

Lots of work ahead



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Buyout of Zain-Africa - inked

Bharti has entered into a legally binding definitive agreement with Zain Group to acquire Zain Africa. To summarise: 1) deal valuation (EV of US\$10.7bn) appears unchanged post the due diligence process; 2) regulatory approvals will now be sought & payment to Zain will be soon after approvals; 3) Bharti seems comfortable about the way forward with minorities of Zain-Nigeria; 4) Bharti will use the "Airtel" brand" in all markets; 5) Bharti has tied-up the entire funding largely via US\$-debt; media reports suggest an all-in cost of ~195bps over LIBOR

Overseas operations - lots of work ahead

Pending guidance on key milestones for the Africa operations, we assume that the deal will turn EPS neutral for Bharti in CY12. This will require solid execution to 1) improve capital productivity of African ops that is currently much lower vs the India ops and 2) improve Africa margins despite likely lower tariffs and higher distribution + outsourcing intensity. Visibility on Bharti-Bangladesh is also low.

India operations - readying for 3G; pressure in 2G continues

On the India front, Bharti appears to be sharpening its 3G focus with 1) the launch of its own mobile applications store and 2) an exclusive tie-up for HTC smartphones. 3G spectrum auctions are slated to commence on 9th April. We expect ~US\$1.3bn outgo per operator for pan-India 3G. Meanwhile, our feedback suggests that the industry's wireless margins continue to witness pressure.

Many moving parts; valns. vulnerable to execution delays

Based on our rough-sketch estimates for Africa, we estimate that Bharti is trading at a PE of ~14.5x CY10E and an EV/EBITDA of ~7.5x CY10E. These present a 15-30% premium vs GEM wireless and can be justified only if we assume seamless execution in Africa & profit improvement in India over next 2 years.

Estimates (Mar)

(Rs)	2008A	2009A	2010E	2011E	2012E
Net Income (Adjusted - mn)	67,008	84,699	92,012	95,780	107,152
EPS	17.66	22.31	24.24	25.23	28.22
EPS Change (YoY)	57.2%	26.3%	8.6%	4.1%	11.9%
Dividend / Share	0	1.00	0	6.31	7.06
Free Cash Flow / Share	(4.56)	(5.41)	10.77	15.23	21.33

Valuation (Mar)

	2008A	2009A	2010E	2011E	2012E
P/E	17.60x	13.93x	12.83x	12.32x	11.01x
Dividend Yield	0%	0.322%	0%	2.03%	2.27%
EV / EBITDA*	11.34x	8.50x	7.93x	7.46x	6.75x
Free Cash Flow Yield*	-1.47%	-1.74%	3.46%	4.90%	6.86%

* For full definitions of *iQmethod*SM measures, see page 5.

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Stock Data

Price	Rs310.85
Price Objective	Rs290.00
Date Established	15-Feb-2010
Investment Opinion	C-3-7
Volatility Risk	HIGH
52-Week Range	Rs229.50-Rs518.00
Mrkt Val / Shares Out (mn)	US\$26,173 / 3,796.5
Average Daily Volume	9,006,879
BofAML Ticker / Exchange	BHTIF / BSE
Bloomberg / Reuters	BHARTI IN / BRTI.BO
ROE (2010E)	26.5%
Net Dbt to Eqy (Mar-2009A)	22.2%
Est. 5-Yr EPS / DPS Growth	14.0% / 50.0%
Free Float	32.9%

iQprofileSM Bharti Airtel

Key Income Statement Data (Mar)	2008A	2009A	2010E	2011E	2012E
(Rs Millions)					
Sales	270,250	369,615	395,560	436,492	479,157
Gross Profit	113,715	151,679	162,582	172,950	190,969
Sell General & Admin Expense	NA	NA	NA	NA	NA
Operating Profit	76,455	104,097	102,407	109,212	120,732
Net Interest & Other Income	82	(10,311)	5,155	1,260	691
Associates	0	0	0	0	0
Pretax Income	76,537	93,786	107,562	110,471	121,423
Tax (expense) / Benefit	(8,378)	(6,615)	(14,040)	(14,420)	(17,064)
Net Income (Adjusted)	67,008	84,699	92,012	95,780	107,152
Average Fully Diluted Shares Outstanding	3,794	3,796	3,796	3,796	3,796

