Motilal Oswal

Bharti Airtel

STOCK INFO. BSE Sensex: 12,907	BLOOMBERG BHARTI IN	27 Oc	ctober 200	6								Buy
S&P CNX: 3,739	REUTERS CODE BRTI.BO	Previo	ous Recomn	nendation	n: Buy							Rs527
Equity Shares (m)	1,895.0	YEAR	NET SALES	ΡΑΤ	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
52-Week Range (F	Rs) 530/305	END	(RSM)	(RSM)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
1,6,12 Rel. Perf. (%	6/22/4	3/06A	116,631	22,584	11.9	47.4	44.2	10.9	29.5	21.6	9.0	24.0
M.Cap. (Rs b)	999.2	3/07E	184,415	38,378	20.3	69.9	26.0	7.7	34.5	27.5	5.8	14.9
M.Cap. (US\$ b)	22.1	3/08E	258,184	53,436	28.2	39.2	18.7	5.4	34.0	29.2	4.2	10.6

Bharti Airtel' 2QFY07 reported results were better than estimates, but adjusting for accounting changes results were in line with our estimates. Revenues grew 13% QoQ to Rs43.6b (v/s our estimate: Rs42.7b) and profits grew 23.7% QoQ to Rs9.34b (v/s our estimate: Rs8.77b). EBITDA margins were at 39.1% v/s our estimate of 39%.

- Mobility revenues grew 16.2% QoQ (ahead of our estimates), driven by strong subscriber additions and marginal decline in ARPUs. We are positively surprised by ARPU, which was almost flat on QoQ basis from Rs441 to Rs438. Although average revenue per minute was down marginally by 3%, average MOUs grew 2.2 % QoQ keeping the ARPUs almost flat on a QoQ basis.
- EBITDA margins for mobility business improved 50bp QoQ to 36.9% (v/s estimates of 36.6%).
- Long distance revenues grew 18.4% ahead of our expectation, due to robust volume growth, driven by access business. NLD minutes grew 26% QoQ and ILD minutes grew 17% QoQ.
- Consolidated EBITDA margins expanded 10bp QoQ to 39.1%, driven by lower access costs and lower network expenses.
- Interest costs were down 65% QoQ to Rs587m. The company incurred forex gains of Rs471m during the quarter against losses of Rs967m in 1QFY07.
- Raising EPS estimates: We are raising our EPS estimates by 7.7% for FY07 to Rs20.3 and by 9.7% for FY08 to Rs28.2. The stock is trading at P/E of 26x FY07E EPS and 18.7x FY08E EPS. We reiterate Buy with a price target of Rs620 at 22x FY08E earnings.

