

## Bharti Airtel

STOCK INFO.	BLOOMBERG
BSE Sensex: 10,617	BHARTI IN
	REUTERS CODE
S&P CNX: 3,110	BRTL.BO

26 July 2006

**Buy**
*Previous Recommendation: Buy*
**Rs383**

	YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/	
	END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA	
Equity Shares (m)	1,884.1											
52-Week Range (Rs)	433/261											
1,6,12 Rel. Perf. (%)	0/0/-2	3/06A	116,631	22,584	12.0	48.3	31.9	7.9	29.5	21.6	6.6	17.7
M.Cap. (Rs b)	721.4	3/07E	169,324	34,599	18.3	52.6	20.9	5.7	31.7	25.5	4.7	12.1
M.Cap. (US\$ b)	15.4	3/08E	209,859	45,627	24.1	31.9	15.9	4.2	30.5	26.1	3.8	9.2

- Bharti Airtel' 1QFY07 results were better than expected, driven by strong top line growth and lower-than-expected SG&A expense. Revenues grew 13% QoQ to Rs38.56 b (Vs our expectation Rs 37.28b) and PAT grew 10.7% QoQ to Rs7.5b (Vs our expectation Rs7.4b). EBITDA margins were at 39% Vs our expectation of 37.7%
- **Mobility business revenues grew 17.4% QoQ** ahead of our expectations, driven by strong subscriber additions. Mobility margins expanded by 20bps inline with our estimates at 36.4%. We are positively surprised by ARPU, which were flat on QoQ basis from Rs442 to Rs441. Although Average revenue per minute was down marginally by 2% (10% in 4QFY06), Average MOUs grew 2.5% QoQ keeping the ARPUs flat at on QoQ basis.
- **Long Distance margins expanded 180 bp** QoQ driven by increase in traffic and reduced license fees and ADC. Enterprise business margins expanded substantially by 1,193 bps at 47.5% up from 35.6% in previous quarter.
- **Overall EBITDA margins expanded 150bp QoQ** driven by sharp margin expansion in the Enterprise business, further aided by marginal improvement in mobility operating margins. Operating margin expansion for the quarter is attributable to lower SG&A costs and flat employee costs.
- **Interest costs were up 130% QoQ to Rs1691m** (our expectations of Rs1019m), primarily due to higher forex losses during the quarter. In spite of forex loss of Rs967m during the quarter (Rs113m in 4QFY06), PAT was higher than estimate at 7.5b.
- **Raising EPS estimates:** We are raising our EPS estimates marginally by 2.8% for FY07 to Rs18.3 and by 2.2% for FY08 to Rs24.1. The stock is attractively valued at 15.9x FY08 earnings. Maintain **Buy**.

**QUARTERLY PERFORMANCE (CONSOLIDATED)**

(RS MILLION)

Y/E MARCH	FY 06				FY 07E				FY 06	FY 07E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
<b>Gross Revenue</b>	<b>25,172</b>	<b>27,090</b>	<b>30,256</b>	<b>34,113</b>	<b>38,564</b>	<b>40,691</b>	<b>43,645</b>	<b>46,424</b>	<b>116,631</b>	<b>169,324</b>
YoY Growth (%)	48.6	46.3	41.9	46.7	53.2	50.2	44.3	36.1	45.7	45.2
QoQ Growth (%)	8.2	7.6	11.7	12.7	13.0	5.5	7.3	6.4		
Access & Interconnect Charges	4,849	4,928	5,571	6,447	6,612	6,917	7,420	7,892	21,795	28,841
<b>Net Revenue</b>	<b>20,323</b>	<b>22,162</b>	<b>24,685</b>	<b>27,666</b>	<b>31,952</b>	<b>33,773</b>	<b>36,225</b>	<b>38,532</b>	<b>94,836</b>	<b>140,483</b>
Total Operating Expenses	10,916	11,951	13,486	14,884	16,930	17,873	19,260	20,425	51,237	74,488
<b>EBITDA</b>	<b>9,407</b>	<b>10,211</b>	<b>11,199</b>	<b>12,782</b>	<b>15,022</b>	<b>15,901</b>	<b>16,965</b>	<b>18,107</b>	<b>43,599</b>	<b>65,995</b>
Margin (%)	37.4	37.7	37.0	37.5	39.0	39.1	38.9	39.0	37.4	39.0
Net Finance Costs	149	845	924	733	1,691	874	934	994	2,651	<b>4,493</b>
Cash Profit from Operations	9,258	9,366	10,275	12,049	13,331	15,027	16,031	17,113	40,948	61,502
Depreciation & Amortisation	3,403	3,703	4,026	4,698	4,972	5,224	5,624	6,024	15,830	<b>21,844</b>
<b>Profit before Tax</b>	<b>5,980</b>	<b>5,795</b>	<b>6,386</b>	<b>7,413</b>	<b>8,600</b>	<b>9,853</b>	<b>10,577</b>	<b>11,199</b>	<b>25,574</b>	<b>40,230</b>
Income Tax Expense / (Income)	815	514	858	549	952	1,330	1,428	1,512	2,736	<b>5,222</b>
<b>Net Profit / (Loss)</b>	<b>5,099</b>	<b>5,209</b>	<b>5,453</b>	<b>6,823</b>	<b>7,552</b>	<b>8,404</b>	<b>9,052</b>	<b>9,591</b>	<b>22,584</b>	<b>34,599</b>
QoQ Growth (%)	11.1	2.2	4.7	25.1	10.7	11.3	7.7	5.9	50.8	

