

Bharti Airtel

The Zain Telecom deal – gambling on a turnaround

Bharti Airtel (Bharti) has placed a bid of US\$ 10.7bn for acquiring the African assets of Zain Telecom (Zain), which the board of the latter has approved. In our opinion, the deal does not appear highly expensive and earnings dilutive for Bharti. Moreover, even if the entire deal were to be funded through debt, Bharti's net debt would rise from nil currently to a comfortable US\$ 10-12bn. However, a turnaround in Zain's deteriorating operating and financial metrics remains pertinent to our hypothesis. This apart, though Zain's acquisition would be a strategic fit for Bharti in Africa's high growth market, Bharti's move seems to be a desperate attempt to avert a decline in its growth trajectory as the domestic market gets increasingly competitive.

Deal valuation: Bharti has valued Zain Africa on 7.7x and 9.2x CY08 and CY09 EBITDA of the company (full value) against 7x for its own domestic operations. This valuation, we believe, is fair taking into consideration the premium attached to the controlling stake as well as the high growth profile of the African territory. However, adjusted for the minority interest in Zain Africa, the deal becomes expensive at 9.8x and 11.6x.

Zain's African operations, after reporting strong growth in CY07 and CY08, have deteriorated in CY09. Turning around Zain's Africa operations thus assumes critical importance for Bharti to make this acquisition value accretive. This turnaround, we believe, is at least two years ahead. The Bharti management has been accredited for its execution capabilities in the Indian territory; however, it has little experience in managing cross-border operations. It therefore remains to be seen if Bharti is able to replicate its domestic growth story in Africa.

An EPS neutral deal: We find the deal to be EPS neutral for Bharti as Zain's EBITDA (US\$ 1.4bn) would be sufficient to offset the increase in depreciation and interest cost for Bharti post acquisition (\$1.2-\$1.4bn). Lower-than-estimated interest costs, higher tax shields, and operating synergies would thus be positive for Bharti. In contrast, the investment banking fees and merger / re-branding cost would have one time negative impact.

Balance sheet stretch to be comfortable: Assuming that Bharti funds the entire deal through debt, its net debt would rise from nil currently to US\$ 10-12bn. Even at this elevated level, Bharti's D/E would stand at 1x and D/EBITDA of 2-2.4x (inclusive of Zain Africa) – a comfortable zone. The IPO of Infratel / Indus tower would further help de-leverage Bharti's balance sheet, mostly in FY11.

Valuation & rating: Bharti will hold exclusive talks with Zain till 25 March '10. Deal closure remains subject to due diligence and regulatory approvals. In the past, Bharti made two failed attempts to close the deal with MTN. We maintain our estimates and Buy rating on Bharti with target price of Rs 380.

Financial highlights

(Rs mn)	FY09	FY10	FY11E	FY12E
Revenue	369,615	393,373	442,485	509,441
Growth (%)	36.8	6.4	12.5	15.1
Adj net income	84,701	90,234	86,371	99,577
Growth (%)	26.4	6.5	(4.3)	15.3
FDEPS (Rs)	22.3	23.8	22.8	26.2
Growth (%)	26.3	6.5	(4.3)	15.3

Profitability and return ratios

(%)	FY09	FY10	FY11E	FY12E
EBITDA margin	41.0	40.8	37.0	37.7
EBIT margin	28.2	25.5	23.5	24.0
Adj PAT margin	22.9	22.9	19.5	19.5
ROE	32.2	26.3	20.8	21.0
ROIC	29.7	20.7	18.3	19.1
ROCE	25.6	19.2	17.2	17.7

What's New? Target Rating Estimates

CMP	TARGET	RATING	RISK
Rs 272	Rs 380	BUY	HIGH

BSE	NSE	BLOOMBERG
532454	BHARTIARTL	BHARTI IN

Company data

Market cap (Rs mn / US\$ mn)	1,097,183 / 23,779
Outstanding equity shares (mn)	3,796
Free float (%)	32.2
Dividend yield (%)	0.3
52-week high/low (Rs)	518/230
2-month average daily volume	5,981,256

Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
Bharti	272	(14.4)	(10.3)	(33.6)
Sensex	16,227	(7.6)	(4.7)	5.3

