

Bharti Tele-Ventures

STOCK INFO.	BLOOMBERG
BSE SENSEX: 9,550	BHARTI IN
	REUTERS CODE
S&P CNX: 2,908	BRTI.BO

24 January 2006

Buy
Previous Recommendation: Buy
Rs347

Equity Shares (m)	1,884.1
52-Week Range (Rs)	377/192
1,6,12 Rel. Perf. (%)	-4/3/16
M.Cap. (Rs b)	654.6
M.Cap. (US\$ b)	14.8

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/05A	80,028	14,978	8.1	-	43.0	10.5	28.0	16.9	8.7	23.2
3/06E	115,803	22,246	11.8	46.1	29.4	7.7	30.8	20.8	6.1	16.2
3/07E	154,343	33,889	18.0	52.3	19.3	5.5	33.8	24.0	4.6	12.0

- 3QFY06 margins were lower than our estimates, due to lower margins in the long distance and enterprise business.
- Mobility business revenues grew 14.1% QoQ driven by strong subscriber additions and lowest ARPU decline in more than three years. Blended MoUs grew 5.9% QoQ, the fastest growth in MoUs in the past four quarters.
- Mobility business EBITDA margins remained flat QoQ even as revenue growth was robust. We are encouraged by lower ARPU decline but particularly by the growth in MoUs.
- Long Distance and Enterprise business margins were down sharply QoQ by 264bp and 678bp respectively. Management said that reduction in IPLC prices and expansion in overall network were the primary reasons for lower margins. Further, they said that they were getting strong orders in the Enterprise business, for which certain capex and operating expenses needed to be incurred upfront resulting in lower margins.
- Overall EBITDA margins contracted 70bp QoQ as lower margins on non-mobile business offset strong operating performance in the mobile business. We believe that margins for non-mobile business are likely to remain under pressure in the short term as the company is expanding these business segments.
- Cutting EPS estimates. We are lowering our EPS estimates to Rs11.8 in FY06E and Rs18 in FY07E to take into account lower margins, higher forex cost for FY06 and higher tax liability. We are introducing our FY08 estimates at Rs24. At 29.4x FY06E earnings, 19.3x FY07E earnings and 14.5x FY08E earnings, the stock is still attractively valued compared to Tier-I companies in the IT industry. We maintain **Buy**.

QUARTERLY PERFORMANCE (CONSOLIDATED)

(RS MILLION)

Y/E MARCH	FY05				FY06				FY05	FY06E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Gross Revenue	16,941	18,513	21,319	23,255	25,172	27,090	30,256	33,285	80,028	115,803
YoY Growth (%)	92.3	74.0	49.8	48.2	48.6	46.3	41.9	43.1	231.1	44.7
QoQ Growth (%)	-1.2	9.3	15.2	9.1	8.2	7.6	11.7	10.0		
Access & Interconnect Charges	3,931	3,872	4,538	4,529	4,849	4,928	5,571	6,058	16,870	21,406
Net Revenue	13,010	14,641	16,781	18,726	20,323	22,162	24,685	27,227	63,158	94,397
Total Operating Expenses	6,803	7,714	8,837	9,677	10,916	11,951	13,486	14,672	33,031	51,025
EBITDA	6,207	6,927	7,944	9,049	9,407	10,211	11,199	12,555	30,127	43,372
Margin (%)	36.6	37.4	37.3	38.9	37.4	37.7	37.0	37.7	37.6	37.5
Net Finance Costs	949	280	-32	798	149	845	924	581	1,995	2,499
Cash Profit from Operations	5,258	6,647	7,976	8,251	9,258	9,366	10,275	11,975	28,132	40,874
Depreciation & Amortisation	2,400	2,573	3,162	3,270	3,403	3,703	4,026	4,514	11,405	15,646
Profit before Tax	2,837	3,890	4,748	5,127	5,980	5,795	6,386	7,606	16,602	25,767
Income Tax Expense / (Income)	455	249	358	467	815	514	858	1,034	1,529	3,221
Net Profit / (Loss)	2,382	3,641	4,363	4,589	5,099	5,209	5,453	6,485	14,975	22,246
QoQ Growth (%)		52.9	19.8	5.2	11.1	2.2	4.7	18.9	NA	48.6

