Q2FY12 Result Update

November 14, 2011

Bharti recently reported its Q2FY12 results, which were above estimates on the operational front but the profit at net level was lower on account of higher interest cost and tax outgo. Given below are some of the key highlights, which we came across while reviewing the results.

Key highlights of Q2FY12 results:

- Bharti reported 13.4% y-o-y and 1.7% q-o-q growth in revenues at Rs.17,629.8 cr. EBITDA stood at Rs.5,815 cr which is up 13.2% over Q2FY11 and 1.9% over Q1FY12. EBITDA margin stood at 33.7%. Net profit for the quarter was Rs.1,027 cr, which was down by 15.5% q-o-q and down by 38.2% y-o-y. Net profit margin for the quarter was 5.9%.
- Bharti's African business posted strong revenues of US$1,030 mn and EBITDA of US$270 mn for Q2FY12 in the mobile services segment. EBITDA margin stood at 26.2%.
- In its dominant India & SE Asia wireless business, Bharti's EBITDA margin stood at 33.7% vs 35.2% in Q2FY11. In Q2FY12, Bharti's monthly subscriber churn increased to 7.2% versus 6.4% in Q1FY12.
- Among the non-wireless businesses, passive-infrastructure posted margin improvement but a sharp drop in enterprise and telemedia services margins dragged overall non-wireless performance.
- During the quarter, the US dollar appreciated against the Indian Rupee and several African currencies, resulting in forex restatement losses of US$52 mn (Rs.239 cr) (vs gain of US$54 mn (Rs.249 cr) in Q2FY11).

Quarterly Consolidated Financials:

(Rs. in Cr)

Particulars	Q1FY12	Q1FY11	% Chg	Q4FY11	% Chg	Remarks
Revenues	17269.8	15231.1	13.4%	16974.9	1.7%	Driven by increase in subscriber base from 143 mn in Q2FY11 to 173 mn in Q2FY12. Revenue growth has been steady across all geographies.
Other Operating Income	6.6	0.8	725.0%	7.9	-16.5%	
Total Revenues	**17276.4**	**15231.9**	13.4%	**16982.8**	1.7%	
Operating Expenses						
- Access Charges	2331.1	1883.9	23.7%	2215.8	5.2%	
- License fees, revenue share & spectrum charges	1450.7	1305.2	11.1%	1493.9	-2.9%	
- Network operating costs	3803.8	3252.7	16.9%	3730.8	2.0%	
- Employee costs	869.1	881.6	-1.4%	924.6	-6.0%	
- SG&A	3006.6	2770.7	8.5%	2911.8	3.3%	
Total Opex	11461.3	10094.1	13.5%	11276.9	1.6%	
Reported EBIDTA	**5815.1**	**5137.8**	13.2%	**5705.9**	1.9%	
EBIDTA Margins %	*33.7%*	*33.7%*		*33.6%*		EBITDA margin was flat y-o-y and q-o-q despite higher access charges, aided by lower employee costs
Net Finance cost	1118.6	331.9	237.0%	855.0	30.8%	Sharp increase in the interest and finance cost was on account of forex losses to the tune of Rs.239 cr and booking for certain upfront one-time charges
Depreciation	3183.9	2579.0	23.5%	3131.4	1.7%	
Share of profits in associates/JVs	0.0	-0.2	-100.0%	0.0	-	
PBT	1512.6	2226.7	-32.1%	1719.5	-12.0%	

PBTM %	*8.8%*	*14.6%*		*10.1%*	-13.5%	
Tax	490.0	567.8	-13.7%	514.1	-4.7%	
Effective Tax Rate %	*32.4%*	*25.5%*		*29.9%*	8.3%	Higher owing to a reduction in tax holiday benefits
PAT	1022.6	1658.9	-38.4%	1205.4	-15.2%	
Minority Interest	4.4	2.3	91.3%	9.8	-55.1%	
Net Profit	**1027.0**	**1661.2**	-38.2%	**1215.2**	-15.5%	Fell on the back of higher interest cost and tax outgo
NPM%	*5.9%*	*10.9%*		*7.2%*		
Equity	1898.4	1898.4	0.0%	1898.8	0.0%	
EPS	**2.7**	**4.4**	-38.2%	**3.2**	-15.5%	

(Source: Company, HDFC Sec)

Quarterly Financials - Segmental:

(Rs. in Cr)