Valuation matrix

(x)	FY09	FY10E	FY11E	FY12E
P/E @ CMP	12.3	11.5	12.0	10.4
P/E @ Target	17.0	16.0	16.7	14.5
EV/EBITDA @ CMP	7.0	6.7	6.5	5.6





Fig 1 - Zain Africa's deal valuation for Bharti

	Full value		Proportionate share adj. for minority interest	
	CY08	CY09E*	CY08	CY09E*
Zain acquisition expensive on proportionate share basis for Bharti				
Enterprise value	10,700	10,700	10,700	10,700
EBITDA of Zain Africa	1,397	1,159	1,087	923
EV/EBITDA	7.7	9.2	9.8	11.6
Revenue of Zain Africa	4,160	3,643	3,310	2,936
EV/Sales	2.6	2.9	3.2	3.6
Subscribers of Zain Africa (in 000's)	41,018	42,190	32,416	33,742
EV/Subscriber	261	254	330	317

Source: RHH, Company

Fig 2 - Earning dilution for Bharti in FY12E

(\$ mn)	Bharti	Zain	Consolidated
Revenue	10,956	4,007	14,963
EBITDA	4,135	1,402	5,537
EBITDA margin %	37.7	35.0	37.0
Interest	9	749	758
Depreciation	1,511	900	2,411
PBT	2,615	(247)	2,368
Tax	418		418
Minority interest	55	(74)	(19)
Tax shield on interest to Bharti @ 15%		(112)	(112)
PAT	2,141	(60)	2,081
% reduction in PAT			-2.8%

Source: RHH, Company

(Note: 1) It has been assumed that Bharti will fund the Zain acquisition of \$10.7bn through debt. Interest at \$749mn based on \$10.7bn debt @7%. 2) Depreciation for Zain Africa assumed at \$900mn. Depreciation for Zain International estimated to be at \$1.35bn in CY09 and Zain Africa's share at 60% to be at \$810mn in CY09.

Fig 3 - Net debt/equity and net debt/EBITDA for Bharti, post acquisition

	FY11E	FY12E
Net debt for Bharti - pre acquisition	336	64
Acquisition cost	10,700	10,700
Net debt - post acquisition	11,036	10,764
Equity	9,618	10,804
Consolidated EBITDA (Bharti + Zain)	4,723	5,537
Net Debt/Equity	1.15	1.00
Net Debt/EBITDA	2.34	1.94

Source: RHH

Earnings dilution to be restricted for Bharti excluding one time merger/integration cost and any benefit from synergy in operations

IPO of Infratel / Indus tower to help further de-leverage the balance sheet, which remains likely in FY11

**Fig 4 - Financial / Operating performance – Zain Consolidated (Middle East + Africa)**

(\$ mn)	CY06	CY07	CY08	9m, CY09
Revenue	4,466	5,912	7,441	6,169
EBITDA	1,953	2,424	2,776	2,624
PAT	1,015	1,130	1,196	677
Capex	1,882	2,112	2,370	1,421
Subs (in 000's)	27,038	42,501	63,535	71,826
Margin %				
EBITDA	43.7	41.0	37.3	42.5
PAT	22.7	19.1	16.1	11.0
% growth YoY				
Revenue		32.4	25.9	10.5
EBITDA		24.1	14.5	26.0
PAT		11.3	5.8	(24.5)
Subs		57.2	49.5	17.4

Source: RHH, Company

Fig 5 - Financial / Operating performance – Zain Middle East

(\$ mn)	CY06	CY07	CY08	9m, CY09
Revenue	1,980	2,748	3,281	3,437
EBITDA	898	1,295	1,379	1,754
PAT	685	757	1,074	789
Capex	746	592	488	577
Subs (in 000's)	10,167	15,683	22,517	29,636
Margin %				
EBITDA	45.4	47.1	42.0	51.1
PAT	34.6	27.5	32.7	23.0
% growth YoY				
Revenue		38.8	19.4	39.6
EBITDA		44.2	6.5	69.6
PAT		10.5	41.9	(2.1)
Subs		54.3	43.6	42.2

