ICICI direct.com Research
It's Advice, Not Adventure

April 29, 2010

Bharti Airtel (BHATE)

Rs 294

Rating matrix

Rating	:	**Buy**
Target	:	Rs 347
Target Period	:	12-15 months
Potential Upside	:	18%

Financials

(Rs Crore)	FY09	FY10E	FY11E	FY11E
Net Sales	36961.5	39615.0	41768.3	43546.9
EBITDA	15167.7	16026.6	16285.0	17008.0
Net Profit	8469.9	9102.5	8663.9	9947.9
EPS	22.3	24.0	22.8	26.2

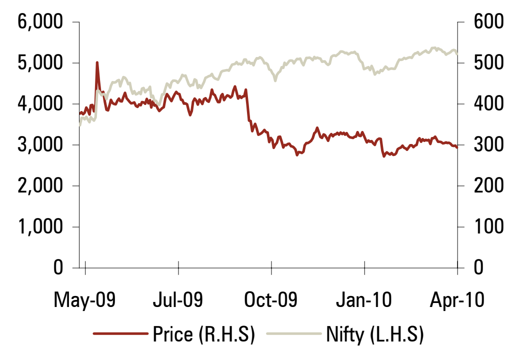
Valuation summary

	FY09	FY10E	FY11E	FY11E
PE (x)	13.2	12.3	12.9	11.2
Target PE (x)	15.5	14.5	15.2	13.2
EV/EBITDA (x)	7.8	6.9	6.4	5.8
P/BV (x)	3.7	2.7	2.2	1.9
RoNW (%)	27.9	22.0	17.4	16.8
RoCE (%)	24.6	20.9	18.0	16.6

Stock data

Market Capitalisation	Rs 111540.6 Crore
Debt-Cons. (FY10)	Rs 6461.8 Crore
Cash & Invst.-Cons. (FY10)	Rs 7742.5 Crore
EV	Rs 110259.9 Crore
52 week H/L	518 / 270
Equity capital	Rs 1898.2 Crore
Face value	Rs 5
MF Holding (%)	7.9
FII Holding (%)	18.0

Price movement (Stock vs. Nifty)



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WHAT'S CHANGED...

PRICE TARGET .... Changed from Rs 388 to Rs 347
EPS (FY11E) .... Changed from Rs 24.0 to Rs 22.8
EPS (FY12E) .... Introduced Rs 26.2
RATING... Changed from STRONG BUY to BUY

Better-than-expected performance...

Bharti Airtel reported its consolidated results, which were slightly higher than our expectations. The company reported a topline of Rs 10055.7 crore against our expectation of Rs 9906.8 crore for Q4FY10. The topline grew 2.9% and 2.4% QoQ and YoY, respectively. However, Bharti Airtel reported a lower-than-expected EBITDA margin of 38.0% (declining 202 bps QoQ and 272 bps YoY) primarily on the back of higher sales and marketing cost, which grew 18.3% QoQ and 34.8% YoY. The PAT for the quarter at Rs 2055.1 crore was aided by forex gain of Rs 147 crore. However, due to lower EBITDA margin and higher tax outgo, the PAT was down 8.2% YoY.

- **Highlights of the quarter**

  In Q4FY10, the company attained several key milestones, wherein it closed a historical deal with Zain for its South African assets. With this acquisition, the company will have operations in 15 African countries in addition to its operation in South Asian countries.
  The company also crossed the Rs 10,000 crore mark in terms of quarterly revenue. ARPU for the quarter stood at Rs 220, down from Rs 230, declining 4.3% QoQ, lower than our estimate of 6.3%. Subscribers during the quarter grew 7.3% sequentially. MoU grew by 4.9% QoQ to 468 minutes resulting in a 9.1% decline in ARPM from Rs 0.52 in Q3FY10 to Rs. 0.47 in Q4FY10. Share of VAS was up as well from 11.0% in Q3FY10 to 12.0%.

