VISIT UPDATE

LARGE CAP

Share Data

Reuters code	BRTI.BO
Bloomberg code	BHARTI IN
Market cap. (US$ mn)	28,906
6M avg. daily turnover (US$ mn)	47.0
Issued shares (mn)	3,798
Target price (Rs)	356

Performance (%)	1M	3M	12M
Absolute	2	(5)	7
Relative	2	(6)	(11)

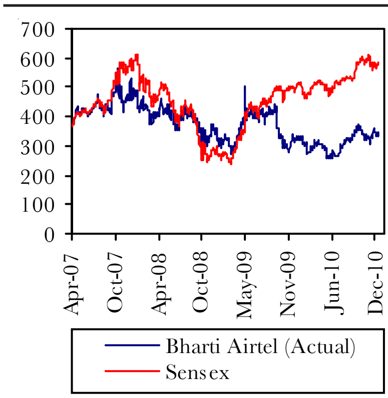
Valuation ratios

Yr to 31 Mar	FY11E	FY12E
EPS (Rs)	17.6	20.3
+/- (%)	(25.6)	15.4
PER (x)	19.5	16.9
PBV (x)	2.7	2.3
Dividend/Yield (%)	0.3	0.3
EV/Sales (x)	2.2	1.8
EV/EBITDA (x)	6.4	5.3

Major shareholders (%)

Promoters	68
FIIs	18
MFs	4
BFSI's	5
Public & Others	5

Relative performance



Bharti Airtel

Maintain Outperformer

Price: Rs 343 | **BSE Index: 20,016** | **23 December 2010**

One-time re-branding costs to dampen an otherwise good 3QFY11; African margins to improve 1QFY12E onwards...

We met the management of Bharti Airtel; gleaned here are key takeaways:

Re-branding: Bharti Airtel re-launched its brand with a new logo and a more vibrant brand identity targeting the youth. The 'Airtel' brand was launched in Africa (replacing the former Zain brand) and re-branded in India, Sri Lanka (SL) and Bangladesh in November (3QFY11). Media reports suggest Bharti Airtel could have spent Rs 3 bn on the one-time rebranding exercise. Although management did not provide specific numbers, it confirmed that the one-time re-branding cost would reflect in the P&L in 3QFY11E numbers in addition to normal marketing expenses. Although 3Q is expected to be a better quarter than 2Q owing to growth in minutes on network (MoN), the re-branding expenses could take away the shine.

Indian operations

MoN: 2Q was seasonally a dull quarter and 3Q has seen growth coming back sequentially because of festive demand.

Average revenue per minute: No major pricing actions were visible on an all-India basis; however, circle level pricing activity continues. The rate of tariff decline has decelerated and any decline in 3QFY11 would be in line with this trend.

Subscriber addition: The past few months have seen robust subscriber addition and Bharti Airtel expects to add 2.5-3 mn subscribers every month if monthly subscriber addition rates of the industry stay at the current level. Bharti Airtel faced a lull in subscriber addition during July-September 2010 owing to the subscriber verification exercise telcos were mandated to undertake.

Virtual consolidation: While management did not specifically comment on the ongoing '2G scam', it believed that 'virtual consolidation' is underway. Management believes that new operators would become weaker because of the penalty that may be levied by DoT for not meeting roll-out obligations. Management stated it would not be surprised if DoT cancels a few licences to free up spectrum.

3G launch: Bharti Airtel expects to launch 3G in four metros by 2010-end and would complete the next tranche of 40-city launch by FY11-end. Management did not provide specific 3G tariffs; however it indicated that although it would be competitive, it would not come cheap. Bharti Airtel will not subsidise 3G handsets and is considering bundling 3G plans with a few handset vendors. It is also in talks with other 3G operators to offer 3G services in circles where it has not won spectrum (Bharti Airtel has 3G spectrum in 13 circles out of 22).

Impact of 3G launch and costs: Bharti Airtel plans to shift 2G voice traffic of subscribers with 3G handsets to its 3G network. This will free up some capacity on its 2G network, which would improve quality of minutes and user experience. This is the first benefit 3G spectrum will give Bharti Airtel.

Launch of 3G services will not strain the P&L in terms of incremental cost because:

- Network operating costs will not increase significantly as Bharti Airtel is just 'loading' its 3G equipment on its current rented 2G network across ~50 cities. Bharti Airtel will have to pay for loading but this charge will be far lower than paying for new tower rentals because of increase in tenancy (could be ten times lower).
- Marketing costs will not increase because Bharti Airtel already has a large marketing budget that will easily absorb 3G marketing costs; it will lower 2G marketing expense to accommodate 3G.
- Employee expenses will not increase as the company has not hired significantly to launch 3G services; administration charges too would remain at the same level.

However, spectrum usage charge will increase for circles where Bharti Airtel has won 3G spectrum and launched 3G operations. Bharti Airtel will have to pay increased spectrum charge not only on 3G revenue but 2G revenue as well. It is significant to note that is not possible to bifurcate 3G and 2G revenue.

