

Telecoms, Media & Technology
Wireless Telecoms
Equity – India

Overweight (V)

Target price (INR)	786.00
Share price (INR)	688.20
Potential total return (%)	14.2

Performance	1M	3M	12M
Absolute (%)	20.9	11.7	-16.4
Relative ^A (%)	-1.3	-7.5	25.5

Index^A BOMBAY SE IDX

RIC BRTI.BO
Bloomberg BHARTI IN

Market cap (USDm) 25,964
Market cap (INRm) 1,306,369

Enterprise value (INRm) 1,343,097
Free float (%) 32

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

21 April 2009

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Bharti Airtel

Retain OW (V); Focussing on the last mile

- ▶ **Bharti may be considering outsourcing the last-mile connectivity as per news reports**
- ▶ **We would view such a move positively, as it should allow Bharti to leverage its investment in fibre assets**
- ▶ **We retain our Overweight (V) rating and INR786 target price; we expect Q4 (March) results to be lacklustre**

News reports suggest that Bharti may consider outsourcing its last-mile connectivity of its broadband operations and enterprise operations. The reports, by the Business Standard, among others, suggest that this will help the company focus on its core competencies, beyond reducing costs of operations. Outsourcing has been a key part of Bharti's overall strategy; its mobile network has been outsourced to Nokia Siemens and Ericsson and its IT operations to IBM.

Frost & Sullivan, a business research and consulting firm, estimates the Indian enterprise data services market at INR51bn and expects a CAGR of 25.1% for this segment to INR154bn by FY13e. Large enterprise contributes c70% of the total market, and growth of the data market is driven by MPLS/VPN, which is expected to have a market share of nearly 50% in FY12-13.

While there is no official confirmation of the news item, we believe that an outsourcing deal would allow Bharti to boost its capabilities in network integration. In our view, network integrators have assumed significance recently on the back of complications involving sourcing equipment from multiple vendors and equipment interoperability.

We expect Q4 FY09e (March) results will be lacklustre for Bharti as a result of pricing pressures following the RCOM GSM rollout. We estimate Q4 revenues will decline 2% q-o-q. We estimate the EBITDA margin at 40%, compared to 41% in Q3 FY09. Similarly, we expect net income for Q4 to decline 2% sequentially. We retain our Overweight (V) rating on Bharti shares and our INR786 target price.

Bharti Airtel: Key parameters

(INRm)	2008	2009e	2010e
Revenue	270,250	370,279	447,110
EBITDA	113,715	150,270	168,900
EBITDA margin	42%	41%	38%
Net profit	67,008	83,678	93,347
EPS (INR)	35.37	44.16	49.27

Source: HSBC

Financials & valuation

Financial statements

Year to	03/2008a	03/2009e	03/2010e	03/2011e
Profit & loss summary (INRm)				
Revenue	270,250	370,279	447,110	528,192
EBITDA	113,715	150,289	168,900	203,744
Depreciation & amortisation	-37,260	-42,551	-47,184	-53,279
Operating profit/EBIT	76,455	107,739	121,716	150,465
Net interest	-3,352	-9,897	-4,532	-1,555
PBT	76,536	97,272	117,325	151,327
HSBC PBT	73,102	96,575	117,325	151,327
Taxation	-8,378	-10,866	-20,540	-35,311
Net profit	67,008	83,678	93,347	112,290
HSBC net profit	63,574	82,981	93,347	112,290

Cash flow summary (INRm)

Cash flow from operations	119,741	140,592	150,592	175,926
Capex	-138,467	-153,501	-111,126	-73,577
Cash flow from investment	-140,724	-158,249	-111,126	-73,577
Dividends	0	0	0	-47,250
Change in net debt	-744	-2,662	-58,780	-54,862
FCF equity	-21,012	-9,412	42,836	103,414

Balance sheet summary (INRm)

Intangible fixed assets	40,247	40,128	39,422	38,787
Tangible fixed assets	313,407	332,771	443,994	464,927
Current assets	113,782	123,132	215,678	305,196
Cash & others	54,948	45,129	135,016	218,395
Total assets	472,643	554,109	758,096	868,604
Operating liabilities	149,982	183,102	196,295	213,677
Gross debt	97,063	84,582	115,689	144,206
Net debt	42,115	39,453	-19,327	-74,189
Shareholders funds	222,585	276,500	435,847	500,377
Invested capital	262,506	267,800	367,783	376,837

