

Telecoms, Media & Technology
Wireless Telecoms
Equity – India

Neutral (V)

Target price (INR) 305.00
Share price (INR) 292.85
Potential total return (%) 4.1

Performance	1M	3M	12M
Absolute (%)	-30.1	-28.6	-10.4
Relative ^A (%)	-24.7	-29.6	-44.8

Index^A BOMBAY SE IDX

RIC BRTI.BO
 Bloomberg BHARTI IN

Market cap (USDm) 23,675
 Market cap (INRm) 1,111,905

Enterprise value (INRm) 1126644
 Free float (%)

Note: (V) = volatile (please see disclosure appendix)

2 November 2009

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Bharti Airtel (BHARTI IN)

N(V): Cutting TP; Bharti shifts to per-second billing

- ▶ **Bharti announced its move to per-second billing; we agree with the strategy but view the move as revenue destructive**
- ▶ **The move significantly negative for new players; limits their ability to survive in longer term and cut tariffs further**
- ▶ **Retain N(V); cutting target price to INR305 (from INR368) as we factor in the impact of per-second billing**

Bharti announced its move to offer per-second billing-based products. In our note *Bharti Airtel – Likely to shift to billing per second* (21 October 2009), we suggested that Bharti will have to move to per-second billing format to curb the dual SIM phenomenon and prevent the building of scale by new players. While we agree with the strategy, the move is revenue-destructive for the company as such we have cut our FY11 EPS estimate by 34%. We don't rule out the possibility of near-term share price weakness post this move.

Strategic implications. With this move we expect the overall sector to shift to the per-second billing format. We believe the move is significantly negative for new players such as Aircel, Tata-DoCoMo, Etisalat-India operations and Telenor-India operations as it would limit their ability to use pricing as a subscriber acquisition tool.

Valuation and ratings. We have cut our target price to INR305 (from INR368) as we factor in the move to per-second billing from 3Q FY10 onwards but retain our N(V) rating. We value the core business at INR235/share, on a mix of PE and DCF, and the tower business at INR70/share using DCF. We would view declining subscriber net additions of new entrants and the ability of Bharti to retain revenue market share leadership over the next few quarters as lead indicators of early consolidation.

Catalysts: A shift to a market-based regime for 2G spectrum. **Risks:** Downward pressure may stem from spectrum constraints which may limit Bharti's abilities to accommodate subscriber growth. We would view any cut in termination charges by the regulator as a downside risk.

Bharti: key financial data

INRm	2009	2010e	2011e
Revenue	369,615	386,035	394,154
Net profit	84,699	86,394	65,400
EPS (INR)	22.3	22.8	17.2

Source: HSBC estimates, company data

Financials & valuation

Financial statements

Year to	03/2009a	03/2010e	03/2011e	03/2012e
Profit & loss summary (INRm)				
Revenue	369,615	386,035	394,154	495,892
EBITDA	151,678	152,778	128,777	165,445
Depreciation & amortisation	-47,581	-58,991	-60,374	-67,525
Operating profit/EBIT	104,097	93,787	68,404	97,919
Net interest	-11,613	4,296	3,249	-3,914
PBT	93,073	101,643	84,026	109,737
HSBC PBT	93,073	101,643	84,026	109,737
Taxation	-6,615	-13,464	-16,485	-24,235
Net profit	84,699	86,394	65,400	83,211
HSBC net profit	84,699	86,394	65,400	83,211

Cash flow summary (INRm)

Year to	03/2009a	03/2010e	03/2011e	03/2012e
Cash flow from operations	125,393	149,690	145,550	133,733
Capex	-140,171	-89,114	-198,270	-142,076
Cash flow from investment	-140,171	-89,114	-198,270	-142,076
Dividends	-7,584	0	0	-25,052
Change in net debt	27,531	-52,185	69,910	38,450
FCF equity	-25,221	65,964	-46,912	-9,098

Balance sheet summary (INRm)