Amortisation of license fees and capitalised interest expenses: Bharti Airtel will amortise 3G licence fees circle-wise as and when it launches 3G operations in a particular circle. The treatment would be similar for interest cost on debt taken to pay 3G licence fees. On interest capitalised until date, Bharti Airtel will take a one-time hit (circle-wise) of the capitalised interest as and when it launches 3G services in a particular circle.

MNP: Bharti Airtel believes that mobile number portability (MNP) will not have an adverse impact on its operations; on the contrary, it believes that it would be a net gainer because of MNP. Bharti Airtel customer market share is 22% whereas that of other incumbents is ~75%. According to the company, this clearly indicates that the probability is higher of people shifting to its network than leaving it. Bharti Airtel does not expect postpaid tariff to decline drastically because of MNP-initiated offers.

Payment for spectrum beyond 6.2 MHz: Bharti Airtel does not believe that it would have to pay for the excess spectrum beyond 6.2 MHz (it has in 13 circles). Nevertheless, it is ready to pay if treatment for all telcos is equal. Bharti Airtel would challenge the order in the courts in case of unfair treatment. It also strongly opposes equating 2G spectrum price with 3G.

Capex plans: For FY11, Bharti Airtel (India+SL+Bangaldesh) capex is expected at ~US$ 2 bn (excluding payment for 3G and BWA licence fees) and capex for its tower subsidiary is expected at US$ 300 mn.

BWA: Bharti Airtel has not yet decided whether it will go ahead with Wimax or support the developing TDD-LTE architecture. Management is focusing on 3G launches and will concentrate on BWA only next fiscal.

African operations

African operations were branded as Airtel Africa in November 2010 and the one-time expense to that extent would reflect in 3QFY11 results.

Tariff cuts: Airtel Africa has cut tariffs across almost all African markets. Airtel's strategy here is not to be a price leader. However, after a thorough audit of Zain Africa, Airtel realised that tariff in few countries was at an unnecessary premium to competition and had to be brought down to a level playing field. In few markets, the tariff was cut because the regulator had decreased interconnect charges and Airtel had taken the lead in passing on the benefits to its customers.

Airtel Africa believes that subscribers should not think twice before making an off-net or an on-net call. On-net calls average at 70% across most African countries. Airtel Africa is trying to simplify its tariffs by launching unified access plans. This should decrease the incidence of multi-SIMs in the African market, which remains high despite relatively lower tele-density.

Zain's strategy was high on price and low on volumes whereas Airtel's strategy is to be low on price and high on volumes; hence the pricing actions were necessary. Airtel Africa might undertake more tariff interventions depending on regulatory changes or market dynamics.

Elasticity: 2QFY11 results showed elasticity of higher than 1 in the African markets whereas tariff was cut 9% and MoN grew a strong 13% (comparable). Management is cautious and claims that these are early days to conclude whether elasticity will be more than 1 in Africa; however, it is confident that elasticity definitely exists in this market, especially with usage being low compared with the rest of the world. We currently model 0.6 elasticity over the longer term in our financials for the African operations.

Subscriber addition: Airtel added 3.2 mn active subscribers in 2QFY11 in Africa and 3QFY11 subscriber addition appears healthy. Management expects subscriber addition to remain robust because of tariff interventions and re-branding efforts, which would bear fruit over time. Airtel Africa had also undertaken a thorough network audit; it reinstalled excess capacity into areas where capacity was deficient. This improved overall user experience of the network. As this spreads through word of mouth and as Airtel keeps investing in its network coverage in Africa, subscriber addition is expected to increase at a robust pace.

Capex plans: Airtel Africa maintained that annual capex would be US$ 800 mn-1 bn. This capex outlay may look low compared with Airtel's competition in Africa; nevertheless, Airtel believes that it is securing extremely competitive rates from vendors for equipment procurement because of the large order quantity (India plus Africa). Airtel thinks that its procurement rates are far lower currently compared with the period prior to the Zain acquisition.

The minutes factory model: Airtel Africa already announced outsourcing deals with its preferred IT partners and has outsourced its customer service unit as well. It will soon be shifting to a dollar per erlang model from the current box model of network architecture and procurement. Zain's procurement rate for equipment was high and Airtel is confident that its preferred vendor partners will provide competitive rates. In the meanwhile, Airtel initiated price interventions and is trying to induce elasticity in the medium term, thus increasing the volume of minutes carried on its network. Airtel Africa is confident of implementing its 'minutes factory' model in Africa, which will help shore up margins.

Improving margins: Airtel Africa is confident that all the steps taken towards outsourcing functions such as IT, customer service, and network (yet to be finalised) and other managed services will bear fruit. It expects 1QFY12E to be the first quarter when margin improvement would be visible in its African business. Airtel is benchmarking its costs in Africa to India and is trying to implement the best practices it has implemented in India to achieve best-in-industry margins. Cost saving would also come from passive infrastructure sharing which, though allowed by the regulators, has not been in practice in Africa due to mindset issues of other operators. Airtel initiated passive infra sharing and is seeing other operators also coming forward to some extent. However, it would take some more time before a considerable number of sites are shared to bring about cost efficiencies.

