



Bharti Airtel

STOCK INFO. BLOOMBERG
BSE Sensex: 15,235 BHARTI IN
REUTERS CODE
S&P CNX: 4,445 BRTI.BO

27 July 2007

Buy

Previous Recommendation: Buy

Rs892

		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
Equity Shares (m)	1,897.0	3/07A	185,199	42,571	22.5	88.6	39.7	12.5	37.4	29.0	9.4	23.4
52-Week Range (Rs)	960/367	3/08E	272,369	65,528	34.5	53.8	25.8	8.4	38.9	33.5	6.4	15.3
1,6,12 Rel. Perf. (%)	1/18/84	3/09E	359,066	84,531	44.6	29.0	20.0	5.9	34.7	34.0	4.8	11.2
M.Cap. (Rs b)	1,692.8											
M.Cap. (US\$ b)	41.8											

- Bharti Airtel reported revenues of Rs59b for 1QFY08, up 9.5% QoQ against our estimate of 11% QoQ growth. Net profit grew 11.7% QoQ to Rs15.1b, in line with our estimate. Adjusted for one-time forex and derivatives gains of Rs2.4b, however, PAT growth was just 1% QoQ. Since other income is taxed at 33%, the effective tax rate increased to 19% in 1QFY08 as against 9% in 4QFY07.
- Mobility business revenues grew 10.7% QoQ, aided by robust subscriber additions. ARPU declined 4% QoQ, while average revenue per minute was down 4.5%. However, EBITDA margins for the business expanded QoQ to 40.6% against our estimate of 39%.
- Demerger of the tower subsidiary (Bharti Infratel) would be completed by 3QFY08. We expect Bharti Infratel to add ~25,000 towers in FY08 to its existing base of 40,000 towers, making it the largest tower company, globally. The management is considering various options to unlock value from its tower subsidiary. While operating details are unclear, we believe Bharti Infratel could add Rs131 to our target price.
- The operational results for 1QFY08 are largely in line with our estimates. We have raised our EPS estimates by 2.6% to Rs34.5 for FY08 and by 6.6% to Rs44.6 for FY09 to adjust for higher subscriber additions. The stock is trading at 25.8x FY08E EPS and 20x FY09E EPS. We reiterate **Buy** with a revised target price of Rs1,070 (24x FY09E EPS).

QUARTERLY PERFORMANCE (CONSOLIDATED)									(RS MILLION)	
Y/E MARCH	FY07				FY08				FY07	FY08E
	1Q	2Q	3Q	4Q	1Q	2QE	2E	4QE		
Gross Revenue	38,564	43,572	49,130	53,933	59,047	64,943	71,160	77,219	185,199	272,369
YoY Growth (%)	53.2	60.8	62.4	58.1	53.1	49.0	44.8	43.2	58.8	47.1
QoQ Growth (%)	13.0	13.0	12.8	9.8	9.5	10.0	9.6	8.5		
Access & Interconnect Charges	6,612	7,190	8,242	9,335	9,071	10,001	10,959	11,914	31,379	41,945
Net Revenue	31,952	36,382	40,888	44,598	49,976	54,942	60,201	65,305	153,820	230,424
Total Operating Expenses	16,930	19,357	20,834	22,190	25,509	27,731	30,065	32,481	79,311	115,787
EBITDA	15,022	17,025	20,054	22,408	24,467	27,211	30,136	32,824	74,509	114,638
Margin (%)	39.0	39.1	40.8	41.5	41.4	41.9	42.4	42.5	40.2	42.1
Net Finance Costs	1,691	587	-1,317	477	-1,752	1,050	1,050	1,234	1,438	1,582
Cash Profit from Operations	13,331	16,438	21,371	21,931	26,219	26,161	29,086	31,590	73,071	113,056
Depreciation & Amortisation	4,972	5,926	7,072	7,239	8,120	8,500	9,500	9,850	25,209	35,798
Profit before Tax	8,600	10,782	14,410	15,068	18,901	18,211	19,736	21,888	48,860	78,908
Income Tax Expense / (Income)	952	1,378	2,139	1,353	3,594	2,732	2,960	3,312	5,822	12,625
Profit / (Loss) to Minority Shareholders	96	66	121	184	191	184	190	188	467	754
Reported Net Profit / (Loss)	7,552	9,338	12,150	13,531	15,116	15,295	16,586	18,388	42,571	65,528
QoQ Growth (%)	10.7	23.7	30.1	11.4	11.7	1.2	8.4	10.9	88.5	53.9
Margin (%)	19.6	21.4	24.7	25.1	25.6	23.6	23.3	23.8	23.0	24.1
Adj. PAT (forex/ derivative gains)	8,197	9,024	10,688	13,422	13,519	15,295	16,586	18,388	41,330	63,931
QoQ Growth (%)	18.8	10.1	18.4	25.6	0.7	13.1	8.4	10.9	83.0	54.7

