

Company In-Depth

2 January 2007 | 9 pages

Bharti Airtel Limited (BRTI.BO)

Organic Success

Rating change
Target price change
Estimate change

- Increasing estimates and target price** — Bharti's strong execution sets it apart from the rest, which should make it the biggest beneficiary of surging wireless penetration. Our earnings upgrade of 2.4%-8.8% over FY07-09E and target price upgrade to Rs750 reflects that, plus the expected commensurate benefits in its wholesale voice business.
- Hutch sale should be positive, one way or another** — While there is a probability of losing the #1 status if Hutch goes to RCOM, we believe it will be offset by the benefits of earlier-than-expected consolidation. Early stage of penetration and less tangible benefits of market leadership (EBITDA margins consistent across operators in mid-30s) means Bharti may not miss much.
- Will Vodafone's exit provide opportunities?** — Though Vodafone-Hutch deal will be a setback to consolidation, the inevitable control premium would have a ruboff impact on Bharti. The consequent unwinding of Vodafone's 10% stake in Bharti could provide further buying opportunities on any overhang related weakness, be it SingTel or investors seeking liquidity.
- Top pick, but foreign premium poses technical constraints** — We roll forward our DCF to March-08 yielding our new target price. Bharti continues to be our top-pick in the region. Valuations adjusted for growth (EV/EBITDA of 11.8x FY08E) still look reasonable. The lack of headroom in the foreign limit (despite the hike in FDI cap) remains an irritant though to gain exposure.

Buy/Low Risk	1L
Price (29 Dec 06)	Rs631.35
Target price	Rs750.00
	<i>from Rs600.00</i>
Expected share price return	18.8%
Expected dividend yield	0.3%
Expected total return	19.1%
Market Cap	Rs1,196,878M
	US\$27,143M

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



See page 7 for Analyst Certification and important disclosures.

Figure 1. Statistical Abstract

Year end March	Net Profit (Rs m)	EBITDA (Rs m)	P/E (x)	EV/EBITDA (x)
2005A	14,978	29,687	77.8	40.4
2006A	22,566	42,981	52.8	28.5
2007E	39,190	72,984	30.4	16.8
2008E	57,388	104,376	20.8	11.8
2009E	70,972	131,761	16.8	9.3

Source: Citigroup Investment Research estimates

Figure 2. Earnings Estimate Revisions

	Net Profit	EPS	% Change	EBITDA
2007E	39,190	20.7	2.4	72,984
<i>Old</i>	<i>38,272</i>	<i>20.2</i>		<i>70,366</i>
2008E	57,388	30.3	7.8	104,376
<i>Old</i>	<i>53,213</i>	<i>28.1</i>		<i>97,375</i>
2009E	70,972	37.5	8.8	131,761
<i>Old</i>	<i>65,224</i>	<i>34.4</i>		<i>120,886</i>