Ratio, growth and per share analysis

Year to	03/2008a	03/2009e	03/2010e	03/2011e
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Y-o-y % change

Revenue	45.9	37.0	20.7	18.1
EBITDA	52.6	32.2	12.4	20.6
Operating profit	55.1	40.9	13.0	23.6
PBT	56.6	27.1	20.6	29.0
HSBC EPS	61.1	30.5	12.5	20.3

Ratios (%)

Revenue/IC (x)	1.2	1.4	1.4	1.4
ROIC	29.6	33.9	31.6	32.9
ROE	35.5	33.3	26.2	24.0
ROA	18.6	19.8	15.8	15.1
EBITDA margin	42.1	40.6	37.8	38.6
Operating profit margin	28.3	29.1	27.2	28.5
EBITDA/net interest (x)	33.9	15.2	37.3	131.0
Net debt/equity	18.7	13.8	-4.3	-14.5
Net debt/EBITDA (x)	0.4	0.3	-0.1	-0.4
CF from operations/net debt	284.3	356.4		

Per share data (INR)

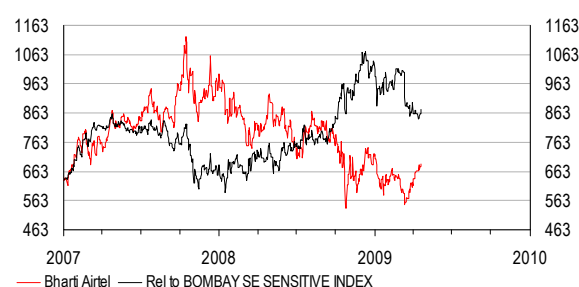
EPS reported (fully diluted)	35.35	44.14	49.25	59.24
HSBC EPS (fully diluted)	33.54	43.78	49.25	59.24
DPS	0.00	0.00	0.00	14.40
Book value	117.43	145.87	229.93	263.98

Valuation data

Year to	03/2008a	03/2009e	03/2010e	03/2011e
EV/sales	5.0	3.6	2.9	2.3
EV/EBITDA	11.8	8.9	7.6	6.0
EV/IC	5.1	5.0	3.5	3.3
PE*	20.5	15.7	14.0	11.6
P/Book value	5.9	4.7	3.0	2.6
FCF yield (%)	-1.6	-0.7	3.3	7.9
Dividend yield (%)	0.0	0.0	0.0	2.1

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

Price relative



Source: HSBC

Note: price at close of 20 Apr 2009

Outsourcing has been the heart of Bharti's strategy

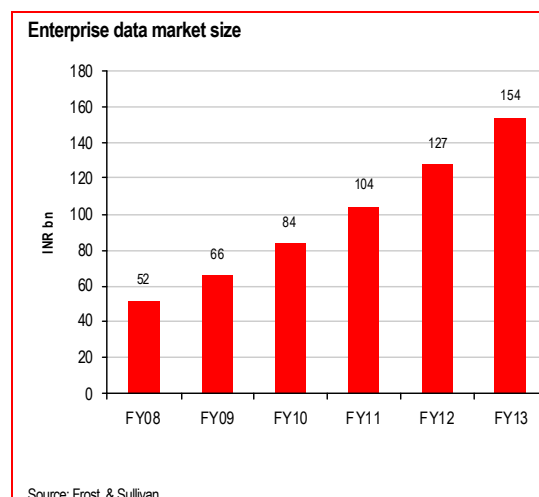
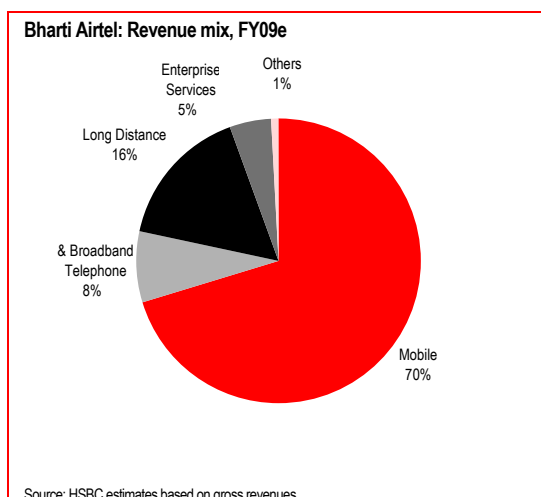
Outsourcing has been the core of Bharti's strategy, though domestic outsourcing has not picked up so much in the Indian context. Bharti's last mile outsourcing, if it happens, would follow its network outsourcing deals with Nokia and Ericsson, IT operations deal with IBM, and its call centres to multiple vendors.