E: MOST Estimates ; Financials as per US GAAP

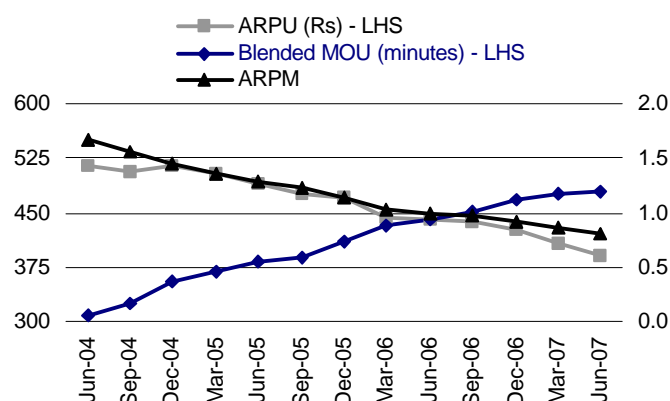
Robust subscriber growth continues to drive mobility revenues

Bharti reported 10.7% QoQ growth in mobility revenues for 1QFY08, driven primarily by robust subscriber additions. The company added 5.6m subscribers during the quarter, a 15% growth. ARPU declined 4% QoQ (v/s our estimate of a 3% decline) to Rs390 from Rs406. While the average revenue per minute (ARPM) was down 4.5%, average MoUs grew much slower at 0.6% QoQ, accelerating the ARPU decline on a QoQ basis.

Bharti changed its accounting policy for lifetime-prepaid subscribers to amortizing such revenues over 24 months from 18 months earlier. This resulted in revenues being understated to the extent of Rs700m, affecting the ARPU in 1QFY08 by ~Rs6. The management has cited the decrease in churn rates to ~4% as the key reason for this change in accounting policy.

Wireless data revenues grew 8.5% QoQ. EBITDA margins for the mobile business continued to improve, with a QoQ expansion of 150bp to 40.6% (v/s our estimate of 39%). Cumulative minutes for mobile services have grown 16% to 57.1b, lower than our estimate of 18.5% growth. Most of the subscriber additions were owing to lifetime schemes in 1QFY08, wherein usage comes with a lag of 3-6 months. We believe the decrease in roaming charges and rentals in 4QFY07 will be offset by demand elasticity over the 6-9 months (NLD traffic has grown 17% QoQ in 1QFY08 v/s 13% growth in 4QFY07).

ARPU TREND



Source: Company

Long distance and enterprise business performance disappoints

Long distance revenues declined 9.3% against our estimate of 1% growth due to an 8% rupee appreciation, pressure on net retention rate in the domestic business and a decrease in access deficit charges (ADC). Bharti is ramping up its national long distance (NLD) backbone from the current ~40,000km to ~65,000km in FY08 (1QFY08 saw an addition of 3,174km).

We believe Bharti's long distance strategy is woven around its wireless strategy. NLD growth is likely to arise as a consequence of Bharti's potentially expanding wireless coverage and the increasing proportion of on-net calls, given its leadership in the wireless market. While the enterprise business, which primarily focuses on the SME space, grew 8.7% QoQ, the overall long distance revenues & enterprise declined 5.7% QoQ.

