Bharti Airtel Ltd

"Standing Tall"

ANTIQUE

Buy | **CMP: INR 810** | **Target Price: INR 974**

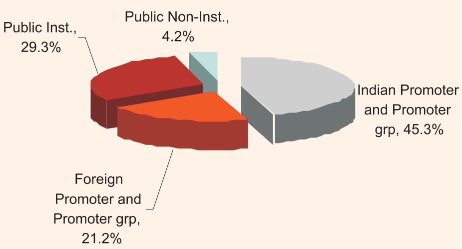
August 22, 2008 — Strictly confidential

Market Data		
Sector	:	Telecoms
Free Float (m)	:	306
Market Cap (INRbn)	:	1,537
O/S Shares (m)	:	1,898
52-wk HI/LO (Rs)	:	1,184/673
Avg 30-day Vol(nos)	:	4,038,467
Face Value (Rs)	:	10
Bloomberg	:	BHARTI IN
Reuters	:	BRTI.BO

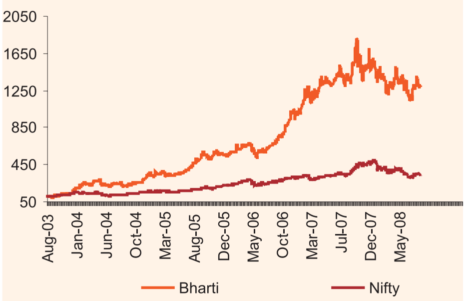
Price Performance (%)

	1m	3m	6m	12m
Absolute	(0.8)	(3.3)	(4.9)	(4.9)
Relative	(1.7)	11.8	16.6	(4.7)

Share Holding Pattern



Share Price Relative to NIFTY



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Bharti Airtel's business model has emerged stronger with profitable market share gains despite intense competitive pressures. We view Bharti Airtel leading the pack on its executional, strategical and investment-based supremacy, and a prime beneficiary of booming Indian telecom space. The operator is best placed to receive 3G spectrum. We believe that slowdown concerns are overdone. We initiate coverage with a BUY recommendation.

Wireless - Cash cow: At Bharti, robust MoU growth has outpaced the price per minute declines. We expect deceleration in ARPM declines and a robust subscriber growth, resulting from the national presence. Based on this premise, we believe that Bharti Airtel's wireless revenue growth would continue its momentum. We estimate a 3-year FY08-11 wireless revenue CAGR of 33% based on 32% 3-year FY08-11 subscriber CAGR.

Attractive tower assets valuation: We expect Bharti's tower business to follow the same growth trajectory as that of the wireless business. We value Bharti's stake in its passive infrastructure tower business at INR 190 per share included in the target price. We can expect positive surprises in Indus' valuations. We believe that the tower business provides potential upside in terms of both monetizing opportunity and incremental revenues from tenants.

Non-wireless - Supporting overall margins: We like Bharti's strategy of geographical concentration in its Enterprise and broadband business. Enterprise corporate and carrier business have shown strong return on asset and margins (24% in FY08 and 44% in Q1FY09 respectively), and broadband growth on the back of overall ARPUs has supported margins at the Telemedia business. We expect these two businesses would continue supporting overall EBITDA margins.

Next-gen opportunities: Although not included in the base case, 3G and DTH are key catalysts in determining growth momentum, the latter being expected one more step towards Telecoms-media convergence.

Valuations

At the CMP of INR 810, the stock is trading at 13.7x P/E and 7.8x EV/EBITDA of our FY10 estimates. We have used PEG based valuation to arrive at the target price of INR 974, which gives a total potential upside of 20% at the current market price of INR 810.

Risks

I) Overpayment of 3G spectrum fee, II) Any increase in spectrum charges, and III) Any increase in revenue share charges in the Long Distance business and interconnect charges in the wireless business.

Key financials (INR m)

INRm	FY08a	FY09e	FY10e	FY11e
Revenues	270,250	383,910	507,720	621,353
EBITDA	113,715	154,836	203,365	248,098
PAT	67,008	87,060	111,889	136,802
EPS(INR)	35.30	45.87	58.95	72.08
P/E	22.9	17.7	13.7	11.2
EV/EBITDA	13.9	10.2	7.8	6.4

Source: Antique Research

Investment thesis

Impregnable forte: Wireless market leadership

Bharti is the best placed operator in the Indian telecom space because of its natural leadership. At Bharti, the fall in average rate per minute (ARPM) has been offset by increase in Minutes of Usage (MoU) because of its minutes stimulation efforts.

Bharti's expertises are still unrivalled

Despite the ARPU declines, we have not seen the equivalent decline in the wireless EBITDA per min (especially between 2QFY07 and 2QFY08) at Bharti, rendering the latter a better measure of profitability. We see the de-growth in ARPM to decelerate. From current levels of 66 paise (1QFY09), we do not see them falling below the level of 50 paise at Bharti (FY10e of 57 paise). This is because competitive concerns are overdone and are only short term in nature. Bharti's expertise in terms of infrastructure, scale, long distance optic fibre, and franchise is still unrivalled. We believe that minute's volume growth will support the wireless revenue growth. Bharti's voice ARPU also benefit from interconnect fee earned on the share of offnet calls (close to 65% of incoming calls). We see increased contribution going forward by data revenues to the overall wireless revenues, contribution increased in 1QFY09 to 5.5% from 5% in previous quarter. We believe that the Indian wireless market itself still has copious demand to be met, and forecast a 5-year FY08-13 subscriber CAGR of 21%.

High value non-core assets

Tower business to provide incremental cash flows

Bharti's tower business is expected to follow the wireless business's path of being a market leader. Bharti already has a fair share of wireless tower market as well (approximately 20%). The incremental EBITDA from the tower business is expected to provide additional value. We see value in the tower business as the growth is linked to the wireless market growth, and expected demand for infrastructure sharing. The increased sharing requirements will stem from 3G rollout needs and diversification in difficult-to-penetrate rural service areas. With Vodafone and Idea as partners, we can expect positive surprise in tower asset valuations.

Emerging integrated player

Bharti Airtel is an integrated operator, serving both corporate and consumer segment, and Reliance Communication is the only competition in this space. Its strategy of geographical concentration in its Enterprise corporate business and 90% captive Long Distance (LD) business has led to generation of strong return on assets and margins, despite the fact that LD is a utility business.

Ready to draw benefits from new opportunities

High leveraging capability and strong cash flow to back up 3G bidding

We believe that Bharti is the one of the few operators that has the competency to bid successfully and acquire 3G spectrum in India in spite of the global participation. Bharti has a higher gearing capacity compared to Idea or RCOM; the Net debt/EBITDA (LTM) for 1QFY09 was 0.33. It has already exhibited strong data growth (82% y-o-y in FY08). 3G not only will provide the company further data opportunities, but also with 3G spectrum under its belt, it would be able to gain high average revenue per user (ARPU) early adopters, help decongest the 2G network and reduce opex (3G is cost-efficient as compared with 2G). Bharti is ready to embark upon Telemedia convergence with its IPTV and DTH services launches, which are set to bring fresh revenue opportunities.

Key Concerns overdone... pose minimal threat for the company

Mobile Number Portability (MNP) and threat of new entrants

International experience in MNP: High bottlenecks and minimal impact on market shares

The concerns that implementation of MNP would lead to increase in churn rates and price per minutes will have to be reduced substantially to ward off competition from new entrants in GSM space, are highly overdone.

MNP: The international experience of implementation and performance of MNP has been heterogeneous, and few constraints have been experienced in few countries like:

- Technical bottlenecks in porting systems. Germany experienced 3 years of delay due to technical non-feasibility.
- Speed of porting: Notice period for contract customers which largely would not be an issue as majority subscriber base in India is prepaid. Albeit, during the porting process the subscriber cannot avail incoming or outgoing calls, porting time could be several hours or several months (Netherlands took 2 months initially to port numbers).
- Tariff transparency reduces, as prefix no longer indicates the network of a subscriber.
- Porting charges for customers: Mostly are regulated, could be nil or could be as high as EUR24.95 charged by Vodafone in Germany.

Going by the international experience, MNP when implemented would cause a slight reshuffle in customer base, but we do not expect such a major exodus which can impact overall volume growth.