Valuation

Although the next few quarters are expected to be dull for the telecom industry and most companies are expected to underperform the market, we are confident about the fundamental strength of the company and positive about its long-term prospects. The lower-than-expected fall in KPIs signify initial signs of recovery in the Indian telecom industry. At the CMP of Rs 294, the stock is trading at 12.9x FY11E EPS of Rs 22.8 and 11.2x FY12E EPS of Rs 26.2. Using SOTP, we value the stock at Rs 347, implying an upside of 18% over its current market price of Rs 294. We rate stock as **BUY.**

Exhibit 1: Key Financials

(Rs Crore)	Q4FY10	Q4FY10E	Q4FY09	Q3FY10	QoQ (Chg %)	YoY (Chg %)
Net Sales	10055.7	9906.8	9824.5	9772.2	2.9	2.4
EBITDA	3822.0	3854.7	4001.4	3911.2	-2.3	-4.5
EBITDA Margin (%)	38.0	38.9	40.7	40.0	-202 bps	-272 bps
Depreciation	1592.8	1591.5	1328.5	1540.3	3.4	19.9
Interest	319.3	193.6	321.0	297.0	7.5	-0.5
Reported PAT	2055.1	1930.6	2239.3	2209.7	-7.0	-8.2
EPS (Rs)	5.4	5.1	5.9	5.8	-7.0	-8.2

Source: Company, ICICIdirect.com Research

After a sequential de-growth in revenues in the last two quarters, the company reported a growth of 2.9% QoQ and 2.4% YoY to Rs 10055.7 crore, primarily due to 2.9% QoQ growth in mobility revenue.

Result Analysis

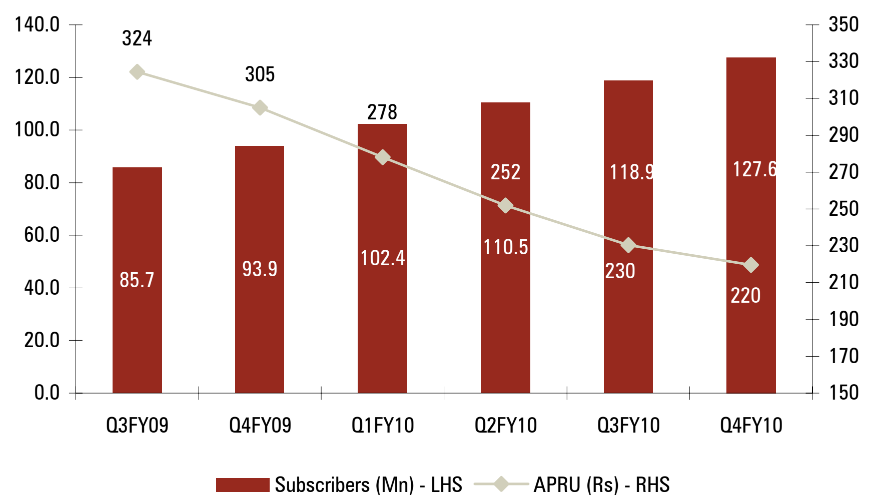
- **Mobility revenue backs total revenue growth**

After a sequential de-growth in revenues in the last two quarters, the company reported a growth of 2.9% QoQ and 2.4% YoY to Rs 10055.7 crore, primarily due to 2.9% QoQ growth in mobility revenue.

The company recorded a growth of 7.3% in subscriber addition taking the total tally to 127.6 million by the end of the Q4FY10. ARPU at Rs 220 declined by 4.3% QoQ while total minutes on the network grew by 12.8% to 17.3 billion. The company was able to keep a check on the fall in ARPU amid intense competition with the introduction of innovative pricing schemes.

The share of value-added revenues in the total topline increased to 12% as compared to 11% in Q3FY10, providing further cushion to the company against falling voice revenues. The growth in VAS share was pushed by aggressive marketing strategies and new product launches. The company launched the first ever Airtel application store with ~1,250 applications. Airtel has increased its focus on the data, entertainment and GPRS segments. We expect the share of VAS to further increase, post the launch of 3G services.

