

DECEMBER 14, 2009

UPDATE

 Coverage view: **Cautious**

 Price (Rs): **332**

 Target price (Rs): **300**

 BSE-30: **17,119**

Relief rally without any signs of relief—an opportunity to cut exposure. We reiterate our current negative outlook on Bharti and recommend using the recent stock outperformance to pare exposure. Better-than-expected December 2009 quarter earnings are likely spurred by higher STV bookings and higher minutes elasticity. However, sector fundamentals remain weak, pricing may yet to bottom out and the full impact of pricing competition will reflect only in the March 2010 quarter. REDUCE.

Company data and valuation summary

Bharti Airtel

Stock data

52-week range (Rs) (high,low) 518-230

Market Cap. (Rs bn) 1,258.9

Shareholding pattern (%)

Promoters 67.7

FIs 18.4

MFs 3.5

Price performance (%)

	1M	3M	12M
Absolute	9.7	(20.9)	(8.3)
Rel. to BSE-30	8.0	(25.1)	(48.1)

Forecasts/Valuations

	2009	2010E	2011E
EPS (Rs)	22.3	23.8	21.7
EPS growth (%)	26.4	6.4	(8.8)
P/E (X)	14.8	13.9	15.3
Sales (Rs bn)	369.6	390.8	422.5
Net profits (Rs bn)	84.7	90.1	82.3
EBITDA (Rs bn)	151.6	159.0	157.2
EV/EBITDA (X)	8.8	8.2	8.1
ROE (%)	31.4	25.1	18.6
Div. Yield (%)	0.6	0.9	1.2

A rally without legs—use it to reduce exposure

We believe that the recent rally in Bharti's stock price may have been driven by (1) relief on pricing post Uninor's 'rational' launch pricing, (2) expectations of reasonable and significantly better-than-feared December quarter earnings, and (3) other potential technical factors. However, we continue to believe that it is too early to take a call on the duration of irrational price competition or the extent of damage it causes to the industry structure. We discuss our views on each of the above 'positive' developments below.

Uninor's rational launch pricing may turn out to be a lull before another storm

We would be wary of viewing Uninor's relatively rational launch pricing as early signs of pricing stability in the market; notions of pricing having bottomed out may be even riskier. Incumbents and new entrants both continue tactical price cuts spanning local & NLD calls, roaming charges, and SMS services. More importantly, there are initial signs of price competition in the post-paid market, especially in the metros. In addition, new network launches are still not over; Tata Docomo is yet to launch in a few circles, Uninor has launched only in seven circles, Etisalat-DB Telecom is close to its initial network launch. We would not rule out another big bang price cut from one of the incumbents, cross-over licensees, or new licensees over the coming months; lower-than-expected network traffic will likely trigger the pricing action.

December quarter earnings may not reflect full impact of recent price cuts

Higher-than-expected minutes elasticity and positive impact of revenue booking of large volumes of STV (special tariff vouchers to avail of discounted tariffs) sales may mean a better-than-initially-feared December quarter earnings. But we highlight three reasons why Dec 2009 quarter earnings will be a poor indicator of underlying earnings, in our view—(1) a part of the minutes elasticity will be purely seasonal, on account of the festive season, (2) higher STV sales bookings (extent of positive impact would depend on the timeframe of amortization) are non-recurring in nature and (3) tariff discounting has happened in steps, and at various times in the middle of the quarter; thus, the full quarter impact of discounted tariffs will not reflect in Dec 2009 earnings.

 Kawaljeet Saluja
 kawaljeet.saluja@kotak.com
 Mumbai: +91-22-6634-1243

 Rohit Chordia
 rohit.chordia@kotak.com
 Mumbai: +91-22-6634-1397

 Kotak Institutional Equities Research
 kotak.research@kotak.com
 Mumbai: +91-22-6634-1100

Betting on consolidation being an absolute positive is just that, a bet. Odds are unfavorable as well, in our view

Viewing consolidation as the magic potion to solve the industry's competitive woes, without venturing into the when and how of the same, is fraught with tremendous risk, in our view. Increased capacity (to the tune of 20-25Mhz of new GSM spectrum issued to the cross-over and new licensees) in the sector is real and the usual merger-driven consolidation will mean a merger of separate chunks of spectrum, increasing capacity even further. Erlang capacity (a measure of peak-hour traffic carrying capacity of a telecom network) of an 8.8 MHz network is 4-6X (depending on configuration) that of a 4.4MHz network!

