Bharti Airtel

Apple Green

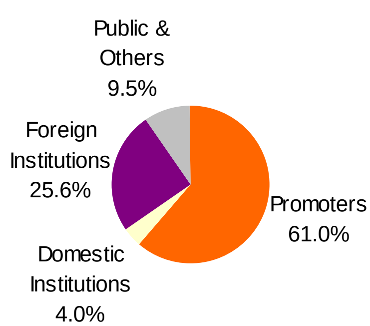
Ringing loud and clear

Buy; CMP: Rs625

Company details

Price target:	Rs780
Market cap:	Rs118,468 cr
52 week high/low:	Rs652/310
NSE volume: (No of shares)	8.8 lakh
BSE code:	532454
NSE code:	BHARTIARTL
Sharekhan code:	BHARTI
Free float: (No of shares)	74.0 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-1.5	35.6	68.4	80.1
Relative to Sensex	-0.5	22.8	29.5	27.1

Key points

- **Leading explosive growth in wireless telephony:** Bharti Airtel Ltd (BAL) has been in the forefront of the wireless telecom revolution and led the growth in this segment. Its total subscriber base has grown at a CAGR of 74.5% over FY2004-06, helping it further consolidate its leadership position in the segment. BAL is expected to continue with the growth momentum and show a 45.7% growth in its mobile subscriber base during FY2006-09E.
- **Most cost efficient player:** BAL has managed to constantly improve its overall profitability through innovative and pioneering initiatives like the outsourcing of non-core activities (eg network expansion and management, billing and customer call centre), the introduction of high-margin low-denomination coupons and the cost saving electronic re-charging system for the pre-paid customers. Consequently, it has been able to continuously improve its overall profitability despite the competition-led pricing pressures.
- **Non-voice value-added services:** Given its focus on value-added services and other non-voice revenue generating opportunities, the company has been able to report a healthy average revenue of around Rs1 per minute of usage, much higher than that of most of its peers. The contribution of the non-voice revenues has grown to 10.5% of the total mobile revenues in H1FY2007 and is expected to reach 13.5-14% by FY2009.
- **Attractive valuation:** The consolidated revenues and earnings of BAL are estimated to grow at a CAGR of 35.1% and 45.7% respectively over FY2006-09. At the current market price the scrip trades at 21.6x FY2008E earnings and 17x FY2009E earnings. We recommend buying BAL with a one-year price target of Rs780 (24x rolling four quarters forward estimated earnings).

Company background

BAL, formerly known as Bharti Tele-Ventures, is India's largest wireless telecom service provider. It is an integrated player with presence in all market segments like wireless, wireline, long distance, broadband and corporate services.

Key financials

Particulars	FY2006	FY2007E	FY2008E	FY2009E
Net profit (Rs cr)	2,257.6	3,602.8	5,487.5	6,976.5
No of shares (crore)	189.4	189.4	189.4	189.4
EPS (Rs)	11.9	19.0	29.0	36.8
(%) y-o-y change	*47.5*	*59.6*	*52.3*	*27.1*
PER (x)	52.4	32.9	21.6	17.0
Price/BV (x)	12.9	9.3	6.5	4.7
EV/EBIDTA(x)	28.4	18.4	13.2	10.6
Market cap/Sales	10.1	6.8	5.0	4.1
RoCE (%)	24.6	28.2	30.0	27.6
RoNW (%)	20.7	25.2	29.7	30.0

BAL has a nationwide footprint and is the only mobile service provider operating in all 23 telecom circles in the country.

Its businesses are structured into three individual strategic business units: mobile services, broadband & telephone services (B&T) and enterprise services. The mobile service group provides GSM mobile services in over 4,300 cities/towns across India while the B&T business group provides broadband and wireless-in-local-loop-based wireline telephone services in 94 cities. The enterprise service group has two sub-units, carriers (international and national long distance services) and customised services to corporates. All these services are provided under the *Airtel* brand name.

