

Bharti Airtel

Rs292
UNDERPERFORMER

RESULT NOTE

Mkt Cap: Rs1,112bn; US\$23.7bn

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Result: Q2FY10

Comment: Sharp erosion in minute base

Last report: 8 October 2009 (Price Rs358; Recommendation: Underperformer)

Key valuation metrics

Year to March 31 (Rsm)	Revenues	yoy change (%)	Net profit	EPS (Rs)	yoy chg (%)	PER (x)	EV/E (x)
2007	185,195	58.8	41,779	11.0	75.7	26.6	15.5
2008	270,250	45.9	67,184	17.7	60.6	16.5	10.2
2009	369,615	36.8	96,622	25.5	43.7	11.5	7.9
2010E	394,918	6.8	88,570	23.3	(8.3)	12.6	7.4
2011E	412,032	4.3	80,484	21.2	(9.1)	13.8	7.3

HIGHLIGHTS OF Q2FY10 RESULTS

- Bharti Airtel in its Q2FY10 results reported sharp erosion in ARPU driven by loss of minute market share and lower ARPU of incremental subscribers. Lower operating costs, however led to a marginal uptick in EBIDTA margins and adjusted net profit stood at Rs23.9bn, up 5.4%qoq and against our estimate of Rs24bn.
- Consolidated revenues fell 1.0%qoq (up 9.1%yoy) to Rs98.4bn and were sharply below our estimate of Rs102.7bn driven by a sharper than estimated drop in wireless ARPU.
- Wireless ARPU dropped 9.4%qoq to Rs252 with the MOU dropping 5.9%qoq to 450min/month and rev/min dropping 4.2%qoq to Rs0.56/min. While the drop in Bharti's rev/min is in line with our estimate, the extent of fall in MOU has been a surprise.
- We believe the sharper than expected drop in MOUs besides being driven by lower usage from incremental subscribers has also been significantly driven by loss of minute market share. Bharti estimates the extent of multiple SIM ownership at 25-30% with the proportion being higher in urban markets. Overall, total wireless minutes grew by just 2.1%qoq to 143.7bn minutes vis-à-vis a 8.5%qoq growth in the average wireless subscriber base during the quarter.
- In the non-mobile businesses, the passive infrastructure business (Bharti Infratel) posted a strong performance with improvement in tenancy rates as well as profitability. The performance of the Telemedia business (Fixed line and Broadband) as well as the Enterprise business (including long distance) remained muted.
- Consolidated EBIDTA margin stood at 42.1%, up 30bp qoq and 110bp yoy and was ahead of our estimate of 41.0%. The uptick in EBIDTA margins, despite the revenue decline, was driven by a 1.5%qoq drop in operating costs. Wireless EBIDTA/min, however, dropped 6.8%qoq to Rs0.18/min and was in line with our estimate. We believe costs related to subscriber acquisition as well as marketing and distribution costs are likely to increase going forward given the heightened competitive intensity in the wireless industry.
- Consolidated EBIDTA stood at Rs41.4bn, down 0.2%qoq (up 12%yoy) and was below our estimate of Rs42.1bn.

- Effective tax rate stood at 10.5% in Q2FY10 against 16.1% in Q1FY10 and against a tax reversal of Rs1.2bn in Q2FY09.
- Adjusted net profit (adjusted for the forex loss of Rs678m) grew 5.4%qoq (down 9.3%yoy) to Rs23.9bn and was marginally below our estimate of Rs24bn. Reported net profit declined by 7.8%qoq (up 13.4%yoy) to Rs23.2bn.