Country	MNP start	Operator	Market share change over three quarters from time of MNP implementation
Belgium	Oct-02	Belgacom	-0.3%
		Mobistar	1.0%
		BASE (KPN)	-0.7%
France	Jun-03	France Telecom	-0.7%
		SFR	0.1%
		Bouygues	0.6%
Germany	Nov-02	T-Mobile	-0.6%
		Vodafone	-0.3%
		E+	0.2%
		mmO2	0.7%
Italy	May-02	Telecom Italia	-0.5%
		Vodafone	0.3%
		Wind	0.2%
Spain	Oct-00	Telefonica	-0.2%
		Vodafone Airtel	-1.6%
		Orange	1.8%

Source: Companies

Tariff reductions by new entrants, including RCOM in GSM space, do not form a profitable option. These entrants cannot achieve the scale, investments and profitability at the same time to match Bharti's competency if they try to drive down tariffs from current rock bottom levels. Each new operation will take time to turn profitable.

C-service area leads on prepaid GSM ARPUs

Historically, the C service area GSM ARPUs have been at a premium to A and B, as the prepaid ARPUs are at a premium to the rest three service areas. There could be two underlying reasons for this pattern, high amount of NLD usage and lower penetration rates. The general concern is that as the penetration will increase, ARPU dilution would begin, however in Bharti's case it will have the first mover advantage of capturing high end users in these areas.

Industry Prepaid GSM ARPU

Service areas	1QFY08	2QFY08	3QFY08	4QFY08
A(INR)	244	231	208	225
B(INR)	239	216	213	214
C(INR)	274	252	244	244
Metro(INR)	261	249	248	235

Source: TRAI

ISP's unrestricted Net-telephony

Firstly mass diffusion of Voice over Internet Protocol (VoIP) in STD and especially local call segment is expected to be constrained because of the access mode. Access devices in India for VoIP will predominantly be fixed and PC based. Broadband wireless access is still far in future. On pricing, the local and STD call rates for Bharti are already competitive and given that ISP would also have to pay interconnect charges on local call, we do not see any pressure on tariffs. We do not see VoIP affecting the business model of telecom operators.

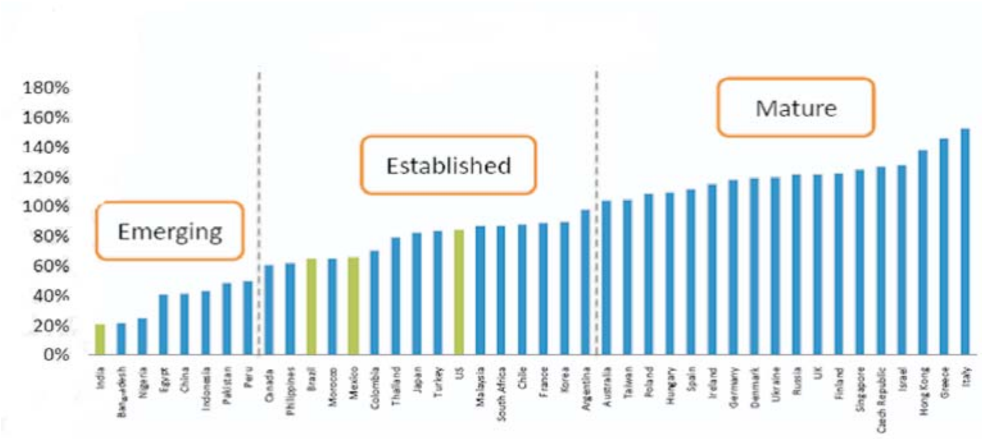
Indian wireless market: The land of opportunities

Low population penetration rates...

All set for colossal growth

Like any other infrastructure business, telecommunications is a building base for the growth of an economy, and the need of telecommunication services is only going to grow. Globally, the contribution of telecom services to the global GDP is consistent at 2-3%.The services have become affordable universally, both in terms of price per usage and price of devices used to access them. This has mainly been the result of the changing regulatory environment, opening up of services to competition, upgrading of the network and innovations.

Wireless Market Penetration as of Dec 2007



Source: American Tower Company

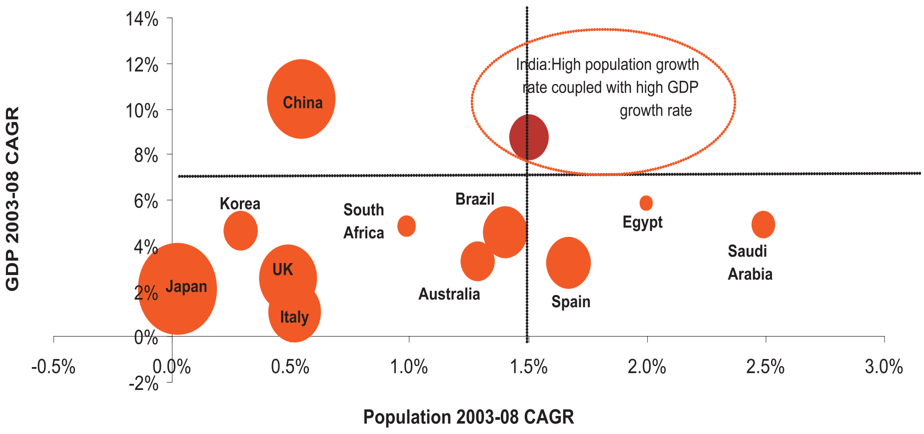
Indian telecom space is predominantly wireless. In India, the terrain has been such that the laying out of fixed-line services has been outpaced by the growth in wireless services. The statistics are overwhelming; in the total telephone user base, wireless subscribers contribute to 87% for 1QFY09. Meanwhile, the mobile market is underdeveloped(especially in rural areas), with penetration standing at just 24% on a headline basis, while fixed-line services are a relatively poor substitute, given low levels of uptake (39mn fixed lines as of 1QFY09). The wireless subscribers have grown at a 5-year CAGR of 83% between 2003 and 2008. Comparing population penetration rates with other countries, there is long way to go before a major portion of the population is covered by wireless services. There exists a huge demand, which still remains unmet in both wireline and wireless sectors, and a telecom operator has huge growth potential in these sectors.

Favorable growth matrix

…. coupled with high GDP growth rates create significant demand potential

The Indian market's growth potential gives it the obvious appeal. The country has the second-largest population (1.1 billion), and is enjoying high growth in both GDP per capita and overall GDP growth rate. India's GDP (at constant prices) during 2003-08 at a 5-year CAGR is 8.8%, which is below China's 10.5%. However, China lags India in terms of population CAGR, whereas the former's 5-year CAGR is 0.5%, the latter has a CAGR of 1.5%.

Population and GDP CAGR (Size represents absolute GDP as of 2008 in USD bn)



Source: IMF

Unsurprisingly, there has been a spur in telecom activities within India, and a lot of interest has also been shown from outside the country. Many operators have made a beeline for the industry, such that the Indian telecom sector now has the highest number of telecom operators globally. As mentioned earlier, the price per usage has declined mainly because of policy, competition and the shift in base to rural areas. Churn rates are high since prepaid customers far exceed postpaid subscribers and MoU are one of the highest in the global set of peers.

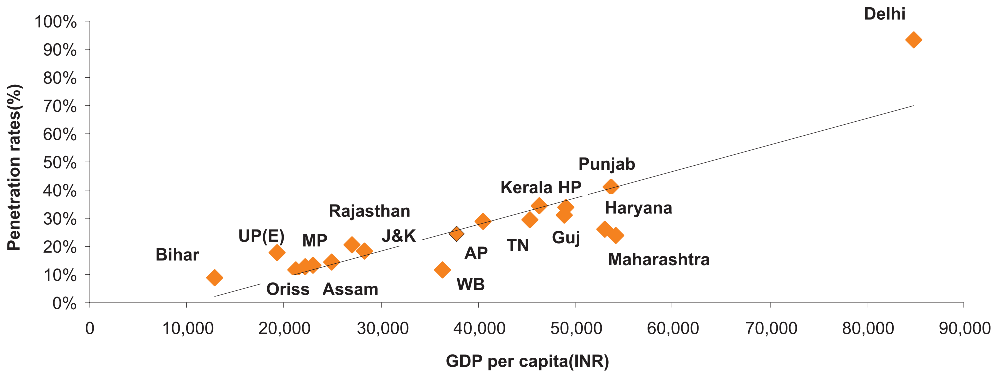
For steady revenue growth, volume share will be critical, which will make or break the case of profitability for an operator who purely focuses on wireless business, unless the portfolio is diversified to provide multiplay services. Being a capital-intensive business, only large operators have the capacity to invest in the next generation network and grow, while marginal operators face the threat of losing steam or being acquired, with only 4-6 big operators surviving.

