

15 February, 2010

**REDUCE**

|               |               |
|---------------|---------------|
| Price         | Target Price  |
| <b>Rs 315</b> | <b>Rs 250</b> |

|               |               |
|---------------|---------------|
| <b>Sensex</b> | <b>15,922</b> |
|---------------|---------------|

**Price Performance**

| (%)            | 1M  | 3M | 6M   | 12M  |
|----------------|-----|----|------|------|
| Absolute       | (4) | 7  | (22) | (5)  |
| Rel. to Sensex | 6   | 11 | (27) | (42) |

Source: Bloomberg

**Stock Details**

|                              |           |
|------------------------------|-----------|
| Sector                       | Telecom   |
| Reuters                      | BRTI1.BO  |
| Bloomberg                    | BHARTI@IN |
| Equity Capital (Rs mn)       | 18985     |
| Face Value (Rs)              | 10        |
| 52 Week H/L (Rs)             | 495/230   |
| Market Cap (Rs bn)           | 1,197     |
| Daily Avg Vol (No of sh)     | 8263740   |
| Daily Avg Turnover (US\$ mn) | 55.4      |

**Shareholding Pattern (%)**

|                            |      |
|----------------------------|------|
| (31 <sup>st</sup> Dec.'09) |      |
| Promoters                  | 67.8 |
| FII/NRI                    | 17.9 |
| Institutions               | 8.0  |
| Private Corp.              | 4.1  |
| Public                     | 2.2  |

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**Bharti Airtel**

Event Update

**Zain Africa – An unattractive proposition**

In yet another attempt to gain entry in African market (after MTN), Bharti Airtel has announced that it has entered into exclusive discussions till 25<sup>th</sup> March 2010, with Zain group for acquisition of Zain Africa BV for an EV of US\$10.7bn. Zain Africa has 41.9mn subscribers with operations spread across 15 countries, in which it is largest operator in 10 countries, #2 in 4 countries and #4 in 1. Zain owns controlling stake in all 15 African operations with stake ranging from 60-100% (refer table 1).

While lower penetration of <40% in Africa offers healthy scope for growth, we highlight that Zain's African operations have recorded Revenue and EBIDTA decline of 11% and 16% and net loss of US\$112mn for the period 9mCY09 v/s net profit of US\$169mn in corresponding period 9mCY08. Based on EBIDTA of US\$870mn for 9mCY09, the deal values Zain's African operations at 9.2x annualized EBIDTA of US\$1.16bn, which we believe are at 28% premium to Bharti's current valuations of 7.2x FY10 EV/EBIDTA. The declining Revenue and EBIDTA together with high capex at ~1x EBIDTA (v/s 0.5x for Bharti's India operations) and also higher valuations make the acquisition unattractive. We believe that the deal appears to be very expensive and the funding of the same would strain the balance sheet and would hence result in overhang on the stock. We continue to retain REDUCE rating on Bharti Airtel with target price Rs250.

**Zain's African performance on declining trend**

While Zain's subscriber base grew by 13% YoY, the Revenue and EBIDTA declined by 10.9% YoY and 16% YoY for the 9mCY09. Moreover Zain's African operations reported net loss of US\$112mn v/s profits of US\$169mn in corresponding period last year. While opportunity in Africa remains healthy considering penetration of <40% but already existing leadership position in most countries present, together with declining capex, makes revenue and EBIDTA growth from the African operations, challenging.

| 9mCY09 (US\$ mn) | Zain Cons | Africa  | Residual |
|------------------|-----------|---------|----------|
| Revenue          | 6,168.6   | 2,732.0 | 3,436.6  |
| EBIDTA           | 2,623.9   | 869.5   | 1,754.4  |
| EBIDTA %         | 42.54     | 31.83   | 51.05    |
| PAT              | 677.1     | (111.6) | 788.7    |

Source: Company

**Expensive valuations and weak financials remain overhang on stock**

The African operation of Zain is not only on declining revenue and profit growth but also has higher capex. Moreover very expensive valuations of 9.2x CY09 annualized EV/EBIDTA on a falling EBIDTA (v/s 7.7x of Bharti's Indian operations) implies Bharti's desperation to acquire overseas assets. The deteriorating financial performance of Zain Africa together with high valuations and concerns on funding the acquisitions would remain overhang on the stock. If the deal goes through and Bharti funds the acquisition fully by debt, Bharti's D/E would increase from our current estimate of 0.1x in FY10 to 1.4x post the deal. We continue to retain REDUCE rating on the stock with price target of Rs250.