Exhibit 2: Mobility — Subscriber and ARPU



Source: Company, ICICIdirect.com Research

- **Pressure on EBITDA margin**

The company reported an EBITDA margin of 38.0% against our expectation of 38.9%. The EBITDA margin was down 202 bps QoQ and 272 bps YoY. This was due to an escalation in the sales and marketing expenditure, which grew 18.3% QoQ and 34.8% YoY to Rs 1602.7 crore. Sales and marketing expenses include one-time advisory and consulting fees of Rs 100 crore in relation to the Warid and Zain acquisitions. Margins in the mobility business declined from 30.4% in Q3FY10 to 29.2% in Q4FY10 due to higher marketing expenses. The EBITDA margin in broadband and telephone services declined from 46.1% to 43.5% in Q3FY10 due to an extraordinary item in Q4FY10.

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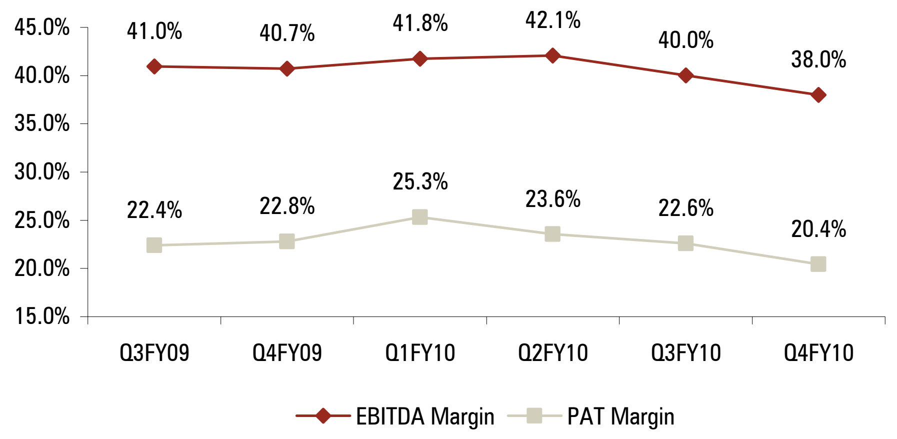
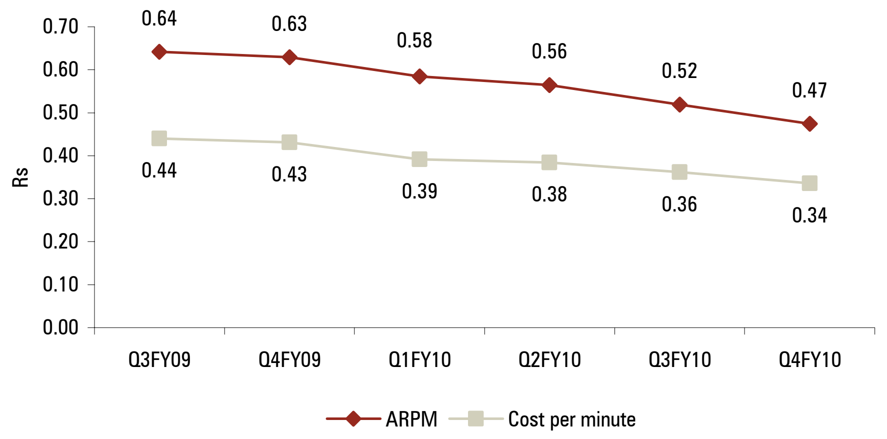
Exhibit 3: EBITDA and PAT margin



Source: Company, ICICIdirect.com Research

The ARPM declined from Rs 0.52 in Q3FY10 to Rs 0.47 in Q4FY10. The company was able to prune its operating cost in the voice segment resulting in the per minute cost falling to Rs 0.34