Next growth drivers: Untapped semi-urban and rural regions

…. Semi-urban and rural areas still have huge unmet demand

In India 70% of the population resides in rural areas and the rest 30% in urban areas. The income disparity is huge across the 23 service areas (Gini coefficient=0.35), which reflects in diverse wireless penetration rates across these areas. Post the deregulation of the sector, growth has been concentrated towards four metro service areas, which now show characteristics of developed markets, with high value (high GDP per capita) and high penetration rates. Now the growth focus is shifting towards semi-urban and rural areas, which (the only plausible option, as the majority of population resides in these areas) have low penetrations, but added set of challenges. These are difficult-to-reach regions in terms of patchy infrastructure, shortages electricity and low capita per GDP. But all these factors still do not undermine the demand for telecom services, and a low GDP per capita does not necessarily signify lower profitability.

GDP per capita (INR) and population penetration rates as of Mar-08



Source: TN GOV and Antique research

.... Network sharing a key strategy to reach untapped service areas

On the lines of an FMCG 'satcheting' strategy in rural areas, operators like Bharti have come up with smaller recharges, mini refill value initiatives to attract a new subscriber and earn the processing fee. The operator is also eyeing the network sharing to address the needs of rural areas. We also expect the demand for fixed line-based broadband services to be strong from the rural areas.

.... A, B and C service area driven growth

Subscriber projections

Subscriber'mn	2008a	2009e	2010e
Metro	45	51	54
A	94	128	159
B	95	139	181
C	27	49	71

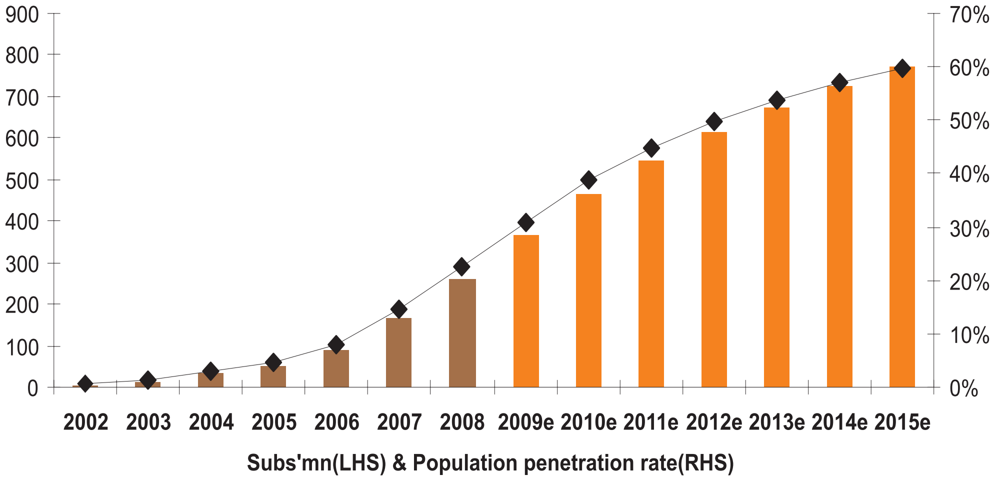
Source: TRAI and Antique

Age group	Rural	Urban
0-14	37.1%	26.6%
15-24	17.4%	22.8%
25-54	33.8%	43.7%
55-64	5.5%	5.2%
64 & Above	6.3%	1.7%
Total	100.0%	100.0%

Source: Antique Research

We have based our subscriber forecast on a relevant age group for rural (50% of 15-24 and 100% of 25-54 age groups) and urban areas (100% of 15-64 age group). We have assumed that handsets and usage charges have become almost affordable. We forecast a FY08-13, 5-year CAGR of 21% in the subscriber base, and expect it to touch the 460-million mark with a population penetration rate of 38% by FY10.

Wireless subscriber base and population penetration rates



Source: TRAI and Antique

Bharti-Business case and forecast

Wireless business: Sustaining volume-driven growth

MoU growth will continue. ARPM decline did not convert into equal EBITDA per min decline

- **Minutes of usage growth would continue to be strong:** We expect Bharti's MoU to continue to hold current strong levels (FY09e:542, FY10e:569), as we expect the subscriber leadership to continue and the price elasticity of minute demand to remain healthy.
- **ARPM declines to decelerate:** With significant downward revisions in tariff rates, the price per minute for almost all telecom operators has converged to approximately 66 paise, and we believe that tariff refreshers would continue at Bharti with floors of 50 paise, and do not expect ARPM to decline from here.

Catch 22: Minutes leadership led to operating leverage, which led to affordance of price cuts, resulting in further stimulation of minutes usage

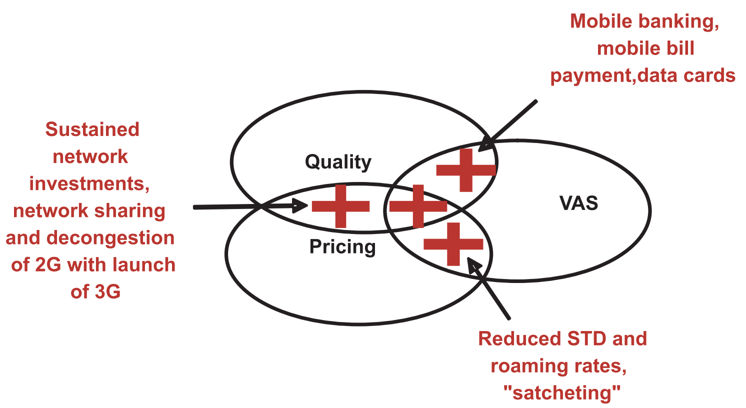
- **Wireless EBITDA per min a better measure of profitability:** Historically, the ARPM or ARPU decline did not translate into wireless EBITDA per min fall at Bharti, for example in Jun-07, the ARPM quarter-on-quarter fall was 4.5%,whereas corresponding fall in EBITDA per min was just 1.1%. (The spike in 4QFY08 and 1QFY09 was largely because of conversion of capex into opex in wireless). This is a result of economies of scale, which Bharti enjoys because of the highest number of minutes carried on its network.
- **Data ARPU contribution to increase:** We expect robust data ARPU growth to continue, and their contribution to blended ARPUs to improve.

Bharti's leadership in wireless market is difficult to be thwarted, and the subscriber base growth is currently accruing from semi-urban and rural areas. The company's competitive advantage is its ability to spread fixed costs over a larger number of minutes. Hence, the company comfortably reduced its tariffs to stimulate usage, but the equivalent contraction was not seen in the EBITDA per min.

What are Bharti's volume growth stimulants?

3D strength: Right technology strategy, pioneer in pricing and VAS strategy

Bharti's pioneering efforts in following areas have led to the first-mover advantage of gaining net adds at an accelerated pace: 1) quality of services, 2) competitive pricing, and 3) value add services.



