

Company Focus

31 October 2008 | 9 pages

Bharti Airtel (BRTI.BO)

 Results

Buy: 2Q EBITDA In-line: Non-Mobile Covers Mobile Shortfall

- EBITDA in-line, forex/deferred taxes distort headline profits** — 2QFY09 EBITDA at Rs37bn (+5%qoq/+37% yoy) was broadly in-line as non-mobile businesses chipped in to cover slightly slower growth in mobile (5%qoq vs. 8-10% in the past). Higher forex losses (Rs5.9bn vs. Rs1.5bn in 1Q) and deferred tax recognitions distorted headline profits. We note PBT ex-forex adjustments were up 42% yoy (vs. headline 13% growth). Bharti stays our top sector pick.
- Mobile margins increase despite seasonally weak quarter** — The seasonal 1.5% QoQ MoU decline was slightly higher than we thought; decline in rev/min was sharper as well (4%qoq). Headline margins (30.2%) were lower. Adjusted for the incremental 140bps on account of full quarter impact of higher NLD carriage charge (2 months in 1Q) and diesel price hike (est. 25bps), EBITDA margins would have been 31.9%.
- Other businesses steady** — Fixed line had another strong quarter as a result of scale economies and higher ARPUs. Long distance volumes have remained strong and enterprise revenues jumped 25% qoq albeit with lower margins. Towerco margins compression of 400bps was primarily on account of higher energy costs, which though passed through, are included in gross rentals.
- We are maintaining estimates** — Our subscriber net addition rate (2.3m/month) for FY09 is well within Bharti's YTD 2.6m rate and provides some cushion from higher than forecast declines in rev/min and margin pressures. Sustained INR weakness will mean forex impacts continue to distort headline profits though.

Buy/Low Risk	1L
Price (31 Oct 08)	Rs649.00
Target price	Rs1,070.00
Expected share price return	64.9%
Expected dividend yield	0.0%
Expected total return	64.9%
Market Cap	Rs1,231,892M US\$25,033M

Price Performance (RIC: BRTI.BO, BB: BHARTI IN)



Figure 1. Statistical Abstract

Rs m	2QFY08	1QFY09	2QFY09	Y/Y (%)	Q/Q (%)
Income from Services	63,374	84,833	90,203	42.3	6.3
Access Charges	9,317	12,426	12,902	38.5	3.8
Network Op. Costs	7,520	12,324	14,392	91.4	16.8
Staff + SGA	13,159	16,330	16,820	27.8	3.0
License Fee	6,281	8,532	9,096	44.8	6.6
EBITDA	27,097	35,221	36,993	36.5	5.0
PBT	17,471	23,814	19,724	12.9	(17.2)
PAT	16,139	20,250	20,463	26.8	1.1