E: MOST Estimates ; Financials as per US GAAP

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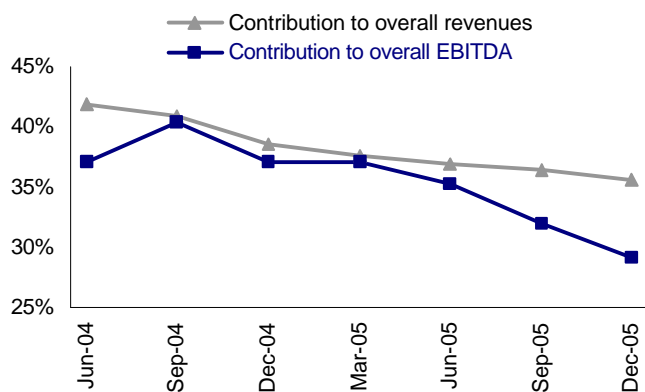
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Non-mobility business drags down overall margins

Long Distance and Enterprise business margins were down sharply by 264bp and 678bp QoQ respectively, dragging down overall margins. According to management, reduction in international private leased circuit (IPLC) prices and expanding operations were the primary cause of lower margins in these businesses. Further, management added they had received strong orders in their Enterprise business, which required certain capital and operating expenditure to be made upfront, for which revenues are expected to flow at a later date. Management believed that margins in this business could remain under pressure in the short term, but expected them to trend upward in medium-long term.

Non-mobile business has been putting pressure on overall margins over the past few quarters, primarily as these businesses are in the investment phase. The contribution of non-mobile business to overall revenues has come down from 41.9% in 1QFY05 to 35.6% in 3QFY06, as mobile revenues have grown at a faster clip. However, contribution of non-mobile business to overall EBITDA has fallen more drastically to 29.2% in 3QFY06 from 37% in 1QFY05. This reflects the extent to which the lower margins of non-mobility business have exerted pressure on the overall margins.

IMPACT OF NON-MOBILE BUSINESS CONTRIBUTION TO OVERALL REVENUES AND EBITDA

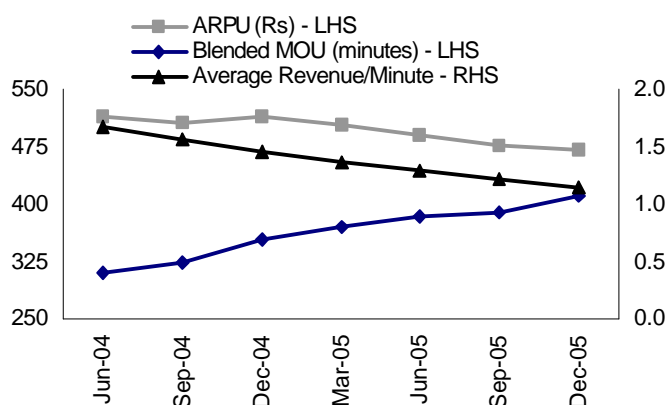


Source: Company/Motilal Oswal Securities

Mobility business delivers strong operating performance

Bharti's 3QFY06 mobile revenues grew 14.1% YoY, ahead of our expectations, driven by strong growth in subscribers and the lowest ARPU decline in over three years. However, we were particularly impressed by the growth in blended MoUs, which grew 5.9% QoQ, the fastest growth in the past four quarters. The company continued to expand its network to cover 3,300 census towns by 31 December 2005. Further, the company intends to get 3,700-3,800 towns under its network umbrella by FY06, and all the census towns (5,101) by FY07.

