

Bharti Airtel Limited

BUY

November 13, 2006

CMP (INR)	544
Target Price (INR)	653

Key Data	
Bloomberg Code	BHARTI IN
Reuters Code	BRTI.BO
BSE Code	532454
NSE Code	BHARTI
Face Value (INR)	Rs 10
Market Cap. (INR mn.)	702629
52 Week High (INR)*	553
52 Week low (INR)	310
Avg. Daily Volume (6m)	229392

Shareholding	%
Promoters	45.37
Banks/MFs	3.96
FII	25.62
Foreign Companies	15.60
Indian Residents/Pvt Bodies	2.68
NRI/OCB's/Foreign Bodies	6.77
Total	100.00

	FY06	FY07E	FY08E
Revenues (Rs.mn)	117256.9	171173.5	227660.3
EBIDTA	42119.6	62700.9	86009.8
PAT	20281.32	30192.08	41292.92
EPS (Rs.)	10.71	17.52	26.14
Price/BV	14.11	9.10	5.96
RoCE (%)	20.7	21.4	21.5
RoNW (%)	27.5	29.1	28.5

Analyst

Deepti Chauhan

deepti.chauhan@acm.co.in

Tel Nos: 22700115

Bharti Airtel Limited has once again proved itself to be a market leader and continued its growth trajectory during the quarter ended September 30, 2006, as the company had posted revenues of Rs. 43,293 mn, a growth of 59% compared to the quarter ended September 30, 2005. The net profit registered a 73% growth at Rs.8788 mn. Revenues from Bharti's mobile services represented 76% of the total revenues for the quarter ended September 30, 2006. Non-voice revenue contributed to approximately 15.2% of the total revenues for the quarter. EBITDA margins have improved from 37.7% in Q2FY06 to 39.6% in Q2 FY07. Net profit margins have improved from 18.6% to 20.2% during the quarter ended September 30, 2006.

Key Highlights

- As at the end of the quarter, the company had 27,061,349 GSM mobile customers on its network, which accounted for a market share of 21.4% of the all India mobile market. Postpaid customer contributed approximately 14.5% to the overall customer base while pre-paid customers contributed the balance 85.5%.
- Bharti's coverage of 4357 census towns and over 1,55,000 non-census towns and villages in India, covering approximately 50% of the country's population, is a positive signal towards its aim to cover 5161 census towns by the end of 2006-07. Since the company covers 4% of the population, quarter on quarter, we expect the company to cover almost 75% of the population by 2008E.
- With a view to concentrate on its core activities, the company has been outsourcing its non-core activities of network management maintaining, expansion etc. It has recently entered into a network-outsourcing contract worth \$400m with Nokia for expanding its GSM networks. This would reduce its network-operating cost substantially, thereby improving its margins.
- The company's management is actively scouting opportunities in the African Middle East region and SAARC regions and is prepared to take its low cost model outside India.
- We believe that Bharti will continue to maintain its growth momentum on the back of robust subscriber additions, cost reduction initiatives and high degree of earnings visibility. We therefore reiterate a "BUY" on Bharti Airtel with a target price of Rs.653 with an estimated forward P/E of 25.

*Growth in India
surpasses that of China*

*Cellular growth driving
Industry*

*GSM achieving ever-
increasing growth levels*

INDUSTRY OUTLOOK

The Indian telecom market is witnessing a tremendous growth in the cellular market with the subscriber base for telephony services continuously growing. As at the end of September 2006, total wireline subscribers were 40.75 mn and wireline were 129.51 mn. The gross telephony subscribers in country reached 170.26 mn as compared to 164.31 mn in August 2006. The overall tele-density reached around 15.44 in September 2006 as compared to 14.80 at the end of August 2006. For the first time ever the country mobile net adds on a per month basis surpassed those of China in August 2006 and again in September 2006. This is a very important achievement which shows that Indian Telecom industry is witnessing a much faster and sharper growth trajectory.

□ **Cellular telephony driving growth:**

According to “Wireless Intelligence”, the total number of cellular connections worldwide has crossed 2.5 billion. The industry is witnessing a growth of 40 mn connections every month, which is the highest volume of growth that this market has ever witnessed. Majority of growth is being witnessed in the emerging markets where the penetration rates are lower. India and China are among the fastest growing telecommunications markets, with one-fourth of the growth coming from these two countries.