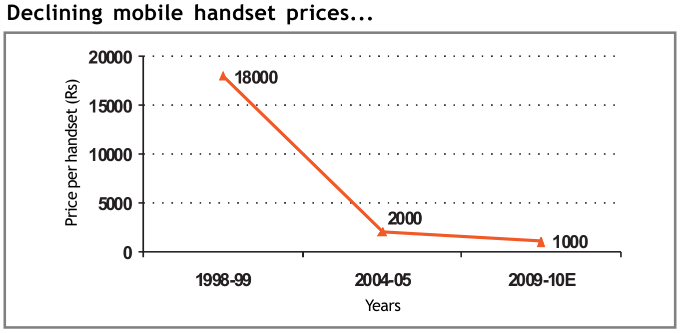
Investment arguments

Exploding subscriber base

The Indian telecom market has shown impressive and sustained high growth rates in the past. The government played its part by opening up the telecom service segment to the private sector and following it up with some growth oriented regulatory and policy changes over the years. The most significant policy changes made were the introduction of the "calling party pays" regime (that made the incoming calls free on the mobile services) as well as the more recent initiatives like the lowering of the licence fee (as a percentage of the gross revenues) and the reduction in the access deficit charges (the key to reduction in long distance call rates). The recent guidelines for allocation of additional spectrum to mobile operators is another step towards bringing in more clarity and facilitating growth in the telecom sector.

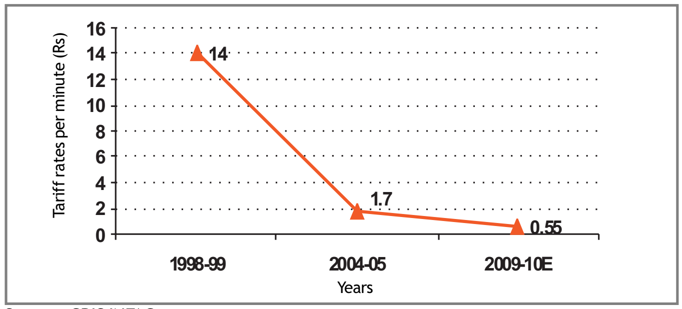
In addition to the government's initiatives, a host of other factors are also contributing to the exponential growth in the subscriber base. The key growth drivers are the growing disposal income resulting from the healthy economic scenario and the increased affordability in terms of the declining cost of handsets and services. Consequently, the wireless subscriber base has grown at a compounded annual growth rate (CAGR) of 90% over the past three years. The phenomenal growth has taken the gross telecom subscriber base to 139.4 million (including 93 million mobile subscribers) and the total tele-density in India to 12.4% by the end of March 2006.

Declining mobile handset prices...



Source: CRIS INFAC

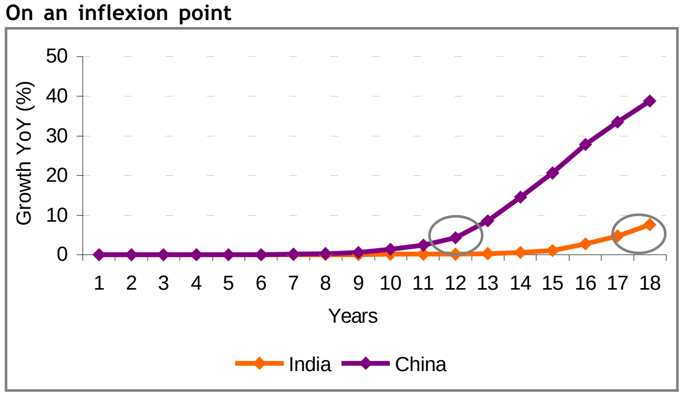
...mobile tariffs



Source: CRIS INFAC

China has been recognised as one of the fastest developing countries to deploy mobile telephony services since it has added about 4-5 million mobile subscribers per month in the last five years. India also achieved this landmark in December 2005 when its mobile subscriber addition reached around 4.5 million in a single month for the first time since the launch of mobile services in 1995. Thus India has really caught up with China in mobile growth. In fact, the performance of the Indian mobile sector appears better than that of China, if we compare the first 11 years of the business for the two countries. The subscriber base at the end of 11 years after the start of mobile services for India and China are shown below, currently India is at a stage where China was seven years back.

On an inflexion point



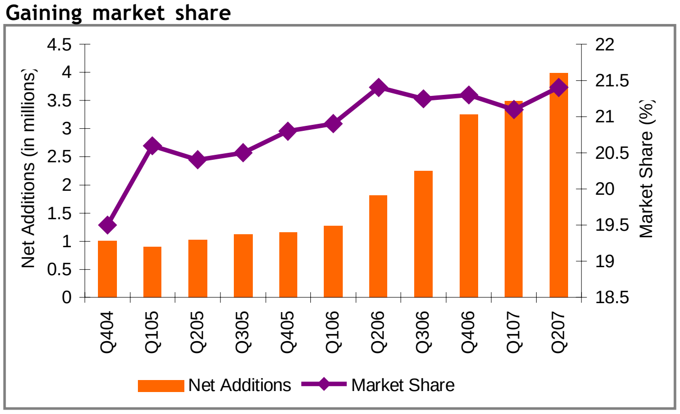
Source: Company, Sharekhan Research

Leader all the way

BAL has led the growth in India's mobile subscriber base with a compounded annual growth of 82.3% during the last three years. Despite the intensified competition from the incumbent Bharat Sanchar Nigam and the aggressive competition by the CDMA-based wireless operators, the company has not only maintained its leadership position but also further consolidated its position with a market share of 21.4% as on September 2006.