Particulars	Q2FY12	Q2FY11	% Chg	Q1FY12	% Chg	Remarks
Revenues						
- Mobile Services India & South Asia	9782.7	8820.6	10.9%	9840.4	-0.6%	
- Mobile Services Africa	4703.2	3890.6	20.9%	4378.4	7.4%	Good momentum in Africa on q-o-q and y-o-y basis
- Telemedia Services	952.7	911.8	4.5%	945.8	0.7%	
- Enterprise Services	1104.1	1038.2	6.3%	1041.0	6.1%	
- DTH	313.4	169.0	85.4%	293.5	6.8%	
- Passive Infra	2376.6	2116.1	12.3%	2276.7	4.4%	
- Others	85.9	59.7	43.9%	79.1	8.6%	
Less: Inter Segment Revenues	2048.8	1774.9	15.4%	1879.9	9.0%	
Total revenues	**17269.8**	**15231.1**	13.4%	**16975.0**	1.7%	
EBIT						
- Mobile Services India & South Asia	1977.6	2120.6	-6.7%	2085.5	-5.2%	Margins under pressure helped by fall in MoU and slow growth in non mobile revenue
- Mobile Services Africa	376.8	135.3	178.5%	227.1	65.9%	Margins improved y-o-y and q-o-q
- Telemedia Services	212.4	223.9	-5.1%	222.1	-4.4%	
- Enterprise Services	105.3	148.0	-28.9%	68.2	54.4%	
- DTH	-180.6	-137.0	31.8%	-149.0	21.2%	Continues to bleed at EBIT level
- Passive Infra	352.1	288.5	22.0%	343.2	2.6%	
- Others India & South Asia	-211.9	-220.2	-3.8%	-221.5	-4.3%	
Less: Inter Segment Revenues	0.5	0.5	0.0%	0.9	-44.4%	
Total	**2631.2**	**2558.6**	2.8%	**2574.7**	2.2%	
Less: Interest	1118.6	331.9	237.0%	855.0	30.8%	
PBT	**1512.6**	**2226.7**	-32.1%	**1719.7**	-12.0%	
EBIT Margins %						
- Mobile Services India & South Asia	20.2%	24.0%		21.2%		
- Mobile Services Africa	8.0%	3.5%		5.2%		
- Telemedia Services	22.3%	24.6%		23.5%		
- Enterprise Services	9.5%	14.3%		6.6%		

- DTH	-57.6%	-81.1%		-50.8%		
- Passive Infra	14.8%	13.6%		15.1%		
- Others	-246.7%	-368.8%		-280.0%		

(Source: Company, HDFC Sec)

Some observations on Q2FY12 results:

Mobile Services - India & Asia Break up:

Particulars	Q2FY12	Q2FY11	% Chg	Q1FY12	% Chg	Remarks
Subscribers (Cr.)	17.27	14.32	20.6%	16.92	2.1%	
ARPU (Rs.)	183.0	202.0	-9.4%	190.0	-3.7%	
Total minutes (Cr.)	22,473.4	19,619.6	14.5%	22,833.1	-1.6%	
RPM	0.43	0.44	-2.7%	0.43	0.9%	
Average minutes per user (MoU)	423	454	-6.8%	445	-4.9%	
Non-mobile share (%)	14.5%	12.7%		14.6%		Data revenue declined due to cut in data rates, greater TRAI restrictions on 2G VAS and disruptions during the quarter due to shift to integrated billing in the quarter
Non Mobile Revenue (Rs.Cr.)	1,418.5	1,118.2	26.9%	1,436.7	-1.3%	
Mobile Revenue (Rs.Cr)	8,364.2	7,686.3	8.8%	8,403.7	-0.5%	
Total Revenue (Rs.Cr.)	9,782.7	8,804.5	11.1%	9,840.4	-0.6%	Sequential fall in revenues due to 2% q-o-q decline in India minutes

(Source: Company, HDFC Sec)

- Wireless revenues for Indian and South Asia operations were flat q-o-q at Rs.9782.7 cr in Q2FY12 as revenue/minute offset decline in total minutes. The impact from seasonality was significant, with MOUs down 5% and wireless margins down 50bps q-o-q. No savings were seen in subscriber acquisition costs despite a decline in subscriber additions. ARPM increased marginally to 43.2 paisa from 42.8 paisa in Q1FY12. Share of value-added services decreased marginally from 14.6% in Q1FY12 to 14.5% in Q2FY12. The management guided that data revenues will pick up in Q3FY12 as the increase in usage in Q2FY12 was mitigated by tariff reduction for 3G services. MoU for the quarter declined q-o-q from 445 to 423. Total Indian subscriber base grew by 2.1% to 172.8 mn subscribers while that for Bangladesh and Sri Lanka increased by 1.2% q-o-q to 5.8 mn. ARPU for Indian operations in Q2FY12 stood at Rs.183, down from Rs.190 in Q1FY12, reporting a decline of 4%. Airtel has about 7 mn subscribers active on 3G while about 25% use 3G on a daily basis.

