

Bharti Airtel

Q2FY11 Result update

12 November 2010

Buy

Target Price: Rs424

CMP: Rs317*

Upside:34%

*as on 11 November 2010

Operating matrix improving

Bharti Airtel's (Bharti) results were above our estimates as the company registered better than expected revenue per minutes and higher revenue from its Africa business. We have revisited our estimates to correct our conservative stance on financials. We re-iterate Buy from a long term perspective considering minutes of usage growth, stability in revenue per minute (RPM) and scope of improvement in margins in its Africa business.

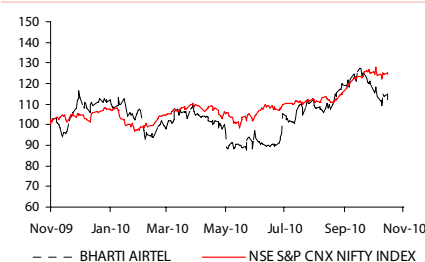
- **Revenue (Ex-Africa) remains flat QoQ:** Revenue was flat in Q2FY11 at Rs113bn (0.5% QoQ growth) as total minutes of usage remained at Q1FY11 levels. We expect a pick-up in minutes of usage growth in the 2HFY11E on the back of seasonality factor.
- **Africa market's operational matrix improving:** The first full quarter result of the Africa business revealed net sales of Rs38.9bn. In Q2FY11 subscriber net adds were 3.7bn with improvement in MoU/sub to 112 vs 103 in Q1FY11. We believe that growth in minutes could be strong in Africa considering the low usage and rationalisation of tariffs.
- **Revised earnings estimate:** We are revising our EBITDA estimates upward by 9.5% and 5.4% for FY11E and FY12E respectively to factor in lower fall in RPM, improvement in margins of enterprise and passive infrastructure segments & adjusting for lower EBITDA margin for the Africa business.
- **Reiterate buy with a long term view:** The stock trades at 7.6x FY12E EV/EBITDA. We reiterate Buy on the stock considering early signs of lower fall in revenue per minute with stable margin and improvement in the Africa business.

Key Data

Bloomberg Code	BHARTI IN
Reuters Code	BRTI.BO
Current Shares O/S (mn)	3,797.5
Diluted Shares O/S(mn)	3,797.5
Mkt Cap (Rsbn/USDbn)	1,202.9/27
52 Wk H / L (Rs)	377/230
Daily Vol. (3M NSE Avg.)	4,782,313
Face Value (Rs)	5

USD = Rs 44.6

One Year Indexed Stock Performance



Price Performance (%)

	1M	6M	1Yr
Bharti Airtel	(6.6)	21.2	6.0
NIFTY	1.6	20.0	24.9

Source: Bloomberg, Centrum Research
*as on 11 November 2010

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Y/E March (Rsmn)	Q2FY11	Q2FY10	YoY (%)	Q1FY11	QoQ (%)	Q2FY11E	Variance (%)
Net sales	152,150	103,785	46.6	122,308	24.4	128,046	18.8
Access charges	18,839	10,698		14,227		15,839	
% of sales	12.4	10.3		11.6		12.4	
License fees and spectrum charges	12,540	10,224		11,742		12,064	
% of sales	8.2	9.9		9.6		9.4	
Network operations cost	32,895	22,321		27,268		35,051	
% of sales	21.6	21.5		22.3	(67) bp	27.4	
SGA, employee cost and other exp	36,664	17,535		24,931		24,196	
% of sales	24.1	16.9		20.4		18.9	
Operating profit	51,212	43,007	19.1	44,140	16.0	40,895	25.2
OPM (%)	33.7	41.4	(778) bp	36.1	(243) bp	31.9	172 bp
Depreciation and amortisation	25,790	15,246		19,467		26,261	
Interest	3,322	2,391		6,941		2,355	
EBT	22,100	25,370		17,732		12,279	
Other income	335	681		3,373		1,229	
Share of profits(losses) in joint ventures	(2)	(6)		(72)			
PBT	22,267	25,858	(13.9)	20,719	7.5	13,509	64.8
Provision for tax	5,678	2,753		3,750		2,281	
-effective tax rate	25.5	10.6		18.1		16.9	
Minority interest	(23)	477		153		(570)	
PAT (reported)	16,589	22,628	(26.7)	16,969	(2.2)	11,797	40.6
Exceptional item (adj-post tax)	(9,122)	(58)		2,762			
PAT (adjusted)	25,711	22,686	13.3	14,207	81.0	11,797	117.9
NPM (%)	16.9	21.9	(496) bp	11.6	528 bp	16	107 bp

