenses at the same levels of sharing is expected to be in the region of \$1.28bn (Rs5, 132.4cr), indicating an industry saving of \$3bn in the year 20 12. The overall success and confidence in this business model has today led to the proliferation of several independent and operator -owned tower companies.

While subscriber base is growing rapidly, ARPU decline and growing competition (a number of new licensees have lined up for spectrum) are bringing down the prospects of sustained profitability-costs have gone up while returns on investment are diminishing.

Spectrum row has settled:

In January 2008, the government allocated start-up spectrum to all prior licensees awaiting spectrum (does not include Lols issued in January 2008). These include Aircel (14 circles), Idea (2 circles), RCOM (14 circles) and Vodafone (6 circles). GSM incumbents have also been allocated spectrum in some circles and, as per our calculations, they will be eligible for additional spectrum in many more circles as they hit subscriber thresholds over the next 24 months. The start-up spectrum allocation to awaiting licensees was widely expected by the market and has now temporarily put to rest the long-drawn uncertainty over this key issue. We believe lower risk perception on regulatory front would provide better macro environment for sector outperformance.

Exhibit 5: Indian telecom industry



Source: Company

Competition**Consolidation in the tower business**

The key GSM players – Bharti, Vodafone-Essar & Idea are collaborating to form an independent tower entity called Indus Towers.

The move is aimed at consolidating their position in the emerging Indian Telecom Tower Industry. Indus Towers, with ~70,000 towers encompasses 16 circles and is likely to service ~44% of the Indian wireless subscribers base (Oct 2007) from its anchor tenants in these circles.

- The equity ownership is largely in proportion to the contribution of the number of towers by each entity
- Vodafone appears to be a key beneficiary with equal ownership with Bharti. We believe certain qualitative factors such as prospective entry into additional circles (for Idea and Vodafone), quality of towers, presence in various circles (16 for Bharti & Vodafone v/s 9 for Idea), % of overlapping towers etc could have also played a role in influencing the ownership structure. Refer page 3-5 for evaluation of anchor clients.
- Idea is likely to benefit from low capex/ opex in new roll-outs. Vodafone estimates a cost saving of USD 1bn over the next 5 yrs due to infrastructure sharing (Src: Media, www.vodafone.com).
- We expect value unlocking when Indus Towers comes up for an IPO

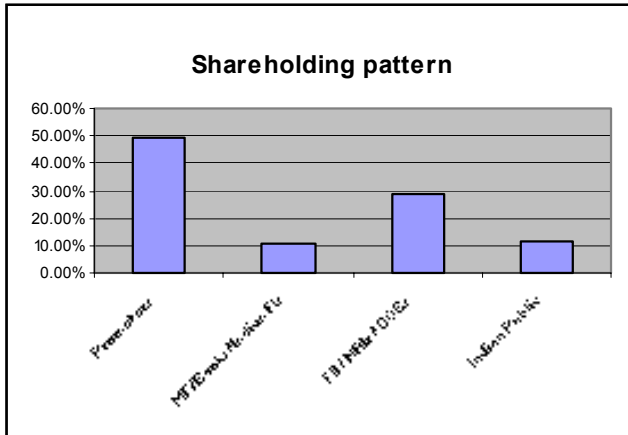
Tata Tele-Services Limited is looking forward for outsourcing its tower infrastructure as well as relying on third-party towers to expand into newer areas. TATA has already come out with a Request for Proposal (RFP) for outsourcing the management of its 4,500 existing sites to tower companies and which involve an eventual hive-off of tower infrastructure assets. TATA has also issued another Request for Proposal for rollout of 2,000 sites on a build-operate- lease basis.

Spice Telecom has been particularly active in relying on tower companies to expand its network. The Company has signed for 200 new towers with GIL on a build-operate-lease basis in Punjab and Karnataka circles.

Reliance has so far stayed away from infrastructure sharing. However, with its GSM rollout plans in various parts of India, Reliance would consider both operator-sharing as well as leasing from tower companies. Reliance already confirmed its plans to do so for its GSM India expansion as well as offering its existing GSM infrastructure to other players expanding into these 'C' circles.