OLIDATED)								(R S	MILLION)
	FY0	6			FY0	7		FY06	FY07E
1Q	2 Q	3 Q	4 Q	1Q	2 Q	3QE	4QE		
25,172	27,090	30,256	34,113	38,564	43,572	48,953	53,326	116,631	184,415
48.6	46.3	41.9	46.7	53.2	60.8	61.8	56.3	45.7	58.1
8.2	7.6	11.7	12.7	13.0	13.0	12.4	8.9		
4,849	4,928	5,571	6,447	6,612	7,190	8,077	9,119	21,795	30,998
20,323	22,162	24,685	27,666	31,952	36,382	40,876	44,207	94,836	153,417
10,916	11,951	13,486	14,884	16,930	19,357	21,718	23,312	51,237	81,316
9,407	10,211	11,199	12,782	15,022	17,025	19,158	20,895	43,599	72,101
37.4	37.7	37.0	37.5	39.0	39.1	39.1	39.2	37.4	39.1
149	845	924	733	1,691	587	1,099	1,203	2,651	4,581
9,258	9,366	10,275	12,049	13,331	16,438	18,059	19,692	40,948	67,520
3,403	3,703	4,026	4,698	4,972	5,926	6,276	6,807	15,830	23,981
5,980	5,795	6,386	7,413	8,600	10,782	12,033	12,985	25,574	44,400
815	514	858	549	952	1,378	1,624	1,753	2,736	5,707
5,099	5,209	5,453	6,823	7,552	9,338	10,335	11,153	22,584	38,378
11.1	2.2	4.7	25.1	10.7	23.7	10.7	7.9		
20.3	19.2	18.0	20.0	19.6	21.4	21.1	20.9	19.4	20.8
	10 25,172 48.6 8.2 4,849 20,323 10,916 9,407 37.4 149 9,258 3,403 5,980 815 5,099 11.1	FY0 10 20 25,172 27,090 48.6 46.3 8.2 7.6 4,849 4,928 20,323 22,162 10,916 11,951 9,407 10,211 37.4 37.7 149 845 9,258 9,366 3,403 3,703 5,980 5,795 815 514 5,099 5,209 11.1 2.2	FY06 1Q 2Q 3Q 25,172 27,090 30,256 48.6 46.3 41.9 8.2 7.6 11.7 4,849 4,928 5,571 20,323 22,162 24,685 10,916 11,951 13,486 9,407 10,211 11,199 37.4 37.7 37.0 149 845 924 9,258 9,366 10,275 3,403 3,703 4,026 5,980 5,795 6,386 815 514 858 5,099 5,209 5,453 11.1 2.2 4.7	FY06 1Q 2Q 3Q 4Q 25,172 27,090 30,256 34,113 48.6 46.3 41.9 46.7 8.2 7.6 11.7 12.7 4,849 4,928 5,571 6,447 20,323 22,162 24,685 27,666 10,916 11,951 13,486 14,884 9,407 10,211 11,199 12,782 37.4 37.7 37.0 37.5 149 845 924 733 9,258 9,366 10,275 12,049 3,403 3,703 4,026 4,698 5,980 5,795 6,386 7,413 815 514 858 549 5,099 5,209 5,453 6,823 11.1 2.2 4.7 25.1	FY06 10 20 30 40 10 25,172 27,090 30,256 34,113 38,564 48.6 46.3 41.9 46.7 53.2 8.2 7.6 11.7 12.7 13.0 4,849 4,928 5,571 6,447 6,612 20,323 22,162 24,685 27,666 31,952 10,916 11,951 13,486 14,884 16,930 9,407 10,211 11,199 12,782 15,022 37.4 37.7 37.0 37.5 39.0 149 845 924 733 1,691 9,258 9,366 10,275 12,049 13,331 3,403 3,703 4,026 4,698 4,972 5,980 5,795 6,386 7,413 8,600 815 514 858 549 952 5,099 5,209 5,453 6,823 7,552 1	FY06 FY0 10 20 30 40 10 20 25,172 27,090 30,256 34,113 38,564 43,572 48.6 46.3 41.9 46.7 53.2 60.8 8.2 7.6 11.7 12.7 13.0 13.0 4,849 4,928 5,571 6,447 6,612 7,190 20,323 22,162 24,685 27,666 31,952 36,382 10,916 11,951 13,486 14,884 16,930 19,357 9,407 10,211 11,199 12,782 15,022 17,025 37.4 37.7 37.0 37.5 39.0 39.1 149 845 924 733 1,691 587 9,258 9,366 10,275 12,049 13,331 16,438 3,403 3,703 4,026 4,698 4,972 5,926 5,980 5,795 6,386 7,413 8,600<	FY06 FY07 10 20 30 40 10 20 30E 25,172 27,090 30,256 34,113 38,564 43,572 48,953 48.6 46.3 41.9 46.7 53.2 60.8 61.8 8.2 7.6 11.7 12.7 13.0 13.0 12.4 4,849 4,928 5,571 6,447 6,612 7,190 8,077 20,323 22,162 24,685 27,666 31,952 36,382 40,876 10,916 11,951 13,486 14,884 16,930 19,357 21,718 9,407 10,211 11,199 12,782 15,022 17,025 19,158 37.4 37.7 37.0 37.5 39.0 39.1 39.1 149 845 924 733 1,691 587 1,099 9,258 9,366 10,275 12,049 13,331 16,438 18,059 3	FY06 FY07 10 20 30 40 10 20 30E 49E 25,172 27,090 30,256 34,113 38,564 43,572 48,953 53,326 48.6 46.3 41.9 46.7 53.2 60.8 61.8 56.3 8.2 7.6 11.7 12.7 13.0 13.0 12.4 8.9 4,849 4,928 5,571 6,447 6,612 7,190 8,077 9,119 20,323 22,162 24,685 27,666 31,952 36,382 40,876 44,207 10,916 11,951 13,486 14,884 16,930 19,357 21,718 23,312 9,407 10,211 11,199 12,782 15,022 17,025 19,158 20,895 37.4 37.7 37.0 37.5 39.0 39.1 39.1 39.2 149 845 924 733 1,691 587 1,099	FY06 FY07 FY06 10 20 30 40 10 20 30E 49E 25,172 27,090 30,256 34,113 38,564 43,572 48,953 53,326 116,631 48.6 46.3 41.9 46.7 53.2 60.8 61.8 56.3 45.7 8.2 7.6 11.7 12.7 13.0 13.0 12.4 8.9 4,849 4,928 5,571 6,447 6,612 7,190 8,077 9,119 21,795 20,323 22,162 24,685 27,666 31,952 36,382 40,876 44,207 94,836 10,916 11,951 13,486 14,884 16,930 19,357 21,718 23,312 51,237 9,407 10,211 11,199 12,782 15,022 17,025 19,158 20,895 43,599 37.4 37.7 37.0 37.5 39.0 39.1 39.1 39.2 37.4<