Year to	03/2009a	03/2010e	03/2011e	03/2012e
Intangible fixed assets	40,364	39,835	38,116	36,569
Tangible fixed assets	409,136	444,585	550,182	626,279
Current assets	144,079	158,384	153,706	163,349
Cash & others	49,154	85,505	80,504	80,504
Total assets	603,947	657,188	961,239	1,062,291
Operating liabilities	170,498	155,424	191,503	196,817
Gross debt	118,801	102,967	167,876	206,326
Net debt	69,646	17,462	87,372	125,822
Shareholders funds	303,945	387,108	590,083	647,306
Invested capital	373,926	401,874	469,997	548,877

Ratio, growth and per share analysis

Year to	03/2009a	03/2010e	03/2011e	03/2012e
Y-o-y % change				
Revenue	36.8	4.4	2.1	25.8
EBITDA	33.4	0.7	-15.7	28.5
Operating profit	36.2	-9.9	-27.1	43.1
PBT	21.6	9.2	-17.3	30.6
HSBC EPS	26.3	2.0	-24.3	27.2

Ratios (%)

Year to	03/2009a	03/2010e	03/2011e	03/2012e
Revenue/IC (x)	1.2	1.0	0.9	1.0
ROIC	27.3	19.9	12.8	15.5
ROE	32.2	25.0	13.4	13.4
ROA	18.6	14.1	8.9	9.3
EBITDA margin	41.0	39.6	32.7	33.4
Operating profit margin	28.2	24.3	17.4	19.7
EBITDA/net interest (x)	13.1			42.3
Net debt/equity	22.1	4.4	14.5	19.1
Net debt/EBITDA (x)	0.5	0.1	0.7	0.8
CF from operations/net debt	180.0	857.3	166.6	106.3

Per share data (INR)

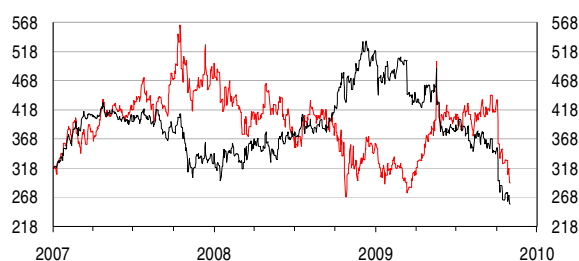
Year to	03/2009a	03/2010e	03/2011e	03/2012e
EPS reported (fully diluted)	22.34	22.78	17.25	21.94
HSBC EPS (fully diluted)	22.34	22.78	17.25	21.94
DPS	2.00	0.00	0.00	6.61
Book value	80.15	102.09	155.61	170.70

Valuation data

Year to	03/2009a	03/2010e	03/2011e	03/2012e
EV/sales	3.2	2.9	3.0	2.5
EV/EBITDA	7.8	7.4	9.3	7.5
EV/IC	3.2	2.8	2.5	2.3
PE*	13.1	12.9	17.0	13.3
P/Book value	3.7	2.9	1.9	1.7
FCF yield (%)	-2.3	5.9	-4.2	-0.8
Dividend yield (%)	0.7	0.0	0.0	2.3

Note: * = Based on HSBC EPS (fully diluted)

Price relative



Source: HSBC

Note: price at close of 31 Oct 2009

Bharti: revenue per minute is declining

Items	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09
ARPU (INR)	335	324	305	278	252
MOU	526	505	485	478	450
Voice ARPU (INR)	302	293	277	252	227
Voice RPM (INR)	0.57	0.58	0.57	0.53	0.50
Overall RPM (INR)	0.64	0.64	0.63	0.58	0.56