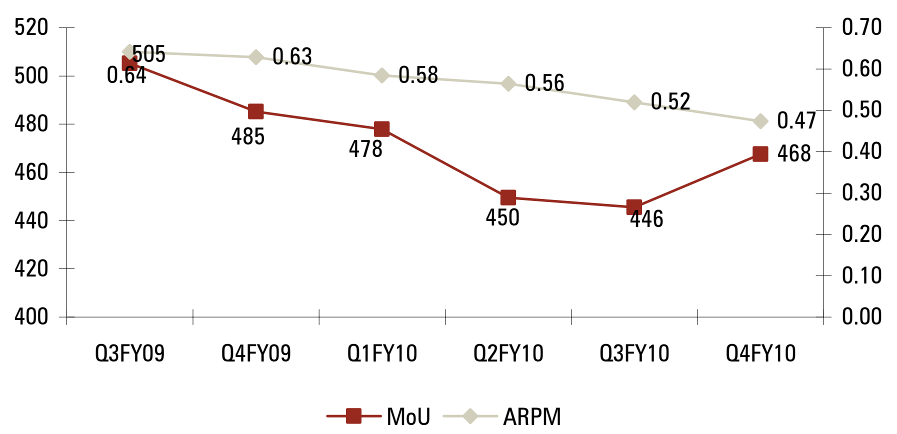
Exhibit 4: Cost per minute



Source: Company, ICICIdirect.com Research

The MoU for the quarter stood at 467 as compared to 445 in the last quarter. The total minutes on the network went up by 12.7% to 17.3 billion for Q4FY10. The sharp increase in MoU resulted in a 9.1% decline in ARPM from Rs 0.52 in Q3FY10 to Rs 0.47 in Q4FY10

Exhibit 5: Mobility – MoU, ARPM



Source: Company, ICICIdirect.com Research

The MoU for the quarter stood at 467 as compared to 445 in the last quarter. The company has launched 'Advantage plan'. This contributed to the increase in MoU and large number of subscribers opting for the new plan leading to higher number of minutes on the network. The total minutes on the network went up by 12.7% to 17.3 billion for Q4FY10. The sharp increase in MoU resulted in a 9.1% decline in ARPM from Rs 0.52 in Q3FY10 to Rs 0.47 in Q4FY10.

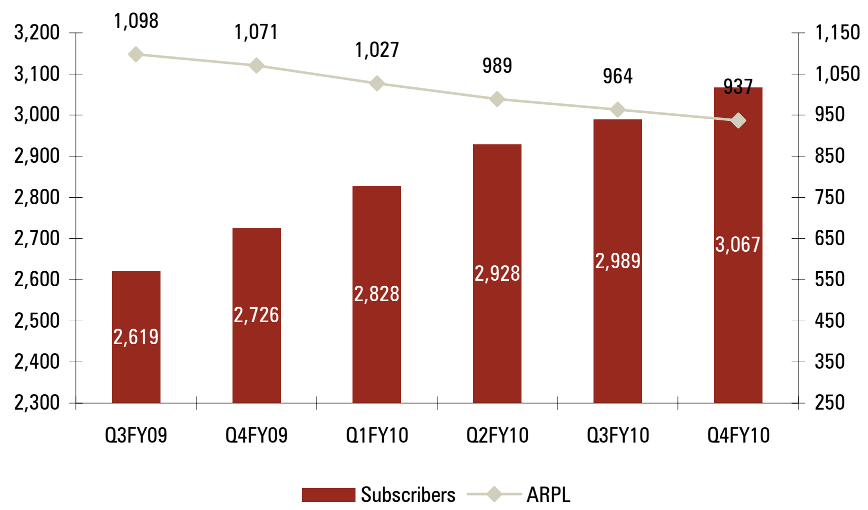
Telemedia and enterprise segment

The telemedia segment reported gross revenues of Rs 2924.8 crore for Q4FY10, which was flat over the last quarter. Revenues from the broadband segment have been flat for the last six quarters. The subscribers at the end of Q4FY10 stood at 3.1 million, growing 2.6% QoQ while the ARPL declined 2.7% QoQ from Rs 963 in Q3FY10 to Rs 936 in Q4FY10. The EBITDA margin declined from 46.11% in the last quarter to 43.5% in Q4FY10 due to a one-time extraordinary expense in this segment. We expect the company to maintain its EBITDA margin around 45% in this segment in FY11E.

Revenues from enterprise services were also flat sequentially. However, they declined 4.1% YoY. The NLD and ILD minutes on the network grew 13.8% and 2.3%, respectively, as compared to the last quarter.