Key Cash Flow Statement Data

Net Income	67,008	84,699	92,012	95,780	107,152
Depreciation & Amortization	37,260	47,582	60,175	63,738	70,237
Change in Working Capital	15,519	(18,500)	(16,167)	(1,487)	(4,028)
Deferred Taxation Charge	(36)	0	0	0	0
Other Adjustments, Net	2,373	8,361	6,804	2,912	3,153
Cash Flow from Operations	122,124	122,142	142,824	160,944	176,514
Capital Expenditure	(139,436)	(142,677)	(101,949)	(103,107)	(95,542)
(Acquisition) / Disposal of Investments	74	(20)	(9,856)	(28,475)	(21,870)
Other Cash Inflow / (Outflow)	0	0	(35,000)	0	0
Cash Flow from Investing	(139,362)	(142,697)	(146,805)	(131,582)	(117,412)
Shares Issue / (Repurchase)	21,147	(3,636)	0	0	0
Cost of Dividends Paid	0	(3,796)	0	(23,945)	(26,788)
Cash Flow from Financing	62,633	14,763	3,982	(29,361)	(59,102)
Free Cash Flow	(17,312)	(20,535)	40,875	57,837	80,972
Net Debt	42,200	69,731	73,713	68,296	35,983
Change in Net Debt	(793)	27,531	3,982	(5,416)	(32,314)

Key Balance Sheet Data

Property, Plant & Equipment	313,407	409,136	451,544	491,546	519,235
Other Non-Current Assets	45,454	50,732	90,727	118,583	138,083
Trade Receivables	15,986	18,262	19,681	21,804	23,996
Cash & Equivalents	54,863	49,070	49,070	49,070	49,070
Other Current Assets	42,933	76,747	82,156	90,657	99,519
Total Assets	472,643	603,947	693,179	771,661	829,903
Long-Term Debt	77,715	53,993	57,975	52,558	20,245
Other Non-Current Liabilities	15,195	18,120	22,906	23,746	24,622
Short-Term Debt	19,348	64,808	64,808	64,808	64,808
Other Current Liabilities	134,787	152,377	143,038	152,175	159,201
Total Liabilities	247,045	289,298	288,727	293,288	268,875
Total Equity	225,598	314,649	404,451	478,373	561,028
Total Equity & Liabilities	472,643	603,947	693,179	771,661	829,903

iQmethodSM - Bus Performance*

Return On Capital Employed	25.5%	24.8%	18.6%	17.0%	16.7%
Return On Equity	37.4%	32.2%	26.5%	22.4%	21.3%
Operating Margin	28.3%	28.2%	25.9%	25.0%	25.2%
EBITDA Margin	42.1%	41.0%	41.1%	39.6%	39.9%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	1.8x	1.4x	1.6x	1.7x	1.6x
Asset Replacement Ratio	3.7x	3.0x	1.7x	1.6x	1.4x
Tax Rate (Reported)	10.9%	7.1%	13.1%	13.1%	14.1%
Net Debt-to-Equity Ratio	18.7%	22.2%	18.2%	14.3%	6.4%
Interest Cover	24.8x	6.4x	NM	24.3x	23.8x

Key Metrics

* For full definitions of iQmethodSM measures, see page 5.

Company Description

Bharti Airtel (Formerly Bharti Televentures) is India's largest private sector provider of integrated telecom services, especially wireless. The wireless business accounts for nearly three-fourths of the company's revenues. The company is a market leader with pan-India presence.

Investment Thesis

Our underperform rating on Bharti reflects our concerns over the proposed acquisition of Zain Africa. Deal valuations seem rich and growth outlook for the African portfolio seems uncertain. Assuming 100% debt-financing and overall margin improvements, the deal could dilute Bharti's EPS by 6-14% in CY10-11. Also, we do not foresee any strong upside surprises from Bharti's India operations at least over next 2 quarters.

Stock Data

Price to Book Value 3.0x

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 around 7x. The consolidated valuation places Bharti at 0-15% premium vs GEM wireless majors and allows for likely stronger EBITDA growth of Bharti-Zain (around 10-12%) vs GEM wireless growth at around 5%. Upside risks to our PO could stem from 1) stronger than expected profit contribution from Zain Africa, 2) sooner than expected industry consolidation in India, and 3) unforeseen cost savings across Bharti's operations. Further increase of competitive intensity in India and poor execution in Africa pose downside risks.

Link to Definitions

Media & Telecom

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APR - Telecommunications Coverage Cluster