The global mobile subscriber base swelled by 500 mn over the last 12 months and India's share is over 50mn thereby accounting for 10% of the global adds over the last 12 months. The cellular industry took 20 years to reach 1bn connections, three years to reach 2bn connections and is on target to reach its third billion in a period of just over two years.

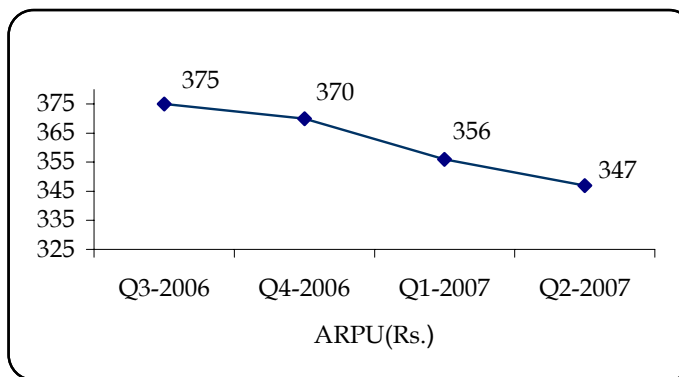
Also the government has decided to bring the mobile telephony services in rural areas under the Universal Service Obligation fund (USO), which again would give boost to cellular growth in the rural areas.

□ **Revenues of GSM operators rising consistently.**

According to Telecom Regulatory Authority of India, on a year on year basis, the revenues of private GSM mobile operators have risen from Rs 3,760 Crs for Apr. to June 05 quarter to Rs 5,621 Crs for Apr. to June 06 quarter, thereby witnessing a 49% rise in revenues. In spite of a rise in the Adjusted Gross Revenue, the private GSM industry has witnessed a fall in ARPU since the September 05 quarter. The average industry ARPU has fallen from Rs 375 for Sept. 05 quarter to Rs 347 for June 2006 quarter, a decline of 7%. Continuous decline in ARPU is a strong evidence of the ever-improving affordability of the GSM Mobile service, as a result of which the GSM service is achieving ever-increasing growth levels. Being a GSM player Bharti would benefit from the falling ARPU's.

*Recommendations on
Spectrum - a big
positive for the Industry*

*Infrastructure Sharing
to reduce capex and
increase roll out*



Source: TRAI

□ **Recommendations on Spectrum.**

The TRAI released its recommendation on allocation and pricing of spectrum for 3G services and Broadband Wireless Access (BWA) for Indian telecom operators. The recommendations are as follows:

- A recommended base price for the acquisition of spectrum for 3G services was set at 800 mn rupees (US\$17.4 mn) for "A" circles and the Delhi and Mumbai metros, 400 mn rupees for "B" circles and the Chennai and Kolkata metros, and 150 mn rupees for "C" circles.
- The highest bidder for each telecoms zone would get to choose the spectrum with the least interference and widest reach. Other successful bidders would have to pay a price at least 75% of that of the highest successful bidder.
- The recommendations also included the setting up of a National Frequency Management Board to ensure the availability of additional spectrum and its efficient utilisation, and to plan for future spectrum requirements.

Spectrum is a scarce resource for telecom companies' in India, and hence, these recommendations are a big positive for the industry. However, Bharti is disappointed with the minimum pricing and has appealed to the DOT to reset the price to lower levels. It believes that the entry cost should be as low as possible allowing the services to go into the segments at the lower end of the segment right from day one rather than progressively over a period of time.

□ **Infrastructure Sharing**

In order to increase competitiveness, most of the operators are going in for infrastructure sharing. Infrastructure sharing refers to sharing existing cell sites, thereby enabling a faster rollout. This brings about considerable savings in their capital and operating expenditure in the market, thereby declining tariff. TRAI has also recommended infrastructure sharing for improving rural teledensity. Apart from saving on capex and operating

Monthly additions in mobile subscribers continue to increase quarter on quarter

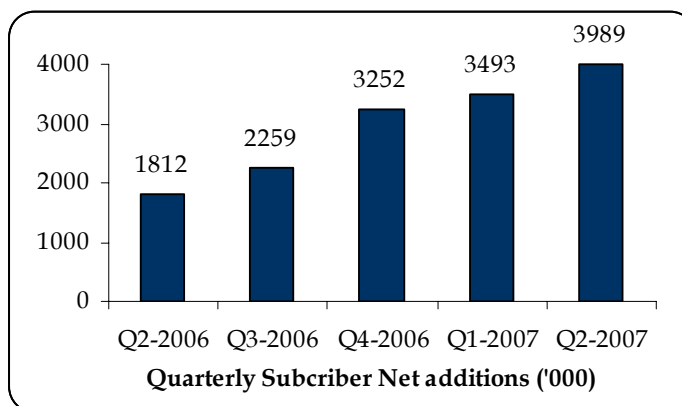
expenses and faster rollout, the move also adds a revenue stream for companies, as they would charge rental for sharing the cell sites.