The above is just one of the consolidation-related risks that one needs to be cognizant of before viewing consolidation as an unconditional positive for the industry. What's important is how the industry structure looks post consolidation, which players are left, what their relative market shares are, and what the cost of consolidation was. All of these will determine the competitive dynamics of the industry post consolidation.

A relatively stronger Bharti (post consolidation) may not mean absolute stock returns from these levels; REDUCE

We concur with the view that the leading GSM incumbents will emerge 'relatively' stronger post the inevitable consolidation in the industry. However, we see no reason to believe that the post-consolidation industry pie (in terms of revenues, EBITDA, or market capitalization) will be larger or even similar to today's levels. One also needs to remember that the high-growth phase of the Indian wireless industry is behind us. Incremental subscriber (and not the reported SIM-card-in-use) growth will likely drop to low teens by FY2011E and even lower beyond that. Increase in tax rates over the next few years (from the current ~10% levels) will impact earnings growth even further for Bharti.

From the perspective of long-term exposure to the Indian telecom space, Bharti will be at the top of our buy pad as well. However, we do not see any margin of safety in the current stock price, in case (1) hyper-competition lasts longer than expected and/or does more damage than envisaged today, or (2) costs of consolidation are higher-than-expected and/or further increase in industry capacity post consolidation sustains irrational pricing behavior. We believe that all of these are high-impact events and none is really a very-low-probability one. We reiterate our REDUCE recommendation on Bharti and Idea, and SELL on RCOM.

Indian telecom companies valuation analysis, March fiscal year-ends, 2008-2012E

	Price (Rs)	Target price	P/E (X)					EV/EBITDA (X)				
	11-Dec-09	(Rs)	2008	2009	2010E	2011E	2012E	2008	2009	2010E	2011E	2012E
Bharti	332	300	18.7	14.8	13.9	15.3	13.7	11.4	8.8	8.2	8.1	6.9
Idea	60	45	14.6	19.9	29.4	47.3	32.3	10.6	7.7	7.8	8.1	7.1
MTNL	76	50	10.4	30.9	(31.1)	(23.4)	(38.1)	1.8	(0.7)	(4.1)	(5.0)	24.8
RCOM	184	150	6.9	5.8	12.2	14.0	10.2	7.6	8.0	10.0	9.4	6.7
TCOM	352	400	32.5	26.2	25.4	23.5	22.7	16.9	12.9	11.6	10.6	8.9

	KS rating	Market cap.	Revenues (Rs bn)					EBITDA (Rs bn)				
		(US\$ bn)	2008	2009	2010E	2011E	2012E	2008	2009	2010E	2011E	2012E
Bharti	SELL	25.1	270	370	391	423	473	113	152	159	157	176
Idea	REDUCE	3.6	67	101	117	141	162	23	28	31	32	38
MTNL	0	0.9	47	45	38	37	39	7	2	(1)	(1)	0
RCOM	REDUCE	7.4	191	229	222	246	286	82	93	75	81	101
TCOM	SELL	2.0	33	38	42	46	49	6	8	9	10	10

	Net Income (Rs bn)					EPS (Rs)				
	2008	2009	2010E	2011E	2012E	2008	2009	2010E	2011E	2012E
Bharti	66	84	89	80	89	17.7	22.3	23.8	21.7	24.2
Idea	10	9	6	4	6	3.9	2.9	2.0	1.2	1.8
MTNL	4	1	(2)	(2)	(1)	7.1	2.4	(2.4)	(3.2)	(2.0)
RCOM	56	67	32	28	38	26.5	31.6	14.9	13.0	17.9
TCOM	3	4	4	4	4	10.9	13.6	14.0	15.2	15.7