Source: Company, Centrum Research

Y/E March (Rsmn)	Revenue	YoY (%)	EBITDA	EBITDA (%)	Adjust. PAT	YoY (%)	Fully DEPS	RoE (%)	P/E (x)	EV/EBITDA (x)
FY09	369,616	36.8	151,678	41.0	92,571	39.6	24.4	35.5	13.0	8.4
FY10	396,150	7.2	144,596	36.5	81,997	(11.4)	21.6	22.5	14.7	8.4
FY11E	583,999	47.4	196,160	33.6	70,467	(14.1)	18.5	20.7	17.1	9.9
FY12E	689,339	18.0	241,919	35.1	74,920	6.3	19.7	22.0	16.1	7.6
FY13E	765,175	11.0	283,237	37.0	99,825	33.2	26.2	23.4	12.1	6.1

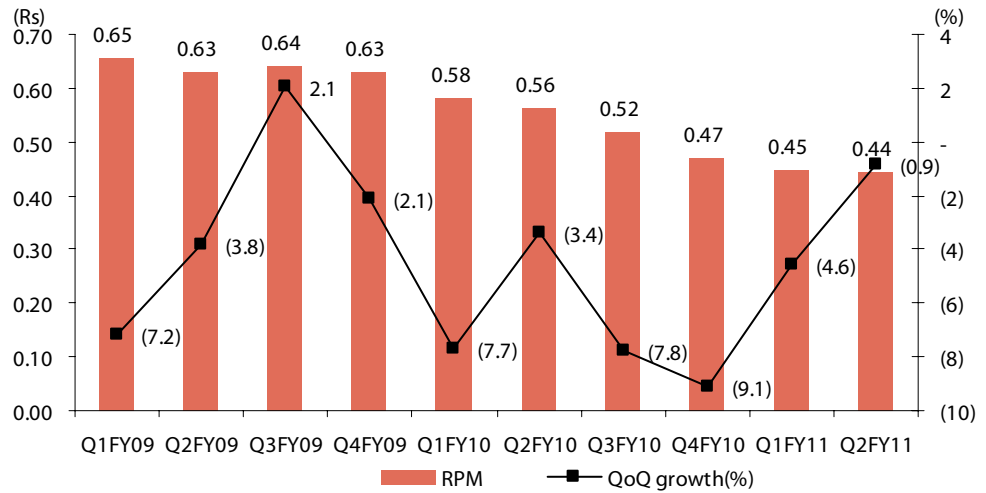
Source: Company, Centrum Research Estimates

Please refer to important disclosures/disclaimers in Appendix A

Flat revenue per minutes indicates ease of pricing pressure

Revenue per minute (RPM) at 44p (decline of 0.9% QoQ) was better than our estimate of 42.5p. This indicates improvement in pricing environment in the domestic market and easing of competitive pressures. We expect the RPM fall to slow down going forward in the absence of any change in base tariff rates. We do not expect any significant price war on MNP implementation as further rate cut would hamper the business model of players. Also, stronger players like Bharti have a better chance of retaining high average revenue per user (ARPU) customers with its 3G service offerings at a Pan India level because 3G launch would come before mobile number portability (MNP).

Exhibit 1: Revenue per minutes remained in Q2 was better than expected

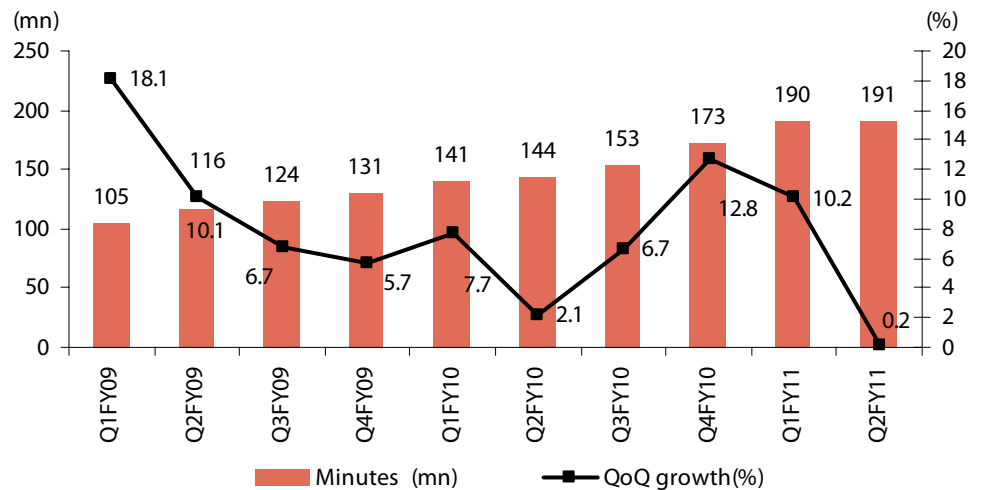


Source: Company, Centrum Research

... and minutes of usage too

Minutes of usage remained flat on a QoQ basis in Q2FY11 as it is seasonally a weak quarter. We expect revival in minutes of usage in FY12 due to the same reason along with the affordability factor. However, due to re-verification of customer details (KYC), the net subscriber addition for Q3FY11E is likely to remain subdued.