Key Performance indicators (wireless business)

Wireless performance Indicators	Q1FY09	Q2FY09	Q3FY09	Q4FY09	Q1FY10	Q2FY10
Subscribers (EOP) (m)	69	77	86	94	102	111
MOU (min)	534	526	505	485	478	450
Rev/min (Rs)	0.66	0.63	0.64	0.63	0.58	0.56
ARPU (Rs)	350	331	324	305	278	252
Total minutes (bn)	105	116	124	131	141	144
qoq growth (%)						
Subscribers (EOP)	11.9	11.7	10.5	9.7	9.0	8.0
MOU	5.3	(1.5)	(3.9)	(4.0)	(5.9)	(5.9)
Rev/min	(8.8)	(4.3)	2.1	(2.0)	(8.5)	(4.2)
ARPU	(2.1)	(5.3)	(2.1)	(5.9)	(14.3)	(9.4)
Total minutes	18.1	10.1	6.7	5.7	(70.4)	2.1

Source: Company reports

❑ **Passive Infrastructure business going strong; Enterprise and Telemedia businesses post muted performance**

- **Passive Infrastructure:** Bharti's passive infrastructure business (Bharti Infratel) posted a strong performance with 7.1%qoq growth in revenues at Rs8.6bn. Total tower base grew by 3.7%qoq to 29,112 towers with tenancy factor rising 4.2%qoq to 1.49x from 1.43x as on June 2009. Sharing revenues/operator/month grew 0.8%qoq to Rs36,696. EBIDTA margin increased from 44.4% in Q1FY10 to 46.8% in Q2FY10 and EBIDTA grew by 13.0%qoq to Rs4bn. Indus' total tower base increased to 100,728 towers as on September 2009 from 97,925 towers as on June 2009 while its tenancy factor increased to 1.61x as on September 2009 from 1.55x in June 2009.
- **Telemedia:** The telemedia business (Fixed line and broadband business) post a muted performance with revenues remaining flat qoq at Rs8.54bn. Total subscribers base increased by 3.5%qoq to 2.9m while ARPU dropped 3.7%qoq to Rs989 due to increased migration of voice usage from fixed line to mobile. Broadband subscribers accounted for 1.2m (40.5%) out of the total telemedia subscriber base up from 1.14m (40.3%) in Q1FY10.
- **Enterprise and Long Distance:** Bharti's Enterprise business revenues remained flat qoq at Rs21.3bn even as EBIDTA margins in this business improved from 49.1% in Q1FY10 to 51.7% in Q2FY10. Domestic long distance minutes grew by 5.4%qoq to 12.4bn minutes and international long distance minutes grew by 10.9%qoq to 3.2bn minutes. Management has indicated that the Enterprise Services (Corporate) business continued to experience sluggishness due to slowdown in corporate spending while in the long distance (carriers) segment, even as volumes continued to grow, pricing remained under pressure due to intense competition. Revenue growth also remained impacted due to pass through of the reduction in access charges.

Non-mobile businesses performance

Rsm	Q2FY09	Q1FY10	Q2FY10	QoQ	YoY (%)
Passive Infrastructure*					
Total Towers (nos)	59,966	28,078	29,112	3.7	NC
Sharing factor (x)	1.3	1.43	1.49	4.2	NC
Sharing revenue/op/mth (Rs)	32,177	36,420	36,696	0.8	NC
Revenues	11,983	8,020	8,586	7.1	NC
EBITDA	3,991	3,557	4,020	13.0	NC
EBIDTA margin (%)	33.3	44.4	46.8		
Telemedia: Broadband and Telephone Business					
Subscribers (m)	2,509,460	2,827,881	2,928,254	3.5	16.7
ARPU (Rs)	1,147	1,027	989	-3.7	(13.8)
Revenues	8,486	8,550	8,544	-0.1	0.7
EBITDA	3,696	3,463	3,667	5.9	(0.8)
EBIDTA margin (%)	43.6	40.5	42.9		
Long Distance (carriers) & Enterprise					
NLD minutes (m)	11,349	11,781	12,417	5.4	9.4
ILD minutes (m)	2,284	2,869	3,181	10.9	39.3
Revenues	21,874	21,333	21,331	0.0	(2.5)
EBITDA	9,369	10,468	11,023	5.3	17.7
EBIDTA margin (%)	42.8	49.1	51.7		

Source: Company reports * - September 2008 figures include the towers transferred to Indus wef January 1st 2009 under IRU. NC - not comparable

❑ Capex target maintained at \$2-2.2bn for the core business; potential for capex deferment in the tower business

Bharti Airtel maintained its capex guidance for FY10 at \$2-2.2bn notwithstanding concerns on the sharp fall in MOU during the quarter. The company however indicated that there is potential for some deferment in tower business capex (Infratel + Indus) - ~\$700m (Bharti's share) vis-à-vis the earlier target of \$1bn. Total capex (including Bharti Infratel) for Q2FY10 stood at Rs22.8bn while that for H1FY10 stood at Rs49.9bn.