Reliance Communications, Bharti Airtel, Aircel and Spice Telecom are in advanced stages of talks to share each other's existing cell site across the country. Reliance Communications is also believed to have hived off its cellphone towers into a subsidiary and offload a significant stake to the \$18-billion US company American Towers Inc. The move is a step ahead in the current trend of private mobile phone operators sharing each other's towers (co-location) in order to reduce costs and achieve better coverage.

COMPANY OVERVIEW

Mobile services: Major contributor to revenues

- ❑ Bharti's presence in 4357 census towns and over 1,55,000 non-census towns and villages in India, covering approximately 50% of the country's population is a positive signal towards its aim to cover 5161 census towns by the end of 2006-07. Also the company expects to cover 55% of the population by 2006-07.
- ❑ Mobile revenues have accounted for around 70% of the total revenues. The topline growth at Bharti Airtel is expected to be driven by a strong growth in the mobile subscriber base.
- ❑ Although the verification drive initiated by the Department of Telecommunications lead to deactivation of some subscribers of the company but it has not had much impact on the revenues and the company has completed verification of almost 45% of its customers.
- ❑ The company has been more than successful in adding one mn subscribers each month as planned by it, thereby adding approx 4.1 mn-subscriber last quarter.



Source: Company Report

Going forward, we expect mobile services to continue to be the revenues driver, constituting 75% of the revenues in FY08E

Growth in IT Industry and the boom in BPO business, fuelling growth for the broadband business

Reduction in access and interconnect charges to improve margins

Outlook

- ❑ Going forward we expect the mobile revenues would continue to constitute around 75% of the revenues.
- ❑ We expect the network cost to decline due to the various network expansion agreements entered with Nokia and Ericsson. It has awarded a network outsourcing contract worth \$400mn to Nokia for expanding its managed GSM networks in eight circles. Also, it has entered in a \$1bn three-year service contract with Ericsson towards design, supply, installation, commissioning and upgrading of its network in 15 telecom circles. This will enable Bharti to focus on its core areas and concentrate more on customers.
- ❑ At the same time, the access charges would also reduce mainly on account of change in the Access Deficit Charge (ADC). The new ADC regime has moved from a fixed charge of 30 paise/minute for STD calls and Rs 2.50/minute and Rs 3.25 for ISD calls for outgoing and incoming calls respectively, to a revenue share percentage for all local and international calls.

Broadband and telephone services:

- ❑ This business is offering great opportunities for the company. The main strategy of the company in this segment is to just concentrate on cities with high revenues potential and to maintain the minimum revenues from this business, per line.
- ❑ With the regulator recommending provision for adequate spectrum for broadband wireless access on high priority, this will enable the company to increase penetration of broadband services in the country, especially the rural areas.
- ❑ At the same time, to improve profitability, the company is eyeing IPTV business. Many trials have been completed successfully in the NCR region and the commercial launch may take place early next year. Increasing IT led automation, booming KPO & BPO businesses are further fuelling growth for the broadband business.

Enterprise services:

- ❑ The long distance services are registering a robust growth where the revenues have grown by 50% over the last quarter. The enterprise corporate business is one of the smallest but one of the fastest businesses of the group due to the increasing globalization and the need to be connected. With the reduction in the access and interconnect charges, we expect margins to improve gradually and to show stable growth going forward.

Segmental Analysis: (Figures based on US GAAP)

Segment	Q2FY07	% Change	H1FY07	% Change
Revenues				
Mobile	33022	73%	61432	68%
B & T	5244	43%	10426	48%
Long Distance	8362	50%	15426	43%
Enterprise-Corp	2148	26%	4116	24%
EBITDA Margin				
Mobile	36.9%		36.7%	
B & T	20.4%		21.7%	
Long Distance	40.3%		39.3%	
Enterprise-Corp	42.2%		44.8%	

Source: Company Quarterly Report

Enterprise services registering high margins and volumes driving the margins of mobile segment

During the half-year ended September 2006, the mobile revenues have grown by 68%. The total number of customers has registered a 92% growth. The total broadband and fixed line segment are showing robust growth where they have registered a 48% growth in revenues. The enterprise business is also slowly picking up where the EBITDA margins are the highest. With the cut in ADC, we expect this to improve further.