Source: Antique

Rather than the type of technology (GSM or CDMA), a consumer weighs a wireless commodity over the following parameters:

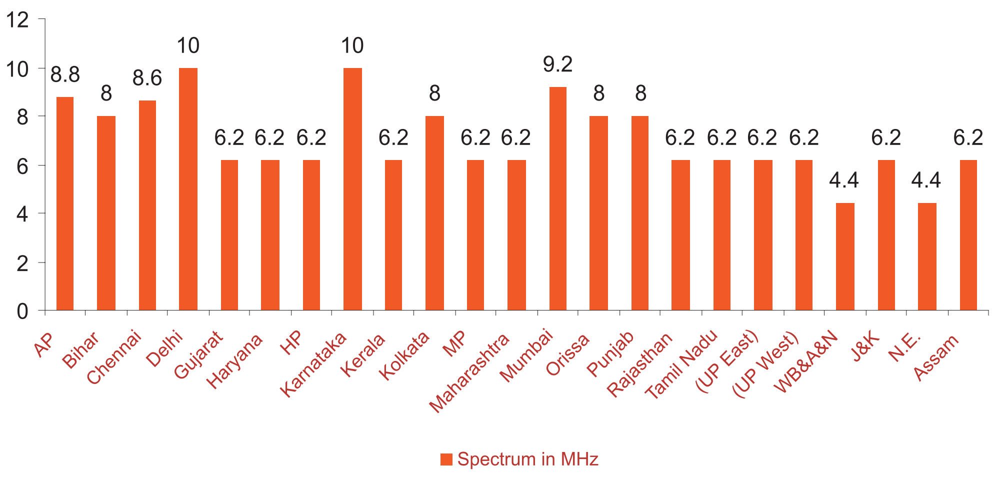
- **Quality:** With the sudden boom in subscriber growth, networks have become congested, and voice quality has become questionable. Spectrum and investments are key determinant factors for this.
- **Pricing:** Bharti has been a leader in setting benchmark tariffs in the market. Bharti underwent major tariff refreshers in April this year and has made the pricing platform even more competitive. Going forward, we do expect cuts in tariffs to be carried out by Bharti, but price per minute fall to decelerate, and expect that the elasticity lag effect should come into play to improve the MoU growth.
- **Value-added services:** Bharti is not only a pioneer in bringing 'satcheting' plans, but also has introduced services such as mobile banking, electronic refilling and data cards, bringing it on par with global service providers like Vodafone.

Spectrum and network technology

Additional spectrum obtained in 8 circles

In 1QFY09 results, Bharti has announced that it has obtained additional spectrum for eight service areas. Bharti's spectrum position is strong, and in 11 out of 23 circles, Bharti has spectrum in the 900 MHz band. This band has a stronger coverage as compared with 1,800 MHz; on an average, the difference in signal strength between the two is between 8 dB and 10 dB at any location. 900 MHz can cover land with significantly fewer base stations, and low frequency signals have better bendability qualities as well. The bearish view is that as soon as Reliance Communication (RCOM) rolls out its GSM services, Bharti would lose its competitive edge. However, we should take into consideration the fact that RCOM's GSM rollout is happening in the 1,800 MHz which, as mentioned earlier, would be technologically inferior to 900 MHz band, plus RCOM would be rendered as a late entrant in the GSM space.

Spectrum as of August 2007 (ex any additional spectrum granted post-August 2007)



Source: TRAI

USP: Outsourcing model, upgrading existing network to push higher minutes

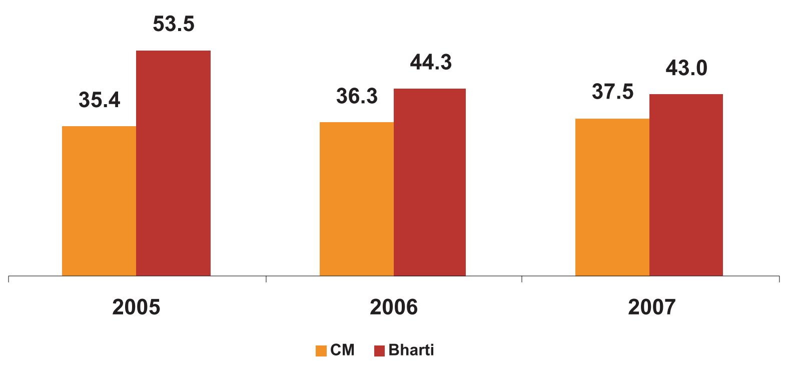
Telecom IT and network partnership - Key to success: Bharti has a network management outsourcing agreement with Nokia and Ericsson for 15 and 8 service areas, respectively. The key is the payment method, which is linked to minutes carried (pay-as-you-grow model), rather than upfront payment like what is done by BSNL. But the fact that this method would incentivize both Nokia and Ericsson for pushing higher minutes on network, the 'existing' network will be utilized to its utmost potential. This, in turn, reduces network operational costs and capital expenditure for new network rollout. One example of efficient use of network is the EDGE technology or 2.5G network upgrade by Bharti with the help of Nokia (USD125mn agreement entered in 2005-06 for eight circles), which is a cost-effective method of voice transmission that provides for efficient use of radio spectrum.

Optimal spend on telecoms infrastructure (capex per subscriber)

Not overspending, but optimally spending to meet supply side requirements

Bharti is consistently reducing its capex spend and adding net adds at a faster rate, 28% in 2007 vs. 24% by China Mobile in the same period, once again reasserting the importance of its low-cost outsourcing model.

Wireless capex per sub (USD) comparison:



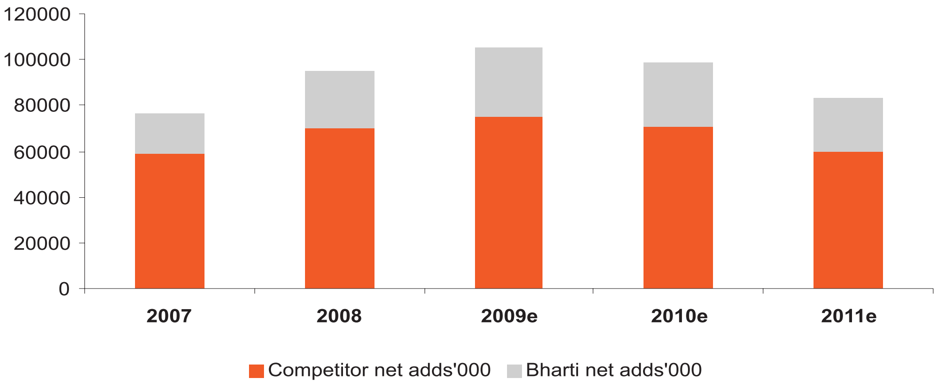
Source: Company (FY Dec ending, Bharti's Mar numbers converted to dec, FY08 wireless capex adjusted for passive capex).

Usage growth: Continued leadership

Unmoved net add leadership

On the back of its presence in 23 service areas, and additional spectrum granted in eight new service areas and all other strengths discussed earlier, we believe that Bharti will continue to gain net adds at a steady pace. We forecast net adds market shares of 29% for FY10.

Net adds comparison



Source: TRAI and Antique estimates

As mentioned earlier, the next phase of growth is expected to be primarily from under-penetrated B and C service areas, besides the A service area. Growth in metro service areas seem to be slowing down.

We believe that Bharti will be able to continue its leadership due to its national presence in terms of coverage, requisite spectrum, competitive tariff plans and widespread network. It has invested USD3.4 bn in building assets in 2008. As of June 2008, the company has a wireless asset base of 58,013 towers. It is also in strategic tie-ups with operators for passive infrastructure sharing. We expect the company would be able to increase its market share to 26% by 2011 based on an overall subscriber base of 144mn; and a 3-year FY08-11 subscriber CAGR of 32%.

MoUs to grow at a steady pace

MoUs to grow at a steady pace

We expect the subscriber growth and good elasticity to keep up the minutes of usage growth. Elasticity of 1 (i.e., fall in the rate per minute exactly matched by minutes increase) generates higher service revenue growth as was seen in 4QFY08 (service revenue grew by 12% with elasticity of 1, as compared with 7% in Sep-07 when elasticity was -0.4). The price per minute decline in 1QFY09 is yet to fully reflect in minutes of usage growth.

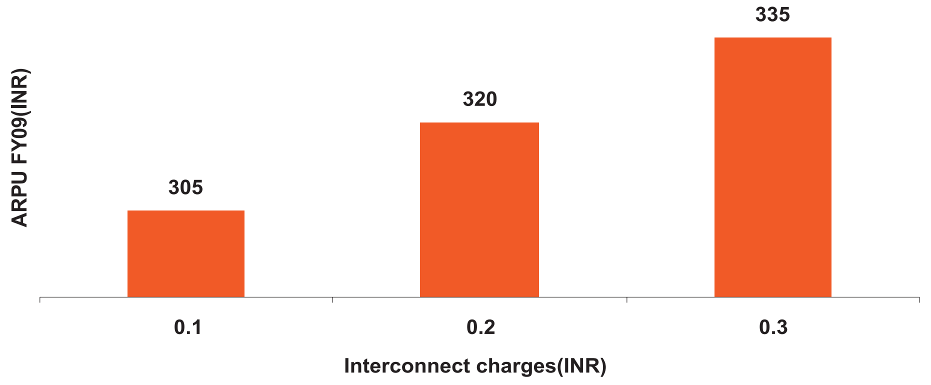
Hence, there is still room for MoUs to expand, and going forward, when the ARPM decline is curbed, increase in MoUs is only going to add incremental value to service revenues.