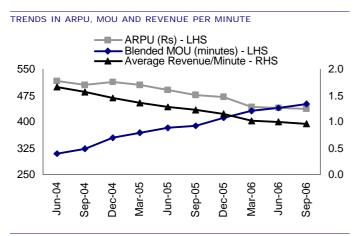
E: MOSt Estimates ; Finacials as per US GAAP

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Robust subscriber growth and flat ARPUs drive Mobility revenues

Bharti reported 16.2% QoQ growth in Mobility revenues for 2QFY07, driven primarily by record subscriber additions. The company added 3.98m subscribers during the quarter, a 17.2% growth in subscriber base for the quarter. ARPUs were flat on a QoQ basis from Rs441 to Rs438. ARPUs were flat due to improvement in minutes of usage. Although average revenue per minute was down marginally by 3%, average MOUs grew 2.2 % QoQ keeping ARPUs almost flat, QoQ. Our conversation with industry indicated increased usage in the B and C circles.

EBITDA margins for mobile business improved 50bp QoQ to 36.9% (v/s estimates of 36.6%). We believe that at lower tariffs MOUs will continue to rise due to elasticity of demand. The company expanded its network to 4,357 census towns and more than 150,000 non-census towns and villages.



Source: Company/ Motilal Oswal Securities

Adjusting for accounting changes, results are in line with our estimates

Bharti made one-time dad debt provision of Rs240m which resulted in lower fixed line margins. Fixed line business margins were at 20.4% v/s our estimate of 24%. Further, there was a reversal of revenue to the tune of Rs292m. Bharti also reclassified customer premise equipment (boosted 2QFY07 profit by Rs581m) and changed its depreciation policy for assets costing less than Rs5,000. Earlier Bharti would amortise the entire amount at the time of deployment but will now change the methodology to amortise over 12 months from deployment. This also boosted 2QFY07 profits by Rs405m.

If these extraordinary items were to be normalized, adjusted EBITDA of Rs16.75b would be in line with our estimate of Rs16.65b. Assuming the same tax rate as applicable in 2QFY07, extraordinary items had an impact of Rs330m on profit after tax. The adjusted profit after tax of Rs9b is 2.6% higher than our estimate of Rs8.77b.

Aggressive capex surprises but management maintains US\$2b guidance

We were positively surprised by the company's aggressive capex of US\$720m (36% of full year guidance at US\$2b). Management attributed the higher capex to the accelerating momentum in wireless subscriber additions. Further, the company managed to finance aggressive capex largely from working capital reduction and operating cash flows. Debt went up marginally by Rs628m. Net debt/EBITDA improved to 0.8x as of 2QFY07 versus 0.86x as of 1QFY07. Interest costs were down 65% QoQ to Rs587m. The company incurred forex gains of Rs471m during the quarter against losses of Rs967m in 1QFY07.

Robust performance by Long Distance and Enterprise business

Long Distance revenues grew by 18.4% QoQ against our expectation of 2% growth, due to robust volume growth driven by the access business. NLD minutes grew 26% QoQ and ILD minutes grew 17% QoQ. Enterprise business revenues also grew by 9.1% QoQ v/s our estimate of 5%. Bharti is also ramping up its NLD backbone. We think Bharti's Long Distance strategy is tightly woven around its wireless strategy and its expansion of NLD presence is likely to be following up of wireless coverage expansion.