Source: HSBC, company data

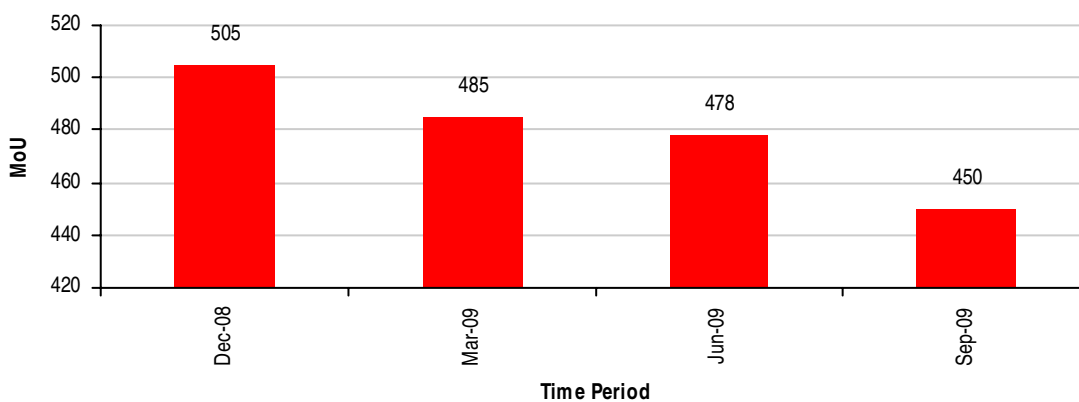
Assumptions of new entrants have now been misplaced

The aforesaid event (Bharti shifting to per second billing) is a setback for new entrants as they were of the assumption that Bharti will not shift to disruptive pricing and sacrifice revenues from existing subscriber base. We believe the move will prove to be near-term revenue-destructive as effective revenue per minute on the per-second plan is c29% lower than present revenue per minute.

However, we would like to draw investor attention to the fact that per-second billing is one of the products in the overall product portfolio and, as subscribers will have to opt for the plan, assuming 100% penetration would be a very conservative assumption. Reference can be made to the lifetime plan which, although it was rolled out way back in CY07, has yet not reached a penetration rate of 100%. We believe there will be segments of subscribers which are insensitive to the recent tariff cuts and may continue with their existing schemes.

We see multiple benefits for Bharti post the announcement of the per-second plan, which include improvements in the growth of wireless minutes, a reduction in pre-paid churn and higher gross additions. However, as the overall sector would now shift to per-second billing and the number of players remains 10, ground-level execution now holds the key. With the drop in realised rates we expect a substantial impact on wireless EBITDA margins and model FY11 wireless EBITDA margins at 22%, in comparison to the present 32%.

Bharti MoU in last 4 quarters (impacted by dual SIM, rural penetration and poor quality marginal subscribers)



Source: HSBC, company data

Valuation and risks

We value Bharti Airtel's core business using a mix of PE and discounted cash flow (DCF) methodologies, attaching equal weightings to each. For our DCF analysis, we assume a cost of equity of 12% (150bp higher than that provided by the HSBC strategy team), and a cost of debt of 10%; a target debt-to-total capital ratio of 20%; our assessment of weighted average cost of capital (WACC) is 11% and the terminal growth rate is 1%. From this, we assign a value of INR303 per share. For our PE methodology, we use a PE of c10x based on our 12-month forward earnings estimate to arrive at a fair value of the core business at INR166 per share. We arrive at a fair value of INR235 per share for the core business using a blended approach which implies a PER of 14x FY11e. This is a 15% discount to the current Sensex multiple as compared to the last 6-month average PE discount to the Sensex of 7%.

We value the Bharti tower business (Bharti Infratel and the 42% stake in the Indus Tower JV) at INR70 using DCF (assuming a sliding WACC of 11% and a terminal growth rate of 4%), implying an FY11 EV/tower at INR5m, which is a 30% discount to recent transaction multiples.

Using our blended approach, we arrive at a 12-month target price of INR305. Under our research model, for stocks with a volatility indicator, the Neutral band is 10ppt above and below our hurdle rate for Indian stocks of 10.5%, or 0.5-20.5% around the current share price. Our INR305 target price implies a potential total return of 4%, which is within the Neutral band; thus, we reiterate our Neutral (V) rating on Bharti shares.