Source: RHH, Company

Fig 6 - Financial / Operating performance – Zain Africa

(\$ mn)	CY06	CY07	CY08	9m, CY09
Revenue	2,486	3,164	4,160	2,732
EBITDA	1,055	1,129	1,397	870
PAT	330	374	122	(112)
Capex	1,136	1,519	1,882	844
Subs (in 000's)	16,871	26,818	41,018	42,190
Margin %				
EBITDA	42.4	35.7	33.6	31.8
PAT	13.3	11.8	2.9	(4.1)
% growth YoY				
Revenue		27.3	31.5	(12.4)
EBITDA		7.1	23.7	(17.0)
PAT		13.0	(67.3)	(221.8)
Subs		59.0	52.9	3.8

Source: RHH, Company

Middle East remains one of the most profitable operations for Zain

African operations drag down Zain's overall performance



Fig 7 - Zain Africa as % of Zain International

(\$ mn)	CY06	CY07	CY08	9m, CY09
Revenue	55.7	53.5	55.9	59.1
EBITDA	54.0	46.6	50.3	44.2
PAT	32.6	33.1	10.2	(22.0)
Capex	60.4	71.9	79.4	59.4
Subs (in 000's)	62.4	63.1	64.6	58.7

Source: RHH, Company

Fig 8 - Zain Africa's country-wise KPIs

Country	Popn (000's)	GDP/Capita (\$; PPP)	Ownership	Subs (000's)	Market share %	Market position	Penetration %	Peers	ARPU
Burkina Faso	15,772	1,259	100.0	1,444	51	1	23	2	7
Chad	11,480	1,670	100.0	1,194	70	1	19	1	10
Congo	3,951	4,044	90.0	1,415	53	1	75	2	12
DRC	67,470	340	98.5	3,569	45	1	14	4	8
Gabon	1,375	14,747	90.0	870	62	1	123	2	25
Ghana	24,537	1,513	75.0	1,208	9	4	61	4	3
Kenya	39,888	1,735	95.0	2,191	17	2	48	3	4
Madagascar	20,901	995	100.0	1,425	38	2	23	2	5
Malawi	14,766	850	100.0	1,711	72	1	17	1	8
Niger	15,412	691	90.0	1,432	67	1	16	4	10
Nigeria	155,770	2,142	65.7	14,936	25	2	45	3	7
Sierra Leone	6,095	728	100.0	555	46	1	39	3	7
Tanzania	45,782	1,352	60.0	4,764	39	1	33	3	5
Uganda	33,276	1,148	100.0	2,243	37	2	35	3	4
Zambia	12,453	1,397	78.9	2,940	70	1	33	2	8
Total	468,928	1,502		41,897	31		36		7