Consolidated EBITDA margins likely to sustain

Overall EBITDA margins expanded 10bp QoQ to 39.1% (v/s our expectation of 39%), driven by margin expansion in the Mobility and Long Distance business. Access and interconnection expenditure, as a percentage of gross

revenue, declined to 16.5% from 17.1%. While mobility margins are likely to expand further, Long Distance margins are likely to remain at the current level of 39%-40%. Fixed line margins which were lower due to reversal of revenue and bad debts provision are likely to bounce back . We expect consolidated margins to remain at current levels driven by mobility margins and improvement in fixed line margins.

Revising forecasts on the back strong subscriber additions and lower ARPU drop

We are revising our forecasts upward to adjust for the stronger growth in the Mobility business and better-thanexpected margins. We are revising our subscriber estimates to 1.4m/month for the remainder of FY07 (1.25m earlier) and 1.3m for FY08 (1.25m earlier). We are also reducing our estimate of ARPU decline to 6% for FY07 (10% earlier) and 6% in FY08 (8% earlier). We are raising our EPS estimates by 7.7% for FY07 to Rs20.3 and by 9.7% for FY08 to Rs28.2.

Valuation and view

Bharti's 2QFY07 overall performance was ahead of our estimates, with the Mobility business reporting higher topline and wireless 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. 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 by 7.7% for FY07 to Rs20.3 and by 9.7% for FY08 to Rs28.2. The stock is trading at P/E of 26x FY07E EPS and 18.7x FY08E EPS. With strong earnings visibility and scope for positive surprises, we reiterate **Buy** with a price target of Rs620 at 22x FY08E earnings.

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 27m 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 VA	LUATIONS			
		BHARTI	INFOSYS	TCS
P/E (x)	FY07E	26.0	30.0	25.9
	FY08E	18.7	23.8	20.4
P/BV (x)	FY07E	7.7	11.2	11.8
	FY08E	5.4	8.2	8.1
EV/Sales (x)	FY07E	5.8	5.7	5.6
	FY08E	4.2	7.8	4.2
EV/EBITDA (x)	FY07E	14.9	24.2	20.7
	FY08E	10.7	18.1	15.6

SHAREHOLDING PATTERN (%)

	SEP.06	JUN.06	SEP.05
Promoter	45.4	45.4	45.7
Domestic Inst	4.0	5.0	3.2
Foreign	47.9	47.2	48.5
Others	2.7	2.4	2.6

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 48.7% and earnings CAGR of 53.8% over FY06-08E. Valuations at 26x FY07E earnings and 18.7x 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 Rs620, an upside of 17.6% from current levels.

Sector view

- Rapid growth in mobile subscriber base enabling thecellular market to surpass that of fixed telephony.
- Industry is forecasting subscriber base would touch 325m by FY10 implying a 38% CAGR over the next 4 years.
- Tariff cuts to be compensated by volume and cut in regulatory levies, resulting in decent margins and RoE.



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INCOME STATEMENT				(R:	s Million)
Y/E MARCH	2005	2006	2007E	2008E	2009E
Revenues	80,028	116,631	184,415	258,184	322,939
Change (%)	65.6	45.7	58.1	40.0	25.1
Total Expenses	49,963	73,032	112,314	156,224	192,443
EBITDA	30,065	43,599	72,101	101,960	130,496
% of Gross sales	37.6	37.4	39.1	39.5	40.4
Depn. & Amortisation	11,341	15,830	23,981	31,631	38,831
EBIT	18,724	27,769	48,120	70,329	91,665
Net Interest	1,996	2,651	4,581	5,497	5,387
Other Income	-124	456	861	500	600
PBT	16,604	25,574	44,400	65,333	86,878
Тах	1,528	2,736	5,707	11,433	17,376
Rate (%)	9.2	10.7	12.9	17.5	20.0
Adjusted PAT	14,978	22,584	38,378	53,436	68,886
Change (%)	195.1	50.8	69.9	39.2	28.9
PAT after EO	14,978	22,584	38,378	53,436	68,886