Going forward also, we believe that the company will be able to maintain its leadership position. It has planned capital expenditure (capex) of around $1.8-2 billion for this fiscal, which would enable it to cover additional 1,500 towns (taking the coverage to around 5,500 cities/towns).

Gaining market share



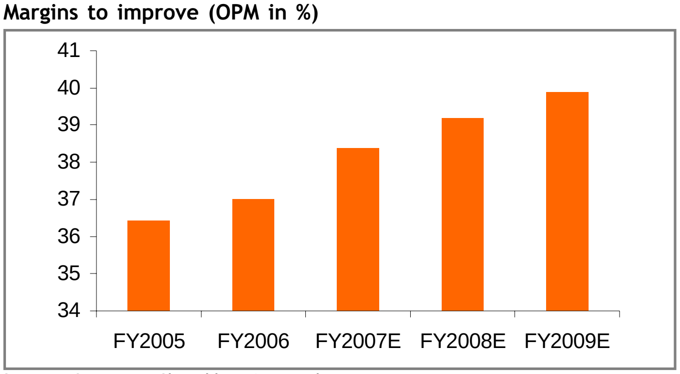
Source: Company, Sharekhan Research

Given the aggressive network roll-out plans, we estimate BAL's mobile subscriber base to grow at a CAGR of 45.7% to 60.6 million subscribers over the three-year period FY2006-09E.

Unmatched execution skills

In addition to the aggressive addition to its subscriber base, BAL has shown an unmatched capability to not only effectively manage growth but also emerge as one of the most profitable telecom service providers in the country. The innovative idea of outsourcing network management (to leading global players like IBM, Nokia, Ericsson and Motorola) as well as billing and call centre activities has enabled the company to effectively overcome the ramp-up issues and focus on its core competence of distribution, sales & marketing, branding and promotion. Going forward, in spite of the competition-led pricing pressure, BAL would further improve its margins as the aggressive investments in the new circles yield results. We estimate the operating profit margins to improve by 290 basis points over the three-year period FY2006-09.

Margins to improve (OPM in %)



Source: Company, Sharekhan Research

Better quality of revenues

BAL is effectively tapping the huge potential in terms of revenues from the non-voice services like enterprise data traffic and other value-added non-voice services. Its non-voice revenues contributed 10.5% of its total mobile revenues in H1FY2007 (around 7% in case of Reliance Communications [RCom]) and were among the highest in the industry. Consequently, the reported revenue per minute of around Rs1.0 is also far ahead of Rs0.7 reported by its closest competitor, RCom. Moreover, innovative efforts like the introduction of the high-margin, low-denomination pre-paid coupons and the cost saving electronic re-charge system are also supporting the margins.

Consequently, the company has been able to absorb the adverse impact of a sharp decline in the monthly average revenue per unit (ARPU) and shown an improvement in the overall profitability. In terms of capital productivity also, the ratio of revenues to gross capex is also maintained at a healthy level of over 60%.

Despite the lead over its peers, BAL is taking several initiatives to further boost the contribution from the non-voice business. In a recent effort, it is aggressively marketing "Easy Music" stores for users to download ring tones from a vast library of songs. We expect the non-voice revenues as a percentage of ARPU to increase to around 13.5-14% by FY2009 and be an important factor in mitigating the impact of the declining ARPUs.

Re-rating trigger

The on-going tussle to acquire Hutchison Essar Ltd (HEL), the fourth largest telecom service operator in India, is likely to benefit BAL if either of the two suitors, Vodafone and RCom, are successful. First, the fierce competition would set a relatively much higher valuation benchmark. As per media reports, HEL is estimated to be valued at around $21 billion, which amounts to an enterprise value (EV) of over $900 per subscriber. Currently, BAL's valuation works out to EV of $768 per subscriber (based on FY2007 estimated subscriber base of 36.07 million) and $547 per subscriber (based on FY2008 estimated subscriber base of 50.37 million). Also, the consolidation process in a growth industry is always favourable for the market leader.