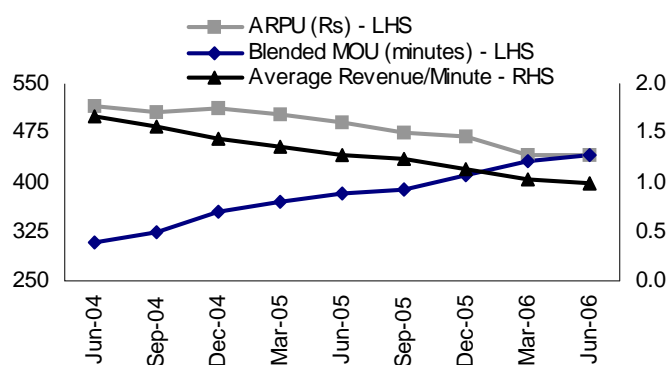
E: MOSt Estimates ; Financials as per US GAAP

### Solid subscriber growth and Flat ARPUs drive mobility revenues.

Bharti reported 17.7% QoQ growth in Mobility revenues for 1QFY07, primarily driven by record subscriber additions during the quarter. The company added 3.5m subscribers during the quarter, 18 % growth in subscriber base for the quarter. ARPUs were flat on QoQ basis from Rs 442 to Rs 441. ARPUs were flat due to improvement in minutes of usage as well as change in incoming out going ratio in favor of out going minutes. Management expects improvement in usage to continue.

Although Average revenue per minute was down marginally by 2% (down 10% in 4QFY06), average MOUs grew 2.5% QoQ keeping the ARPUs flat on QoQ basis. Management indicated that outgoing usage by lifetime scheme users is encouraging and Easy recharge continues to do well (75% share of recharges). On the verification front, the company does not expect any major hiccups and expects 'miniscule' disconnections. EBITDA margins for mobile business improved 20bp QoQ to 36.4% inline with our estimates. We believe that at lower tariffs MOUs will continue to go up due to elasticity of demand. The company expanded network coverage to 4,026 census towns and more than 100,000 towns and villages.

TRENDS IN ARPU, MOU AND REVENUE PER MINUTE



Source: Company/ Motilal Oswal Securities

### Fixed line business margin improves

Fixed line Revenues grew by 26% ahead of our expectation part of which was due to realignment of retail DSL business.

Retail DSL business which had revenues of ~ Rs750m has been realigned from Enterprise business to fixed line business. Removing the impact of transfer fixed line business grew by 8% QoQ (against our expectations of 1.9%). Although existing fixed line business margins went down marginally from 34.4% to 33.2%, total fixed line margins improved by 60 bp from 22.8% to 23.4%. Although fixed line new business loss continues to be high, improvement is expected in following quarters.

### Long distance under pressure.

The government had reduced annual license fees for the Long distance operators in November 2005 and TRAI reduced ADC charges on National and International Long distance calls with effect from March 2006. Bharti's long distance margins improved by 180bps from 37.1% to 38.9%, as 1QFY07 is the first quarter, which had full impact of regulatory cuts. Absolute EBITDA was down marginally by 1% despite 30% growth in NLD minutes and 10 % growth in ILD minutes. This seems to be result of tariff pressure and ceiling of Re0.65 on NLD carriage charges. We believe that Long Distance traffic will continue to increase at a rapid pace.