TRENDS IN ARPU, MOU AND REVENUE/MINUTE



Source: Company/Motilal Oswal Securities

Management confident of maintaining mobility margins

Management was confident of maintaining the current momentum in subscriber additions. Management has decided to book processing fee of Rs892 on the Rs999 coupon over the estimated life of the subscriber (estimated at 18 months). The management in its conference call was confident of retaining operating margins at current levels over the medium-long term.

We believe that ARPUs will continue to decline in the medium term, given the price competitive nature of the market. However, we believe that higher subscriber growth and increase in blended MoUs would be able to offset the impact of falling ARPUs. We expect Bharti to maintain its

margins at current levels in short-medium term and expand them going forward, given their proven history of strong operating efficiencies.

Aggressive capex outlay likely for FY07

Bharti incurred capex of Rs15.9b for 3QFY06 and Rs39.1b for 9MFY06. The company has given guidance for capex of US\$1.2-US\$1.3b for FY06 and further suggested that capex outlay for FY07 is likely to be higher than US\$1.5b. We believe that the aggressive expansion plans that the company is undertaking in both the mobile and non-mobile business is likely to keep the capex outlay high for the next few years.

Effective tax rate increase impacts overall PAT

Bharti's effective tax rate increased to 13.4% in 3QFY06 from 8.9% in 2QFY06. According to management, effective tax rate would not be lower than 13.4% in FY07, due to increase in deferred tax liabilities resulting from depreciation benefits on aggressive capex.

Revising forecasts

We are revising our forecasts downward to adjust for lower margins in the non-mobile business, which we expect to drag overall margins in the short term. Further, we are increasing our estimates of effective tax rate. We are reducing estimated EPS for FY06 and FY07 to Rs11.8 and Rs18 respectively.

REVISED FORECASTS

	FY06E			FY07E		
	OLD	NEW	VAR	OLD	NEW	VAR
Revenues	114,388	115,803	1.2	152,464	154,343	1.2
Growth (%)	42.2	44.7		33.2	33.3	
EBITDA Margin	38.7	37.5		39.9	38.6	
Net Profit	24,776	22,246	-10.2	37,745	33,889	-10.2
Growth (%)	72.7	48.5		48.3	52.3	
EPS (Rs)	13.2	11.8	-10.2	20.0	18.0	-10.2
Growth (%)	62.7	46.1		52.3	52.3	

Source: Company/Motilal Oswal Securities

Valuation and view

Bharti's 3QFY06 overall performance was below our estimates primarily due to lower margins on the non-mobility business. Further, higher income tax expense further impacted overall PAT. However, the core mobile business continued to perform strongly. We believe that the momentum in the mobile business is likely to be accelerated in the short term with introduction of the lifetime valid coupon. However, the impact of this coupon in the short term on EBITDA will depend on usage patterns of subscribers. We are confident that over the long term this coupon will have neutral impact on margins.

The stock has underperformed the market due to concerns of the impact of the new lifetime validity coupon on ARPUs and operating profits. However, we continue to believe that the long term story remains intact. The stock is trading at 29.4x FY06E EPS, 19.3x FY07E EPS and 14.5x FY08E EPS. We maintain **Buy** with a price target of Rs430 based on 20x FY08 EPS.

Bharti Tele-Ventures: an investment profile

Company description

Bharti Tele-Ventures, promoted by Sunil Bharti Mittal, is the largest cellular services provider in India with a subscriber base of about 11m and a market share of over 21% of the overall cellular market. It is the first cellular services provider to have introduced the lowest denomination recharge coupon for prepaid subscribers and electronic recharge. It is also the most profitable cellular services provider and is managed by a very strong team of professionals. It is the only player to have a presence in all 23 circles in India.

Key investment arguments

- Leader in the fast growing Indian cellular market and enjoys scale advantage.
- Strong innovative management, the biggest differentiator.
- Most profitable cellular services provider.