Investment rating	Company	BofAML ticker	Bloomberg symbol	Analyst
BUY				
	Advanced Info	XVDIF	ADVANC TB	Thititthep Nophaket
	Axiata Group	XLMTF	AXIATA MK	Reena Verma Bhasin, CFA
	China Telecom	CHA	CHA US	Cynthia J.H. Meng
	China Telecom-H	CHJHF	728 HK	Cynthia J.H. Meng
	China Unicom	CHUFF	762 HK	Cynthia J.H. Meng
	China Unicom - A	CHU	CHU US	Cynthia J.H. Meng
	Globe Telecom	GTMEF	GLO PM	Jidgette Velasco
	Indosat	PTITF	ISAT IJ	Chen Hsung Khoo, CFA
	Indosat - A	IIT	IIT US	Chen Hsung Khoo, CFA
	KT	KT	KT US	Sean Oh
	KT	KTCNF	030200 KS	Sean Oh
	LG Telecom	LTCLF	032640 KS	Sean Oh
	MobileOne	MBOFF	M1 SP	Chen Hsung Khoo, CFA
	Philippine Long Distance Telephone	ZHPLF	TEL PM	Edser Trinidad
	PLDT -A	PHI	PHI US	Edser Trinidad
	SingTel	SNGNF	ST SP	Reena Verma Bhasin, CFA
	Total Access	TACJF	DTAC SP	Thititthep Nophaket
	Total Access Communication	TACPF	DTAC TB	Thititthep Nophaket
	TRUE Corp	TCPJF	TRUE TB	Thititthep Nophaket
NEUTRAL				
	China Mobile	CHLKF	941 HK	Cynthia J.H. Meng
	China Mobile - A	CHL	CHL US	Cynthia J.H. Meng
	Idea Cellular	IDEAF	IDEA IN	Reena Verma Bhasin, CFA
	SK Telecom	SKM	SKM US	Sean Oh
	SK Telecom	SKMTF	017670 KS	Sean Oh
UNDERPERFORM				
	Bharti	BHTIF	BHARTI IN	Reena Verma Bhasin, CFA
	DiGi.com Bhd	DIGBF	DIGI MK	Chen Hsung Khoo, CFA
	Maxis	MXISF	MAXIS MK	Chen Hsung Khoo, CFA
	MTNL	MTE	MTE US	Reena Verma Bhasin, CFA
	MTNL	XMTNF	MTNL IN	Reena Verma Bhasin, CFA
	RCVL	RLCMF	RCOM IN	Reena Verma Bhasin, CFA
	SK Broadband	HANTF	033630 KS	Sean Oh
	StarHub	SRHBF	STH SP	Chen Hsung Khoo, CFA
	Tata Communications Limited	TCL	TCL US	Reena Verma Bhasin, CFA
	Tata Communications Limited	VLSLF	TCOM IN	Reena Verma Bhasin, CFA
	Telekom Malaysia	MYTEF	T MK	Chen Hsung Khoo, CFA
	Telkom	TLKMF	TLKM IJ	Chen Hsung Khoo, CFA
	Telkom - A	TLK	TLK US	Chen Hsung Khoo, CFA

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iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales} + \text{Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

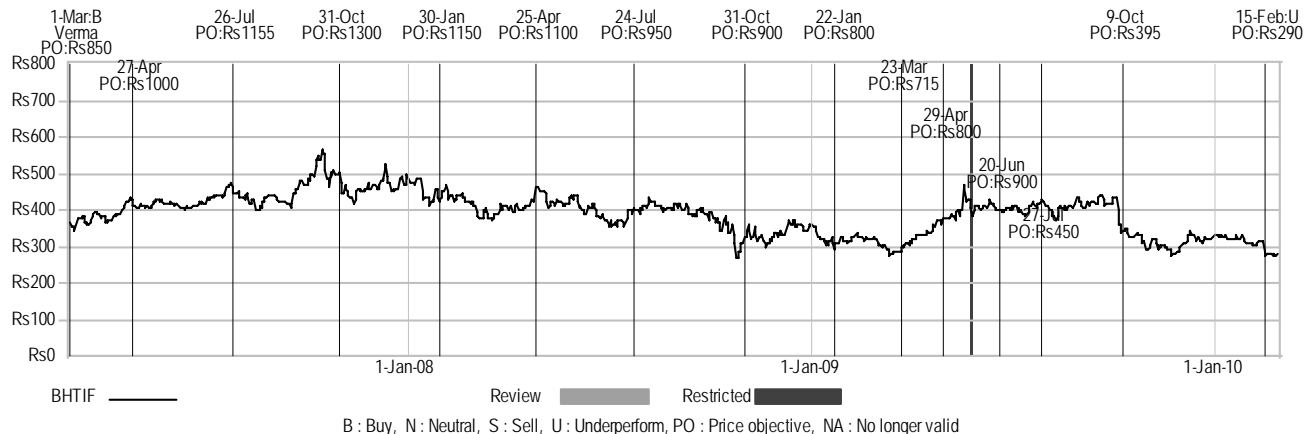
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Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	82	45.81%	Buy	42	61.76%
Neutral	56	31.28%	Neutral	33	75.00%
Sell	41	22.91%	Sell	20	58.82%

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

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1699	50.78%	Buy	904	58.82%
Neutral	841	25.13%	Neutral	491	65.03%
Sell	806	24.09%	Sell	368	49.80%

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