Source: Bloomberg, Kotak Institutional Equities estimates

Consolidated profit and loss for Bharti Airtel, March fiscal year-ends, 2008-2017E (Rs mn)

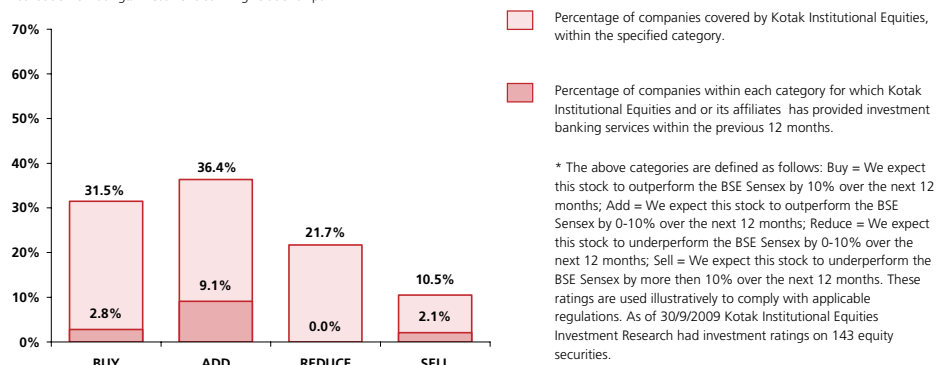
	2008	2009	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Revenues										
Wireless	217,861	303,601	317,093	335,838	371,277	404,893	427,281	443,691	457,695	469,703
Fixed line	28,484	33,517	34,418	38,263	42,099	45,366	48,418	51,274	53,968	56,499
DLD	22,103	41,835	42,174	46,774	50,588	53,747	56,279	58,294	59,891	61,150
ILD	21,067	26,102	27,906	29,821	31,968	33,695	35,510	37,426	39,449	41,586
Enterprise services	13,217	16,945	17,792	21,351	23,913	26,304	27,619	29,000	30,450	31,973
Others	2,431	3,611	5,236	6,807	8,168	8,985	9,883	10,872	11,959	13,155
Less: Intersegment eliminations	(40,936)	(98,485)	(88,304)	(95,191)	(100,702)	(105,030)	(108,712)	(112,043)	(115,054)	(117,742)
Consolidated revenues	270,250	369,615	390,842	422,549	473,178	518,265	551,436	579,001	604,612	627,490
Interconnection costs	(41,110)	(52,903)	(43,286)	(48,147)	(52,051)	(57,946)	(61,868)	(64,778)	(67,392)	(69,723)
License fees and spectrum charges	(26,900)	(38,266)	(39,410)	(42,868)	(47,861)	(52,289)	(55,499)	(58,129)	(60,536)	(62,764)
Network operating costs	(33,002)	(59,355)	(76,410)	(94,639)	(108,545)	(117,141)	(123,177)	(128,642)	(133,867)	(138,342)
Sales and marketing expenses	(19,058)	(26,762)	(30,177)	(34,890)	(39,378)	(43,181)	(46,231)	(48,870)	(51,298)	(53,566)
Employee costs	(14,768)	(16,992)	(17,751)	(18,494)	(20,928)	(22,808)	(24,553)	(26,279)	(28,033)	(29,757)
G&A costs	(22,187)	(23,774)	(24,793)	(26,327)	(28,487)	(30,246)	(31,518)	(32,837)	(33,974)	(34,968)
Consolidated EBITDA	113,225	151,563	159,015	157,184	175,928	194,654	208,590	219,466	229,511	238,370
Other income incl. Interest income	4,136	645	7,230	3,485	5,171	6,305	10,263	14,386	18,357	21,982
Interest expense	(4,054)	(11,613)	(1,857)	(1,789)	(661)	—	—	—	—	—
Amortization of entry fee	(1,829)	(2,122)	(1,148)	(1,148)	(1,148)	(1,148)	(1,148)	(1,148)	(1,148)	(1,148)
Depreciation	(34,942)	(45,344)	(58,364)	(62,098)	(68,559)	(74,157)	(77,042)	(80,196)	(84,386)	(85,519)
Pretax profits	76,536	93,129	104,875	95,634	110,732	125,655	140,663	152,508	162,334	173,686
Extraordinary income/(charges)	—	—	—	—	—	—	—	—	—	—
Prior period adjustments	—	—	—	—	—	—	—	—	—	—
Current tax expense	(8,414)	(7,371)	(19,602)	(17,638)	(22,496)	(34,765)	(39,991)	(45,188)	(53,636)	(57,193)
Deferred tax (liability)/asset	36	756	5,807	4,546	2,232	6,134	6,310	7,188	11,425	9,812
Minority interest expense	(1,151)	(1,759)	(1,688)	(2,336)	(3,185)	(3,706)	(4,004)	(4,557)	(5,103)	(5,600)
Equity in earnings of affiliates	—	(56)	748	2,104	4,565	5,929	7,175	8,594	9,981	11,330
Reported net profits	67,007	84,699	90,141	82,310	91,847	99,247	110,153	118,545	125,001	132,035
Adjusted net profits	67,007	84,699	90,141	82,310	91,847	99,247	110,153	118,545	125,001	132,035
Adjusted EPS (Rs)	17.7	22.3	23.8	21.7	24.2	26.1	29.0	31.2	32.9	34.8
Shares outstanding (mn)	3,796	3,797	3,797	3,797	3,797	3,797	3,797	3,797	3,797	3,797
Current tax rate (%)	11.0	7.9	18.7	18.4	20.3	27.7	28.4	29.6	33.0	32.9
Effective tax rate (%)	10.9	7.1	13.2	13.7	18.3	22.8	23.9	24.9	26.0	27.3
Growth (%)										
EBITDA	52.3	33.9	4.9	(1.2)	11.9	10.6	7.2	5.2	4.6	3.9
Net profits	65.0	26.4	6.4	(8.7)	11.6	8.1	11.0	7.6	5.4	5.6
EPS	65.0	26.4	6.4	(8.8)	11.6	8.1	11.0	7.6	5.4	5.6
Margin (%)										
EBITDA	41.9	41.0	40.7	37.2	37.2	37.6	37.8	37.9	38.0	38.0
Net profits	24.8	22.9	23.1	19.5	19.4	19.1	20.0	20.5	20.7	21.0
EBIT	28.3	28.2	25.5	22.2	22.4	23.0	23.6	23.9	23.8	24.2