|        | Net     | EBITDA  | ROCE | EV/    | P/BV | EPS    |      |      |      |
|--------|---------|---------|------|--------|------|--------|------|------|------|
| YE-Mar | Sales   | (Core)  | (%)  | PAT    | (%)  | EBITDA | (Rs) | (Rs) | P/E  |
| FY08   | 270,250 | 113,398 | 42.0 | 67,007 | 28.2 | 10.9   | 5.4  | 17.7 | 17.8 |
| FY09   | 369,615 | 151,458 | 41.0 | 84,699 | 26.3 | 8.3    | 3.9  | 22.3 | 14.1 |
| FY10E  | 386,683 | 158,216 | 40.9 | 84,291 | 21.0 | 7.7    | 3.1  | 22.2 | 14.1 |
| FY11E  | 370,475 | 142,812 | 38.5 | 64,964 | 14.8 | 8.3    | 2.8  | 17.1 | 18.4 |

Table 1: Zain group financial performance for period ended 9mCY09

| Countries            | Ownership        | Subs<br>( 000s) | Mkt sh | Penetration | ARPU<br>(\$) | Revenue<br>(\$ Mn) | EBIDTA<br>(\$mn) | EBIDTA<br>% | Net<br>Inc<br>(\$mn) | Rank # |
|----------------------|------------------|-----------------|--------|-------------|--------------|--------------------|------------------|-------------|----------------------|--------|
| <b>Middle East</b>   |                  |                 |        |             |              |                    |                  |             |                      |        |
| Bahrain              | 56.3%            | 693             | 51.0%  | 188%        | 26           | 191.7              | 70.1             | 36.6%       | 54.6                 | 1.0    |
| Iraq                 | 71.7%            | 10063           | 46.8%  | 71%         | 11           | 994.0              | 479.2            | 48.2%       | 197.4                | 1.0    |
| Jordan               | 56.5%            | 2625            | 45.0%  | 91%         | 14           | 346.6              | 175.2            | 50.5%       | 93.1                 | 1.0    |
| Kuwait               | 100.0%           | 1808            | 49.0%  | 128.0%      | 55.0         | 916.9              | 471.8            | 51.5%       | 390.5                | 1.0    |
| Lebanon              | Mgmt<br>contract | 1273            | 56.0%  | 53.0%       |              | 64.6               | 14.8             | 22.9%       | 12.6                 | -      |
| KSA                  | 25.0%            | 4401            | 15.0%  | 122.0%      | 19.0         | 562.3              | -261.1           | -46.4%      | -651.1               | 3.0    |
| Palestine            | 56.5%            | 1731            | 100%   | 40.0%       |              | 348.8              | 145.0            | 41.6%       | 109.6                | 1.0    |
| Sudan                | 100.0%           | 7335            | 58.0%  | 40.0%       | 13.0         | 718.4              | 405.3            | 56.4%       | 263.6                | 1.0    |
| <b>Africa</b>        |                  |                 |        |             |              |                    |                  |             |                      |        |
| Burkina Faso         | 100.0%           | 1,444.0         | 51.0%  | 23.0%       | 7.0          | 91.1               | 37.9             | 41.6%       | 13.4                 | 1.0    |
| Chad                 | 100.0%           | 1,194.0         | 70.0%  | 19.0%       | 10.0         | 101.1              | 43.7             | 43.2%       | 10.5                 | 1.0    |
| Congo<br>Brazzaville | 90.0%            | 1,415.0         | 53.0%  | 75.0%       | 12.0         | 153.8              | 42.7             | 27.8%       | 8.6                  | 1.0    |
| DRC                  | 98.5%            | 3,569.0         | 45.0%  | 14.0%       | 8.0          | 244.3              | 50.7             | 20.8%       | (19.5)               | 1.0    |
| Gabon                | 90.0%            | 870.0           | 62.0%  | 123.0%      | 25.0         | 191.7              | 79.7             | 41.6%       | 1.7                  | 1.0    |
| Ghana                | 75.0%            | 1,208.0         | 9.0%   | 61.0%       | 3.0          | 34.5               | (29.2)           | -84.5%      | (74.1)               | 4.0    |
| Kenya                | 95.0%            | 2,191.0         | 17.0%  | 48.0%       | 4.0          | 117.8              | 13.5             | 11.5%       | (28.3)               | 2.0    |
| Madagascar           | 100.0%           | 1,425.0         | 38.0%  | 23.0%       | 5.0          | 56.7               | 11.9             | 21.0%       | (18.2)               | 2.0    |
| Malawi               | 100.0%           | 1,711.0         | 72.0%  | 17.0%       | 8.0          | 111.6              | 46.9             | 42.0%       | 21.6                 | 1.0    |
| Niger                | 90.0%            | 1,432.0         | 67.0%  | 16.0%       | 10.0         | 113.3              | 53.1             | 46.9%       | 27.4                 | 1.0    |
| Nigeria              | 65.7%            | 14,936.0        | 25.0%  | 45.0%       | 7.0          | 985.9              | 331.2            | 33.6%       | (88.3)               | 2.0    |
| Sierra Leone         | 100.0%           | 555.0           | 46.0%  | 39.0%       | 7.0          | 33.4               | 2.2              | 6.6%        | (15.8)               | 1.0    |
| Tanzania             | 60.0%            | 4,764.0         | 39.0%  | 33.0%       | 5.0          | 207.1              | 79.2             | 38.2%       | 11.2                 | 1.0    |
| Uganda               | 100.0%           | 2,243.0         | 37.0%  | 35.0%       | 4.0          | 76.4               | 9.0              | 11.8%       | (3.6)                | 2.0    |
| Zambia               | 78.9%            | 2,940.0         | 70.0%  | 33.0%       | 8.0          | 213.3              | 97.0             | 45.5%       | 41.8                 | 1.0    |
| <b>Africa Total</b>  |                  | <b>41,897.0</b> |        |             |              | <b>2,732.0</b>     | <b>869.5</b>     |             | <b>(111.6)</b>       |        |