For GSM operators, the incoming to outgoing ratio on average is 53:47. Though India has one of the highest MoUs in the world, revenue generating units are just 50%, as incoming MoUs are almost close to outgoing MoUs. Hence, it is not just a robust MoU growth, which has helped Bharti sustain its revenue growths, but the other important portion is the interconnecting charge. Due to its ubiquitous presence, Bharti has an edge in terms of having a widespread terminating network in India (apart from BSNL and RCOM in CDMA), and benefits in terms of interconnect revenues. We estimate that out of total incoming minutes, close to 65% of revenues are offnet on which the company is earning revenues at the rate of 30 paise.

ARPUs are sensitive to any interconnect cut

We have adopted interconnect charges at the rate of 30 paise for calculating the voice ARPU. We have not incorporated any probable cut in interconnect rates in our base case. Our base case ARPU sensitivity to any cuts as high as 40-50% is as shown in the chart.

FY09 ARPU sensitivity to interconnect rate



Source: Antique

Average Revenue per Minute to bottom out

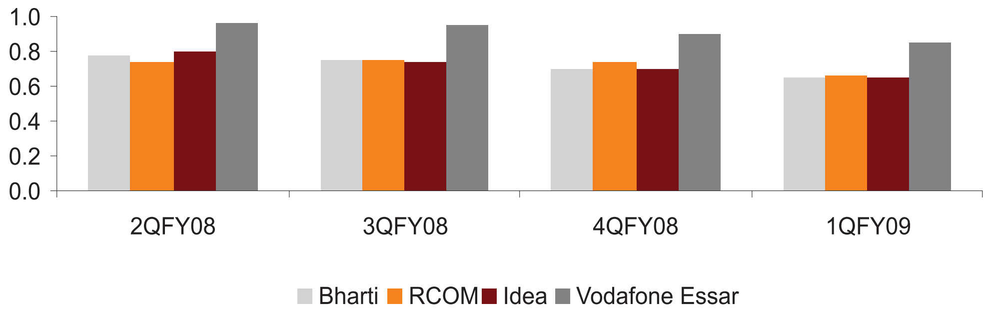
Double digit falls to contract down to single digits

The quarter-on-quarter falls in ARPMs at Bharti accelerated in 4QFY08 and 1QFY09, at a rate of 7%. STD and roaming cuts of 40%, which the company carried out in April 2008, were in order to pass on the benefits of discontinuation of revenue share Access Deficit Charge (ADC) and the reduction of ADC on incoming calls from Re 1 per minute to 50 paise per minute. Even this 50 paise per minute will be completely withdrawn with effect from September 2008. According to the company management, we are likely to see further cuts in tariff in part to pass on the full effect of ADC cuts.

Fall in ARPM more than offset by increase in MoU

We believe that the de-growth in ARPM will decelerate and will finally stabilize at 50 paise level at Bharti, as tariffs are already the lowest with respect to global standards, and any fall below this will be irrational from an operator's profitability point of view. We project that the double-digits fall (18% in FY08) will decline down to single digit by FY10 (8%), and will continue slowing down further thereafter.

Industry ARPM (INR) ex Vodafone Essar converged towards INR0.66



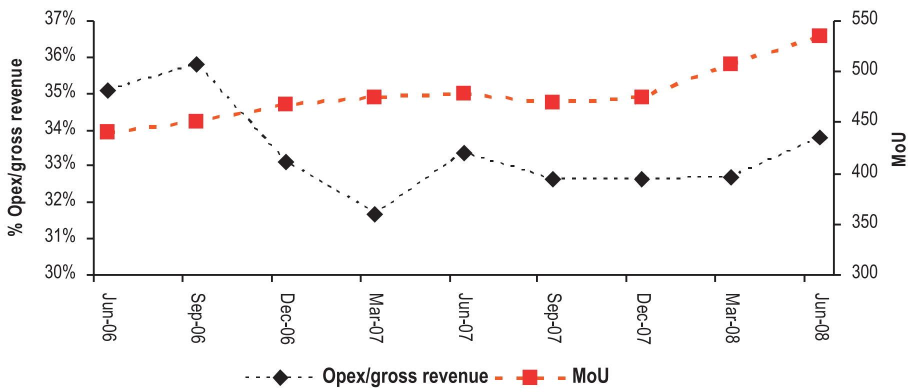
Source: Company

Catch 22: Economies of scale helped affordance of price cuts

Bharti has been able to spread its operating costs (= network opex, employee cost, equipment costs, and SG&A) on a larger number of minutes. This operating leverage has allowed Bharti to compete on prices, and unlike few of the competitors, judging from the wireless EBITDA per minute profile, Bharti has been able to survive the average revenue per minute fall. And, in turn, the ARPM fall has induced further usage, which was more than enough to offset the fall. For example, in 1QFY08, the quarter-on-quarter fall in ARPM and EBITDA per minute was 4.5% and just 1.1%, respectively. We did see a higher negative spike in EBITDA per minute in 4QFY08 and 1QFY09, but this was largely due to the pass-through payments done to the passive infrastructure business.

Ability to spread costs will continue as MoUs increase

Opex/gross revenue and MoU schedule



Source: Company

We believe that Bharti will continue to enjoy the scale advantage, with the deceleration in ARPM decline rate, and the increase in MoU growth is only going to provide incremental value to wireless revenues and EBITDA per minute.

Data revenues to accelerate

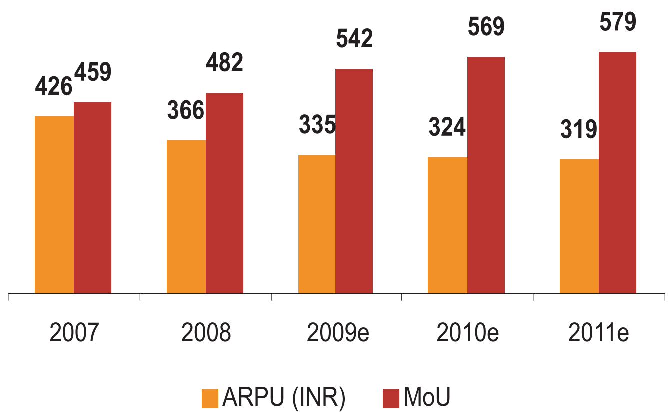
Bharti's wireless revenues comprise, apart from voice, SMS and non-voice/non-SMS or data revenues. Data revenues have shown stupendous growth in FY08 at 82% and their contribution, though small, to blended ARPU also increased in

1QFY09 to 5.5 %(against 5% in 4QFY08). The 'hello tunes', music-on-demand Airtel live and data card services have commanded a strong response from consumers under flat rate plans. Going forward, we will see mobile banking, mobile bill payment and mobile refills services to push the data contribution even further. On the back of existing 2.5G based data services, we forecast a contribution of 6.2% and 6.7% in FY10 and FY11, respectively. These are still early days to see data acceleration from 3G services, because the 3G handsets and 3G content will take time in India to diffuse as and when these fall within affordable range.

Operational forecasts

For the non-voice segment, we observe a declining trend in SMS revenues, and have continued this trend for future forecast. However, data revenues are projected to increase at a rate of 45% and 31% in FY09 and FY10, respectively. Combinations of these factors lead us to the conclusion that for FY10 and FY11, ARPUs would be INR 324 and INR 319, respectively. We forecast an MoU growth of 12% in FY09 (as the effect of price cuts would be seen in the remaining 3 quarters of FY09) at 542, and post this to grow at a stable rate of 5% at 569 in FY10.

Bharti's ARPU and MoU forecast



Source: Antique

Wireless financial forecasts

On the back of these forecasts we expect wireless revenues to grow at a 3-year FY08-11 CAGR of 33%. Currently, the company is converting its wireless capex to wireless opex. That is it is now paying electricity and fuels costs or pass-through costs to the passive infrastructure division. For the past 2 quarters, wireless margins have seen sharp declines of 530 bps and 480 bps on account of restructuring and reporting of passive infrastructure services as a separate segment, completion of license moratorium in seven service areas, deep STD and roaming rate cuts, and increase in LD charges.