Tower alliances, capital scarcity, spectrum sharing and improved technology are risks:

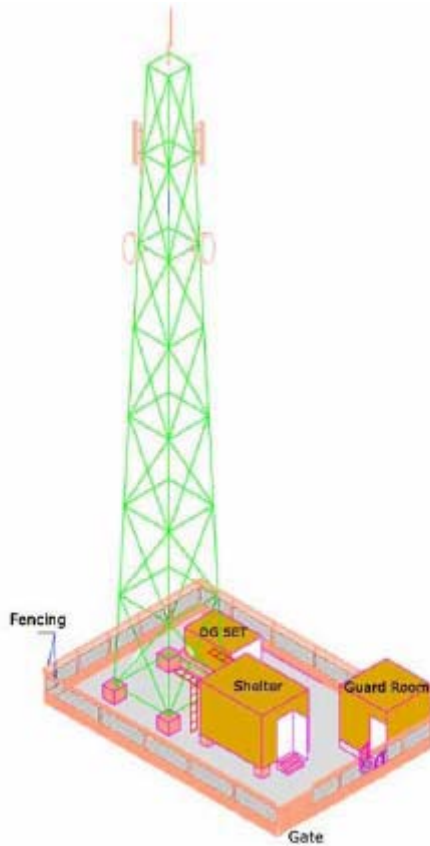
Indus Towers is likely to be followed by more such telco-led alliances, which would affect GIL's business growth. Global capital market conditions may stay difficult, adversely affecting GIL's capital raising plans and rollout. Active infrastructure and spectrum-sharing are risks to demand for tower capacity. Lastly, improving range and capacity of wireless technologies such as WCDMA and LTE may enable coverage to be achieved with fewer towers in the long run.



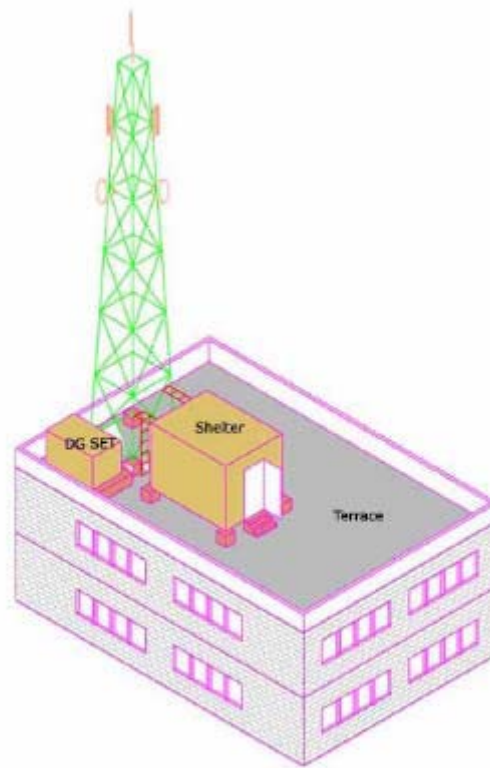
Company Background

GTL Infrastructure Ltd (GIL) is the only listed third-party tower operator in India. GIL is one of the leading player in shared infrastructure services for telecom operators in India, was formed in early 2004 by de-merging GTL's (parent company) shared infrastructure services. GTL Infrastructure Limited is in the business of providing passive telecom infrastructure on a build, own & operate (BOO) model basis to all the telecom operators and has presence in 15 circles and expected to increase to pan India in next one year. GIL covers the entire gamut of activities including the tower design, construction and maintenance of the passive telecom infrastructure.

Exhibit 5: Ground based and roof top towers



Ground Based Tower



Roof Top Tower

Source: Company

Exhibit 6: Cost Structure for a tower

	% of total	Rs lacs
Ground based tower		
Tower erection cost	60	18
Site setup cost including shelter, DG sets, cabins etc	25	7.5
Land lease, licensing, property cost & taxes etc	15	4.5
Total	100	30
Roof top tower		
Tower erection cost	65	10
Site setup cost including shelter, DG sets, cabins etc	20	3
Land lease, licensing, property cost & taxes etc	15	2
Total	100	15

Source: Company, Parsoli research

Tower companies follow two models for construction of a tower

1. Build to suite
2. Proactive basis

Build to suite

In this model the operator who is willing to rent a tower at a particular location approaches a tower company. The tower company builds the tower for the anchor tenant according to requirement and charges monthly rental from the tenant. Capex cost is born by the tower company while fuel and power cost which is variable in nature is passed on to the tenant.

The tower company then approaches other players to rent the same tower and increase occupancy. As most of the cost is fixed in nature the profitability of the tower increases and the same is passed to the anchor tenants in form of reducing rentals to the tune of 10-15%. The contracts are mostly signed for more than 15 years.

Proactive basis

This model is mostly followed by independent tower companies. The tower company identifies potential area and builds tower on proactive basis and then invites operators to install their active components. In this model the lag time is in the range of 3-5 months till an operator becomes a tenant compared to build to suite where it is less than one month.

GIL operates on both the business models and has 60% of its towers on build to suite model where as remaining are build on proactive basis. The company plans to reduce proactive component to 25-30% going forward. Tenancy in build to suite model is 1.35 compared to 0.6 for proactive model for GIL.