Source: Company reports, Citi Investment Research

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Fiscal year end 31-Mar	2007	2008	2009E	2010E	2011E
Valuation Ratios					
P/E adjusted (x)	28.9	18.4	14.5	12.1	10.9
EV/EBITDA adjusted (x)	17.1	11.3	8.4	6.8	5.7
P/BV (x)	9.1	5.5	4.0	3.1	2.6
Dividend yield (%)	0.0	0.0	0.0	1.2	1.8
Per Share Data (Rs)					
EPS adjusted	22.45	35.31	44.76	53.43	59.42
EPS reported	22.45	35.31	44.76	53.43	59.42
BVPS	71.50	117.28	162.04	206.53	252.66
DPS	0.00	0.00	0.00	8.00	11.90
Profit & Loss (RsM)					
Net sales	185,196	270,250	380,807	464,185	527,965
Operating expenses	-135,896	-193,796	-275,963	-336,963	-384,961
EBIT	49,300	76,454	104,844	127,222	143,004
Net interest expense	-1,438	-2,341	-6,904	-6,065	-3,257
Non-operating/exceptionals	999	2,422	2,000	2,500	3,000
Pre-tax profit	48,861	76,535	99,940	123,657	142,746
Tax	-5,822	-8,378	-14,991	-22,258	-29,977
Extraord./Min.Int./Pref.div.	-468	-1,150	0	0	0
Reported net income	42,571	67,007	84,949	101,399	112,770
Adjusted earnings	42,571	67,007	84,949	101,399	112,770
Adjusted EBITDA	74,125	113,225	154,552	193,097	221,975
Growth Rates (%)					
Sales	59.4	45.9	40.9	21.9	13.7
EBIT adjusted	78.6	55.1	37.1	21.3	12.4
EBITDA adjusted	72.5	52.7	36.5	24.9	15.0
EPS adjusted	88.4	57.2	26.8	19.4	11.2
Cash Flow (RsM)					
Operating cash flow	70,548	129,071	146,333	186,148	199,523
Depreciation/amortization	24,825	36,771	49,708	65,875	78,971
Net working capital	-672	17,127	4,772	12,809	4,525
Investing cash flow	-72,788	-139,737	-174,793	-147,624	-123,568
Capital expenditure	-74,798	-138,470	-177,205	-149,084	-126,195
Acquisitions/disposals	1,952	-2,578	0	0	0
Financing cash flow	7,054	61,295	-7,316	-34,482	-41,108
Borrowings	7,428	44,602	2,000	-10,000	-10,000
Dividends paid	0	0	0	-16,957	-25,223
Change in cash	4,813	50,630	-35,776	4,042	34,847
Balance Sheet (RsM)					
Total assets	296,690	469,872	574,332	666,376	752,767
Cash & cash equivalent	7,464	54,863	22,317	26,359	61,206
Accounts receivable	17,982	28,062	38,081	41,777	42,237
Net fixed assets	248,403	353,654	477,921	561,130	608,354
Total liabilities	159,336	244,274	263,784	271,387	270,232
Accounts payable	0	0	0	0	0
Total Debt	52,461	97,063	99,063	89,063	79,063
Shareholders' funds	137,354	225,598	310,547	394,989	482,535
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	40.0	41.9	40.6	41.6	42.0
ROE adjusted	37.4	37.4	32.0	29.0	25.9
ROIC adjusted	27.0	28.9	26.4	24.1	23.0
Net debt to equity	32.8	18.7	24.7	15.9	3.7
Total debt to capital	27.6	30.1	24.2	18.4	14.1

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Mobile – MoU weakness due to seasonality