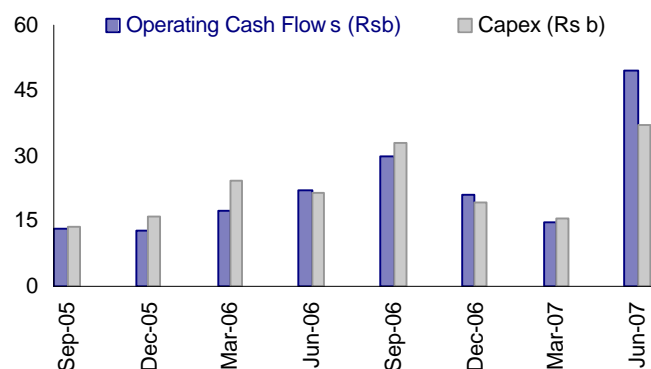
Long distance EBITDA margins have declined marginally from 35.8% in 4QFY07 to 34.4% primarily due to rupee appreciation, as ADC decline has been a pass-through. Enterprise business margins have declined sharply by 760bp to 42.5% in 1QFY08.

Robust cash flows to support aggressive capex plans

Bharti has reported a huge increase in cash flows from operating activities (post working capital changes) in 1QFY08. Cash flows for the quarter were Rs49.6b, the highest ever for the company. Capex also stood at an all-time high of Rs37.2b, with ~88% of capex towards wireless business. Bharti has guided capex of US\$3.3-3.5b for FY08. We have factored in capex of US\$3.3b FY08.

Our estimates suggest that most of the capex would be funded through cash flows generated from operations, given the huge negative working capital float that the company generates from its prepaid subscriber base (~90% of the total subscriber base). We note that prepaid subscribers now form ~98% of the incremental subscriber additions.

STRONG CASH FLOWS SUPPORTING CAPEX PLANS



Source: Company

Fixed line & broadband strategy paying off

Bharti has adopted the strategy of cherry-picking customers for its fixed line and broadband customers. With a clear focus on only the top 100 cities in India, Bharti plans to expand deeper within the cities rather than expanding its coverage geographically. The total subscriber base in the broadband segment has grown 31% YoY to ~2m. Bharti has been able to consistently maintain its ARPU above Rs1,100 for the previous 4 quarters, with 1QFY08 showing an increase of 1% in ARPU to Rs1,121. Given the fixed cost nature of the business, margins have improved by 12% over the last year to 32.2% in 1QFY08.

Consolidated EBITDA margins likely to improve

Overall EBITDA margins declined by 11bp QoQ to 41.4%, in line with our estimates. Access and interconnect charges (includes ADC) declined by 195bp QoQ to Rs9.1b (an absolute decline of 2.8% QoQ), whereas the sales & marketing costs grew by 160bp to Rs9.2b (15.5% of revenues in 1QFY08). PAT for 1QFY08 was boosted primarily due to higher than expected forex & derivative gains on account of the sharp appreciation in rupee (Rs2.4 b in 1QFY08 v/s estimate of Rs1b). Adjusted for the one-time forex gains, PAT has grown by a mere 1% QoQ to Rs13.5b.

While the enterprise business & fixed line margins are likely to stabilize, we believe that mobility margins will improve primarily on account of opex leverage. We expect consolidated margins to improve from 40.2% in FY07 to

42.1% in FY08 and 42.6% in FY09, driven by opex leverage and lower ADC in mobility business.

Revising estimates to factor robust subscriber additions

Although operational results have been in line with our estimates, we are raising our EPS estimates for FY08 and FY09 marginally to adjust for robust subscriber additions and aggressive network expansion plans. We now expect Bharti to add 1.95m subscribers per month in FY08 (earlier estimate of 1.85m) and 1.85m in FY09 (earlier estimate of 1.5m).

Bharti's opex (includes network operating charges, employee costs and SG&A costs) has reduced from 34.4% of revenues in FY06 to 33.7% in FY07. We expect the opex leverage to continue accruing to the company, with increasing scale of operations, though 1QFY08 has seen a significant rise in opex. We have raised our EPS estimates for FY08 by 2.6% to Rs34.5 and for FY09 by 6.6% to Rs44.6.

Valuation and view

Bharti's 1QFY08 EBITDA was in line with our estimates, though adjusted PAT growth has been muted at 1% QoQ. While consolidated revenues were lower than expected at Rs59b (estimate of Rs60b) due a higher than expected ARPU fall, consolidated EBITDA margins at 41.4% were in line with our estimate, driven by a 150bp increase in mobility margins. We continue to be impressed with Bharti's subscriber additions and expect it to add 1.95m subscribers per month in FY08. The company has reported additions ahead of market expectations and our estimates.