With the growth in the number of customers, the total traffic on the network has increased two fold from 20,411 mn min in September 2005 to 42,434 mn min in September 2006. For each segment as well, the total traffic in minutes has shown robust growth. While volumes are driving the growth in the mobile segment, the booming IT industry and BPO and KPO businesses are fuelling growth for the B&T, Enterprise segments.

Revenue Mix

Segment	FY06	FY07E	FY08E
Mobile	70%	73%	75%
B & T	12%	12%	10%
Long Distance	12%	10%	10%
Enterprise-Corp	6%	5%	5%

Source: Company Report and ACMIL Estimates

Revenue Mix to shift in favour of high margin segments

Going forward, we expect the mobile segment to contribute approximately 75% to the revenue of the company. Although the share of the broadband and fixed line segment (B& T) and enterprise services are more or less same, due to the reduction in access and interconnect charges and robust growth registered by these segments, we expect the revenue mix to shift to these high margin business, which show lot of potential.

VALUATION

Given the growth potential within the sector as well as the company's leadership position within it, we believe Bharti will continue to maintain its growth momentum on the back of robust subscriber additions, cost reduction initiatives and high degree of earnings visibility. We recommend a **"BUY"** on Bharti with a target price of Rs.653 with an estimated forward P/E of 25.

INTERIM RESULTS

(Rs Million)

Particulars	Q2FY06	Q2FY07	% Growth	HI FY06	HIFY07	% Growth
Net Sales	27281.0	43293.0	58.7	52417.0	41448.0	55.4
Total Expenditure	17116.0	26468.0	54.6	32850.0	49650.0	51.1
Operating Profits	10165.0	16825.0	65.5	19567.0	31798.0	62.5
Other Income	146.0	338.0	131.5	284.0	604.0	112.7
EBDIT	10311.0	17163.0	66.5	19851.0	32402.0	63.2
Depreciation	3488.0	5647.0	61.9	6635.0	10339.0	55.8
Ammortisation	368.0	452.0	22.8	735.0	905.0	23.1
EBIT	6455.0	11064.0	71.4	12481.0	21158.0	69.5
Interest	596.0	834.0	39.9	1153.0	1476.0	28.0
PBT	5859.0	10230.0	74.6	11328.0	19682.0	73.7
Taxes	716.0	1386.0	93.6	1411.0	2412.0	70.9
Profit After Tax	5143.0	8844.0	72.0	9917.0	17270.0	74.1
Minority Interest	72.0	56.0	-22.2	140.0	168.0	20.0
Net Profits	5071.0	8788.0	73.3	9777.0	17102.0	74.9

EARNINGS SUMMARY

(Rs Million)

Particulars	FY04	FY05	FY06	FY07E	FY08E
Net Sales	50369.4	81557.9	117256.9	171173.5	227660.3
Total Expenditure	33354.9	51404.9	75137.3	108472.7	141650.5
Operating Profits	17014.5	30152.9	42119.6	62700.9	86009.8
Other Income	0.0	0.0	0.0	0.0	0.0
EBDIT	17014.5	30152.9	42119.6	62700.9	86009.8
Depreciation	6847.4	10441.5	14819.2	22423.7	30734.1
Ammortisation	1947.3	1440.3	1599.6	2225.3	3301.1
EBIT	8219.8	18271.2	25700.8	38051.9	51974.5
Interest	2692.7	2439.2	2244.1	3325.6	4458.0
PBT	5527.2	15832.0	23456.7	34726.3	47516.5
Taxes	-322.0	3595.4	2908.9	4229.2	5806.5
Profit After Tax	5849.1	12236.6	20547.8	30497.0	41710.0
Minority Interest	12.2	120.9	266.5	305.0	417.1
Profit After Minority Interest	5836.9	12115.7	20281.3	30192.1	41292.9
Growth in sales (%)	64.8	61.9	43.8	45.9	33.0
Operating Profits Growth (%)	134.7	77.2	39.7	48.9	37.2
PAT Growth (%)	-384.6	107.6	67.4	48.8	36.8
Operating Profit Margin (%)	33.8	37.0	35.9	36.6	37.8
Net Profit Margin (%)	11.6	15.0	17.5	17.8	18.3