Risks: Given rising competitive intensity in the Indian wireless space, our biggest concern among downside risks stems from the threats to declining revenue per minute that could be deeper than expected. Other risks would include spectrum constraints and any cut in termination charges by the regulator. Upside risks, in our view, include a shift to a market-based regime for 2G spectrum allocation and earlier-than-expected consolidation.

Bharti: computation of fair value for the core business

Core business	Assumptions	Value (INR)
PE methodology	We assume a 12-month forward PE of 10x	166
DCF methodology	WACC of 11%, terminal growth rate c1%	303
Fair value of core business	Providing equal weightage to both PE and DCF	235

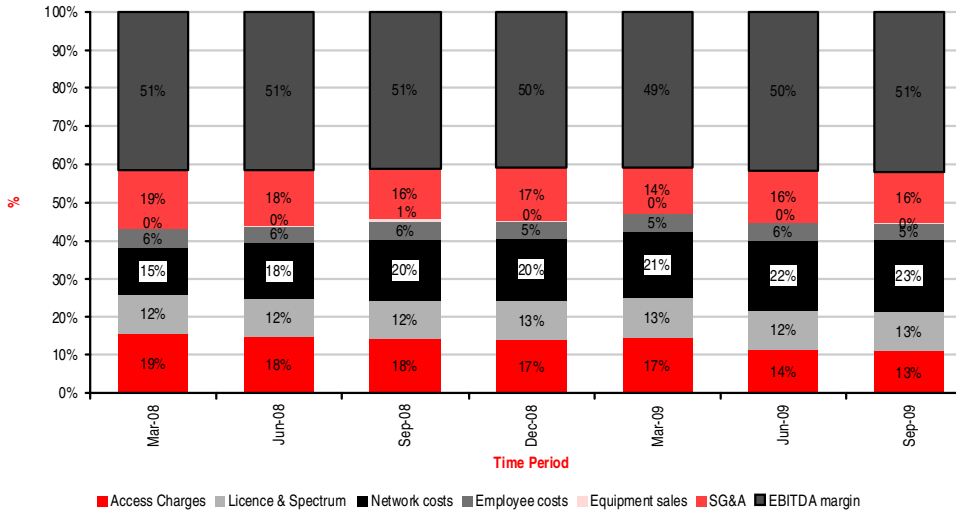
Source: HSBC estimates

Bharti: target price computation

(INR/share)	Assumptions	Value
Core business	Providing equal weightage to both PE and DCF	235
Tower business	DCF	70
Target price		305

