

Company

13 September 2010 | 6 pages

Bharti Airtel (BRTI.BO)

Equity

Indian Safari, in Tanzania

- Africa – different countries, similar trends** — We now focus on Tanzania after looking at the Kenyan market (<https://www.citigroupgeo.com/pdf/SAP39771.pdf>). While initial feel of Zain was multi-country operations, we now sense that the business structure and trends across markets are broadly similar. High interconnect rate has resulted in 3 operators dominating the Tanzanian mkt (94% share) while also skewing traffic (on-net is 80% of MoU). Our Millicom analyst however believes that regulator is likely to bring it down (similar to neighboring countries) and this should help lower tariffs while also giving smaller telcos chance to compete. Millicom in their recent Tanzania investor day disclosed that while on-net tariffs came down by 75% in the last 30 months, off-net tariffs have remained broadly unchanged. Below are takeaways from the investor meet:
- #1: Mgmt claims rev/min unlikely to fall but reality suggests otherwise** — Millicom acknowledged a better funded competitor in Bharti though believes that Bharti's "minutes factory" model is unlikely to be a success in African countries; while rev/min is higher (US\$0.04-0.06), it comes with higher network opex (esp fuel cost) which constrains any move to cut tariffs. This is contrary to what has been recently witnessed in Kenya and Nigeria with sharp tariff cuts by Bharti and Etisalat respectively
- #2: Network coverage – calibrated and not saturated holds the key** — Management indicated Bharti's US\$800m capex guidance for the current year to be low in context to the investment required. In addition, while Bharti is likely to take 18-24 months to match network coverage of larger operators, rolling out "high rev" sites can be achieved faster (similar to what we had highlighted for Kenya) given ~70% revs come from 4-5 cities. Interesting highest sub growth has been witnessed in Dar-es-Salaam (capital) where penetration grew by 15% in last 12 months v/s 1-9% for the other areas highlighting larger operators too focus primarily on the urban markets.
- #3: Tower sharing: way forward for competing with larger operators** — The trend of tower/backhaul sharing and hiving off/tower sale has already started. We are however unlikely to see advent of large towercos like India as dominant operators (esp MTN) are unlikely to open their towers for full sharing (inherent advantage given difficulty of rolling out network). Operators lower down the order (like Bharti) are likely to take the lead in infra sharing (in contrast to India).
- African safari on an Indian elephant** — Zain has been underinvested and Bharti can potentially do much more notwithstanding competition from well entrenched operators (MTN/Millicom/Vodacom). We however believe that it is still early days; Bharti's strategy in the larger mkts (esp Nigeria) holds the key though turnaround of smaller countries would provide the swing in the earnings.

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

| | |
|------------------------------|-----------------------------|
| Hold/Low Risk | 2L |
| Price (09 Sep 10) | Rs349.55 |
| Target price | Rs350.00 |
| Expected share price return | 0.1% |
| Expected dividend yield | 0.7% |
| Expected total return | 0.8% |
| Market Cap | Rs1,327,427M US\$28,551M |

Price Performance (RIC: BRTI.BO, BB: BHARTI IN)



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Bharti Airtel

Company description

Bharti Airtel, through its group companies, provides cellular-phone services in all of India's 23 telecom circles. The group also provides fixed-line phone services, broadband, long-distance and enterprise services. It is listed on The Stock Exchange, Mumbai (BSE) and The National Stock Exchange of India Limited (NSE). Major shareholders are Bharti Telecom, SingTel and Vodafone.

Investment strategy

We rate Bharti shares Hold/Low Risk (2L). Bharti is in our view best positioned to capture Indian wireless growth profitably. However, the recently released TRAI recommendations on spectrum policy and M&A (if accepted by the DoT) have once again exposed the sector to pricing competition and pressure on the B/S from cash outgo related to one-time spectrum charges and renewals. The fragmented 3G spectrum has also increased risks of a sharp tariff cut in the as yet untouched post-paid segment (tariffs are 30% higher than pre-paid), especially with RCOM's win in Mumbai/Delhi.

Zain remains the key swing factor for Bharti's earnings. While it can potentially do much more with Zain, which has been losing ground (Africa EBITDA down 16% in 2009) due to funding constraints, our MTN analyst believes that the physical limitations of rolling-out network in Africa may pose challenges in replicating Bharti's "minutes factories" model. A full debt funding of Zain however has reduced the overhang of a potential rights issue.

Valuation

Our target price of Rs350 comprises (i) core business value of Rs359 based on Sep10 DCF. We estimate value depletion from Zain at Rs18/share. We add the Indus stake value (Rs27/share) but also reduce the potential cash outgo (Rs18) related to one-time excess spectrum charges and license renewal fees.

Risks

Our quantitative risk-rating system, which tracks 260-day share price volatility, rates Bharti shares as Low Risk. We are comfortable with this for the following reasons: 1) Bharti has a track record of profitability and execution and 2) strong FCF generation.

Downside risks include competition-led tariff pressures. Upside risk could emerge from faster than expected consolidation, sharper than expected pullback in MOUs and an earlier-than-expected turnaround of Zain. These risks could prevent the stock from achieving our target price.

Appendix A-1

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Bharti Airtel (BRTI.BO)

Ratings and Target Price History Fundamental Research

Analyst: Gaurav Malhotra, CFA
Covered since June 18 2010

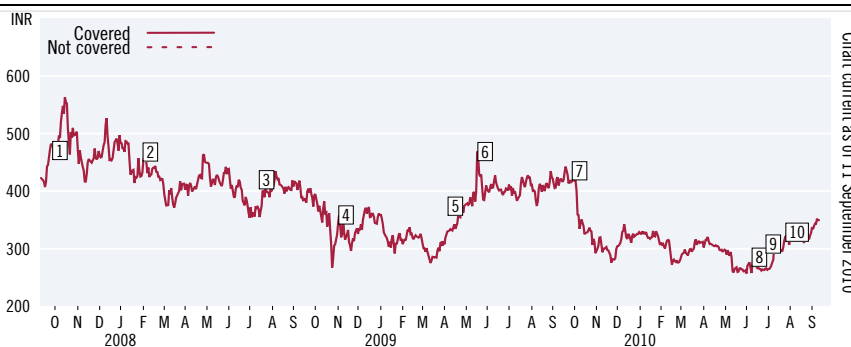


Chart current as of 11 September 2010

| | Date | Rating | Target Price | Closing Price |
|---|-----------|--------|--------------|---------------|
| 1 | 8-Oct-07 | 1L | *600.00 | 492.40 |
| 2 | 12-Feb-08 | 1L | *575.00 | 427.90 |
| 3 | 24-Jul-08 | 1L | *535.00 | 398.98 |
| 4 | 13-Nov-08 | 1L | *450.00 | 315.63 |

| | Date | Rating | Target Price | Closing Price |
|---|-----------|--------|--------------|---------------|
| 5 | 16-Apr-09 | 1L | *420.00 | 334.38 |
| 6 | 28-May-09 | 1L | *465.00 | 397.60 |
| 7 | 8-Oct-09 | *2L | *370.00 | 334.65 |
| 8 | 18-Jun-10 | 2L | *303.00 | 264.85 |

| | Date | Rating | Target Price | Closing Price |
|----|-----------|--------|--------------|---------------|
| 9 | 8-Jul-10 | 2L | *300.00 | 280.85 |
| 10 | 11-Aug-10 | 2L | *350.00 | 319.70 |

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 30 Jun 2010

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|--|-----|------|------|
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