Key investment risks

- Tariffs still higher than competitors.
- Being a listed company, can't be a price leader due to focus on profitability and hence is reactive to competitor's pricing.

Recent developments

- Introduced India's first Rs 999 Lifetime prepaid card with a lifetime validity on December 23, 2005.
- Awarded the 'Best Managed Company Award 2005' in the large cap category by Asia Money.
- Vodafone picked up a 10% effective stake in the company for a consideration of £0.82m.

Valuation and view

- Revenue CAGR of 35% and earnings CAGR of 44% over FY05-08E.
- Valuations at 19.3x FY07E earnings and 14.5x FY08E earnings are attractive and at a discount to some similar-sized peers in other fast growing industries, like TCS and Infosys.
- Buy** with a target price of Rs430, an upside of 23.9% from current levels.

Sector view

- Rapid growth in mobile subscriber base enabling the cellular market to surpass that of fixed telephony.
- Industry and government forecasting subscriber base would touch 200m by FY09 implying a 41% CAGR over the next four years.
- Tariff cuts to be compensated by higher usage resulting in decent margins and return ratios.

COMPARATIVE VALUATIONS

		BHARTI	INFOSYS	TCS
P/E (x)	FY06E	29.4	30.6	27.9
	FY07E	19.3	23.7	22.0
P/BV (x)	FY06E	7.7	10.8	13.5
	FY07E	5.5	8.0	9.1
EV/Sales (x)	FY06E	6.1	7.5	6.3
	FY07E	4.6	5.6	4.7
EV/EBITDA (x)	FY06E	16.2	23.0	21.6
	FY07E	12.0	17.3	16.5

SHAREHOLDING PATTERN (%)

	DEC.05	SEP.05	DEC.04
Promoters	45.6	45.7	46.6
Domestic Institutions	3.7	3.2	2.9
FII's/FDIs	47.9	48.5	47.8
Others	2.8	2.6	2.7

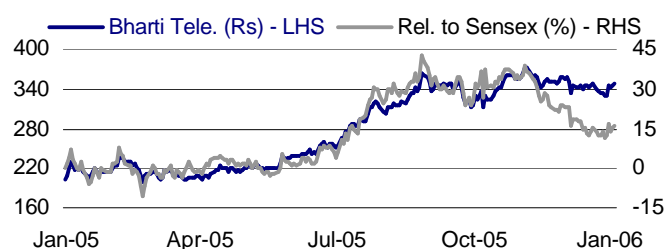
EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	11.8	12.4	-5.1
FY07	18.0	18.3	-1.4

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
347	430	23.9	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Revenues	48,320	80,028	115,803	154,343	200,518
Change (%)	64.0	65.6	44.7	33.3	29.9
Total Expenses	31,766	49,963	72,431	94,838	120,647
EBITDA	16,554	30,065	43,372	59,505	79,871
% of Gross sales	34.3	37.6	37.5	38.6	39.8
Depn. & Amortisation	7,733	11,341	15,646	18,138	23,988
EBIT	8,821	18,724	27,726	41,367	55,883
Net Interest	2,380	1,996	2,499	2,134	2,792
Other Income	182	-124	539	-100	0
PBT	6,624	16,604	25,767	39,133	53,091
Tax	901	1,528	3,221	5,244	7,964
Rate (%)	13.6	9.2	2.5	13.4	15.0
Adjusted PAT	5,723	14,978	22,246	33,889	45,127
Change (%)	17.2	161.7	48.5	52.3	33.2
PAT after EO	6,024	14,978	22,246	33,889	45,127