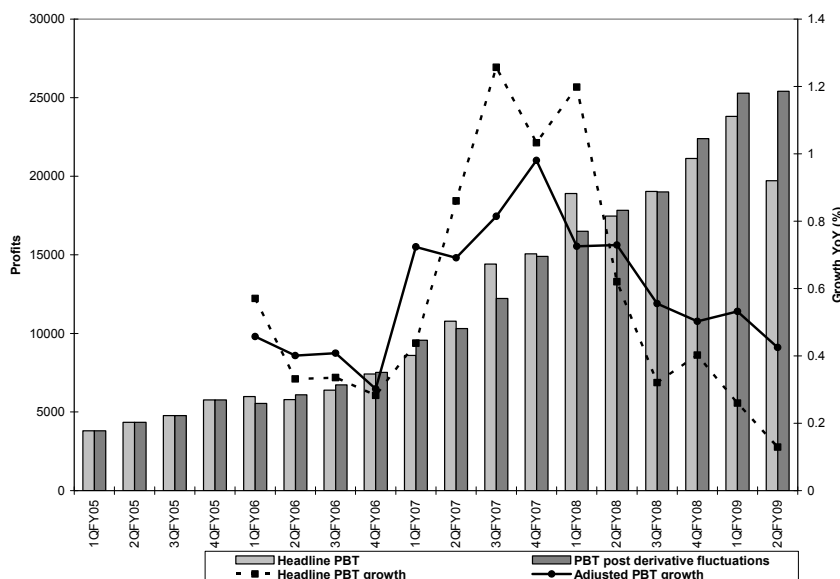
Figure 2. Wireless Business parameters

Rs m	2Q08	3Q08	4Q08	1Q09	2Q09	Remarks
Revenue	50,579	56,105	64,201	69,150	72,843	Soft growth at 5% in a seasonally weak quarter
EBITDA	20,728	22,887	22,779	21,218	22,009	
EBITDA margin (%)	41.0	40.8	35.5	30.7	30.2	Adjusted for full quarter of higher NLD carriage charge and diesel price hike, margins would have been up 120bps qoq
ARPU	366	358	357	350	331	Lower than expected
MoU	469	474	507	534	526	Decline in MoU expected, result of seasonality
Prepaid as % of net adds	95.4	95.4	96.3	97.9	98.4	
Data as % of revenues	9.8	9.3	9.4	9.7	10.0	
Number of cell sites		60,299	69,141	75,876	82,554	
Census towns	4,876	4,902	5,023	5,048	5,050	
Non-census towns/villages	290,000	320,623	342,623	364,287	384,521	
Population coverage	65%	68%	71%	74%	77%	On track to achieve 80-85% coverage by end FY09
Minutes (mn)	64375	73840	89058	105217	115834	
Revenue per minute (Rs)	0.79	0.76	0.72	0.66	0.63	Continues to fall faster than expectations, trend needs to be closely watched
EBITDA per minute (Rs)	0.32	0.31	0.26	0.20	0.19	
Capex per minute (Rs)	2.73	2.86	1.34	1.98	2.12	

Source: Company reports, Citi Investment Research

Comparing Bharti's PBT (stripping out derivative fluctuations similar to RCOM) vs. headline PBT

Figure 3. Headline vs. adjusted PBT (absolute – Rs m and growth - %)



Source: Company reports, Citi Investment Research

Infratel – Tenancy to increase post launch by new entrants

Figure 4. Bharti Infratel Summary

Rs m	4Q08	1Q09	2Q09	Remarks
Revenue	6,023	10,563	11,983	
EBITDA	2,236	3,870	3,991	
EBITDA margin (%)	37%	37%	33%	Result of an increase in pass through costs
Number of towers	53,083	58,013	59,966	
GBT	34,261	38,845	40,692	Most of the additions are in GBT
RTT	18,822	19,168	19,274	
Tenancy	1.22	1.22	1.26	Likely to rise post launch by new entrants
Rental/tower/month	30,017	31,893	32,177	Doesn't include pass through costs
Gross Rentals (incl. pass thrus)	46,502	49,749	52,816	

Source: Company reports, Citi Investment Research

Wholesale Voice – Strong volume growth

Figure 5. Long Distance voice parameters

Rs m	2Q08	3Q08	4Q08	1Q09	2Q09	Remarks
NLD minutes	6774	7898	9398	10322	11,349	Slowdown in growth due to non-Bharti volumes dropping off
ILD minutes	1345	1591	1850	2048	2,284	
Revenue	10,048	11,346	12,566	15,694	17,002	
EBITDA	3,462	3,652	4,027	6,884	7,351	
EBITDA margin (%)	34.5	32.2	32.0	43.9	43.2	
EBITDA / LD minutes (Rs)	0.43	0.38	0.36	0.56	0.54	Slight dip in realizations

Source: Company reports, Citi Investment Research

Fixed line – Cherry picking and scale benefits continue

Figure 6. Fixed line and broadband parameters

Rs m	2Q08	3Q08	4Q08	1Q09	2Q09	Remarks
Revenue	7,023	7,307	7,641	7,988	8,486	
EBITDA	2,790	3,173	3,344	3,367	3,696	
EBITDA margin (%)	39.7	43.4	43.8	42.2	43.6	Sharp increase as a result of cherry picking and scale economies
ARPU	1150	1140	1137	1138	1147	ARPU remains stable
Coverage of towns	94	94	94	94	95	Rolled out service in Surat, Gujarat
Number of DSL subs	705,512	751,470	794,598	852,169	920,803	Continues to improve materially

Source: Company reports, Citi Investment Research

Figure 7. Enterprise (Corporate) Business parameters

Enterprise Business	2Q08	3Q08	4Q08	1Q09	2Q09	Remarks
Revenue	3,423	3,290	3,774	3,878	4,872	Sharp jump during the quarter
EBITDA	1,435	1,377	2,152	1,771	2,018	
EBITDA margin (%)	41.9	41.9	57.0	45.7	41.4	Long term margins to remain in 40-45% range

Source: Company reports, Citi Investment Research

Bharti Airtel

Company description

Bharti Airtel, through its group companies, provides cellular-phone services in all the 23 telecom circles of India. The group also provides fixed-line phone services, broadband, long-distance and enterprise services. The company is listed on The Stock Exchange, Mumbai (BSE) and The National Stock Exchange of India Limited (NSE). Major shareholders are Bharti Telecom, SingTel and Vodafone.

