Enterprising India

Bharti Airtel - BUY

Telecom

08 February 2010

Pricing to ease; rural markets to fuel growth

Bharti Airtel attended IIFL's conference and was represented by Manik Jhangiani (Group CFO) and Harjeet Kohli (Group Treasurer and IR head) and addressed concerns with regards to the ongoing tariff wars and regulatory challenges facing the industry. Bharti was cautiously optimistic on recovery prospects for the industry and bullish on its own prospects for reasons of reach, scale, low debt levels and brand strength. Key takeaways were:

- Tariff wars cannot go on for long, as new entrants are on capex-light and opex-heavy model. Hence, losses will be visible at EBITDA level and increase with volumes—making sustained price aggressiveness very expensive.
- Rural subscribers start with 50-100 MoUs a month, but within nine months, reach 70% of the average of 450 minutes. 56% of Bharti's net adds are rural. In rural areas, rate per minute is higher, while real estate costs are lower; tower-sharing helps lower opex, and diesel costs will be replaced by electricity over time. Hence, rural expansion is not such a drag on profitability as is generally presumed.
- 50% subscribers and a majority of high-ARPU prepaid subscribers have migrated to per-second billing. Hence, fall in rate per minute from migration should be largely over by 4Q. Rural subscribers, and to a small extent, urban subscribers, exhibited elasticity, delivering positive growth in 3Q.
- Pricing strategy was determined by associate Singtel's experience through its investment in Telkomsel of Indonesia, one of the most competitive markets in the world. The main learning was that the leader should not match the aggressor, because the aggressor becomes desperate to maintain a rate gap. This is why Bharti's rate has stayed at 1.2p/second instead of 1p/second.
- 3G would definitely be positive for Bharti, as bid value will be based on benefits from voice traffic decongestion and data-related upsides. Competitors would need to match Bharti's bid, but without matching payoffs. 3G capex will largely replace 2G capex.
- In DTH, EBITDA loss was flat QoQ. Over 120m mobile subscribers form a big captive market, even if only 10% of mobile subscribers convert to DTH. Dish TV broke even at 4m and Bharti is at 2m, with better cost structure. Distribution synergies significant with mobile. 1.5m retail outlets and 10,000 exclusive distributors reaching Bharti DTH to places even Dish TV cannot.

CMP	**Rs300**
12-mth Target price (Rs)	***366***
Market cap (US$ m)	**24399**
Bloomberg	**BHARTI IN**
52Wk High/Low (Rs)	518/230
Diluted o/s shares (m)	3797
Daily volume (US$ m)	57
Dividend yield FY10ii (%)	0.4
Free float (%)	32.2

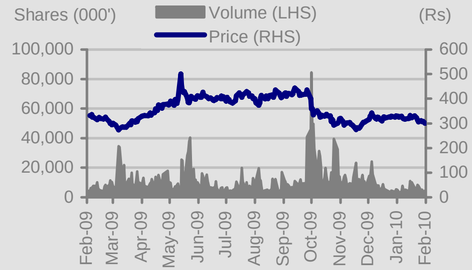
Shareholding pattern (%)

Promoters	67.8
FIIs	17.5
Domestic MFs	7.9
American Depository Receipts	0.0

Price performance (%)

	1M	3M	1Y
Bharti	-7.6	-6.1	-7.1
Rel. to Sensex	2.5	-4.6	-78.3
RCOM	-8.7	-7.4	1.4
Idea	-5.4	13.5	27.9
MTNL	-14.2	0.1	5.6

Stock Performance



Financial Summary

Y/e 31 Mar	FY08A	FY09A	FY10ii	FY11ii	FY12ii
Revenues (Rs m)	270,249	369,615	391,619	427,300	496,096
EBITDA Margins (%)	42.0	41.0	40.6	39.2	40.4
Pre-Exceptional PAT (Rs m)	67,007	84,699	89,749	84,645	102,693
Reported PAT (Rs m)	67,007	84,699	89,749	84,645	102,693
EPS (Rs)	17.7	22.3	23.6	22.3	27.0
Growth (%)	57.2	26.4	6.0	-5.7	21.3
PER (x)	**17.0**	**13.5**	**12.7**	**13.5**	**11.1**
ROE (%)	36.9	31.4	25.1	19.2	19.5
Debt/Equity (x)	0.4	0.4	0.3	0.2	0.2
EV/EBITDA (x)	**10.2**	**7.9**	**7.5**	**7.1**	**5.8**
Price/Book (x)	5.1	3.8	2.9	2.5	2.1

Source: IIFL Research, Priced as on 08 February 2010

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Key to our recommendation structure

BUY - Absolute - Stock expected to give a positive return of over 20% over a 1-year horizon.
SELL - Absolute - Stock expected to fall by more than 10% over a 1-year horizon.

In addition, **Add** and **Reduce** recommendations are based on expected returns relative to a hurdle rate. Investment horizon for **Add** and **Reduce** recommendations is up to a year. We assume the current hurdle rate at 10%, this being the average return on a debt instrument available for investment.

Add - Stock expected to give a return of 0-10% over the hurdle rate, ie a positive return of 10%+.
Reduce - Stock expected to return less than the hurdle rate, ie return of less than 10%.