- Revenues from enterprise services stood at Rs.1,104.2 cr, growth of 6.1% q-o-q. The y-o-y comparison is not meaningful as the NLD and ILD business has been transferred to mobility only in Q3FY11.

- Bharti started reporting DTH numbers separately for the first time in Q2FY12. The DTH subscriber base grew by 0.4 mn in Q2FY12 as compared to an increase of 0.6 mn in Q1FY12. The total subscriber base at the end of Q2FY12 stood at 6.6 mn. The ARPU for the quarter stood at Rs.161 as compared to Rs.158 in Q2FY11. After turning EBITDA positive in Q4FY11, Bharti has maintained the trend. The EBITDA margin for Q2FY12 stood at 3.7%. DTH Market share is estimated at ~12-13%.

- The passive infrastructure segment, including both Bharti Infratel and Indus, grew by 4.4% to Rs.2376.6 cr against Rs.2276.7 cr in Q1FY12. The EBIT margin in this segment remained more or less flat at 14.8% in Q2FY12 vs 15.1% in Q1FY12. Bharti Infratel has a portfolio of 33,056 towers with a tenancy ratio of 1.79x. Indus Towers has a portfolio of 108,998 towers with a tenancy ratio of 1.89x. Indus Towers has sharing revenue per operator per month Rs.31,112 (~16% discount compared to Bharti Infratel).

Mobile Services - Africa Break up:

Particulars	Q2FY12	Q2FY11	% Chg	Q1FY12	% Chg	Remarks
Subscribers (Cr.)	4.84	4.01	20.7%	4.63	4.5%	Healthy growth in subscriber on q-o-q and y-o-y basis
ARPU (US$)	7.3	7.4	-1.4%	7.3	0.0%	
Total minutes (Cr.)	1,795.0	1,278.2	40.4%	1,633.7	9.9%	
RPM (US Cents)	5.7	6.6	-13.6%	6.00	-5.0%	Fell due to pricing pressure
Average minutes per user (MoU)	128	112	14.3%	121	5.8%	Q-o-Q rise in MoU is encouraging and reflects market share gain

Non-mobile share (%)	8.5%	7.1%		8.4%		
Non Mobile Revenue (Rs.Cr.)	399.8	276.2	44.7%	367.8	8.7%	
Mobile Revenue (Rs.Cr)	4,304.2	3,614.4	19.1%	4,010.3	7.3%	
Total Revenue (Rs.Cr.)	4,704.0	3,890.6	20.9%	4,378.1	7.4%	Robust traffic growth (up 9.9% q-o-q) with enhanced ARPU led the performance

(Source: Company, HDFC Sec)

- Bharti reported strong revenue growth of 7.4% q-o-q driven by ~10% growth in volumes. Volume growth was largely led by 5% growth in MoU and subscriber addition of 2.1 mn during the quarter. ARPU was flat q-o-q at US$7.3/month in Q2FY12.

- EBIT margin of the Africa operation improved considerably to 8% in Q2FY12 as compared to 5.2% in Q1FY12 due to savings made in sales, general & administrative expenses and network operating expenses during the quarter. The management has indicated that this growth could continue at a steady rate. The net loss from Africa reduced to Rs.4.26 bn in Q2FY12 as compared to a net loss of Rs.5.63 bn in Q2FY11.

- Capex for Africa was higher at US$575 mn taking the total capex for H1FY12 to US$1 bn. The management has increased its capex guidance to US$1.4 bn-1.5 bn for the full year from US$1.2bn on account of strong execution and market growth.

- On the African business front, the various transition to the outsourcing model is at its completion and the benefits of the same are likely to emerge in the next few quarters. On an overall basis, the management sounded confident of the business and re-emphasised that in all the 16 countries of its operations, it has seen revenue market share gains. This makes for a positive outlook, despite the prospects of rollout costs suppressing EBITDA growth in FY12.

Other Highlights:

- The management cited heightened seasonality during Q2FY12 as the reason for a sequential decline in the traffic. In line with Idea Cellular's results, where traffic decline was seen, Bharti's traffic growth too registered a 1.6% sequential decline, the first sequential decline in the traffic on the network.

- All the other businesses showed a good growth in the revenue and EBITDA, and from this quarter onwards the company has started reporting its direct-to-home (DTH) performance. It has overall 6.3 mn subscribers with an ARPU of Rs.163 and the DTH business is profitable at the EBITDA level.

- The recent recommendations released by TRAI were in contrast with its recommendations in May 2010. The regulator has recommended liberalised M&A guidelines by increasing the cap on the market share of combined entity to 60% from 40% earlier and secondly, limit of spectrum held by the resultant combined entity be revised to 25% of spectrum assigned in the particular service area as against earlier recommended cap of 14.4MHz /10MHz for GSM/CDMA, respectively. The recommendation gives clear direction for the consolidation in the 14 player highly competitive Indian telecom market. The management views the progress in the regulatory environment as pragmatic and positive. Thus consolidation in the sector is possible and could pave the way for a conductive competitive environment.