Managed network contracts will help to rapidly expand its mobile services footprint further and help it to improve its asset turnover. We believe that Bharti will be able to sustain its premium over other operators because of its market leadership, de-risked business model and management's ability to tap new areas of revenues and efficiency. The stock is trading at 25.8x FY08E EPS and 20x FY09E EPS. We reiterate **Buy** with a revised target price of Rs1,070 (24x FY09E EPS; excluding valuation of tower subsidiary).

Bharti Airtel: an investment profile

Company description

Bharti Airtel, promoted by Sunil Bharti Mittal, is the largest cellular services provider in India with a subscriber base of more than 42m and market share of over 23% 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

- Declining ARPMs could lead to lower operating margins.
- Being a listed company, cannot be a price leader due to focus on profitability and hence is reactive to competitors' pricing.

Recent developments

- A Bharti group company, acquired 4.99% stake in Bharti Airtel from Vodafone Enterprises as a part of the agreement entered earlier consolidating the promoters holding over 50%.
- Introduced lifetime prepaid at a price point of Rs495.

Valuation and view

- Revenue CAGR of 39% and earnings CAGR of 41% over FY07-FY09E. Valuations at 25.8x FY08E earnings and 20x FY09E earnings.
- Buy** with a revised target price of Rs1,070 (excluding tower subsidiary valuation), an upside of 20% from current levels.

Sector view

- We believe handset pricing is becoming more important from the perspective of total cost of ownership rather than tariffs. RCom has recently launched its Classic range of handsets at attractive price points of Rs777 and Rs1,234.
- We have revised our wireless subscriber base (inclusive of FWP) estimates to 331m by FY09 and 393m by FY10, rising from the current subscriber base of 181m.
- Tariff cuts to be compensated by volume and cut in regulatory levies, resulting in stable margins and RoE.

COMPARATIVE VALUATIONS

		BHARTI	INFOSYS	TCS
P/E (x)	FY08E	25.8	24.8	22.7
	FY09E	20.0	20.4	18.5
P/BV (x)	FY08E	8.4	7.6	11.2
	FY09E	5.9	5.9	7.9
EV/Sales (x)	FY08E	6.4	6.1	4.7
	FY09E	4.8	4.5	3.6
EV/EBITDA (x)	FY08E	15.3	19.9	18.1
	FY09E	11.2	15.1	14.2

SHAREHOLDING PATTERN (%)

	JUN-07	MAR-07	JUN-06
Promoter	45.3	45.4	45.4
Domestic Inst	4.2	3.8	5.0
Foreign	47.1	47.7	47.2
Others	3.4	3.1	2.4

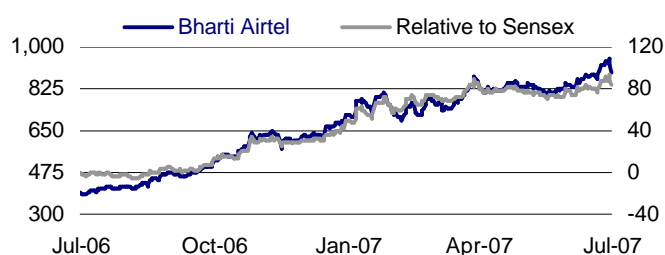
EPS: MOST FORECAST V/S CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	34.5	33.2	3.9
FY09	44.6	43.9	1.6

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
892	1,070	20.0	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007	2008 E	2009 E
Revenues	80,028	116,631	185,199	272,369	359,066
Change (%)	65.6	45.7	58.8	47.1	318
Total Expenses	-49,963	-73,032	-110,690	-157,732	-206,228
EBITDA	30,065	43,599	74,509	114,638	152,838
% of Gross Sales	37.6	37.4	40.2	42.1	42.6
Depn. & Amortisation	11,341	15,830	25,209	35,798	47,711
EBIT	18,724	27,769	49,300	78,839	105,128
Net Interest	-1,996	-2,651	-1,438	-1,582	-2,215
Other Income	-124	456	998	1,650	750
PBT	16,604	25,574	48,860	78,908	103,663
Tax	1,528	2,736	5,822	12,625	18,141
Rate (%)	9.2	10.7	11.9	16.0	17.5
Adjusted PAT	14,978	22,584	42,571	65,528	84,531
Change (%)	-79.9	50.8	88.5	53.9	29.0
PAT after EO	14,978	22,584	42,571	65,528	84,531