### Overall improvement in EBITDA margins likely to be sustained.

Overall EBITDA margins expanded 150bp QoQ to 39.0% (against our expectations of 37.7%), driven by margin expansion in the Mobility and Enterprise business. While mobility margins are likely to expand further, enterprise business margins of 47.5 % are unlikely to sustain at current levels. Long distance margins are likely to remain at current level of 38-39%. SG&A expenditure as a % of gross revenue declined from 17.1% to 15.8%. We expect that SG&A expenditures would continue to act as lever for improving EBITDA margins. Employee costs went down from 6.9% of gross revenues to 6.1% gross revenues. We expect consolidated margins to remain at current levels driven by mobility margins and improvement in fixed line margins.

### Revising forecasts

We are revising our forecasts upward to adjust for the stronger growth in the Mobility business and better than expected margins. We are raising our EPS estimates marginally by 2.8% for FY07 to Rs18.3 and by 2.2% for FY08 to Rs24.1.

#### REVISED FORECAST

	FY07			FY08		
	OLD	NEW	VAR	OLD	NEW	VAR
Revenues	164,558	169,324	2.9	206,367	209,859	1.7
<i>Growth %</i>	<i>41.0</i>	<i>45.0</i>		<i>25.4</i>	<i>23.9</i>	
EBITDA Margin	38.6	39.0		39.9	40.9	
Net Profit	33,622	34,599	2.9	44,382	45,627	2.8
<i>Growth (%)</i>	<i>49.0</i>	<i>53.0</i>		<i>32.0</i>	<i>31.9</i>	
EPS (Rs)	17.8	18.3	2.8	23.6	24.1	2.2
Growth (%)	48.0	52.0		32.6	31.9	

Source Motilal Oswal Securities

### Valuation and view

Bharti's 1QFY07 overall performance was ahead of our estimates, with the Mobility business reporting higher top line and consolidated operating margins, doing significantly better than our expectations. We were impressed by the company's growth in its mobility business and believe that this business will continue to gain momentum driven by strong subscriber additions. Fixed line business continues to be robust, with strong subscriber additions and expanding margins. In the long distance segment although margins are likely to be stabilize, volume growth is likely to be robust. We are raising our EPS estimates marginally by 2.8% for FY07 to Rs18.3 and by 2.2% for FY08 to Rs24.1. The stock is attractively available at a PER of 20.9x FY07 EPS and 15.9x FY08 EPS. Reiterate **Buy**.

## Bharti Airtel: an investment profile

### Company description

Bharti Airtel, promoted by Sunil Bharti Mittal, is the largest cellular services provider in India with a subscriber base of more than 23m and a market share of over 21% of the overall cellular market. It is the first cellular services provider to have introduced the lowest denomination recharge coupon for prepaid subscribers and electronic recharge. It is also the most profitable cellular services provider and is managed by a very strong team of professionals. It is the only player to have a presence in all 23 circles in India.

### Key investment arguments

- Leader in the fast growing Indian cellular market and enjoys scale advantage.
- Strong innovative management, the biggest differentiator.
- Most profitable cellular services provider.

### Key investment risks

- Declining ARPM's could lead to lower operating margins.
- Being a listed company, can not be a price leader due to focus on profitability and hence is reactive to competitor's pricing.

#### COMPARATIVE VALUATIONS

		BHARTI	INFOSYS	TCS
P/E (x)	FY07E	20.9	24.8	26.4
	FY08E	15.9	20.6	21.6
P/BV (x)	FY07E	5.7	9.1	11.9
	FY08E	4.2	6.8	8.3
EV/Sales (x)	FY07E	4.7	4.7	5.5
	FY08E	3.8	6.2	4.3
EV/EBITDA (x)	FY07E	12.1	19.2	20.2
	FY08E	9.2	15.0	16.0

#### SHAREHOLDING PATTERN (%)

	MAR.06	DEC.05	MAR.05
Promoters	45.5	45.6	46.5
Domestic Institutions	3.9	3.7	2.9
FII's/FDIs	48.1	47.9	48.0
Others	2.6	2.8	2.7

### Recent developments

- Introduced India's first Rs999 Lifetime prepaid card with a lifetime validity on 23 December 2005.
- Launched Easy Lifetime Prepaid.
- Launched Airtel Mega its Fixed wireless phone service

### Valuation and view

- Revenue CAGR of 34.1% and earnings CAGR of 42.1% over FY06-08E. Valuations at 20.9x FY07E earnings and 15.9x FY08E earnings are attractive and at a discount to some similar sized peers in other fast growing industries, like TCS and Infosys.
- **Buy** with a target price of Rs471, an upside of 25.8% from current levels.