Source: HSBC estimates

Bharti: margins improved on the back of non-wireless business



Source: HSBC, company data

Bharti: 1-year forward PE band

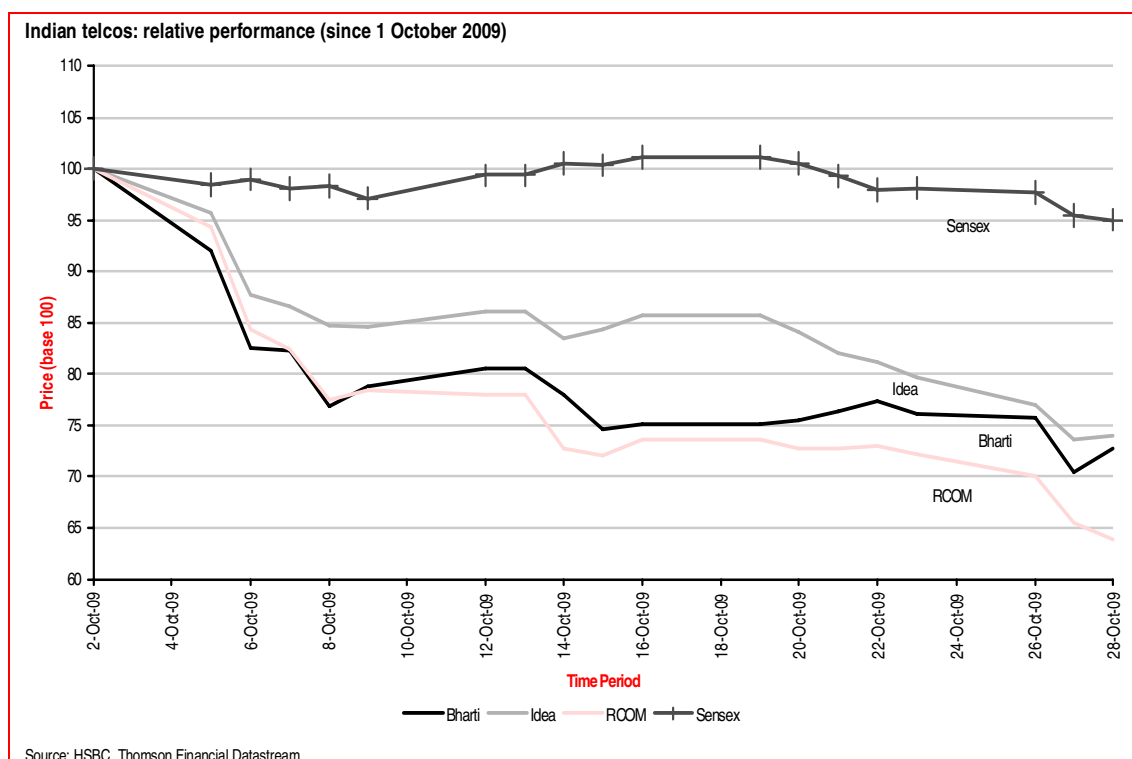


Source: HSBC, Thomson Financial Datastream

Bharti: 1-year forward EV-EBITDA band



Source: HSBC, Thomson Financial Datastream



Bharti: change in estimates

INRm	FY10e			FY11e		
	New	Old	Change	New	Old	Change
Sales	386,035	403,520	-4.3%	394,154	438,439	-10.1%
EBITDA	152,778	166,527	-8.3%	128,777	166,567	-22.7%
Net income	86,394	101,407	-14.8%	65,400	98,533	-33.6%
EPS (INR)	22.8	26.7	-14.8%	17.25	25.98	-33.6%

Source: HSBC estimates

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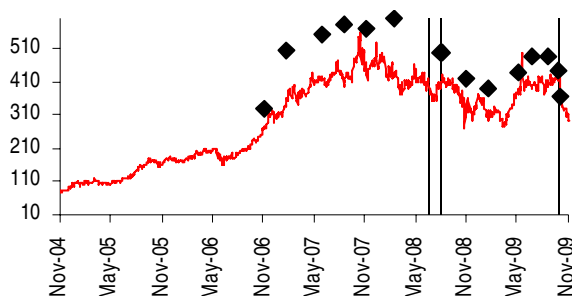
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Share price and rating changes for long-term investment opportunities

Bharti Airtel (BRTI.BO) Share Price performance INR Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Overweight	Overweight	20 June 2008
Overweight	Overweight (V)	30 July 2008
Overweight (V)	Neutral (V)	30 September 2009
Target Price	Value	Date
Price 1	330.00	02 November 2006
Price 2	505.50	24 January 2007
Price 3	555.00	04 June 2007
Price 4	585.00	21 August 2007
Price 5	570.00	07 November 2007
Price 6	603.00	17 February 2008
Price 7	501.50	30 July 2008
Price 8	501.00	04 August 2008
Price 9	421.50	03 November 2008
Price 10	393.00	21 January 2009
Price 11	438.00	04 May 2009
Price 12	488.50	22 June 2009
Price 13	488.50	18 August 2009
Price 14	448.00	30 September 2009
Price 15	368.00	07 October 2009

Source: HSBC

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Company	Ticker	Recent price	Price Date	Disclosure
BHARTI AIRTEL	BRTI.NS	292.85	31-Oct-2009	6, 7

Source: HSBC

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