Source: RHH, Company



Fig 9 - Zain Africa's country-wise growth

	Subscribers ('000's)				Revenue (\$ mn)				EBITDA (\$ mn)			
	2006	2007	2008	2009E	2006	2007	2008	2009E	2006	2007	2008	2009E
Burkina Faso	0.5	0.9	1.3	1.9	61	101	129	121	28	46	53	51
Chad	0.3	0.6	1.0	1.6	65	92	124	135	26	34	48	58
Congo	0.7	1.0	1.3	1.9	144	211	228	205	57	91	85	57
DRC	1.8	2.3	3.3	4.8	253	297	381	326	91	89	86	68
Gabon	0.5	0.7	0.8	1.2	165	233	273	256	89	112	122	106
Ghana	-	-	0.3	1.6		-	13	46		-	(29)	(39)
Kenya	1.9	2.1	3.1	2.9	174	194	162	157	51	32	(25)	18
Madagascar	0.3	0.6	1.2	1.9	36	49	83	76	12	12	14	16
Malawi	0.4	0.7	1.3	2.3	42	71	128	149	17	32	54	63
Niger	0.4	0.7	1.1	1.9	61	93	129	151	29	46	59	71
Nigeria	6.4	11.1	17.2	19.9	610	1,172	1,644	1,315	221	394	585	442
Sierra Leone	0.2	0.3	0.5	0.7	45	43	48	45	13	7	9	3
Tanzania	1.5	2.5	3.9	6.4	170	265	328	276	63	97	137	106
Uganda	0.5	1.4	2.1	3.0	40	91	137	102	0	15	30	12
Zambia	1.3	2.0	2.7	3.9	190	252	354	284	85	123	169	129
Overall	16.9	26.8	41.0	55.8	2,055	3,164	4,160	3,643	782	1,129	1,397	1,159
% Change YoY												
Burkina Faso		77.2	42.4	47.3		64.2	28.0	(5.5)		65.0	15.6	(5.4)
Chad		71.0	73.9	53.8		39.9	35.5	8.7		29.7	40.5	21.6
Congo		48.5	30.3	42.8		47.2	8.0	(10.1)		61.1	(7.2)	(32.7)
DRC		24.0	45.3	44.0		17.2	28.5	(14.6)		(1.8)	(4.3)	(21.0)
Gabon		29.6	21.5	43.4		41.6	17.0	(6.3)		26.0	9.1	(12.9)
Ghana				496.5				256.6				35.2
Kenya		535.6	46.3	(5.2)		11.5	(16.4)	(3.3)		(37.6)	(177.1)	(173.2)
Madagascar		60.8	117.1	52.5		38.5	67.3	(8.4)		(1.7)	18.3	16.7
Malawi		64.7	94.2	79.6		68.5	79.3	16.7		87.6	71.0	15.4
Niger		(89.6)	66.8	71.8		51.4	39.7	16.9		55.1	29.4	20.0
Nigeria		4,467.1	55.0	15.8		92.2	40.3	(20.0)		78.1	48.7	(24.5)
Sierra Leone		(77.1)	32.5	60.5		(3.3)	11.1	(7.4)		(47.0)	28.2	(67.8)
Tanzania		433.4	54.0	64.4		56.3	23.7	(15.8)		54.7	40.4	(22.7)
Uganda		8.3	44.8	43.9		129.6	50.1	(25.8)		7,200.0	108.2	(60.5)
Zambia			35.8	46.8		32.5	40.3	(19.6)		45.9	36.8	(23.4)
Overall		59.0	52.9	36.2		53.9	31.5	(12.4)		44.4	23.7	(17.0)

Source: RHH, Company



Consolidated financials (excluding Indus towers)

Profit and Loss statement

Y/E March (Rs mn)	FY09	FY10E	FY11E	FY12E
Revenues	369,615	393,373	442,485	509,441
Growth (%)	36.8	6.4	12.5	15.1
EBITDA	151,680	160,373	163,835	192,274
Growth (%)	33.4	5.7	2.2	17.4
Depreciation & amortisation	47,581	59,927	59,640	70,260
EBIT	104,099	100,446	104,195	122,013
Growth (%)	36.2	(3.5)	3.7	17.1
Interest	11,613	(4,147)	1,191	437
Other income	589	900	-	-
EBT	93,075	105,492	103,004	121,576
Income taxes	6,615	13,597	14,421	19,452
Effective tax rate (%)	7.1	12.9	14.0	16.0
Extraordinary items	-	-	-	-
Min into / inc from associates	1,759	1,661	2,212	2,547
Reported net income	84,701	90,234	86,371	99,577
Adjustments	-	-	-	-
Adjusted net income	84,701	90,234	86,371	99,577
Growth (%)	26.4	6.5	(4.3)	15.3
Shares outstanding (mn)	3,796.5	3,796.5	3,796.5	3,796.5
FDEPS (Rs) (adj)	22.3	23.8	22.8	26.2
Growth (%)	26.3	6.5	(4.3)	15.3
DPS (Rs)	1.0	2.5	5.0	10.0

Cash flow statement

Y/E March (Rs mn)	FY09	FY10E	FY11E	FY12E
Net income + Depreciation	132,282	150,161	146,011	169,837
Non-cash adjustments	-	-	-	-
Changes in working capital	(24,018)	(38,008)	15,594	(8,421)
Cash flow from operations	108,264	112,154	161,605	161,416
Capital expenditure	(140,171)	(99,154)	(129,131)	(106,874)
Change in investments	-	-	-	-
Other investing cash flow	-	-	-	-
Cash flow from investing	(140,191)	(99,154)	(129,131)	(106,874)
Issue of equity	4,351	-	-	-
Issue/repay debt	21,737	(22,875)	(5,833)	-
Dividends paid	-	(9,448)	(20,006)	(41,889)
Other financing cash flow	-	-	-	-
Change in cash & cash eq	(5,840)	(19,324)	6,635	12,652
Closing cash & cash eq	49,166	29,842	36,478	49,130