❑ Other highlights/key takeaways from the post results conference call

- Bharti's total employee base reduced from 23,789 as on June 30th 2009 to 18,598 as on September 30th 2009 due to migration of 4,000 employees to its JV with Alcatel Lucent (26% stake with Bharti). Resultant employee costs declined 9.2%qoq to Rs4.2bn.
- S,G&A expenses declined 2.7%qoq to Rs13.1bn - 13.3% of revenues against 13.6% in Q1FY10.
- Bharti reported an amount of Rs8m as its share of loss in Indus operations. The company attributes this to certain one-time revenue reversals in Indus during the quarter.
- Bharti expects the performance of the Telemedia business to pick up going forward.
- The management has guided for an effective tax rate of 12-14% in the near term.
- The Rs30.3bn compulsorily convertible debentures issued by Bharti Infratel were scheduled to be converted by September 30th 2009. The conversion of the same has been rescheduled to the next financial year.

❑ Bharti reacts to ongoing tariff war in the industry – introduces per second billing plan

Bharti on October 30th 2009 introduced the 'Freedom Plan' whereby it has offered per second billing option to its customers. The tariff for all local and STD on-net calls (Airtel to Airtel) would be 1ps/second while that for off-net local and STD calls (Airtel to other networks) would be 1.2ps/second. This plan has been offered on a pan India basis for a period of one year and pre-paid subscribers will have to recharge with a special tariff voucher of Rs62 in order to migrate to this plan (as verified with the company's Mumbai contact centre) – details regarding charges for post-paid subscribers are not available currently.

VALUATIONS & VIEW

We recently downgraded our recommendation on the telecommunication sector to Underperformer on concerns of rapid pricing/ARPU erosion percolating to erosion in profitability and earnings as also to pressure on valuations (refer our report dated October 8th 2009 – Fresh wave of tariff aggression – changing sector stance to Underperformer). While Bharti's pricing erosion was in line with our estimate the fall in MOU was much steeper – resulting from loss of minute market share as also due to lower usage of incremental subscribers. We have lowered our wireless ARPU estimate for Bharti by 5.9% for FY10E and 11.8% for FY11E resulting in an EBIDTA downgrade of 3.1% and 6.3% for FY10E and FY11E, respectively. Resultant our earnings have been downgraded by 5.0% for FY10E to Rs23.3/share and 9.7% for FY11E to Rs21.2/share (estimates include 3G capex).

Bharti Airtel's stock price has corrected 19% since our recent rating downgrade vis-à-vis a 5% drop in the Sensex over the same period. Based on our revised estimates the stock trades at EV/EBIDTA of 7.3x and PE of 13.8x FY11E earnings. While we believe the stock has limited valuation downside from current levels based on its historical trading range, upsides would be capped by overhang of weak earnings expectations over the next few quarters and the adverse news flow pertaining to sharp tariff cuts and aggressive new launches. Bharti's latest tariff plan – the 'Freedom Plan' whereby it too has offered per second billing to its subscribers is a case in point. Maintain Underperformer on Bharti with a revised DCF-based price target of Rs343 (Rs397) which includes a valuation of Rs46/share for Bharti Infratel's 42% stake in Indus.