Source: Company, Kotak Institutional Equities estimates

"I, Kawaljeet Saluja, hereby certify that all of the views expressed in this report accurately reflect my personal views about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report."

Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



Source: Kotak Institutional Equities

As of September 30, 2009

Ratings and other definitions/identifiers

Definitions of ratings

BUY. We expect this stock to outperform the BSE Sensex by 10% over the next 12 months.

ADD. We expect this stock to outperform the BSE Sensex by 0-10% over the next 12 months.

REDUCE. We expect this stock to underperform the BSE Sensex by 0-10% over the next 12 months.

SELL. We expect this stock to underperform the BSE Sensex by more than 10% over the next 12 months.

Our target price are also on 12-month horizon basis.

Other definitions

Coverage view. The coverage view represents each analyst's overall fundamental outlook on the Sector. The coverage view will consist of one of the following designations: **Attractive, Neutral, Cautious.**

Other ratings/identifiers

NR = Not Rated. The investment rating and target price, if any, have been suspended temporarily. Such suspension is in compliance with applicable regulation(s) and/or Kotak Securities policies in circumstances when Kotak Securities or its affiliates is acting in an advisory capacity in a merger or strategic transaction involving this company and in certain other circumstances.

CS = Coverage Suspended. Kotak Securities has suspended coverage of this company.

NC = Not Covered. Kotak Securities does not cover this company.