### Sector view

- Rapid growth in mobile subscriber base enabling the cellular market to surpass that of fixed telephony.
- Industry is forecasting subscriber base would touch 200m by FY09 implying a 30% CAGR over the next 3 years. 200m subscriber target will be achieved by mid FY09 even if industry is able to maintain monthly addition of 4m subscribers per month against 5m average additions that industry has seen in 2006.
- Tariff cuts to be compensated by volume and cut in regulatory levies, resulting in decent margins and RoE.

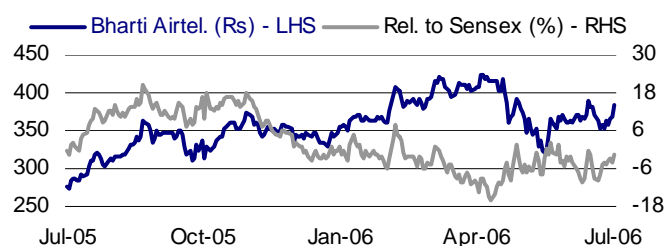
#### EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	18.3	17.6	4.0
FY08	24.1	24.7	-2.4

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
383	471	25.8	Buy

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)				
Y/E MARCH	2004	2005	2006	2007E	2008E	
<b>Revenues</b>	<b>48,320</b>	<b>80,028</b>	<b>116,631</b>	<b>169,324</b>	<b>209,859</b>	
Change (%)	64.0	65.6	45.7	45.2	23.9	
Total Expenses	32,413	49,963	73,032	103,329	124,105	
<b>EBITDA</b>	<b>15,907</b>	<b>30,065</b>	<b>43,599</b>	<b>65,995</b>	<b>85,754</b>	
% of Gross sales	32.9	37.6	37.4	39.0	40.9	
Depn. & Amortisation	7,733	11,341	15,830	21,844	26,914	
EBIT	8,174	18,724	27,769	44,152	58,840	
Net Interest	2,380	1,996	2,651	4,493	5,167	
Other Income	182	-124	456	571	640	
<b>PBT</b>	<b>5,976</b>	<b>16,604</b>	<b>25,574</b>	<b>40,230</b>	<b>54,313</b>	
Tax	901	1,528	2,736	5,222	8,147	
Rate (%)	15.1	9.2	10.7	13.0	15.0	
<b>Adjusted PAT</b>	<b>5,076</b>	<b>14,978</b>	<b>22,584</b>	<b>34,599</b>	<b>45,627</b>	
Change (%)	4.0	195.1	50.8	53.2	31.9	
<b>PAT after EO</b>	<b>5,376</b>	<b>14,978</b>	<b>22,584</b>	<b>34,599</b>	<b>45,627</b>	

BALANCE SHEET		(Rs Million)				
Y/E MARCH	2004	2005	2006	2007E	2008E	
Share Capital	18,534	18,534	18,939	18,952	18,952	
Additional Paid up Capital	48,116	47,987	56,060	56,060	56,060	
Reserves	-20,733	-5,455	16,894	51,660	97,387	
<b>Net Worth</b>	<b>45,916</b>	<b>61,065</b>	<b>91,893</b>	<b>126,672</b>	<b>172,399</b>	
Loans	45,723	49,040	47,395	68,661	69,290	
Minority Interest	0	749	951	1,360	1,899	
Other Liabilities	3,694	3,076	3,704	5,556	5,834	
Deferred Tax Liability	1,127	1,183	1,945	1,945	1,945	
<b>Capital Employed</b>	<b>96,460</b>	<b>115,114</b>	<b>145,888</b>	<b>204,194</b>	<b>251,368</b>	
Gross Block	120,455	163,634	228,252	311,197	367,197	
Less : Depreciation	20,484	31,825	47,655	69,499	96,413	
<b>Net Block</b>	<b>99,972</b>	<b>131,879</b>	<b>180,598</b>	<b>241,898</b>	<b>270,784</b>	
Intangible Fixed assets	36,388	39,211	38,200	34,380	33,349	
Investments	158	671	692	567	1,020	
Other Non-Current Assets	1,911	2,400	3,258	3,421	5,131	
<b>Curr. Assets</b>	<b>15,138</b>	<b>24,124</b>	<b>31,002</b>	<b>44,895</b>	<b>61,496</b>	
Inventories	317	545	381	431	451	
Debtors	5,030	7,308	10,620	22,267	29,898	
Cash & Bank Balance	1,305	3,256	2,838	2,838	8,001	
Other current assets	8,486	13,015	17,163	19,358	23,147	
<b>Curr. Liab. &amp; Prov.</b>	<b>20,719</b>	<b>43,959</b>	<b>69,662</b>	<b>86,586</b>	<b>87,064</b>	
Sundry Liabilities	17,460	40,486	64,879	81,085	81,288	
Other Current Liabilities	3,259	3,473	4,783	5,500	5,775	
<b>Net Curr. Assets</b>	<b>-5,581</b>	<b>-19,835</b>	<b>-38,660</b>	<b>-41,691</b>	<b>-25,567</b>	
<b>Appl. of Funds</b>	<b>96,461</b>	<b>115,114</b>	<b>145,888</b>	<b>204,194</b>	<b>251,368</b>	