- Bharti's net debt increased q-o-q from Rs.600 bn in Q1FY12 to Rs.644 bn, implying net debt/ annualized EBITDA of 2.7x.

- Management has revised FY12 capex to US$1.5 bn in Africa. FY12 capex guidance for India and SA remains unchanged at US$1.9-2 bn (US$1.5 bn for standalone and US$0.4 bn for the tower company). India capex has been a bit front-loaded due to accelerated 3G rollout. On a consolidated basis capex for FY12E would be US$3.5 bn.

Concerns

- Competitive pricing pressures (including from new players) to put pressure of MOUs and ARPUs.

- New rollouts to increase costs and put pressure on margins.

- Slower-than-estimated pick up in 3G services.

- Regulatory risks including refarming of spectrum.

- Rising debt levels need to be serviced out of cashflows and overall interest rates need to be brought down.
- Continued fall in value of Indian Rupee/other African currencies could result in restatement losses.
- Proposed cut in termination charges by 50% to Rs.0.1 could hurt older players like Bharti.

Conclusion & Recommendation

Bharti's Q2FY12 results were in line with street estimates except the bottomline, which were lower due to sharp rise in depreciation allowance, higher tax rate and interest cost. However, on a sequential basis, there was 1% improvement in the average realised rate that increased from 42.8 paise in Q1FY12 to 43.2 paise owing to two factors: 3G roaming pact revenues built in the minutes coupled with some impact of the hike in tariff rates announced in July 2011.

Management indicated that Bharti's operating margins could increase with higher realisation from wireless operations in India. Furthermore, higher capacity utilisation in the Africa operations is likely to drive EBITDA margin. It also indicated that selling & distribution expenses could fall going forward as commissions were overheated during the earlier phase of hyper competition. Further potential cost savings due to recent organizational restructuring could also help going forward.

Any significant tariff disruptions in India could be a key negative for the stock. Strong performance in Africa could help to turnaround the operation sooner than expected. We continue to remain positive and believe that the operating performance of Bharti going ahead could witness good growth driven by 2G tariff increase and pick up of the 3G business. Lower than expected performance on 3G & BWA launch could be a spoilsport, but the trends can only be established after 18-36 months.

Bharti has been doing well in the DTH business through introduction of new products and has a 25% share in gross subscriber additions to its credit. Bharti is ahead of its competitors in terms of number of subscribers especially in the rural market. Even though the business is positive at EBIDTA level, it has to reduce losses at the net level as soon as possible.

We are revising downwards our FY12 PAT estimates and introducing FY13 estimates. At the CMP of Rs.395.5, the stock is trading at 22.7x FY13E EPS of 17.5.

In our Q1FY12 result update dated August 11, 2011, we had stated that the stock could trade in the Rs.377 to Rs.446 band for the next quarter. Post the issue of the report, the stock touched a low of Rs.343.75 on October 10, 2011 and a high of Rs.417 on September 2, 2011.

We feel that the stock could trade in the Rs.367 to Rs.419 (21x - 24x FY13E EPS) band for the next quarter.

Financial Estimates:

Particulars (Rs in Crs)	FY09	FY10	FY11	FY12 (OE)*	FY12 (RE)*	FY13 (E)*
Operating income	36961.5	39615.0	59467.2	69251.3	69251.3	78930.0
PBIDT	15008.4	16026.8	20064.6	23406.9	23406.9	25573.3
PBIDTM (%)	40.6%	40.5%	33.7%	33.8%	33.8%	32.4%
Profit after Tax	8469.9	9302.2	5948.5	7063.6	5450.2	6630.1
PATM (%)	22.9%	23.5%	10.0%	10.2%	7.9%	8.4%
EPS	22.3	24.5	15.7	18.6	14.4	17.5
P/E (x)	17.7	16.1	25.2	21.3	27.6	22.7

* - Quick Estimates, OE - Original Estimates, RE -Revised Estimates (**Source:** Annual Report, HDFC Sec Estimates)

Analyst: Sneha Venkatraman (sneha.venkatraman@hdfcsec.com)

RETAIL RESEARCH Fax: (022) 30753435 Corporate Office
HDFC Securities Limited, I Think Techno Campus, Building - B, "Alpha", Office Floor 8, Near Kanjurmarg Station, Opp. Crompton Greaves, Kanjurmarg (East), Mumbai 400 042 Fax: (022) 30753435
Website: www.hdfcsec.com
Email: hdfcsecretailresearch@hdfcsec.com