Exhibit 2: Minutes of usage remains flat on seasonality factor



Source: Company, Centrum Research

Exhibit 3: Operating margin improved across non –mobile segment

	Q2FY10	Q3FY10	Q4FY10	Q1FY11	Q2FY11	QoQ (%)	YoY (%)
Mobile services							
Revenue	82,902	80,898	83,174	88,237	88,045	(0.2)	6.2
EBITDA	33,310	30,400	30,237	31,710	30,964	(2.4)	(7.0)
EBITDA margin (%)	40.2	37.6	36.4	35.9	35.2		
Telemedia							
Revenue	8,543	8,549	8,511	8,960	9,118	1.8	6.7
EBITDA	3,646	3,933	3,684	3,938	4,200	6.7	15.2
EBITDA margin (%)	42.7	46.0	43.3	44.0	46.1	4.8	7.9
Enterprise Segment							
Revenue	11,355	11,048	10,768	10,186	10,424	2.3	(8.2)
EBITDA	3,141	3,274	3,221	2,497	2,571	3.0	(18.1)
EBITDA margin (%)	27.7	29.6	29.9	24.5	24.7		
Passive infrastructure							
Revenue	17,049	18,407	19,459	20,412	21,161	3.7	24.1
EBITDA	5,831	6,267	7,224	7,240	7,858	8.5	34.8
EBITDA margin (%)	34.2	34.0	37.1	35.5	37.1		

Source: Company, Centrum Research

Exhibit 4: Performance of Bharti (Ex-Africa)

Y/E March (Rsmn)	Q2FY11	Q1FY11	QoQ (%)	Q2FY10	YoY (%)
Revenue	113,244	112,725	0.5	103,785	9.1
EBITDA	42,223	41,518	1.7	43,007	(1.8)
Margin (%)	37.3	36.8	45 bp	41.4	(415) bp
	Q2FY11	Q1FY11	QoQ (%)	Q2FY10	YoY (%)
ARPU (Rs)	202	215	(6.4)	252	(20.0)
MOU	468	480	(2.6)	450	4.1
RPM (Rs)	0.44	0.45	(0.9)	0.56	(20.7)

Source: Company, Centrum Research

Africa business to take time to improve

Though customer acquisition and minutes of usage have improved, we expect the Africa business to take time to reflect this benefit at the EBITDA level. We expect the investment phase to continue in FY11E with the company focussing on outsourcing IT and ITES services, networking rollout processes and launching/building of 'Airtel' brand in Africa. We are positive on the company's strategy of focussing on topline growth knowing the nature of business where acquisition of customers is the first step toward ensuring long term profitability. Hence, we see increase in customers and growth in minutes as signs of improvement.

Exhibit 5: Improvement in MoU/Sub shows elasticity benefit

		Q1FY11*	Q2FY11
Subscribers	mn	36.4	40.1
MoU/Sub	min	103	112
RPM	US¢	7.2	6.6
ARPU	US\$	7.4	7.4
Minutes of Usage	mn min	3,695	12,782
Revenue	Rsmn	9,583	38,906
EBITDA	Rsmn	2,622	8,989
OPM	%	27.4	23.1

Note: * 23 Days

Source: Company, Centrum Research

Change in estimates

We have revised our revenue and EBITDA estimates upward for FY11E and change our conservative stance on topline estimates of the domestic business to factor in slower fall of RPM and improvement in passive infrastructure operating margin. We have also raised our topline estimates for the Africa business considering the strong addition in customer numbers in Q2FY11. We expect some cost escalation for the Africa business in the short term, but our long term outlook on margin expansion remains intact given the scope of cost rationalisation and the ability of management to execute its plans.