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2005	2006	2007 E	2008 E	2009 E
Share Capital	18,534	18,939	18,959	18,959	18,959
Additional Paid up Capital	47,987	56,060	56,645	56,645	56,645
Reserves	-5,455	16,894	59,949	125,477	210,008
Net Worth	61,065	91,893	135,553	201,081	285,612
Loans	49,040	47,395	52,474	64,961	42,474
Minority Interest	749	951	1,801	2,555	3,546
Other Liabilities	3,076	3,704	8,733	9,170	9,628
Deferred Tax Liability	1,183	1,945	2,432	1,945	1,945
Capital Employed	115,114	145,888	200,993	279,712	343,206
Gross Block	163,634	228,983	319,593	454,427	577,156
Less : Depreciation	31,825	47,655	71,007	106,805	154,516
Net Block	131,879	181,329	248,584	347,633	422,638
Intangible Fixed Assets	39,211	38,200	37,800	36,666	35,566
Investments	671	692	500	500	500
Other Non-Current Assets	2,400	2,527	3,887	5,831	6,997
Curr. Assets	24,124	31,002	43,720	68,685	98,874
Inventories	545	381	912	451	451
Debtors	7,308	10,620	13,093	22,387	27,545
Cash & Bank Balance	3,256	2,838	7,464	16,510	34,708
Other Current Assets	13,015	17,163	22,251	29,337	36,171
Curr. Liab. & Prov.	43,959	69,662	95,698	142,936	185,803
Sundry Liabilities	40,486	64,879	89,392	134,108	174,326
Other Current Liabilities	3,473	4,783	6,306	8,828	11,477
Net Curr. Assets	-19,835	-38,660	-51,978	-74,251	-86,929
Appl. of Funds	115,114	145,888	200,993	279,712	343,206

E: MOSI Estimates

RATIOS					
Y/E MARCH	2005	2006	2007 E	2008 E	2009 E
Basic (Rs)					
EPS	8.1	12.0	22.5	34.5	44.6
Cash EPS	14.2	20.3	35.8	53.4	69.8
Book Value	32.9	48.5	71.5	106.1	150.6
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		74.4	39.7	25.8	20.0
Cash P/E		44.0	25.0	16.7	12.8
EV/EBITDA		39.9	23.4	15.3	11.2
EV/Sales		14.9	9.4	6.4	4.8
Price/Book Value		18.4	12.5	8.4	5.9
Dividend Yield (%)		0.0	0.0	0.0	0.0
Profitability Ratios (%)					
RoE	28.0	29.5	37.4	38.9	34.7
RoCE	17.6	21.6	29.0	33.5	34.0

Turnover Ratios					
Debtors (Days)	28	28	22	26	24
Asset Turnover (x)	0.6	0.6	0.7	0.7	0.7
Leverage Ratio					
Debt/Equity Ratio(x)	0.9	0.6	0.5	0.4	0.2

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007 E	2008 E	2009 E
Op.Profit/(Loss) bef Tax	30,065	43,599	74,509	114,638	152,838
Other Income	-124	456	998	1,650	750
Interest Paid	-1,996	-2,651	-1,438	-1,582	-2,215
Direct Taxes Paid	-1,472	-1,974	-5,335	-13,112	-18,141
(Inc)/Dec in Wkg. Cap.	16,731	16,443	19,238	29,799	30,181
CF from Op.Activity	43,205	55,873	87,972	131,393	163,414
(inc)/Dec in FA + CWIP	-43,248	-65,280	-90,609	-134,834	-122,730
(Pur)/Sale of Investments	-2,146	2,848	715	0	0
CF from Inv.Activity	-45,393	-62,432	-89,894	-134,834	-122,730
Issue of Shares	-129	8,073	585	0	0
Inc/(Dec) in Debt	3,317	-1,645	5,079	12,487	-22,487
Other Financing Activities	951	-288	884	0	0
CF from Fin.Activity	4,139	6,141	6,548	12,487	-22,486
Inc/(Dec) in Cash	1,951	-418	4,626	9,046	18,199
Add: Opening Balance	1,305	3,256	2,838	7,464	16,510
Closing Balance	3,256	2,837	7,464	16,510	34,709

E: MOSI Estimates; All Financials as per US GAAP



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Bharti Airtel

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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 |
| 4. Investment Banking relationship with company covered | No |

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