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Share Capital	18,534	18,534	18,534	18,534	18,534
Additional Paid up Capital	47,416	47,587	47,587	47,587	47,587
Reserves	-20,034	-5,056	17,190	51,079	96,207
Net Worth	45,916	61,065	83,311	117,200	162,327
Loans	45,723	49,040	54,884	67,048	76,112
Minority Interest	0	749	849	949	1,049
Other Liabilities	3,694	7,027	7,027	5,622	3,373
Deferred Tax Liability	2,970	3,624	3,624	3,624	3,624
Capital Employed	98,303	121,505	149,695	194,444	246,486
Gross Block	77,825	111,905	171,905	243,905	303,905
Less : Depreciation	18,389	29,575	45,221	63,359	87,348
Net Block	79,369	108,561	142,639	183,708	215,300
Investments	159	740	740	740	740
Goodwill	20,602	23,247	20,922	18,830	16,947
Deferred Tax Asset	1,842	2,441	1,220	1,000	750
Other Non-Current Assets	1,911	2,400	2,239	3,081	6,427
Curr. Assets	15,138	24,124	26,641	37,330	57,082
Inventories	317	545	845	1,345	1,845
Debtors	7,378	10,266	11,104	16,914	27,468
Cash & Bank Balance	1,303	3,087	3,687	4,687	6,187
Other current assets	6,139	10,226	11,004	14,384	21,581
Curr. Liab. & Prov.	20,719	40,008	44,706	50,246	50,760
Sundry Liabilities	19,040	38,265	41,224	43,285	44,151
Other Current Liabilities	1,679	1,743	3,483	6,961	6,609
Net Curr. Assets	-5,581	-15,884	-18,066	-12,916	6,322
Appl. of Funds	98,303	121,505	149,695	194,444	246,487

E: MOST Estimates

RATIOS					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Basic (Rs)					
EPS	2.7	8.1	11.8	18.0	24.0
Cash EPS	7.4	14.2	20.4	28.1	37.3
Book Value	24.8	32.9	45.0	63.2	87.6
DPS	0.0	0.0	0.0	0.0	0.0
Payout %(Incl.Div.Taxes)	0.0	0.0	0.0	0.0	0.0
Valuation (x)					
P/E		43.0	29.4	19.3	14.5
Cash P/E		24.5	17.0	12.4	9.3
EV/EBITDA		23.2	16.2	12.0	9.0
EV/Sales		8.7	6.1	4.6	3.6
Price/Book Value		10.5	7.7	5.5	4.0
Dividend Yield (%)		0.0	0.0	10	10
Profitability Ratios (%)					
RoE	13.9	28.0	30.8	33.8	32.3
RoCE	10.4	16.9	20.8	24.0	25.3
Turnover Ratios					
Debtors (Days)	73	59	43	49	61
Asset Turnover (x)	0.5	0.6	0.5	0.5	0.5
Leverage Ratio					
Debt/Equity Ratio(x)	1.1	0.9	0.7	0.6	0.5

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Op.Profit/(Loss) bef Tax	16,554	30,065	43,372	59,505	79,871
Other Income	182	-124	539	-100	0
Interest Paid	-2,380	-1,996	-2,499	-2,134	-2,792
Direct Taxes Paid	-901	-1,528	-3,221	-5,244	-7,964
(Inc)/Dec in Wkg. Cap.	8,249	12,087	2,781	-4,150	-17,738
CF from Op. Activity	21,706	38,505	40,973	47,877	51,378
(inc)/Dec in FA +CWIP	-22,540	-34,569	-59,839	-72,842	-63,346
(Pur)/Sale of Investments	-12,883	-11,947	10,696	11,747	2,919
CF from Inv. Activity	-35,423	-46,516	-49,143	-61,095	-60,427
Issue of Shares	163	171	0	0	0
Inc/(Dec) in Debt	17,939	6,650	5,844	11,170	7,502
Dividends Paid	0	0	0	0	0
Inc/(Dec) in Cash	698	1,784	600	1,000	1,500
Add: Opening Balance	606	1,303	3,087	3,687	4,687
Closing Balance	1,303	3,087	3,688	4,687	6,188

E: MOST Estimates; All Financials as per US GAAP



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Disclosure of Interest Statement

Bharti Tele-Ventures

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| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | Yes |
| 3. Broking relationship with company covered | No |

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