Exhibit 6: Revision in earnings estimate

(Rsmn)	FY11E			FY12E		
	Revised	Old	Variation (%)	Revised	Old	Variation (%)
Net sales	583,999	517,391	12.9	689,339	664,415	3.8
EBITDA	196,160	179,073	9.5	241,919	229,627	5.4
EBITDA (%)	33.6	34.6	(102) bp	35.1	34.6	53 bp
PAT	70,467	59,753	17.9	74,920	61,662	21.5
NPM (%)	12.1	11.5	52 bp	10.9	9.3	159 bp

Source: Company, Centrum Research Estimates

Reiterate Buy; retain target price

We remain positive on the long term prospects of the company and see Africa business and tower business listing/stake sale as triggers for stock. At the CMP, the stock is trading at 7.6x FY12E EV/EBITDA and we believe that it is attractive to enter at current levels from a long term horizon. We have not revised our target price despite change in estimates as we see value derived from an increase in EBITDA for domestic business (including passive infrastructure segment) is partially negated by lower value for the Africa business (we have reduced estimates for EBITDA for Africa business for FY12E considering a fall in operating profit margin for FY11E and expansion of margin for FY12E on the lower base of FY11E). Hence, the net impact on target price based on sum of parts basis remains the same.

Risk to our recommendation

- We believe MNP will not lead to a severe tariff war as 3G service offering is coming before it. Hence, any base tariff decline would change our revenue estimates for FY12E
- We have already reduced our EBITDA margin assumption for the Africa business. However, we do not have enough clarity on the effective tax rate for this business. Higher payout of tax would change our assumption on profitability in the Africa business

Financials

Exhibit 7: Income Statement

Y/E March (Rsmn)	FY09	FY10	FY11E	FY12E	FY13E
Revenue	369,616	396,150	583,999	689,339	765,175
YoY growth (%)	36.8	7.2	47.4	18.0	11.0
Access charges	52,903	44,806	50,639	57,413	63,689
% of Sales	14.3	11.3	8.7	8.3	8.3
License and spectrum charges	38,266	40,875	45,553	48,836	51,776
% of Sales	10.4	10.3	7.8	7.1	6.8
Network operations cost	59,355	90,031	106,066	121,382	140,065
% of Sales	16.1	22.7	18.2	17.6	18.3
Personnel expenses	16,992	19,028	20,903	21,643	22,356
% of Sales	4.6	4.8	3.6	3.1	2.9
Mktg., Distrib. Admin & other exp.	50,421	56,814	64,407	65,675	69,729
% of Sales	13.6	14.3	11.0	9.5	9.1
EBITDA	151,678	144,596	196,160	241,919	283,237
EBITDA Margin	41.0	36.5	33.6	35.1	37.0
Depreciation	47,581	62,835	93,018	127,686	140,446
PBIT	104,097	81,761	103,142	114,233	142,791
Interest expenses	3,479	2,584	14,168	20,155	17,655
Share of profits / (losses) in joint ventures and associates	(713)	292	-	-	-
PBT from operations	99,905	79,469	88,974	94,078	125,136
Other non operating income	(6,832)	18,474	906	1,919	1,972
PBT before extra-ordinary items	93,073	97,943	89,880	95,997	127,107
PBT	93,073	97,983	89,880	95,997	127,107
Provision for tax	6,615	13,958	20,408	19,732	23,734
Effective tax rate	7.1	14.2	22.7	20.6	18.7
Minority Interest	1,759	1,994	(995)	1,345	3,548
PAT (adjusted)	92,571	81,997	70,467	74,920	99,825
YoY growth (%)	39.6	(11.4)	(14.1)	6.3	33.2
PAT margin	25.0	20.7	12.1	10.9	13.0

Source: Company, Centrum Research Estimates

Exhibit 8: Balance Sheet

Y/E March (Rsmn)	FY09	FY10	FY11E	FY12E	FY13E
Share Capital	18,982	18,988	19,003	19,025	19,047
Reserves	284,963	394,709	463,333	536,276	633,347
Net worth	303,945	413,697	482,336	555,301	652,394
Debt	118,800	64,619	745,000	645,000	532,000
Minority Interest	10,704	28,489	27,494	28,840	32,388
Deferred Tax Liability	(1,254)	(9,442)	(9,442)	(9,442)	(9,442)
Total Capital Employed	432,195	497,363	1,245,388	1,219,698	1,207,340
Gross Block	537,521	638,761	1,547,865	1,669,288	1,793,337
Accumulated depreciation	150,214	213,049	306,067	433,753	574,200
Net Block	387,307	425,712	1,241,798	1,235,535	1,219,138
Capital WIP	35,138	34,000	51,136	33,147	27,365
Total Fixed Assets	422,445	459,712	1,292,934	1,268,682	1,246,503
Goodwill	27,054	36,771	36,771	36,771	36,771
Investments (strategic)	128	172	71,223	71,223	71,223
Invest. (marketable securities)	37,925	63,131	13,131	13,131	14,631
Inventories	963	484	3,162	4,078	4,158
Debtors	18,262	13,757	35,863	45,416	49,257
Cash and cash equivalent	11,241	14,295	6,236	4,164	15,855
Loans and Advances	45,078	23,796	46,132	51,388	56,970
Other current asset	10,266	10,578	11,405	12,334	13,152
Total current assets	85,810	62,910	102,797	117,381	139,393
Current liabilities and provisions	152,377	130,280	277,157	294,083	308,765
Net current assets	(66,567)	(67,370)	(174,360)	(176,702)	(169,372)
Other non-current assets	21,775	13,592	14,679	15,854	17,122
Other non-current liabilities	10,565	8,645	8,991	9,261	9,538
Total Assets	432,195	497,363	1,245,388	1,219,698	1,207,340