Source: Citigroup Investment Research estimates

Rahul Singh¹

+91-22-6631-9863
rahul.r.singh@citigroup.com

Anand Ramachandran, CFA²

+852-2501-2448
anand.ramachandran@citigroup.com

Supriya Gupte¹

supriya.gupte@citigroup.com

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Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	78.1	53.0	30.5	20.8	16.8
EV/EBITDA adjusted (x)	42.7	30.0	18.2	13.1	10.5
P/BV (x)	19.2	13.0	9.4	6.8	5.2
Dividend yield (%)	0.0	0.0	0.3	0.7	1.2
Per Share Data (Rs)					
EPS adjusted	8.08	11.92	20.69	30.30	37.47
EPS reported	8.08	11.92	20.69	30.30	37.47
BVPS	32.95	48.67	67.13	92.39	121.47
DPS	0.00	0.00	2.00	4.50	7.50
Profit & Loss (RsM)					
Net sales	80,028	116,215	191,606	267,562	332,802
Operating expenses	-61,305	-88,610	-143,121	-196,703	-243,559
EBIT	18,723	27,605	48,485	70,859	89,243
Net interest expense	-1,996	-2,512	-3,950	-3,343	-3,217
Non-operating/exceptionals	-124	272	0	0	0
Pre-tax profit	16,604	25,365	44,534	67,515	86,026
Tax	-1,528	-2,539	-5,344	-10,127	-15,055
Extraord./Min.Int./Pref.div.	-98	-260	0	0	0
Reported net income	14,978	22,566	39,190	57,388	70,972
Adjusted earnings	14,978	22,566	39,190	57,388	70,972
Adjusted EBITDA	29,687	42,981	72,984	104,376	131,761
Growth Rates (%)					
Sales	65.6	45.2	64.9	39.6	24.4
EBIT adjusted	129.1	47.4	75.6	46.1	25.9
EBITDA adjusted	89.8	44.8	69.8	43.0	26.2
EPS adjusted	195.1	47.4	73.7	46.4	23.7
Cash Flow (RsM)					
Operating cash flow	32,583	48,320	107,775	114,610	122,570
Depreciation/amortization	10,964	15,376	24,500	33,518	42,518
Net working capital	1,029	7,295	40,135	20,361	5,863
Investing cash flow	-29,938	-54,095	-102,286	-108,569	-92,604
Capital expenditure	-26,982	-57,309	-102,484	-108,906	-92,947
Acquisitions/disposals	-1,464	3,631	0	0	0
Financing cash flow	-860	5,338	1,613	-10,218	-25,457
Borrowings	-1,017	-806	10,000	3,000	-6,000
Dividends paid	0	0	-4,239	-9,538	-15,897
Change in cash	1,784	-438	7,102	-4,177	4,509
Balance Sheet (RsM)					
Total assets	159,073	215,681	306,595	383,432	441,656
Cash & cash equivalent	3,087	2,649	10,513	6,336	10,845
Accounts receivable	10,098	14,203	19,161	24,081	26,624
Net fixed assets	131,809	180,971	258,193	333,581	384,011
Total liabilities	97,258	122,545	178,509	207,496	210,646
Accounts payable	0	0	0	0	0
Total Debt	89,048	112,898	168,862	197,849	200,999
Shareholders' funds	61,814	93,135	128,086	175,936	231,011
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	37.1	37.0	38.1	39.0	39.6
ROE adjusted	28.0	29.5	35.7	38.0	35.0
ROIC adjusted	13.1	13.9	17.2	18.2	18.5
Net debt to equity	139.1	118.4	123.6	108.9	82.3
Total debt to capital	59.0	54.8	56.9	52.9	46.5

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Bharti's engine will continue to roll, Hutch or no Hutch

Bharti's execution track record and its edge in terms of managing growth has been remarkable, in our view. This also shows up in Bharti's relatively stable (yet rising) net adds vis-à-vis the industry. Bharti therefore looks better positioned to gain from upcoming wireless growth.

Figure 3. Our Estimate Changes on Bharti

Year to 31 Mar Rs M	New			Old		
	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E
Revenues	190,423	266,355	331,571	180,802	246,460	302,099
EBITDA	72,984	104,376	131,761	70,366	97,375	120,886
EBITDA %	38.3	39.2	39.7	38.9	39.5	40.0
EBITDA upgrade (%)	3.7%	7.2%	9.0%	NA	NA	NA
Capex	102,484	108,906	92,947	98,295	98,498	81,673
EPS	20.69	30.30	37.47	20.21	28.10	34.44
EPS upgrade (%)	2.4%	7.8%	8.8%	NA	NA	NA

Source: Company Reports, Citigroup Investment Research Estimates

What does Hutch-Essar (HE) sale do to Bharti?

There are two likely scenarios:

1. **RCOM acquires Bharti:** While Bharti would lose its leadership status under this scenario, we don't think it matters too much. In any case, the scale benefits from leadership status have not been very apparent (with all operators having EBITDA margins in the mid-30s) partially on account of heavy upfronting of opex related to the rapid pace of rollout. Early stages of penetration also negates the leadership change to some extent, though admittedly, RCOM-Hutch's combined market share of ~38% would be clear of Bharti's present 22%.
2. **Vodafone acquires Hutch:** While negative for consolidation, Vodafone's entry is unlikely to alter competitive dynamics much. Infact, Vodafone's existing relationship with Bharti might result in increased collaboration between the two especially in the infrastructure sharing space. The control premium paid for the HE acquisition (say 20-25%) would also have a positive bearing on Bharti's valuations. Vodafone would also have to disengage from its 10% economic interest (5.6% direct and 4.4% indirect) in Bharti, which could provide further buying opportunities in case of any overhang related weakness.