Key risks to demand for towers

Apart from the risk of demand waning as telcos form their own tower alliances, we see the following long-term risks for tower capacity demand:

Active sharing: We are of the opinion that before long, the regulatory authorities in India will attempt to usher in sharing of more than just passive infrastructure. This would include:

- **Active network and RAN (radio access network) sharing:**
Where an operator who has spectrum uses it by hiring network capacity of another operator, and reaches out to subscribers. This way, the first operator reduces capex significantly.
- **Spectrum sharing:** Where an operator who has more spectrum than required, invites another operator with network assets but without enough spectrum, to use the surplus spectrum. This way, the first operator can attempt to generate additional revenue from spectrum already in possession.
- **MVNOs:** With the Tata-Virgin deal, talks around an MVNO policy have gained momentum. Here, in a classical MVNO model, an aspiring operator, with neither spectrum nor network assets, simply buys capacity from another operator having an operational network, and reaches out to subscribers.

Technology risks: Wireless technologies have improved in terms of range and capacity. Lower frequencies may be allocated to wireless technologies in future.

- CDMA, which is a more recent technology than GSM, is also spectrally more efficient by a factor of 3x to 6x
- WCDMA, which is the 3G version of GSM, borrows from CDMA technology, but is currently proposed for India in the 2100MHz frequency band. But if operators are allowed to migrate, 2G subscribers to this spectrum and, over time, succeed in replacing their 900MHz GSM networks with 3G, then the superior spectral efficiency of 3G will kick in. This would mean operators need fewer towers for the same coverage and capacity

In India, as in the US and Europe, work is in progress in determining whether spectrum in the 700MHz and 450MHz bands can be made available for use by wireless operators. These have much better propagation characteristics (range) than the 1800MHz that operators are being currently allocated for GSM. Usage of these lower frequencies is likely in the long run in India, and will also result in a reduction in number of towers needed.



Capex:

We estimate that GTLI will need to spend Rs60bn over FY09-11, to reach 25,000 towers by FY11. In FY09 GIL plans to roll out 7,000 towers at a cost of around Rs.1,500 crores. GIL also derives revenue from data centres and call centres, by hiring facilities out to its parent GIL. It does not, however, plan to make any further investment in this business, as the tower-sharing opportunity is much bigger.

GIL will need significant capital over the next three years

The company has arranged the following sources of funds:

1. **Rights issue:** In September 2007, the Company has successfully concluded on 1:1 rights issue. These rights were issued at par to the shareholders. The issue was oversubscribed by 1.05 times. Through the issue, the Company raised Rs. 336.29 Crores (US\$ 83.86 Mn).
2. **Warrants:** In November 2007, the Board of Directors of the Company approved issuance of 26.37 Crores warrants on a preferential basis to Promoter Group, Industrial Development Finance Company Ltd. (IDFC) & Technology Infrastructure Ltd. Each Warrant is convertible into an equity share at Rs.40, over a period of 18 months from the date of allotment. The conversion price for the warrants was arrived to, as per the SEBI approved formula.
3. **FCCBs:** In November 2007, GIL issued zero-coupon FCCBs amounting to US\$300m. Holders of these FCCBs have an option to convert the bonds into equity shares at a price of Rs53.04 per hare before November 2012.

**Financials**

Exhibit 7	Rs Crore				
	Particulars	FY07	FY08	FY09E	FY10E
Sales	49.96	124.58	413.96	831.62	1021.15
% Growth	NA	149.36%	232.28%	100.89%	22.79%
Cost of sales and service	0.90	25.02	82.79	166.32	204.23
Employee cost	5.73	18.20	62.09	124.74	153.17
Administration and other expenses	10.90	18.20	74.51	149.69	183.81
Operating profit	32.30	62.81	194.21	390.51	479.59
Other income	10.20	6.30	30.00	50.00	60.00
PBIDT	42.50	69.11	224.21	440.51	539.59
Depreciation	33.40	82.40	225.40	386.26	408.46
PBIT	9.10	-13.29	-1.19	54.25	131.13
Interest	10.63	7.00	14.00	14.00	14.00
PBT	-1.53	-20.29	-15.19	40.25	117.13
Tax	-21.76	-39.53	0.00	13.28	38.65
PAT	-23.29	-59.81	-15.19	53.53	155.78
Equity	333.00	734.00	734.00	734.00	734.00
EPS	-0.71	-0.80	-0.22	0.76	2.26
CMP		42.35	61.00	65.00	69.00
P/E	-	-	-	-	31
P/BV	1.27	2.57	2.77	2.40	2.80
EV/EBIDTA	56.60	76.96	64.05	68.25	73.50

The company is trading at (52.93) x P/E of FY 2008 EPS of Rs. (0.80). The EPS is expected to grow in FY 10 to Rs. 2.26. In view of the strong fundamentals of the company and the future growth prospects, we feel the stock should command a P/E of at least 31X FY 10. Hence, we recommend a LONG-term price target of Rs. 69.



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