Under Bharti's outsourcing deal with Nokia on mobile phone network management, Nokia deploys the latest radio and core network equipment, including soft switch, flexi-base stations, and mini-Ultra site base stations, and provides services based on Bharti's capacity requirements, delivering a cost-efficient rollout of on-demand capacity. We believe that a Bharti outsourcing deal on the last-mile issue is likely to follow a similar framework.

Corporate Quadrophonia; what matters?

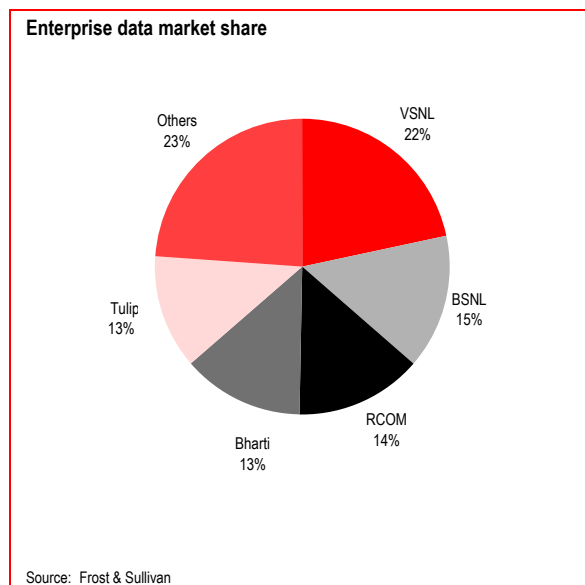
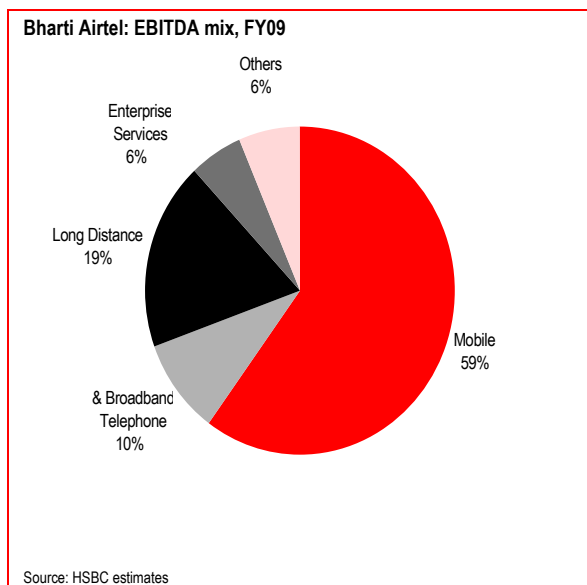
Our August 2006 report, *Corporate Quadrophonia*, examined the parallel process under way between telecoms and IT services. Participants in these two markets must master the art of corporate quad-play – the ability to bundle network, hardware, software, and process services – if they are to win favour with enterprise clients. Fresh revenue opportunities, new competitive threats, and further M&A are all in prospect as they attempt to do so.

We believe that with radical changes in computing, such as corporate moves from LAN to WAN, telcos competing in the sector will have to focus equally on network integration capabilities, and hence, some kind of partnership with IT companies becomes inevitable. HSBC's global telecoms team holds the view that the potential for telcos to take market share will be a function of their ability to put together quad-play offerings, in terms of four files of activity – network, hardware, software, and process – and the four stages involved – consult, design, implement, and outsource. The second differentiator would be scale: global, regional, or local. In terms of distinguishing telecom operators from each other, a third relevant factor is the level of investment committed to next-generation network platforms via capex. We believe that Bharti, with its strong balance sheet, can outspend its rivals, in particular the likes of RCOM, and we would not be surprised by higher capex in the enterprise segment going forward.