Source: Company, Centrum Research Estimates

Exhibit 9: Cash flow

Y/E March (Rsmn)	FY09	FY10	FY11E	FY12E	FY13E
Cash flow from operating					
Profit before tax	91,314	104,984	90,875	94,652	123,559
Depreciation	46,684	59,066	93,018	127,686	140,446
Other	6,339	4,262	(1,901)	(574)	1,577
Interest expenses	3,479	2,584	14,168	20,155	17,655
Cash before WC change	147,816	170,896	196,160	241,919	283,237
Working capital adjustment	(10,125)	16,892	74,808	27,529	1,652
Gross cash flow from op.	137,691	187,788	270,969	269,448	284,889
Direct taxes paid	6,615	13,958	20,408	19,732	23,734
Cash from operations	131,076	173,830	250,561	249,716	261,155
Cash flow from investing					
Capex	(144,313)	(102,047)	(973,911)	(131,597)	(116,550)
Invest. & income for investments	13,854	(22,776)	50,906	1,919	472
Cash flow from investing	(130,459)	(124,823)	(923,005)	(129,678)	(116,078)
Cash flow from financing					
Procd.s from sh. cap & premium	198	194	215	22	22
Borrowings/ (Repayments)	7,031	(23,069)	680,381	(100,000)	(113,000)
Interest paid	(3,479)	(2,584)	(14,168)	(20,155)	(17,655)
Dividend paid	-	(4,442)	(2,043)	(1,978)	(2,753)
Cash flow from financing	3,751	(29,901)	664,384	(122,110)	(133,386)
Net cash increase/ (decrease)	4,368	19,106	(8,059)	(2,072)	11,691
Free cash flow to firm (FCFF)	(19,255)	63,507	(725,661)	115,896	143,280
FCFF per share	(5.1)	16.7	(190.9)	30.5	37.6

Source: Company, Centrum Research Estimates

Exhibit 10: Key Ratios

Y/E March	FY09	FY10	FY11E	FY12E	FY13E
Margin Ratios (%)					
EBITDA Margin	41.0	36.5	33.6	35.1	37.0
PBIT Margin	28.2	20.6	17.7	16.6	18.7
PBT Margin	25.2	24.7	15.4	13.9	16.6
PAT Margin	25.0	20.7	12.1	10.9	13.0
Return Ratios (%)					
ROCE	25.8	18.5	9.2	7.5	9.7
ROIC	29.4	17.5	9.7	7.5	9.8
ROE	35.5	22.5	20.7	22.0	23.4
Turnover Ratios					
Assets Turover Ratio (x)	0.98	0.86	0.67	0.56	0.63
Average collection period (days)	72.7	44.3	74.3	79.4	80.5
Average payment period (days)	163.5	139.0	290.2	320.0	303.1
Inventory holding (days)	1.0	0.4	2.0	2.2	2.0
Per share (Rs)					
Basic EPS	24.4	21.6	18.6	19.7	26.3
Fully diluted EPS	24.4	21.6	18.5	19.7	26.2
CEPS	36.9	38.1	43.0	53.2	63.1
Book Value	80.1	108.9	126.9	145.9	171.3
Solvency ratios					
Debt/ Equity	0.4	0.1	1.5	1.1	0.8
Interest Coverage	29.9	31.6	7.3	5.7	8.1
Valuation parameters (x)					
P/E	13.0	14.7	17.1	16.1	12.1
P/BV	4.0	2.9	2.5	2.2	1.8
EV/ EBITDA	8.4	8.4	9.9	7.6	6.1
EV/ Sales	3.5	3.1	3.3	2.7	2.3
M-Cap/ Sales	3.3	3.0	2.1	1.7	1.6

Source: Company, Centrum Research Estimates

Appendix A

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