E: M OSt Estimates

RATIOS						
Y/E MARCH	2004	2005	2006	2007E	2008E	
<b>Basic (Rs)</b>						
<b>EPS</b>	<b>2.7</b>	<b>8.1</b>	<b>12.0</b>	<b>18.3</b>	<b>24.1</b>	
Cash EPS	7.1	14.2	20.3	29.8	38.3	
Book Value	24.8	32.9	48.5	66.8	91.0	
DPS	0.0	0.0	0.0	0.0	0.0	
Payout %(Incl.Div.Taxes)	0.0	0.0	0.0	0.0	0.0	
<b>Valuation (x)</b>						
P/E		47.4	31.9	20.9	15.9	
Cash P/E		27.0	18.9	12.9	10.0	
EV/EBITDA		25.2	17.7	12.1	9.2	
EV/Sales		9.5	6.6	4.7	3.8	
Price/Book Value		11.6	7.9	5.7	4.2	
Dividend Yield (%)		0.0	0.0	1.0	1.0	
<b>Profitability Ratios (%)</b>						
RoE	12.4	28.0	29.5	31.7	30.5	
RoCE	9.8	17.6	21.6	25.5	26.1	
<b>Turnover Ratios</b>						
Debtors (Days)	50	42	41	58	63	
Asset Turnover (x)	0.3	0.4	0.4	0.5	0.5	
<b>Leverage Ratio</b>						
Debt/Equity Ratio (x)	1.1	0.9	0.6	0.6	0.4	

CASH FLOW STATEMENT		(Rs Million)				
Y/E MARCH	2004	2005	2006	2007E	2008E	
Op.Profit/(Loss) bef Tax	15,907	30,065	43,599	65,995	85,754	
Other Income	182	-124	456	571	640	
Interest Paid	-2,380	-1,996	-2,651	-4,493	-5,167	
Direct Taxes Paid	-1,012	-1,472	-1,974	-5,222	-8,147	
(Inc)/Dec in Wkg. Cap.	9,488	16,731	15,712	4,734	-11,130	
<b>CF from Op.Activity</b>	<b>22,186</b>	<b>43,205</b>	<b>55,142</b>	<b>61,585</b>	<b>61,950</b>	
(inc)/Dec in FA +CWIP	-39,684	-43,248	-64,549	-83,144	-55,800	
(Pur)/Sale of Investments	1,939	-2,146	2,848	125	-1,717	
<b>CF from Inv.Activity</b>	<b>-37,745</b>	<b>-45,393</b>	<b>-61,701</b>	<b>-83,019</b>	<b>-57,517</b>	
Issue of Shares	-81	-129	8,073	0	0	
Inc/(Dec) in Debt	15,994	3,317	-1,645	21,266	629	
Other Financing Activities	346	951	-288	168	101	
<b>CF from Fin.Activity</b>	<b>16,259</b>	<b>4,139</b>	<b>6,141</b>	<b>21,434</b>	<b>730</b>	
<b>Inc/(Dec) in Cash</b>	<b>700</b>	<b>1,951</b>	<b>-418</b>	<b>0</b>	<b>5,163</b>	
Add: Opening Balance	606	1,305	3,256	2,838	2,838	
<b>Closing Balance</b>	<b>1,305</b>	<b>3,256</b>	<b>2,837</b>	<b>2,838</b>	<b>8,001</b>	

E: M OSt Estimates; All Financials as per US GAAP



For more copies or other information, contact

**Institutional:** Navin Agarwal. **Retail:** Manish Shah, Mihir Kothari

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motiloswal.com

**Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021**

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**Bharti Airtel**

- |   |     |
|---|-----|
| 1. Analyst ownership of the stock                       | No  |
| 2. Group/Directors ownership of the stock               | Yes |
| 3. Broking relationship with company covered            | No  |
| 4. Investment Banking relationship with company covered | No  |

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