Wireless revenue projection

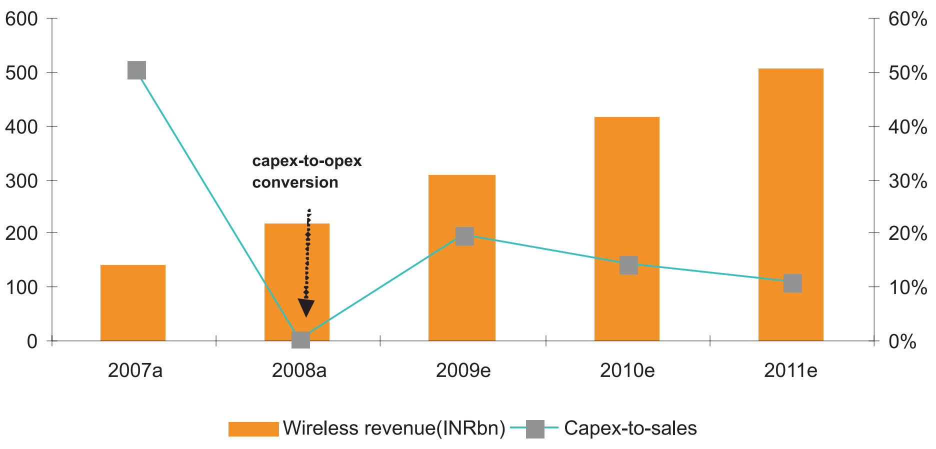
Wireless revenues(INRbn)	2008	2009e	2010e	2011e
Voice	195	279	374	457
SMS	10	12	15	16
Data	11	18	26	34
Total service	216	309	414	507
Other	2.3	0.4	0.6	0.7
Total wireless revenue	218	309	415	508

Source: Company and Antique

Conversion from capex to opex

We estimate that the impact of pass-through costs being paid to passive infrastructure had an impact to the extent of INR 2bn (3.3 percentage points) and INR 3.8 bn (5.5 percentage points), respectively, in 4QFY08 and 1QFY09. Margins for 1QFY09 were 31%; we believe that a 30-31% wireless margin would be sustainable by the company, and we do not expect further dips in margins because of earlier discussed economies of scale. That is because from the next quarter onwards the only sustained effect would be pass-through charges payment to Infratel. We do expect fresh rate cuts. But these will be offset by an increase in minutes of usage. Since the wireless business is only incurring the electronics capex, we have assumed that the wireless capex will trend down to 20% and 14% in FY09 and FY10.

Wireless Revenue and capex projections



Source: Antique

Lucrative non-core business will provide incremental value

Tower business: Potential value unlocker

Bharti's tower business is expected to follow the same trend as its wireless business. More explicitly, in tower business also we see Bharti commanding a higher share of towers, because the correlation between subscriber growth and tower growth is apparent. The company has already pioneered in achieving network sharing agreements with Vodafone and Idea. We believe that in the Indian scenario, tower companies are all set for commanding attractive valuations, and operators like Bharti will benefit hugely by the incremental revenues and by monetizing stakes in their tower companies.

Subscriber base expansion requires equal expansion in number of towers

The following have led to the importance of tower companies:

- Huge demand for towers expected: TRAI estimates that around 330,000 towers are required by December 2010 to cater to about 500 mn subscribers.
- Infrastructure sharing becomes inevitable: Declining ARPUs, the government pressure on passive sharing, and the expansion in less densely populated and remote areas are some of reasons that have led to the need for infrastructure sharing to keep operational costs low, because returns per subscriber are also low in these areas.
- 3G requires network investments: Global operators would either resort to network sharing in case they receive 3G spectrums or will adopt an MVNO route.
- New operators awarded spectrum: New operators would also want to resort to network sharing if they have to carry an accelerated rollout of services.

Assumptions and forecasts:

- We have added the incremental net revenues which will flow from external tenants (for example 0.22x portion of the 1.22x tenancy) of the passive infrastructure business, to the company's consolidated revenues for the forecast period, and made appropriate adjustments in the inter-segment eliminations for the remaining revenues.
- We have not incorporated the transfer of 30,000 towers to Indus.
- Capex recovery rate is assumed to be 12% and life of a tower is taken to be 15 years. Tenancy has been gradually increased from current 1.22x to 1.64x in FY15 to 2.05x in FY20.
- The EBITDA margin (i.e. margin based on net revenue) for tower business is high, we forecast a 57% margins for FY09 and expect this to increase to 66% for FY15.

Overall valuations:

We have used DCF technique to value Bharti's 90% stake in its Infratel business at INR 190 per share (included in the base case), i.e., an EV/EBITDA multiple of 15x for FY10 and EV/tower multiple of INR4.4 mn, net debt is assumed to be zero. The WACC assumed is 12%, taking in account Bharti's costs and beta. A summary of key parameters is given below.

INRm	2009e	2010e	2011e	2012e	2013e	2014e	2015e
Towers'000	75,118	90,433	112,474	130,856	146,576	160,129	171,918
Tenancy' x	1.26	1.32	1.38	1.44	1.50	1.57	1.64
Revenues	31,803	47,801	64,308	81,090	98,563	116,934	136,418
EBITDA	17,430	26,866	36,647	48,314	61,306	75,083	89,412
Growth rate	4.0%						
WACC	12.0%						
NPV	401,717						
Bharti's stake value(INR Per share)	190						
EV/tower FY10(INRm)	4.4						

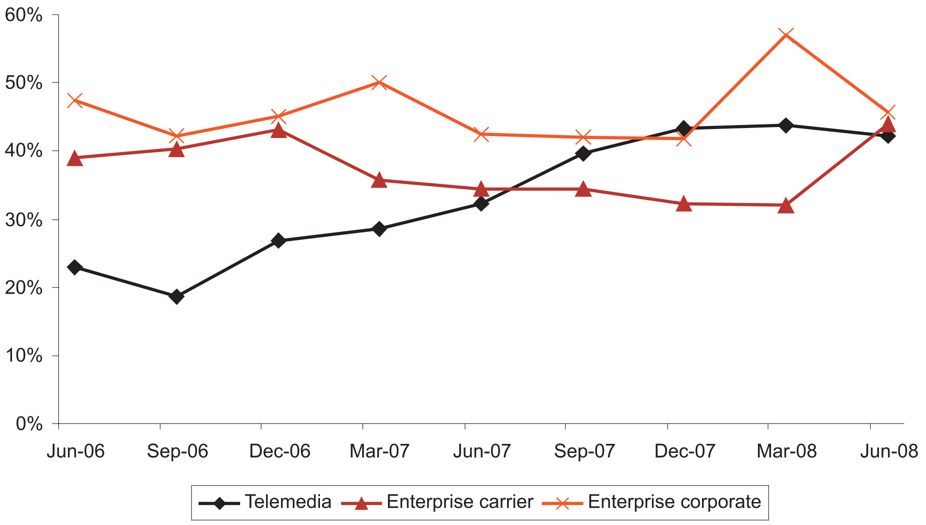
Source: Antique Research

Non-wireless supporting overall margins

Non-wireless growth to provide stability to overall margins

In the enterprise corporate and carrier (or Long Distance) segment, the company has deployed the strategy of geographical concentration to service corporate segment and operate as a carrier's carrier unlike competitors who have laid out optic fiber on a widespread basis, incurring higher capex. In this segment, Bharti faces competition only from RCOM. Enterprise corporate exhibited strong return on assets of 24% for FY08. ES and LD business have shown strong growth in margins in the last few quarters.

EBITDA margins for the three non-wireless divisions



Source: Company

In 1QFY09 quarter, the company has shifted the growth substantially to the Long Distance business, besides changing the historical EBITDA mix. From contributing to 9%, 13% and 78% of group EBITDA in 1QFY08, Telemedia, LD business and wireless business contributed to 10%, 20% and 60% of group EBITDA in 1QFY09, respectively.