Economic Value Added (EVA) analysis

Y/E March	FY09	FY10E	FY11E	FY12E
WACC (%)	12.5	12.5	12.5	12.5
ROIC (%)	29.7	20.7	18.3	19.1
Invested capital (Rs mn)	384,283	461,519	515,416	560,451
EVA (Rs mn)	66,138	38,009	30,359	36,980
EVA spread (%)	17.2	8.2	5.9	6.6

Balance sheet

Y/E March (Rs mn)	FY09	FY10E	FY11E	FY12E
Cash and cash eq	49,166	29,842	36,477	49,130
Accounts receivable	18,262	21,555	24,246	27,915
Inventories	963	1,011	1,061	1,114
Other current assets	66,890	74,729	92,725	100,326
Investments	-	77,348	77,348	77,348
Gross fixed assets	603,221	598,101	727,232	834,107
Net fixed assets	449,626	411,507	480,998	517,612
CWIP	-	-	-	-
Intangible assets	-	-	-	-
Deferred tax assets, net	8,810	9,691	10,661	11,727
Other assets	10,230	12,276	18,414	18,414
Total assets	603,947	637,959	741,930	803,585
Accounts payable	217,185	185,326	221,304	223,483
Other current liabilities	(46,688)	(38,728)	(31,268)	(29,479)
Provisions	-	-	-	-
Debt funds	118,801	95,926	90,093	90,093
Other liabilities	10,704	12,365	14,578	17,125
Equity capital	18,982	18,982	18,982	18,982
Reserves & surplus	284,962	364,088	428,241	483,381
Shareholder's funds	303,944	383,070	447,223	502,363
Total liabilities	603,947	637,959	741,930	803,585
BVPS (Rs)	80.1	100.9	117.8	132.3

Financial ratios

Y/E March	FY09	FY10E	FY11E	FY12E
Profitability & Return ratios (%)				
EBITDA margin	41.0	40.8	37.0	37.7
EBIT margin	28.2	25.5	23.5	24.0
Net profit margin	22.9	22.9	19.5	19.5
ROE	32.2	26.3	20.8	21.0
ROCE	25.6	19.2	17.2	17.7
Working Capital & Liquidity ratios				
Receivables (days)	17	18	19	19
Inventory (days)	3	2	2	2
Payables (days)	450	455	372	358
Current ratio (x)	0.8	0.9	0.8	0.9
Quick ratio (x)	0.4	0.4	0.3	0.4
Turnover & Leverage ratios (x)				
Gross asset turnover	0.7	0.7	0.7	0.7
Total asset turnover	0.7	0.6	0.6	0.7
Interest coverage ratio	9.0	(24.2)	87.5	279.0
Adjusted debt/equity	0.2	0.1	0.1	0.1
Valuation ratios (x)				
EV/Sales	2.9	2.7	2.4	2.1
EV/EBITDA	7.0	6.7	6.5	5.6
P/E	12.3	11.5	12.0	10.4
P/BV	3.4	2.7	2.3	2.1



Quarterly trend

Particulars	Q3FY09	Q4FY09	Q1FY10	Q2FY10	Q3FY10
Revenue (Rs mn)	96,334	98,245	99,416	98,455	97,722
YoY growth (%)	38.3	25.6	17.2	9.1	1.4
QoQ growth (%)	6.8	2.0	1.2	(1.0)	(0.7)
EBITDA (Rs mn)	39,452	40,014	41,518	41,416	39,112
EBITDA margin (%)	41.0	40.7	41.8	42.1	40.0
Adj net income (Rs mn)	21,595	22,393	25,167	23,211	22,068
YoY growth (%)	25.4	20.8	24.3	13.4	2.2
QoQ growth (%)	5.5	3.7	12.4	(7.8)	(4.9)