Telemedia subscribers at the end of Q4FY10 stood at 3.1 million, growing 2.6% QoQ, while the ARPL declined 2.7% QoQ from Rs 963 in Q3FY10 to Rs 936 in Q4FY10

Exhibit 6: Telemedia - Subscribers and ARPL



Source: Company, ICICIdirect.com Research

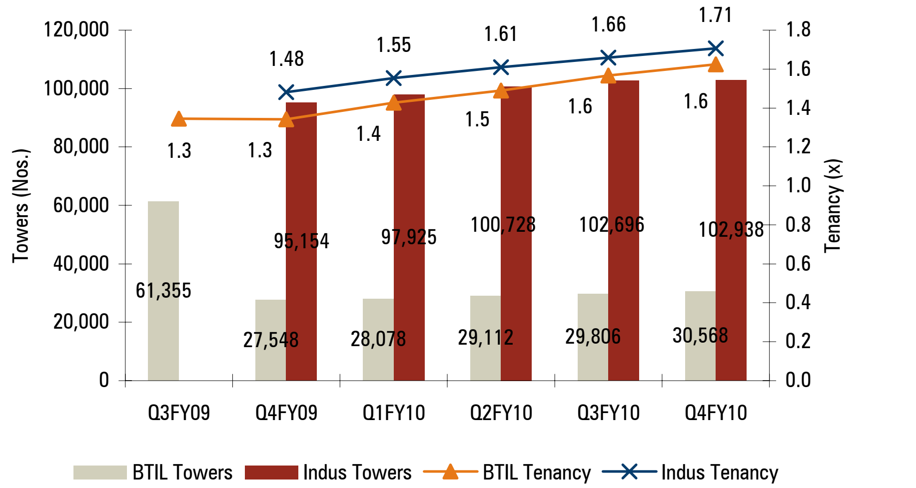
Slight improvement in BTIL operations

The passive infrastructure segment exhibited a marginal improvement with gross revenues growing 3.1% QoQ from Rs 926.7 crore to 955.2 crore. Also, the EBITDA margin in this segment expanded from 46.1% in Q3FY10 to 47.2% in the current quarter.

Total towers under operation increased from 29,806 in Q3FY10 to 30,568 in Q4FY10 in BTIL.

The passive infrastructure segment exhibited marginal improvement with gross revenues growing 3.1% QoQ from Rs 926.7 crore to 955.2 crore. Total towers under operation increased from 29,806 in Q3FY10 to 30,568 in Q4FY10 in BTIL

Exhibit 7: Passive infrastructure



Source: Company, ICICIdirect.com Research

Exhibit 8: Key performance indicators

	Units	FY08	FY09	FY10	FY11E	FY12E	CAGR% (09-12E)
Mobility							
Wireless Subs	Million	62	94	128	153	173	22.7
Blended ARPU	Rs.	366	325	244	200	178	-18.2
Total Minutes	Bn Min	285	475	610	758	842	21.0
MOU per sub	Minutes	479	508	459	451	430	-5.4
ARPM	Rs.	0.77	0.64	0.53	0.44	0.41	-13.5

Source: Company, ICICIdirect.com Research

Exhibit 9: Segmental revenue

(Rs Crore)	FY08	FY09	FY10E	FY11E	FY12E	CAGR %(09 - 12E)
Mobile	21,786.1	30,360.1	32,487.2	33,679.0	34,787.0	4.6
Telemedia	2,848.4	3,351.7	3,415.4	3,435.9	3,464.2	1.1
Enterprise	5,638.7	8,488.2	8,394.8	8,402.0	8,842.4	1.4
Others	243.1	361.1	582.5	1,092.2	1,262.8	51.8
Passive Infra	602.3	4,248.9	3,542.5	4,364.1	4,964.1	5.3
Gross revenue	**31,118.6**	**46,810.0**	**48,422.4**	**50,973.3**	**53,320.7**	**4.4**
Elimination	4,063.7	10,215.2	8,807.4	9,205.0	9,773.8	
Net Revenue	**27,054.9**	**36,594.8**	**39,615.0**	**41,768.3**	**43,546.9**	**6.0**

Source: Company, ICICIdirect.com Research

Outlook and Valuations

Outlook

Bharti Airtel reported better-than-expected results for Q4FY10. The key metrics declined lower than expected while the company exhibited a clear sign of improvement in voice revenues. The management has indicated an aggressive focus towards the data segment while with the increasing cut throat competition, voice revenues are expected to remain under pressure. The company launched the first of its own Airtel application store with more than 1,250 applications. With the launch of 3G services we expect the share of VAS to further increase. It would generate revenues at a higher pace compared to voice revenues.