RS = Rating Suspended. Kotak Securities Research has suspended the investment rating and price target, if any, for this stock, because there is not a sufficient fundamental basis for determining an investment rating or target. The previous investment rating and price target, if any, are no longer in effect for this stock and should not be relied upon.

NA = Not Available or Not Applicable. The information is not available for display or is not applicable.

NM = Not Meaningful. The information is not meaningful and is therefore excluded.

Corporate Office

Kotak Securities Ltd.
Bakhtawar, 1st Floor
229, Nariman Point
Mumbai 400 021, India
Tel: +91-22-6634-1100

Overseas Offices

Kotak Mahindra (UK) Ltd
6th Floor, Portsoken House
155-157 The Minories
London EC 3N 1 LS
Tel: +44-20-7977-6900 / 6940

Kotak Mahindra Inc
50 Main Street, Suite No.310
Westchester Financial Centre
White Plains, New York 10606
Tel:+1-914-997-6120

Copyright 2009 Kotak Institutional Equities (Kotak Securities Limited). All rights reserved.

Kotak Securities Limited and its affiliates are a full-service, integrated investment banking, investment management, brokerage and financing group. We along with our affiliates are leading underwriter of securities and participants in virtually all securities trading markets in India. We and our affiliates have investment banking and other business relationships with a significant percentage of the companies covered by our Investment Research Department. Our research professionals provide important input into our investment banking and other business selection processes. Investors should assume that Kotak Securities Limited and/or its affiliates are seeking or will seek investment banking or other business from the company or companies that are the subject of this material and that the research professionals who were involved in preparing this material may participate in the solicitation of such business. Our research professionals are paid in part based on the profitability of Kotak Securities Limited, which include earnings from investment banking and other business. Kotak Securities Limited generally prohibits its analysts, persons reporting to analysts, and members of their households from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. Additionally, Kotak Securities Limited generally prohibits its analysts and persons reporting to analysts from serving as an officer, director, or advisory board member of any companies that the analysts cover. Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients that reflect opinions that are contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest. Additionally, other important information regarding our relationships with the company or companies that are the subject of this material is provided herein.

This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based on this material. It is for the general information of clients of Kotak Securities Limited. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Before acting on any advice or recommendation in this material, clients should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice. The price and value of the investments referred to in this material and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance, future returns are not guaranteed and a loss of original capital may occur. Kotak Securities Limited does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding any potential investment.

Certain transactions -including those involving futures, options, and other derivatives as well as non-investment-grade securities - give rise to substantial risk and are not suitable for all investors. The material is based on information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied on as such. Opinions expressed are our current opinions as of the date appearing on this material only. We endeavor to update on a reasonable basis the information discussed in this material, but regulatory, compliance, or other reasons may prevent us from doing so. We and our affiliates, officers, directors, and employees, including persons involved in the preparation or issuance of this material, may from time to time have "long" or "short" positions in, act as principal in, and buy or sell the securities or derivatives thereof of companies mentioned herein. For the purpose of calculating whether Kotak Securities Limited and its affiliates holds beneficially owns or controls, including the right to vote for directors, 1% of more of the equity shares of the subject issuer of a research report, the holdings does not include accounts managed by Kotak Mahindra Mutual Fund. Kotak Securities Limited and its non US affiliates may, to the extent permissible under applicable laws, have acted on or used this research to the extent that it relates to non US issuers, prior to or immediately following its publication. Foreign currency denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of or income derived from the investment. In addition, investors in securities such as ADRs, the value of which are influenced by foreign currencies affectively assume currency risk. In addition options involve risks and are not suitable for all investors. Please ensure that you have read and understood the current derivatives risk disclosure document before entering into any derivative transactions.

This report has not been prepared by Kotak Mahindra Inc. (KMInc). However KMInc has reviewed the report and, in so far as it includes current or historical information, it is believed to be reliable, although its accuracy and completeness cannot be guaranteed. Any reference to Kotak Securities Limited shall also be deemed to mean and include Kotak Mahindra Inc.