Outsourcing should allow boost in network integration capabilities

In our view, network integrators have assumed significance recently on the back of complications involving sourcing equipment from multiple vendors and equipment interoperability. We believe that boosting network integration capabilities would allow Bharti to fare better on network design and consulting, supply and installation of network equipment, and network management and maintenance. In our view, the enterprise market is very competitive, and market share gains will be difficult without having adequate provisions for complete end-to-end solutions.



Bharti Airtel: Q4 FY09 estimates

(INRm)	Q4e-FY09	Q3a-FY09	Q4a-FY08	QoQ	YoY
Revenue	93,957	96,334	78,191	-2%	20%
EBITDA	37,556	39,450	32,518	-5%	15%
EBITDA margin	40%	41%	42%	-1%	-2%
PAT	21,707	22,071	19,047	-2%	14%
EPS (INR)	11.24	11.39	9.78	-1%	15%

Source: HSBC

Sensitivity analysis

Bharti's enterprise revenues do not separately disclose the breakdown between data and voice revenues, and moreover, include revenues from the sale of equipment. Thus, it is difficult to analyze any likely impact on revenues from improvement in market share in the data enterprise segment. We believe that the ability to raise market share will not only drive growth in absolute EBITDA but create overall stickiness. We believe that any outsourcing arrangement by Bharti may allow it to benefit from vendor financing beyond cost reductions.

Bharti Airtel: Sensitivity analysis, impact of change in enterprise revenue on net income

% increase in enterprise revenue	Enterprise revenue (INRm)	% change in net income
Base case	41,900	—
15%	48,185	2.1%
20%	50,280	2.6%
25%	52,375	3.2%
30%	54,470	3.7%

Source: HSBC

Valuation and risks

We like Bharti for of its strong balance sheet, large scale, high ROE, and strong corporate governance. The current market favours companies with strong balance sheets, low leverage, large scale, and high ROE. Bharti is in a stronger financial position than its peers, which face subdued EBITDA numbers on the back of rollouts in new markets or technology migrations or both.

We value Bharti using a blended approach. Our fair value for the core business is INR645, which is 13.7x FY2010e core earnings based on a 15% premium to HSBC's Sensex target of 11.9x; we value the tower business at INR141 using DCF, which reflects a 36% discount to recent transaction multiples (we use a sliding WACC starting with 11% and a terminal growth rate of 4.5%). Under our research model, for stocks with a volatility indicator, the Neutral band is 10 percentage points above and below our hurdle rate for Indian stocks of 11%, or 1-21% around the share price. Our 12-month target price of INR786 for Bharti shares suggested a potential total return that was above the Neutral band of our model at the time we set our target; therefore, we rate the stock Overweight (V).

Downside risks, in our view, include an early implementation of MNP, rollout of flat-rate plans, higher-than-estimated decline in margins on the back of rural penetration, and higher spectrum charges.

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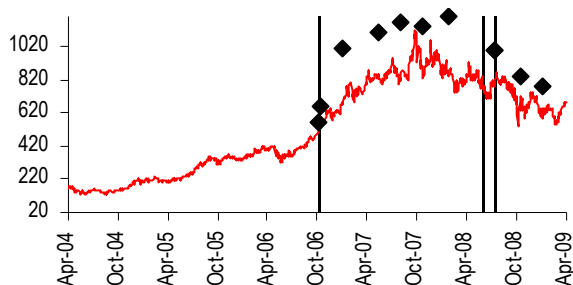
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Neutral (Hold)	37%	(30% of these provided with Investment Banking Services)
Underweight (Sell)	25%	(27% of these provided with Investment Banking Services)

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
Neutral	Overweight	23 October 2006
Overweight	Overweight	20 June 2008
Overweight	Overweight (V)	30 July 2008
Target Price	Value	Date
Price 1	560.00	23 October 2006
Price 2	660.00	02 November 2006
Price 3	1011.00	24 January 2007
Price 4	1110.00	04 June 2007
Price 5	1170.00	21 August 2007
Price 6	1140.00	07 November 2007
Price 7	1206.00	17 February 2008
Price 8	1003.00	30 July 2008
Price 9	1002.00	04 August 2008
Price 10	843.00	03 November 2008
Price 11	786.00	21 January 2009

Source: HSBC

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Company	Ticker	Recent price	Price Date	Disclosure
BHARTI AIRTEL	BRTI.NS	688.20	20-Apr-2009	6, 7

Source: HSBC

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