The management has indicated a capex of $1.5-$1.8 billion for domestic operations (excluding 3G) and ~$2 billion including capex for South Asian operations for FY11E.

The company has taken over the control of Warid Telekom (Bangladesh) from January 2010. We expect the company to transplant its "minute factory model", which would augur well for the lower penetrated Bangladesh market.

The better than expected results inspire confidence that the scenario in the Indian telecom industry is not as bad as it was once feared. The new operators have successfully acquired subscribers and have also been able to trigger an intense price war. However, the extent of damage to larger companies like Bharti Airtel has been limited given their sheer size and scale of operations. In light of the current results, we have marginally revised our estimates for FY11E downwards.

Nevertheless, we expect the current situation of hyper competition to continue for some more time in the industry. We would advise a cautious approach to the Indian telecom industry and advise cherry picking.

We have not included the Bangladesh operations in our estimates. Also, we are awaiting further clarity on the Zain acquisition and would revise our estimates in due course. Given the concern of irrational bidding for 3G spectrum would lead to further debt raising this would stretch the balance sheet of the company. Excessive bidding for 3G would be negative in short term. Considering the concerns, we are discounting our DCF target price by 10%.

Valuation

Although the next few quarters are expected to be dull for the telecom industry and most companies are expected to under-perform the market, we are confident about the fundamental strength of the company and positive about its long-term prospects. The lower than expected fall in KPIs signify initial signs of recovery in the Indian telecom industry.

At the CMP of Rs 294, the stock is trading at 12.9x FY11E EPS of Rs 22.8 and 11.2x FY12E EPS of Rs 26.2.

SOTP based target price of Rs 347/ share

Assuming revenue CAGR of 5.9% over FY11E–FY20E and terminal growth of 3% thereon, we have arrived at a target price of Rs 325/share for the core business. However, we have discounted it by 10% to Rs 292. The discount is with regard to concerns over irrational bidding for 3G spectrum. We value BTIL (ex-Indus) at Rs 22.0/share and the Indus contribution at Rs 33/share to arrive at a target price of Rs 347 per share. Our target price discounts FY11E and FY12E EPS of Rs 22.8 and Rs 26.2 by 15.2x and 13.2x, respectively. The stock is currently trading at Rs 294. Our target price implies an upside potential of 18%. We are downgrading our rating on Bharti Airtel from STRONG BUY to **BUY**.

Exhibit 10: DCF assumption – Core business

Rs in Crore

WACC	11.7%
Revenue CAGR (FY11E-20E)	5.9%
Present Value of Cash Flow till FY20E	70,202.0
Terminal Growth	3.0%
PV of terminal cash flow	58,147.0
PV of firm	128,349.0
Less: Current Debt	6,461.8
PV of the Equity (excluding cash)	121,887.2
Number of Equity Shares outstanding	379.6
Per Share Value (excluding cash)	321.1
Add Current Cash Per Share (Rs)	3.8
DCF - Target price (Rs)	**325**
10% discount	**292**

Source: Company, ICICIdirect.com Research

Exhibit 11: Valuation table

	Sales (Rs cr)	Growth (%)	EPS (Rs)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY09	36961.5	36.8	22.3	26.4	13.2	7.8	27.9	24.6
FY10E	39615.0	7.2	24.0	7.5	12.3	6.9	22.0	20.9
FY11E	41768.3	5.4	22.8	-4.8	12.9	6.4	17.4	18.0
FY12E	43546.9	4.3	26.2	14.8	11.2	5.8	16.8	16.6