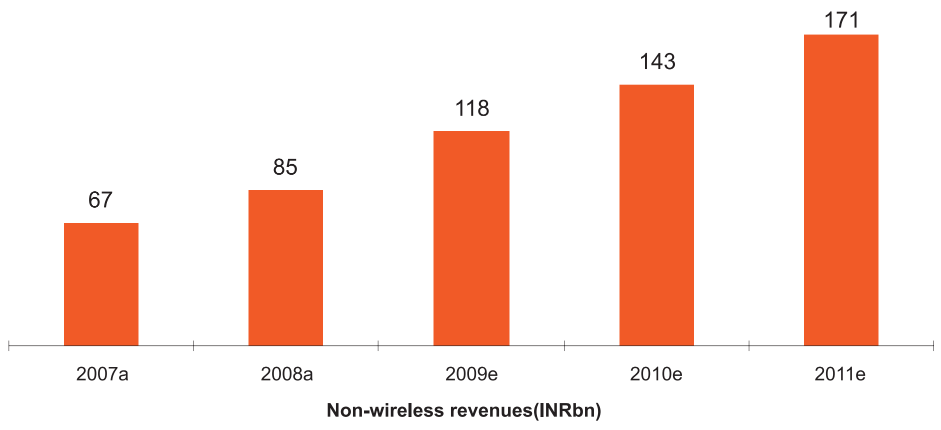
Hence, in spite of the dip in wireless margins, we saw stable margins in 1QFY09 at the group level. Despite the fact that LD is a utility (pure capacity resale) business, we do not see immediate margin erosion in this business, and the slowdown will be a gradual and long-term phenomena. But we do see a regulatory risk of increasing revenue share charges in this segment.

In terms of Telemedia business also, Bharti, which has coverage of 94 cities, is following a strategy of 'selective expenditure' on broadband services. Broadband services household penetration rates are also very low (1-2%). Besides, there is limited competition in this field. Targeting only the niche /premium ARPU segment has been responsible for the robust increase in Telemedia ARPUs. Hence, we continue to see growth potentials in this business.

We believe that the company would continue to maintain its ARPU growth at 1-2% in the rest of three quarters of FY09 with stable margins in the Telemedia business. We forecast a 19% 3-year FY08-11 CAGR for Telemedia revenues. Since this is the capex-heavy segment of the business, we have assumed a capex-to-sales rate of 26% and 20% in FY09 and FY10, respectively.

At the group level we forecast EBITDA margins of 40.3% for FY09 and 40.1% for FY10.

Non-wireless revenues to continue growth momentum



Source: Bharti and Antique research

New opportunities

Heading towards Tele-media convergence and bundled services

DTH and 3G next growth catalysts

In yet another step towards achieving integration, Bharti has announced the launch of IPTV and DTH services, which are expected by the end of this fiscal. These are still early days to say whether these services would be successful as soon as they are launched. But telecom and media convergence will be helpful for curbing long-drawn-out industry problems such as high churn. Bundling (single bill, under one umbrella) of broadband and TV (double play), broadband, TV and Voice (triple play) are strategies which have been adopted by global operators to reduce fixed line losses, improve customer retention and broadband market share and offset the fall in voice ARPUs in the wireline segment.

Currently, the DTH industry has three main established players Tata Sky, Sun TV and Dish TV (DTH Free-to-Air-DD Direct). High fixed costs, such as programming costs and SG&A costs, have not allowed operators like Dish TV to turnaround at the net income level yet. However, this does not undermine the growth potential of the DTH industry, which is expected to grow at a CAGR of 44% in revenue terms between 2008 and 2010 (source: FICCI). Bharti's DTH launch will be ubiquitous or mass-scale phenomena, and hence will have higher operating leverage vis-à-vis IPTV services, which will be a niche segment launch.

While IPTV would not require any major capital expenditure outlay, DTH will need a significant outlay since it will be based on the MPEG4 format. (Tata Sky for its 125 channels initially invested close to INR10 bn). We expect, in the long term, the company will be able to achieve incremental margins in the range of 22-24% in the DTH business in line with UK's BskyB.

Conclusively, we view this as a significant positive move by the company, which primarily would increase customer stickiness and arrest fixed line losses. Our base case does not include any incremental value expected out of the DTH and IPTV business.

Frontrunner in 3G

3G will free up 2G network and improve network efficiencies

We view Bharti as the frontrunner in receiving 3G spectrums and investing to upgrade to 3G, primarily because this is the only operator, which has stronger cash flows and higher leveraging capability amongst its peer group. Smaller operators, due to lack of cash flow, would loose out in the upgrade process, and we might see a consolidation in the industry, thus relieving margin pressures. Bharti has already entered in an agreement with iPhone to launch 3G handsets in India. The following benefits would accrue from the 3G upgrade to Bharti:

- 3G spectrum's benefit in India is more from the angle of better voice quality and less from data services. We should see improvement in voice quality as the 2G network becomes decongested when high ARPU users migrate to 3G and lesser price-sensitive customers to the 2G network. Effectively it's both a customer retention and acquisition strategy.
- 3G is cost-efficient as compared with 2G and 2.5G. Bharti will most likely upgrade to Wideband Code Division Multiple Access (WCDMA)-3G technology, which is three times and two times more cost-effective than GSM and CDMA on cost per Erlang basis, due to the high capacity that it provides (Source:Nokia).
- Still early days to this scenario in India; but 3G-based data ARPUs are higher than 2G, and even voice ARPUs increase with the support of 3G.

Due to limited visibility in terms of planned capex, expected ARPUs and handset subsidy strategy, we have not modeled 3G in our base case. But we believe that in Bharti's case, 3G would be beneficial and will bring intangible (quality and efficiency) incremental value if not tangible (data ARPU).

Valuation summary:

Our PEG-based target price of INR 974 represents an upside of 20% from CMP

We have adopted PEG based valuation to arrive at our target price of INR 974 per share as we believe that this best factors in Bharti's strong earnings visibility. In Jun-08, on an annualized EPS, the company was trading at a 1-year forward PEG of 0.57; we believe that this PEG will be sustained. Thus this PEG multiple of 0.57x, in combination with 2-year EPS CAGR of 29% and FY10 EPS of INR58.9, gives a target price of INR974 representing an upside of 20% from current market price of INR810.

Relative valuation

In the global comparison, Bharti has one of the best earnings visibilities in terms of estimated 2-year forward EPS CAGR of 29%.

	P/E		2-Yr EPS	EV/EBITDA	
Name	FY09	FY10	CAGR	FY09	FY10
Bharti Airtel Ltd	17.7	13.7	29%	10.2	7.8
China Mobile Ltd	15.4	12.8	23%	7.6	6.6
China Unicom Ltd	19.6	18.0	4%	4.8	3.6
France Telecom SA	9.5	9.0	-3%	4.4	4.4
Idea Cellular Ltd	18.0	13.7	23%	7.6	5.9
KDDI Corp	10.8	9.8	15%	3.7	3.4
Magyar Telekom Telecommunications Plc	10.4	9.7	16%	4.2	4.2
NTT DoCoMo Inc	13.6	13.8	3%	4.4	4.5
Oman Telecommunications Co	10.9	10.4	14%	6.3	6.1
PCCW Ltd	15.4	14.7	16%	6.5	6.6
Reliance Communications Ltd	13.9	11.6	16%	9.5	7.4
Saudi Telecom Co	10.6	10.6	3%	6.6	6.5
Singapore Telecommunications Ltd	13.8	12.6	4%	11.2	10.8
Telecom Egypt	9.3	7.8	20%	5.9	5.4
Telefonica O2 Czech Republic AS	14.7	13.6	7%	5.8	5.8
Telefonica SA	10.0	8.7	3%	5.5	5.2
Telekomunikacja Polska SA	12.7	11.9	7%	4.7	4.7
Turkcell Iletisim Hizmet AS	8.8	8.3	9%	4.7	4.4
Vimpel-Communications	11.0	9.1	28%	5.0	4.3
Vodafone Group PLC	10.6	10.0	4%	7.0	6.7

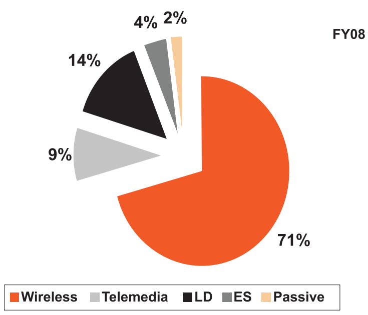
Source: Bloomberg and for Bharti-Antique Research

About the company

A. Company snapshot

Bharti, an integrated player, has a presence in both wireline and wireless space (23 service areas). It has four business segments: Wireless, Telemedia, Enterprise (ES) and Long Distance (LD) and Passive Infrastructure services. Wireless revenues contributed 71%, and rest of the business contributed to around 29% of revenues in FY08.