DuPont analysis

(%)	FY08	FY09	FY10E	FY11E	FY12E
Tax burden (Net income/PBT)	87.6	91.0	85.5	83.9	81.9
Interest burden (PBT/EBIT)	100.1	89.4	105.0	98.9	99.6
EBIT margin (EBIT/Revenues)	28.3	28.2	25.5	23.5	24.0
Asset turnover (Revenues/Avg TA)	70.1	68.7	63.3	64.1	65.9
Leverage (Avg TA/Avg equity)	215.1	204.5	180.8	166.2	162.8
Return on equity	37.4	32.2	26.3	20.8	21.0

Company profile

Bharti Airtel (Bharti) is India's largest integrated telecom operator with a pan-India footprint and a wireless subscriber market share of 22.7%. Bharti is a pioneer in the industry and outsources its core network and IT activities through strategic partnerships with Nokia, Ericsson and IBM respectively.

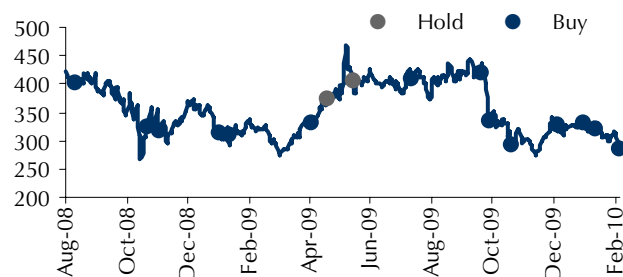
Shareholding pattern

(%)	Jun-09	Sep-09	Dec-09
Promoters	67.4	67.7	67.8
FII's	20.0	18.7	17.5
Banks & FIs	7.9	8.1	8.0
Public	4.7	5.4	6.7

Recommendation history

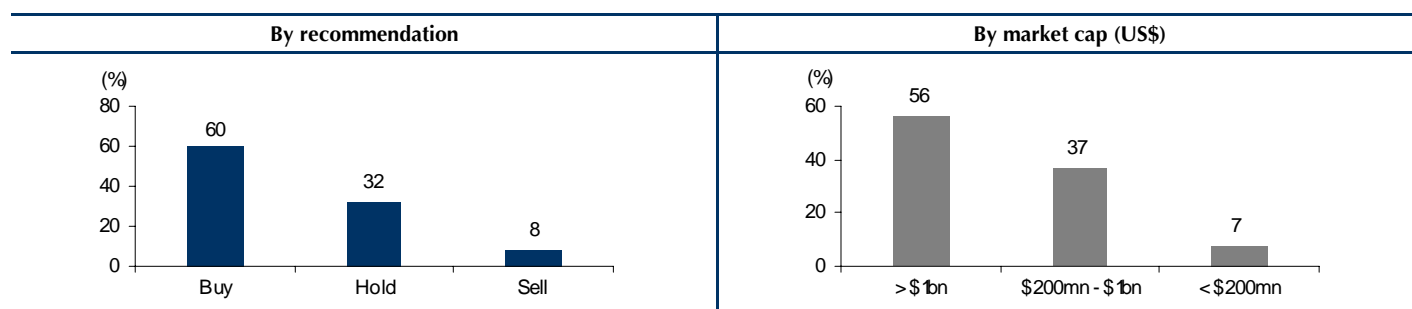
Date	Event	Reco price	Tgt price	Reco
21-Aug-08	RHH Compendium	400	528	Buy
4-Nov-08	Results Review	325	470	Buy
14-Nov-08	Sector Update	316	452	Buy
13-Jan-09	Company Update	312	452	Buy
23-Jan-09	Results Review	310	424	Buy
15-Apr-09	Sector Update	333	379	Buy
30-Apr-09	Results Review	376	363	Hold
26-May-09	Company Update	405	363	Hold
24-Jul-09	Results Review	407	445	Buy
1-Oct-09	Company Update	419	478	Buy
8-Oct-09	Sector Update	334	415	Buy
31-Oct-09	Results Review	293	380	Buy
17-Dec-09	Company Update	326	380	Buy
12-Jan-10	Company Update	329	380	Buy
23-Jan-10	Results Review	322	380	Buy
16-Feb-10	Results Review	272	380	Buy

Stock performance





Coverage Profile



Recommendation interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and -5%
Sell	Less than -5%

Recommendation structure changed with effect from March 1, 2009

Expected absolute returns are based on share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

Religare Capital Markets Ltd

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