Investment concerns

Free cash flow

BAL is still in the investment phase and has indicated capex of $1.5 billion during the current year. Thus, the company is expected to turn cash flow positive only in FY2008. Moreover, the company is not expected to pay any dividend this fiscal also.

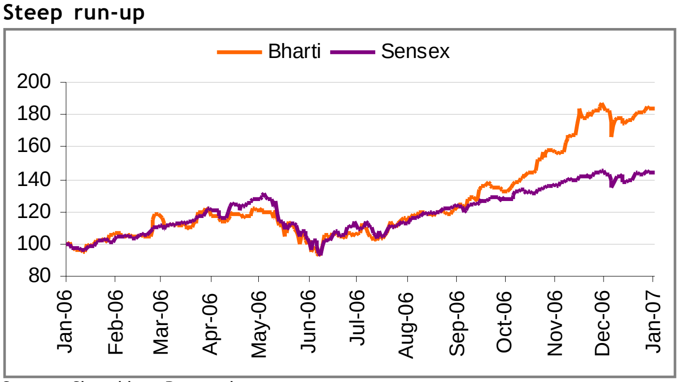
Declining average revenue per minute

The declining trend in the ARPU has resulted in an adverse impact on the average revenue per minute that has declined from Rs1.8 to Rs0.97 in the last eight quarters. Consequently, the average spread per minute has also eroded from Rs0.6 per minute to Rs0.36 per minute in the corresponding period. Any significant decline from the current level could severely affect the overall profitability of the company.

Recent steep appreciation in the share price

BAL's share price has appreciated by over 35.6% in the past three months and the stock has outperformed the Sensex by over 22.8% in the same period. Consequently, the stock could consolidate at the current level and possibly under-perform the Sensex but we are bullish on BAL with a 12-month perspective.

Steep run-up



Source: Sharekhan Research

Valuation

The consolidated revenues and earnings of BAL are estimated to grow at a CAGR of 35.1% and 45.7% respectively over the next three-year period FY2006-09E. At the current market price the scrip trades at 21.6x FY2008E earnings and 17x FY2009E earnings. We recommend a Buy call on the stock with a one-year price target of Rs780 (24x rolling four quarters forward estimated earnings).

Financials

Profit and loss account Rs (cr)

Particulars	FY2006	FY2007E	FY2008E	FY2009E
Revenue	11662.5	17438.9	23665.7	28764.7
Total expenditure	7345.5	10745.4	14391.7	17290.6
Operating profit	4317.0	6693.5	9273.9	11474.1
Other income	59.0	104.6	142.0	172.6
Interest, net	265.0	394.0	298.0	317.5
Depreciation	1543.6	2263.7	2605.1	2954.5
Non operating expense	10.8	10.3	10.3	10.3
PBT	2556.6	4130.2	6502.6	8364.5
Tax	273.6	495.6	975.4	1338.3
Monority share	25.4	31.8	39.7	49.6
PAT	2257.6	3602.8	5487.5	6976.5

Balance sheet Rs (cr)

Particulars	FY2006	FY2007E	FY2008E	FY2009E
Equity capital	1893.9	1893.9	1893.9	1893.9
Reserves	7295.4	10898.2	16385.7	23362.3
Networth	9189.3	12792.1	18279.6	25256.2
Total debt	4590.4	5213.9	4692.5	3754.0
Minority interest	95.1	95.1	95.1	95.1
Capital employed	13874.8	18101.1	23067.2	29105.3
Net fixed assets	18454.7	22314.6	23709.6	24755.1
Net working capital	-4581.0	-4213.5	-1642.3	1850.2
Capital deployed	13873.7	18101.1	22067.2	26605.3

Key ratios

Particulars	FY2006	FY2007E	FY2008E	FY2009E
OPM (%)	37.0	38.4	39.2	39.9
NPM (%)	19.4	20.7	23.2	24.3
RoNW (%)	24.6	28.2	30.0	27.6
RoCE (%)	20.7	25.2	29.7	30.0

Valuation

Particulars	FY2006	FY2007E	FY2008E	FY2009E
EPS (Rs)	11.9	19.0	29.0	36.8
P/E	52.4	32.9	21.6	17.0
Book value	48.5	67.5	96.5	133.4
Price/BV	12.9	9.3	6.5	4.7
EV/EBITDA	28.4	18.4	13.2	10.6
EV/Sales	10.5	7.1	5.2	4.2
Market cap/Sales	10.1	6.8	5.0	4.1

The author doesn't hold any investment in any of the companies mentioned in the article.