Investment strategy

We rate Bharti Buy/Low Risk (1L). We believe continued robust wireless market expansion in India and Bharti's ability to capture this growth profitably will be a recurring theme. We estimate FY08-11E earnings CAGR of 18.9%, ahead of the broader market. We believe that competitive pressures, though intense, will remain rational as low revenue yields and moderate EBITDA margins leave little room for disruptive pricing. Additionally, most regulatory concerns are behind us and 3G recommendations, though discomfoting, cannot derail the growth path, in our view. The company has yet to fully realize benefits of economies of scale, and we expect a slight strengthening of margins over the next 2-3 years. We also expect the towerco hive-off (Bharti Infratel) to be a value accretive looking beyond the immediate impact on margins, given Bharti's stated intentions to be a minority stake owner in the towerco.

Valuation

Our target price of Rs1,070 is based on Mar-09 core DCF of Rs850 and a towerco option value of Rs220. The DCF is based on a WACC of 11.4%, a terminal growth rate of 4% and beta of 0.9. We prefer DCF as our primary valuation methodology because the wireless market will likely continue to see robust growth requiring upfront capex but should generate significant free cash beyond FY09-10E. Our target price (net of towerco value) represents a FY09E P/E of 19.0x, P/CEPS of 12.0x and EV/EBITDA of 10.9x.

Risks

Our quantitative risk-rating system, which tracks 260-day share price volatility, rates Bharti as Low Risk. We are comfortable attributing a Low Risk rating for the following reasons: 1) Bharti has a track record of profitability and execution; 2) the company's capex plans are fully funded; and 3) SingTel's strategic shareholding leaves us comfortable with execution issues and initiatives. Risks that could prevent the stock from reaching our target price include competition-led tariff pressures, un-remunerative capex, overall market downside and higher than expected regulatory charges.

Appendix A-1

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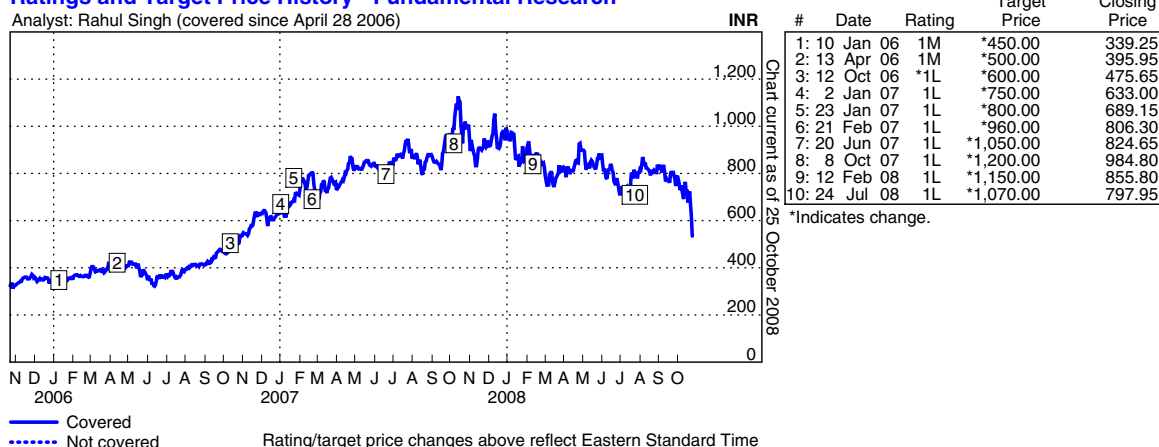
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Analyst: Rahul Singh (covered since April 28 2006)



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