Source: Company, Emkay Research

## Zain Africa's financial performance comparison

| US\$ mn             | 9mCY08         |                |              |              |                | 9mCY09         |              |              |                |              |
|---------------------|----------------|----------------|--------------|--------------|----------------|----------------|--------------|--------------|----------------|--------------|
|                     | Revenue        | EBIDTA         | EBIDTA %     | Net profit   | Capex          | Revenue        | EBIDTA       | EBIDTA %     | Net profit     | Capex        |
| Burkina Faso        | 99.4           | 42.1           | 42.4%        | 17.5         | 33.3           | 91.1           | 37.9         | 41.6%        | 13.4           | 2.9          |
| Chad                | 92.3           | 37.2           | 40.3%        | 9.4          | 32.1           | 101.1          | 43.7         | 43.2%        | 10.5           | 35.1         |
| Congo Brazzaville   | 174.8          | 67.6           | 38.7%        | 40.2         | 63.8           | 153.8          | 42.7         | 27.8%        | 8.6            | 38.0         |
| DRC                 | 279.8          | 59.0           | 21.1%        | (30.2)       | 134.8          | 244.3          | 50.7         | 20.8%        | (19.5)         | 43.4         |
| Gabon               | 207.2          | 96.5           | 46.6%        | 36.7         | 29.4           | 191.7          | 79.7         | 41.6%        | 1.7            | 23.9         |
| Ghana               | 0.0            | 0.0            | 0.0          | 0.0          | 0.0            | 34.5           | (29.2)       | -84.5%       | (74.1)         | 74.0         |
| Kenya               | 121.2          | (9.5)          | -7.8%        | (57.2)       | 31.6           | 117.8          | 13.5         | 11.5%        | (28.3)         | 47.8         |
| Madagascar          | 61.3           | 9.9            | 16.2%        | (3.5)        | 56.5           | 56.7           | 11.9         | 21.0%        | (18.2)         | 13.2         |
| Malawi              | 93.2           | 38.1           | 40.9%        | 18.6         | 36.1           | 111.6          | 46.9         | 42.0%        | 21.6           | 43.8         |
| Niger               | 95.2           | 42.2           | 44.3%        | 24.5         | 30.4           | 113.3          | 53.1         | 46.9%        | 27.4           | 43.4         |
| Nigeria             | 1,194.0        | 399.2          | 33.4%        | 20.0         | 488.8          | 985.9          | 331.2        | 33.6%        | (88.3)         | 356.4        |
| Sierra Leone        | 37.0           | 9.7            | 26.2%        | 1.8          | 7.8            | 33.4           | 2.2          | 6.6%         | (15.8)         | 10.4         |
| Tanzania            | 242.2          | 95.3           | 39.3%        | 40.9         | 114.1          | 207.1          | 79.2         | 38.2%        | 11.2           | 39.3         |
| Uganda              | 104.6          | 18.6           | 17.8%        | (8.0)        | 56.6           | 76.4           | 9.0          | 11.8%        | (3.6)          | 21.1         |
| Zambia              | 265.7          | 128.7          | 48.4%        | 58.2         | 63.2           | 213.3          | 97.0         | 45.5%        | 41.8           | 51.6         |
| <b>Africa Total</b> | <b>3,067.9</b> | <b>1,034.6</b> | <b>33.7%</b> | <b>168.9</b> | <b>1,178.5</b> | <b>2,732.0</b> | <b>869.5</b> | <b>31.8%</b> | <b>(111.6)</b> | <b>844.3</b> |
| Change YoY %        |                |                |              |              |                | -10.9%         | -16.0%       |              | -166.1%        | -28.4%       |

Source: Company, Emkay Research

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