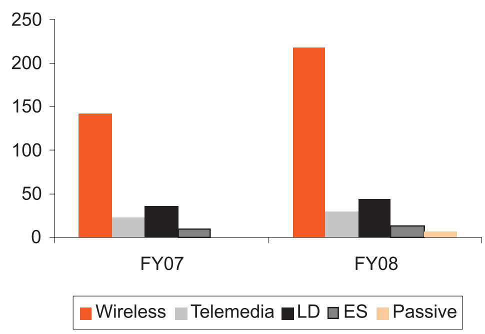
Revenue breakup



B. Business performance

Bharti had wireless population coverage of 74%, and wireline coverage of 94 cities in 1QFY09. Its subscriber base increased by 62% y-o-y and 12% q-o-q. As of 1QFY09, the subscriber base was 69 mn, the subscriber market share was 24%, and net adds market share was 29%. The total revenue grew 46% y-o-y to reach at INR 270 bn in FY08; margins were 42%. Its net income grew 58% to INR 67 bn. The company did a capex of USD3.4 bn in FY08 (against USD2 bn in FY07). The cash position was INR 54 bn and debt position was INR 77 bn.

Revenue by business line in INR bn



C. Business strategy

The company is targeting rural markets to drive volumes with low tariffs. It plans to add DTH and IPTV services in the process of Tele-media convergence. It has consistently worked towards driving cost-efficiencies and capital productivity; the latter is reflected in its low gearing and high return on equity. Telecom and IT network management processes have been outsourced to Nokia, Ericsson and IBM to improve its focus on core business.

Key operational metrics

Key metrics	FY07	FY08	% change
Net Adds'000	17,562	24,844	41%
Wireless ARPU(INR)	426	366	-14%
MoU(Min)	459	482	5%
Wireline ARPU(INR)	1,157	1,141	-1%
Churn	4.4%	3.9%	
Non voice as % of mobile	10.4%	9.6%	
Total LD min'mn	19,830	37,455	89%

Source: Company

Financials (INR m)

Profit and Loss Account

Year ended 31st March	2007	2008	2009e	2010e	2011e
Revenues	185,196	270,250	383,910	507,720	621,353
Expenses	(110,689)	(156,535)	(229,074)	(304,355)	(373,255)
EBITDA	**74,507**	**113,715**	**154,836**	**203,365**	**248,098**
Depreciation & amortisation	(25,208)	(37,261)	(45,353)	(60,075)	(69,316)
EBIT	**49,299**	**76,454**	**109,483**	**143,289**	**178,782**
Interest expense	(1,438)	(2,341)	(5,977)	(5,490)	(436)
Other income	999	2,423	131	(452)	(452)
Profit before tax	**48,860**	**76,536**	**103,638**	**137,347**	**177,894**
Taxes incl deferred taxation	(5,822)	(8,378)	(15,411)	(24,036)	(39,137)
Profit after tax	43,038	68,158	88,226	113,311	138,758
Adjusted profit after tax	**42,571**	**67,008**	**87,060**	**111,889**	**136,802**
Recurring EPS (INR)	**22.5**	**35.3**	**45.9**	**59.0**	**72.1**

Balance Sheet

Year ended 31st March	2007	2008	2009e	2010e	2011e
Networth	**135,553**	**217,042**	**305,139**	**417,027**	**553,829**
Debt	41,536	77,715	78,851	78,851	78,851
Capital Employed	**177,089**	**294,757**	**383,990**	**495,878**	**632,680**
Net Assets	**210,604**	**313,407**	**424,561**	**497,996**	**580,202**
Investments	4,587	5,149	7,061	7,061	7,061
Intangibles	**37,800**	**40,247**	**39,159**	**37,727**	**36,295**
Current Assets, Loans & Advances					
Inventory	912	1,142	1,207	5,092	8,717
Debtors	33,830	57,692	64,305	66,895	69,312
Cash & Bank balance	10,155	55,006	55,716	132,304	238,496
Current Liabilities & Provisions					
Creditors	10,925	19,348	17,651	17,651	17,651
Other liabilities & provisions	95,724	134,787	163,873	205,629	259,879
Net Current Assets	(61,752)	(40,295)	(60,296)	(18,989)	38,995
Deferred tax assets/(liabilities)	(12,349)	(15,195)	(16,381)	(16,381)	(16,381)
Misc.Expenses	(1,801)	(8,556)	(10,114)	(11,536)	(13,492)
Application of Funds	**177,089**	**294,757**	**383,990**	**495,878**	**632,680**

Per share data

Year ended 31st March	2007	2008	2009e	2010e	2011e
No. of shares (m)	1,894	1,898	1,898	1,898	1,898
BVPS (INR)	71.6	114.4	160.8	219.7	291.8
CEPS (INR)	35.8	54.9	69.8	90.6	108.6
DPS (INR)	-	-	-	-	-

Margins (%)

Year ended 31st March	2007	2008	2009e	2010e	2011e
EBITDA	40%	42%	40%	40%	40%
EBIT	27%	28%	29%	28%	29%
PAT	23%	25%	23%	22%	22%

Key Assumptions

Year ended 31st March	2007	2008	2009e	2010e	2011e
Wireless Subscribers'000	37,141	61,985	92,137	120,646	143,999
Wireless net adds'000	17,562	24,844	30,152	28,509	23,352
Wireless market share	22%	24%	25%	26%	26%
ARPU(INR)	426	366	335	324	319
MoU	459	482	542	569	579
Wireline subscribers'000	1,871	2,283	3,164	3,825	4,500

Cash Flow Statement

Year ended 31st March	2007	2008	2009e	2010e	2011e
Adjusted EBIT	**49,831**	**77,727**	**108,447**	**141,415**	**176,374**
Depreciation & amortisation	25,208	37,261	45,353	60,075	69,316
Interest expense	(1,438)	(2,341)	(5,977)	(5,490)	(436)
(Inc)/Dec in working capital	19,354	12,304	23,220	36,703	50,164
Tax paid	(5,822)	(8,378)	(15,411)	(24,036)	(39,137)
Cash flow from operating activities	**87,133**	**116,573**	**155,633**	**208,667**	**256,282**
Capital expenditure	(89,271)	(138,468)	(154,572)	(132,079)	(150,090)
Inc/(Dec) in investments	-	-	-	-	-
Income from investments	7	74	(7)	-	-
Cash flow from investing activities	**(89,264)**	**(138,394)**	**(154,579)**	**(132,079)**	**(150,090)**
Inc/(Dec) in share capital	1,647	21,235	1,710	-	-
Inc/(Dec) in debt	4,716	45,437	(2,054)	-	-
Dividends paid	-	-	-	-	-
Cash flow from financing activities	**6,363**	**66,672**	**(344)**	**-**	**-**
Net cash flow	**4,232**	**44,851**	**710**	**76,588**	**106,192**
Opening balance	5,923	10,155	55,006	55,716	132,304
Closing balance	**10,155**	**55,006**	**55,716**	**132,304**	**238,496**

Growth Indicators

Year ended 31st March	2008	2009e	2010e	2011e
Revenue	46%	42%	32%	22%
EBITDA	53%	36%	31%	22%
PAT	57%	30%	29%	22%
EPS	57%	30%	29%	22%

Valuation (x)

Year ended 31st March	2007	2008	2009e	2010e	2011e
PE	36.0	22.9	17.7	13.7	11.2
P/BV	11.3	7.1	5.0	3.7	2.8
EV/EBITDA	21.2	13.9	10.2	7.8	6.4
EV/Sales	8.5	5.8	4.1	3.1	2.5
Dividend Yield (%)					

Financial Ratios

Year ended 31st March	2007	2008	2009e	2010e	2011e
RoE	31%	31%	29%	27%	25%
RoCE	28%	26%	29%	29%	28%
Debt/Equity (x)	0.31	0.36	0.26	0.19	0.14

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