Source: Company, ICICIdirect.com Research

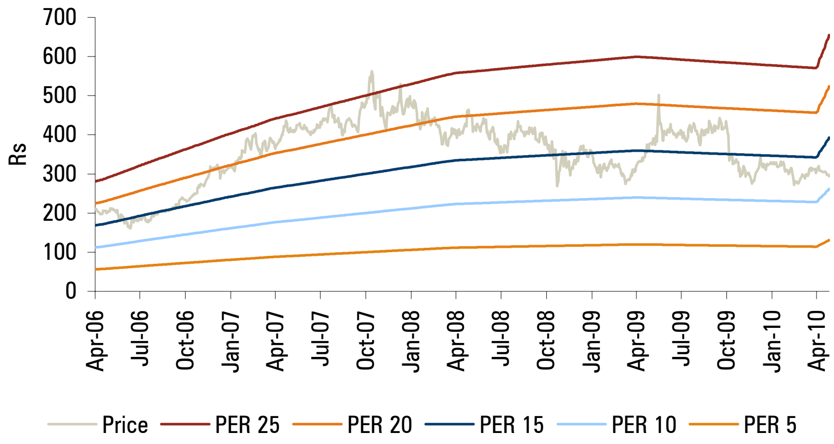
P/E based valuation of Rs 375/ share

Given the near term industry wide concerns we value the stock at a 5% discount to the Sensex, which is trading at ~15.1x FY12 earnings. This implies a target price of Rs 375 per share discounting FY12 EPS by 14.3x.

The stock is currently trading at 12.9x and 11.2x its FY11E and FY12E EPS, respectively. Bharti Airtel has generally been trading at a premium to the benchmark index. However, given the near term industry wide concerns we value the stock at a 5% discount to the benchmark index. The Sensex is currently trading at 15.1x FY12E earnings. We value the stock at 14.3x FY12E EPS to arrive at a target price of Rs 375 per share.

This implies an upside potential of 27.6% over its current market price of Rs 294.

Exhibit 12: One year forward P/E chart



Source: Company, ICICIdirect.com Research

ICICIdirect.com coverage universe (Telecom Service Providers)

Bharti Airtel					Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
Idirect Code	BHATE			**FY09**	36961.5	22.3	13.2	7.8	27.9	24.6
		CMP	293.8	**FY10E**	39615.0	24.0	12.3	6.9	22.0	20.9
		Target	346.8	**FY11E**	41768.3	22.8	12.9	6.4	17.4	18.0
MCap (Rs Cr)	111,540.6	**% Upside**	18.0%	**FY12E**	43546.9	26.2	11.2	5.8	16.8	16.6
RCOM					**Sales (Rs Cr)**	**EPS (Rs)**	**PE (x)**	**EV/EBITDA (x)**	**RoNW (%)**	**RoCE (%)**
Idirect Code	RELCOM			**FY09**	22250.5	29.3	5.7	7.2	14.3	6.1
		CMP	165.9	**FY10E**	21949.8	19.8	8.4	8.2	8.8	4.9
		Target	165.0	**FY11E**	23829.6	16.2	10.2	7.3	6.7	5.0
MCap (Rs Cr)	34,242.1	**% Upside**	-0.5%	**FY12E**	27213.4	17.6	9.4	5.6	6.8	5.7
Idea					**Sales (Rs Cr)**	**EPS (Rs)**	**PE (x)**	**EV/EBITDA (x)**	**RoNW (%)**	**RoCE (%)**
Idirect Code	IDECEL			**FY09**	10131.3	2.8	22.2	8.6	6.6	6.4
		CMP	63.1	**FY10E**	12409.3	2.5	25.5	7.5	5.7	5.9
		Target	61.3	**FY11E**	15704.9	2.9	21.6	6.7	6.3	6.6
MCap (Rs Cr)	20,830.4	**% Upside**	-2.8%	**FY12E**	18511.3	4.7	13.5	5.2	9.2	8.9
TTML					**Sales (Rs Cr)**	**EPS (Rs)**	**PE (x)**	**EV/EBITDA (x)**	**RoNW (%)**	**RoCE (%)**
Idirect Code	HUGTEL			**FY09**	1945.9	-0.9	-26.4	16.0	-6.9	0.4
		CMP	23.7	**FY10E**	2285.2	-1.9	-12.2	15.5	-14.9	-0.1
		Target	20.0	**FY11E**	2485.1	-2.3	-10.1	14.7	-17.9	0.0
MCap (Rs Cr)	4,486.9	**% Upside**	-15.4%	**FY12E**	2515.1	-2.3	-10.2	14.4	-17.7	0.1

Source: Company, ICICIdirect.com Research

RATING RATIONALE

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Strong Buy: 20% or more;
Buy: Between 10% and 20%;
Add: Up to 10%;
Reduce: Up to -10%
Sell: -10% or more;

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