

Pained by Zain; Rating cut

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Rating cut to Underperform on pot'l buyout of Zain-Africa

Media reports suggest that the Zain's board has accepted a US\$10.7bn bid from Bharti for Zain's African assets. Bharti has confirmed exclusive talks with Zain until Mar '25. Although deal finalisation could take some time, we have cut our rating on Bharti from Buy to U/P for 3 key reasons: 1) prima facie deal valuations seem rich, 2) growth outlook for Zain's African portfolio seems unexciting, & 3) the potential deal could materially stress Bharti's bal-sheet. Assuming debt-financing & no synergies, the potential deal could dilute Bharti's EPS by ~10-15%.

Eye-watering valuations; 40-50% premium over MTN

The potential transaction reportedly values the Zain group's African footprint at an EV/EBITDA (10E) of ~8x versus the traded value of Zain's closest competitor at ~5-6x EV/EBITDA (10E) and Bharti's pre-deal EV/EBITDA at ~7.5x Mar'11E. While some premium over MTN would likely be justified for 100% control & scale of operations, a 40-50% premium looks very rich to us.

Asset attractiveness questionable as growth is slowing

Prima facie, growth momentum in the African markets appears to be slowing with wireless population penetration already close to 40%-levels. Also note that Zain's overall RoE (~19%) & RoCE (~13%) are lower than both MTN & Bharti despite higher/similar EBITDA margins. Zain operates in 15 markets of Africa that have a population of ~450mn. Zain-Africa has ~43.8mn forecast YE2009 customers and its principal markets are Nigeria (#2; 36% of ZainAfrica's sub base), Tanzania (#1; 11%), DRC (#1; 9%), Kenya (#2; 5%) and Zambia (#1; 7%).

Bharti's balance-sheet likely to get stretched in short-term

Assuming 100% debt-financing of the Zain acquisition, we estimate Bharti's post deal net-debt/EBITDA at ~2.4x FY11E vs pre-deal levels of ~0.4x FY11E. Post-deal, Bharti's leverage would rank at the top-end of listed Indian wireless majors.

India operations remain a 10-15% growth story

For the India operations, we currently forecast earnings growth at ~10-15% over the next 2-3 years. We think any strong positive surprise on this front is unlikely as industry consolidation will likely be a slow process, if at all. At the recent ML-India conference, Bharti suggested that it will be able to keep EBITDA margins at ~40% levels over the medium term. This is largely in line with our expectations.

Revised PO at Rs290/sh

Our PO of Rs290/sh values Bharti at a standalone PE of ~11.5x Mar '11E and a post-Zain PE of ~13x CY10E & EV/EBITDA of ~6.7x. The consolidated valuation places Bharti at ~5-10% premium vs GEM wireless majors to allow for likely stronger earnings growth of Bharti-Zain (~10%) vs GEM wireless growth at ~7%.

Stock Data

Price	Rs314.50
Price Objective	Rs290.00
Date Established	15-Feb-2010
Investment Opinion	C-3-7
Volatility Risk	HIGH
BofAML Ticker / Exchange	BHTIF / BSE
Bloomberg / Reuters	BHARTI IN / BRTI.BO

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Price objective basis & risk

Bharti (BHTIF)

Our PO of Rs290/sh values Bharti at a standalone PE of 11.5x Mar '11E and a post-Zain PE of around 13x CY10E & EV/EBITDA of 6.7x. The consolidated valuation places Bharti at 5-10% premium vs GEM wireless majors to allow for likely stronger earnings growth of Bharti-Zain (10%) vs GEM wireless growth at around 7%.

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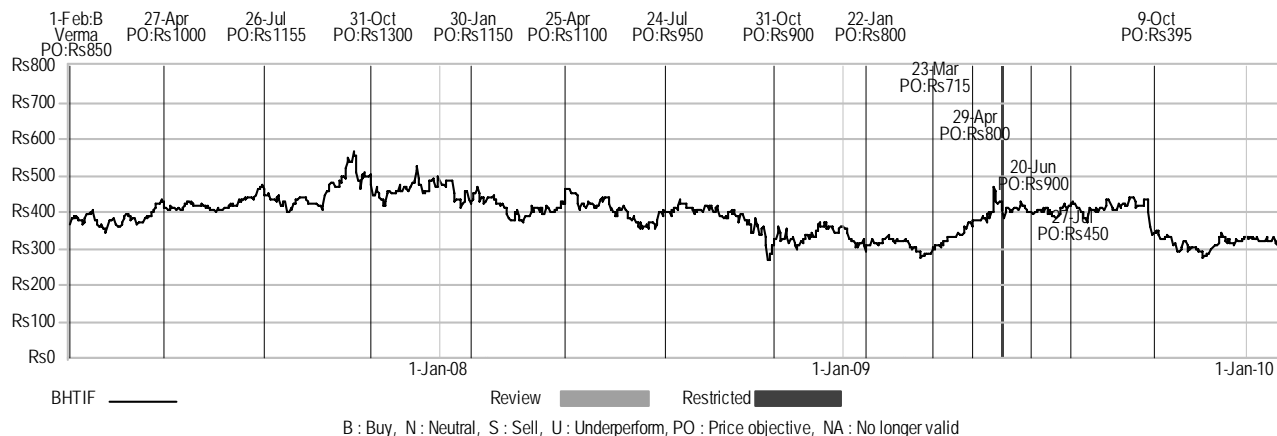
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BHTIF Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

*Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of January 31, 2010 or such later date as indicated.

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Buy	82	45.81%	Buy	42	61.76%
Neutral	56	31.28%	Neutral	33	75.00%
Sell	41	22.91%	Sell	20	58.82%

Investment Rating Distribution: Global Group (as of 01 Jan 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
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Sell	806	24.09%	Sell	368	49.80%

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