Source: Company Annual Report and ACMIL estimates

SOURCES OF APPLICATION AND FUNDS

(Rs Million)

Particulars	FY04	FY05	FY06	FY07E	FY08E
Sources of Funds					
Share Capital	18533.7	18560.9	19060.1	18954.9	18954.9
Reserves and Surplus	30612.5	34639.4	54563.8	84755.9	126048.8
Total Shareholders Funds	49146.2	53200.3	73623.9	103710.8	145003.7
Total Loan Funds	46991.5	50006.0	47728.4	69576.2	89576.2
Minority Interest	103.9	924.6	1091.1	1396.0	1813.1
Net Deferred Tax liability	0.0	1011.0	1948.4	3149.3	4812.3
Total Capital Employed	96241.6	105141.9	124391.7	177832.3	241205.4
Application of funds					
Gross Block	112191.7	140627.3	190488.2	280488.2	395488.2
Less: Accumulated Depreciation	26114.8	36802.3	52302.2	74725.9	105460.1
Net Block	86076.9	103825.0	138186.0	205762.2	290028.1
Capital Work in Progress	4530.9	10166.6	24364.8	24364.8	24364.8
Investments	3345.8	4780.8	2479.6	7702.8	9444.7
Net Current Assets	-6979.0	-22068.7	-40718.1	-60077.0	-82711.7
Other Assets	9191.8	7854.7	0.0	0.0	0.0
Miscellaneous Expenses not w/off	75.2	583.5	79.4	79.4	79.4
Total Assets	96241.6	105141.9	124391.7	177832.3	241205.4

Source: Company Annual report and ACMIL estimates

KEY RATIOS

Particulars	FY04	FY05	FY06	FY07E	FY08E
Profitability Ratios					
Operating Profit Margin (%)	33.8	37.0	35.9	36.6	37.8
EBDT Margin (%)	33.8	37.0	35.9	36.6	37.8
EBIT Margin (%)	16.3	22.4	21.9	22.2	22.8
PAT Margin (%)	11.6	15.0	17.5	17.8	18.3
RONW (%)	11.9	22.8	27.5	29.1	28.5
ROCE (%)	8.5	17.4	20.7	21.4	21.5
Per Share					
Earnings (Rs.)	3.1	6.5	10.7	17.5	26.1
Cash Earnings (Rs.)	9.0	18.2	23.8	38.8	58.1
Book Value (Rs.)	26.5	28.3	38.8	60.1	91.7
Valuation Ratios					
P/E (x)	172.7	83.3	50.8	31.0	20.8
Cash P/E (x)	60.4	29.9	22.9	14.0	9.4
P/BV (x)	20.5	19.2	14.0	9.0	5.9
Value/EBIDT (x)	61.9	35.0	25.7	16.0	10.9
Value/Sales (x)	20.9	12.9	9.2	5.9	4.1
Capital Structure Ratios					
Debt/Equity	1.0	0.9	0.6	0.7	0.6
Current Ratio	0.7	0.5	0.4	0.4	0.4
Quick Ratio	0.3	0.3	0.2	0.2	0.2
Cash Ratio	0.06	0.09	0.05	0.05	0.07
Turnover Ratios					
Inventory Turnover (x)	83.7	76.2	99.8	127.5	97.6
Debtors Turnover (x)	11.2	12.8	12.6	11.9	11.1
Fixed Asset Turnover (x)	0.6	0.8	0.8	0.8	0.8

Source: Company Annual report and ACMIL estimates

Notes

<u>HNI Sales</u>	<u>Institutional Sales</u>
Bharat Patel Tel.: 91-22-28577303/28577309	Sharmila Joshi Tel.: 91-22-22695078 / 22700119-121
 investmentz.com <i>Online trading & more</i>	

Disclaimer:

This document has been prepared by the Research Desk of **Asit C Mehta Investment Intermmediates Ltd.** and is meant for use of the recipient only and is not for circulation. This document is not to be reported or copied or made available to others. It should not be considered to be taken as an offer to sell or a solicitation to buy any security. The information contained herein is from sources believed reliable. We do not represent that it is accurate or complete and it should not be relied upon as such. We may from time to time have positions in and buy and sell securities referred to herein.