Bharti Airtel Limited

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). The major shareholders are Bharti Telecom, SingTel and Vodafone.

Investment thesis

We rate Bharti as Buy/Low Risk (1L) with a target price of Rs750. We believe continued robust wireless market expansion and Bharti's ability to capture this growth profitably will be the recurring theme for the stock. We estimate an FY06-09E EPS CAGR of 46.5% or more than double that of the broader market. We believe that competitive pressures, though intense, will continue to be 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 strategic shareholding of SingTel, which the company has increased over time, leaves us comfortable with execution issues and new initiatives (such as electronic recharge, vendor tie-ups or a One Alliance partnership). Combined with strong brand presence and a good corporate governance standard, Bharti appears a strong investment. The company has yet to realize the benefits of economies of scale, and we expect a slight strengthening of margins.

Valuation

Our 12-month forward target price of Rs750 (previously Rs600) is based on DCF, which suggests a fair value of Rs749 as of March 2008 (rolled forward from March 2007). This is based on WACC of 10.8%, terminal growth rate of 3.5% and beta of 0.9 (implying a terminal EV/EBITDA multiple of 8.0x). 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 2009-10. Our target price represents a FY09E P/E of 20.0x, P/CEPS of 12.5x and EV/EBITDA of 11.2x.

The imputed target PER of 25.0x FY08E is at 25% premium to the broad market PER (20.0 FY08E at the higher end of Citigroup's Sensex target of 16,000). This we believe is justified by above-average earnings growth (FY06-09E EBITDA CAGR of 45.3% and EPS CAGR of 46.5%), improved earnings visibility and relative insulation from macro risks (interest rates and political risks).

Risk

Our quantitative risk-rating system 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) the strategic shareholding of SingTel and Vodafone leaves us comfortable with execution issues and initiatives. The risks that could prevent the stock from reaching our target price include competition-led tariff pressures, un-remunerative capex, overall market downside, and more telecom related paper entering the market.

Figure 4. Income Statement

Year to 31 Mar (Rs m)	2006	2007E	2008E	2009E
Mobile revenue	80,822	144,132	203,841	256,099
Infotel revenue	46,613	67,449	92,110	112,314
Total service revenue	113,724	190,423	266,355	331,571
Other revenue	1,160	1,183	1,207	1,231
Total Revenue	114,884	191,606	267,562	332,802
Access charges	(21,776)	(52,201)	(75,206)	(92,832)
Network operating	(11,729)	(21,525)	(29,765)	(37,148)
Cost of sales of goods	(1,169)	(1,785)	(1,931)	(2,069)
Personnel	(8,186)	(13,016)	(17,253)	(20,352)
SG&A	(19,146)	(32,118)	(42,118)	(52,331)
Intersegment elimination	-	21,158	29,595	36,841
Total Operating Expenses	(62,006)	(99,488)	(136,678)	(167,891)
EBITDA ex license fee	54,210	92,118	130,884	164,911
License fee	(11,228)	(19,133)	(26,507)	(33,150)
Adjusted EBITDA	42,981	72,984	104,376	131,761
Depreciation	(14,206)	(23,343)	(32,396)	(41,430)
Amortization	(1,170)	(1,157)	(1,122)	(1,088)
Net finance costs	(2,512)	(3,950)	(3,343)	(3,217)
PBT	25,365	44,534	67,515	86,026
Current tax	(1,773)	(5,344)	(10,127)	(15,055)
PAT	22,826	39,190	57,388	70,972
EPS (Rs)	11.9	20.7	30.3	37.5
Shares outstanding (MM)	1,894	1,894	1,894	1,894
Growth Y/Y (%)				
Revenues	43.6%	66.8%	39.6%	24.4%
EBITDA	44.8%	69.8%	43.0%	26.2%
EPS	47.4%	73.7%	46.4%	23.7%
DPS	NA	NA	125.0%	66.7%