BALANCE SHEET				(R:	s Million)
Y/E MARCH	2005	2006	2007E	2008E	2009E
Sources					
Share Capital	18,534	18,939	18,952	18,952	18,952
Additional Paid up Capital	47,987	56,060	56,060	56,060	56,060
Reserves	-5,455	16,894	55,439	108,976	177,861
Net Worth	61,065	91,893	130,451	183,988	252,873
Loans	49,040	47,395	71,049	81,479	68,479
Minority Interest	749	951	1,266	1,730	2,347
Other Liabilities	3,076	3,704	5,556	5,834	6,125
Deferred Tax Liability	1,183	1,945	1,945	1,945	1,945
Capital Employed	115,114	145,888	210,267	274,975	331,769
Gross Block	163,634	228,252	319,408	409,408	489,408
Less : Depreciation	31,825	47,655	71,636	103,267	142,098
Net Block	131,879	180,598	247,972	306,141	347,310
Intangible Fixed assets	39,211	38,200	34,380	33,349	32,348
Investments	671 ⁶⁷¹	,	567	567	567
Other Non-Current Assets	2,400	3,258	3,421	5,131	6,158
Other Non-Current Assets	2,400	3,230	3,421	5, 61	0, 00
Curr. Assets	24,124	31,002	44,894	50,200	65,291
Inventories	545	381	431	451	451
Debtors	7,308	10,620	21,220	24,757	35,391
Cash & Bank Balance	3,256	2,838	3,884	3,109	4,663
Other current assets	13,015	17,163	19,358	21,883	24,787
Curr. Liab. & Prov.	43,959	69,662	86,586	87,064	87,556
Sundry Liabilities	40,486	64,879	81,085	81,288	81,491
Other Current Liabilities	3,473	4,783	5,500	5,775	6,064
Net Curr. Assets	-19,835	-38,660	-41,692	-36,863	-22,264
Appl. of Funds	115,114	145,888	210,267	274,975	331,769

Y/E MARCH	2005	2006	2007E	2008E	2009E
Basic (Rs)					
EPS	8.1	12.0	20.3	28.2	36.4
Cash EPS	14.2	20.3	32.9	44.9	56.8
Book Value	32.9	48.5	68.8	97.1	133.4
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
Valuation (x)					
P/E		44.0	26.0	18.7	14.5
Cash P/E		26.0	16.0	11.7	9.3
EV/EBITDA		24.0	14.9	10.6	8.2
EV/Sales		9.0	5.8	4.2	3.3
Price/Book Value		10.9	7.7	5.4	4.0
Dividend Yield (%)		0.0	0.0	0.0	1.0
Profitability Ratios (%)					
RoE	28.0	29.5	34.5	34.0	31
RoCE	17.6	21.6	27.5	29.2	30.4
Turnover Ratios					
Debtors (Days)	42	41	50	42	48
Asset Turnover (x)	0.4	0.4	0.5	0.5	0.9
Leverage Ratio					
Debt/Equity Ratio(x)	0.9	0.6	0.6	0.5	0.3

CASH FLOW STATEMEN	т			(R:	s Million)
Y/E MARCH	2005	2006	2007E	2008E	2009E
Op.Profit/(Loss) bef Tax	30,065	43,599	72,101	101,960	130,496
Other Income	-124	456	861	500	600
Interest Paid	-1,996	-2,651	-4,581	-5,497	-5,387
Direct Taxes Paid	-1,472	-1,974	-5,707	-11,433	-17,376
(Inc)/Dec in Wkg. Cap.	16,731	15,712	5,781	-7,037	-13,779
CF from Op.Activity	43,205	55,142	68,454	78,494	94,554
(inc)/Dec in FA +CWIP	-43,248	-64,549	-91,355	-89,800	-80,000
(Pur)/Sale of Investments	-2,146	2,848	125	0	0
CF from Inv.Activity	-45,393	-61,701	-91,230	-89,800	-80,000
Issue of Shares	-129	8,073	0	0	0
Inc/(Dec) in Debt	3,317	-1,645	23,654	10,430	-13,000
Other Financing Activities	951	-288	168	101	0
CF from Fin.Activity	4,139	6,141	23,822	10,531	-12,999
Inc/(Dec) in Cash	1,951	-418	1,046	-775	1,555
Add: Opening Balance	1,305	3,256	2,838	3,884	3,109
Closing Balance	3,256	2,837	3,884	3,109	4,664

E: MOSt Estimates; All Financials as per US GAAP

E: MOSt Estimates

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D	isclosure of Interest Statement	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	d No

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