Bharti Airtel: Change in estimates

Particulars (In Rsm)	New Estimates			Old Estimates			Change in estimates	
	FY09	FY10E	FY11E	FY09	FY10E	FY11E	FY10E	FY11E
Revenue	369,615	394,918	412,032	369,615	416,866	456,237	(5.3)	(9.7)
EBIDTA	151,680	163,035	164,620	151,680	168,264	175,739	(3.1)	(6.3)
Adjusted PAT	96,622	88,570	80,484	96,622	93,193	89,113	(5.0)	(9.7)
Adjusted EPS (Rs)	25.5	23.3	21.2	25.5	24.5	23.5	(5.0)	(9.7)
Wireless MOU (min)	508	447	415	508	472	466	(5.4)	(11.0)
Wireless Rev/min (Rs)	0.64	0.55	0.47	0.64	0.55	0.47	(0.5)	(1.0)
Wireless ARPU (Rs)	325	244	195	325	259	222	(5.9)	(11.8)
Wireless EBIDTA/min (Rs)	0.20	0.17	0.14	0.20	0.17	0.14	(0.5)	(1.0)

Source: IDFC-SSKI Research

Quarterly results (consolidated)

In Rsm	Q1FY09	Q2FY09	Q3FY09	Q4FY09	FY09	Q1FY10	Q2FY10	FY10E
Total Revenues	84,833	90,203	96,334	98,245	369,615	99,416	98,455	394,918
<i>qoq change (%)</i>	8.5	6.3	6.8	2.0	NA	1.2	(1.0)	NA
Total Expenditure	49,612	53,210	56,882	58,231	217,935	57,898	57,039	231,883
EBITDA	35,221	36,993	39,452	40,014	151,680	41,518	41,416	163,035
Other Income	584	274	239	425	1,522	186	409	1,413
Depreciation & amortisation	10,045	11,549	12,702	13,285	47,581	14,330	14,796	59,964
EBIT	25,760	25,718	26,989	27,154	105,621	27,374	27,029	104,484
Interest	352	(121)	(317)	(226)	(312)	(105)	(250)	(255)
Pre-operating costs	2	-	2	-	4	-	-	-
PBT	25,406	25,839	27,304	27,380	105,929	27,479	27,279	104,739
Provision for tax	3,282	(1,247)	2,558	2,022	6,615	4,442	2,873	14,389
Minority interest	282	508	478	491	1,759	479	506	2,074
Profit/(loss) from associates	(113)	(93)	(451)	(56)	(713)	240	(8)	437
Other non-operating expenses	1	160	3	56	220	131	4	143
Adjusted Net Profit	21,728	26,325	23,814	24,755	96,622	22,667	23,888	88,570
<i>qoq change (%)</i>	10	21	-10	4	NA	(8)	5	NA
Exceptional items/Forex loss (gains)	1,480	5,862	2,221	2,362	11,925	(2,500)	678	(1,822)
Reported Net Profit	20,248	20,463	21,593	22,393	84,697	25,167	23,210	90,392
Shares in issue (m)	3,796	3,796	3,796	3,796	3,778	3,797	3,797	3,797
EPS (Rs)	5.7	6.9	6.3	6.5	25.6	6.0	6.3	23.3
Cash Profit	31,773	37,874	36,516	38,040	144,203	36,997	38,684	148,534
Cash EPS (Rs)	8.4	10.0	9.6	10.0	38.2	9.7	10.2	39.1
Operating ratios (%)								
EBIDTA Margin	41.5	41.0	41.0	40.7	41.0	41.8	42.1	41.3
EBIT Margin	30.4	28.5	28.0	27.6	28.6	27.5	27.5	26.5
Wireless operating cost/min (Rs/min)	0.40	0.43	0.45	0.43	0.44	0.39	0.38	0.35
Wireless EBIDTA/min (Rs/min)	0.26	0.20	0.19	0.20	0.20	0.19	0.18	0.19
PAT margin	25.6	29.2	24.7	25.2	26.1	22.8	24.3	22.4
yoy growth (%)								
Income	43.7	42.3	38.3	25.6	36.8	17.2	9.1	6.8
EBITDA	44.0	36.5	33.1	23.1	33.4	17.9	12.0	7.5
Depreciation	23.7	27.4	22.4	36.9	27.7	42.7	28.1	26.0
PBT	53.9	44.6	43.2	21.1	37.5	8.2	5.6	(1.1)
Adjusted PAT	70.8	59.6	38.5	25.1	43.8	4.3	(9.3)	(8.3)
Reported PAT	34.0	26.8	25.4	20.9	24.6	24.3	13.4	6.7

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