Source: Company Reports and Citigroup Investment Research Estimates

Figure 5. Balance Sheet

Year to 31 Mar (Rs m)	2006	2007E	2008E	2009E
Net PP&E block	142,411	220,790	297,300	348,818
Investments	3,216	3,216	3,216	3,216
Deferred tax asset (net)	(1,946)	(1,946)	(1,946)	(1,946)
Inventories	381	1,253	1,958	2,701
Sundry debtors	14,203	19,161	24,081	26,624
Cash and bank balances	2,649	10,513	6,336	10,845
Other current assets, loans and advances	11,042	11,042	11,042	11,042
Total current assets	28,275	41,968	43,416	51,212
Current liabilities	78,396	124,360	150,346	159,496
Provisions	-	-	-	-
Total current liabilities	78,396	124,360	150,346	159,496
Net current assets	(50,121)	(82,391)	(106,930)	(108,285)
Total Assets	135,339	180,290	231,140	280,215
Share capital	18,939	18,939	18,939	18,939
Reserve and surplus	17,511	52,462	100,312	155,386
Shareholders equity	36,450	71,401	119,251	174,325
Secured loans	34,503	44,503	47,503	41,503
Minority interests	957	957	957	957
Total Liabilities	135,339	180,290	231,140	280,215

Source: Company Reports and Citigroup Investment Research Estimates

Figure 6. Cash Flow Statement

Year to 31 Mar (Rs m)	2006	2007E	2008E	2009E
Cash Flow from Operations	48,320	107,775	114,610	122,570
Capex	(57,309)	(102,484)	(108,906)	(92,947)
Cash Flow from other Investing Activities	(54,095)	(102,286)	(108,569)	(92,604)
Cash flow from Financing Activities	5,338	1,613	(10,218)	(25,457)
Change in cash	(438)	7,102	(4,177)	4,509
Beginning Cash	3,087	3,412	10,513	6,336
Closing cash	2,650	10,513	6,336	10,845

Note: Difference between 2006 Closing and 2007E Beginning Cash is on account of direct additions to equity.

Source: Company Reports and Citigroup Investment Research Estimates

Figure 7. Key Assumptions

Year to 31 Mar	2006	2007E	2008E	2009E
Wireless Subs (m)	19.58	37.07	55.00	70.80
% Prepaid Subscribers	83%	86%	87%	88%
ARPU prepaid (Rs)	326	337	290	264
ARPU postpaid (Rs)	899	912	889	876
MOU prepaid (Mins)	320	358	340	323
MOU postpaid (Mins)	740	784	792	808
Rev. per minute - prepaid (Rs)	1.02	0.94	0.85	0.82
Rev. per minute -postpaid (Rs)	1.22	1.16	1.12	1.08
Capex / Sales (%)	55%	54%	41%	28%

Source: Company Reports and Citigroup Investment Research Estimates

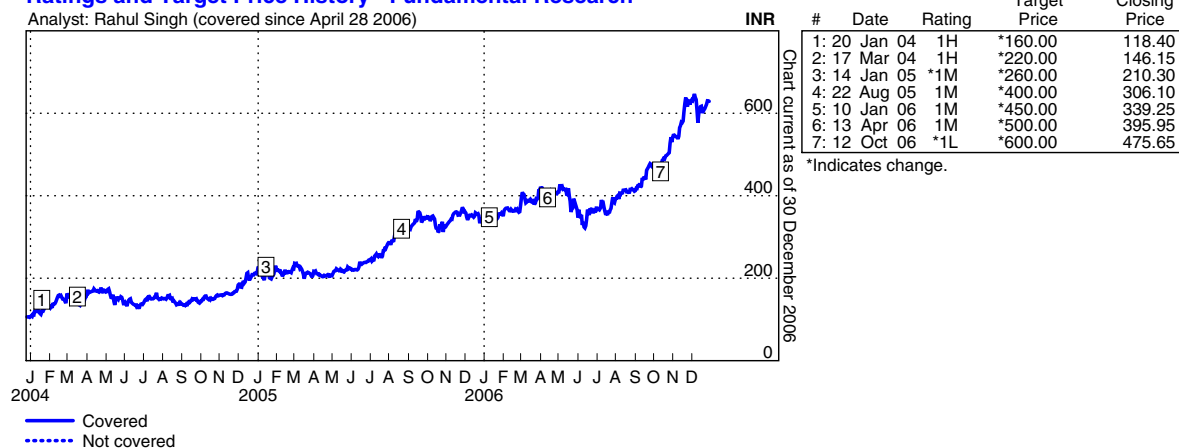
Analyst Certification Appendix A-1

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Analyst: Rahul Singh (covered since April 28 2006)



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