Delisting of the Zambian unit: Airtel has not yet decided on delisting of its Zambian subsidiary. In the meanwhile, Bloomberg reported that Airtel's holding increased to 97% (from ~78%) as many minority-shareholders tendered their shares in the open offer.

Deleveraging its BS: Airtel's consolidated net-debt to EBITDA was 2.8x and the management is comfortable with this. The Indian operations generate enough free-cash flows, which would see leverage reducing in the coming quarters. Airtel plans to prepay some of the debt it had taken for 3G. Management stated it is not in a hurry to raise equity in the tower subsidiary but that is certainly an option to deleverage its BS.

B&K's view

The next few quarters will see the launch of 3G operations in India. Bharti Airtel will start amortising licence fees and interest charges on 3G debt with the launch of 3G services, circle-wise. Capitalised interest will also start showing on the P&L. However, revenue traction from 3G will not be visible until end-FY12E. This could put pressure on the stock price and Bharti Airtel could offer better entry points than current levels. We strongly believe that the next phase of growth in Indian telecom will be spurred by data usage through 3G and broadband. Bharti Airtel will be a key beneficiary of this latent demand, although it would take some time before this starts showing up on its P&L (mostly FY13E onwards).

African operations should inch towards higher EBITDA profitability as outsourcing contracts start bearing fruit FY12E onwards. Re-launch of the brand and tariff interventions should ensure higher incremental customer market share and elasticity in MoU should help Bharti Airtel implement its 'minutes factory' model in Africa. We maintain our Outperformer rating on Bharti Airtel. Key risks include delay in turnaround of the African operations, currency risks arising from African operations, low acceptability of 3G in India, and regulatory risks such as payment for spectrum beyond 6.2 MHz in 13 circles.

Income Statement

Yr end 31 Mar (Rs mn)	FY09	FY10	FY11E	FY12E
Net sales	**369,615**	**418,472**	**605,508**	**736,066**
Growth (%)	*36.8*	*13.2*	*44.7*	*21.6*
Operating expenses	(218,155)	(251,020)	(399,499)	(484,709)
Operating profit	151,460	167,452	206,009	251,357
EBITDA	**151,460**	**167,452**	**206,009**	**251,357**
Growth (%)	*33.6*	*10.6*	*23.0*	*22.0*
Depreciation	(47,583)	(62,835)	(99,442)	(121,608)
Other income	809	649	735	100
EBIT	**104,686**	**105,266**	**107,302**	**129,849**
Interest paid	(11,613)	(181)	(20,382)	(24,796)
Pre-tax profit (before non-recurring)	93,073	105,085	86,920	105,053
Pre-tax profit (after non-recurring)	93,073	105,085	86,920	105,053
Tax (current + deferred)	(6,615)	(13,453)	(20,034)	(27,735)
Net profit (before Minority Interest, Pref. Dividend, etc.)	86,458	91,632	66,887	77,318
Minority interests	(1,759)	(1,870)	(84)	(220)
Reported PAT	**84,699**	**89,762**	**66,803**	**77,098**
Adjusted net profit	**84,699**	**89,762**	**66,803**	**77,098**
Growth (%)	*26.4*	*6.0*	*(25.6)*	*15.4*

Balance Sheet

Yr end 31 Mar (Rs mn)	FY09	FY10	FY11E	FY12E
Cash and marketable sec.	49,154	77,685	51,981	75,000
Other current assets	94,925	60,000	90,695	103,677
Investments	128	7,542	9,532	11,328
Net fixed assets	422,445	542,519	1,228,173	1,282,012
Other non-current assets	37,296	23,194	47,225	55,447
Total assets	**603,948**	**710,940**	**1,427,605**	**1,527,465**
Current liabilities	152,377	108,819	244,663	269,526
Total debt	118,801	101,898	631,732	623,474
Other non-current liab.	18,121	52,998	72,000	74,600
Total liabilities	**289,298**	**263,715**	**948,395**	**967,600**
Share capital	18,982	18,988	18,988	18,988
Reserves & surplus	284,963	402,952	420,223	492,877
Shareholders' funds	**303,945**	**421,940**	**439,211**	**511,865**
Minorities interests	10,704	25,285	40,000	48,000
Total equity & liab.	**603,948**	**710,940**	**1,427,605**	**1,527,465**
Capital employed	**451,571**	**602,121**	**1,182,943**	**1,257,939**

Cash Flow Statement

Yr end 31 Mar (Rs mn)	FY09	FY10	FY11E	FY12E
Pre-tax profit	93,073	105,085	86,920	105,053
Depreciation	47,583	62,835	99,442	121,608
Change in working capital	(22,983)	44,165	91,857	5,658
Total tax paid	(4,360)	(17,272)	(11,771)	(27,135)
Cash flow from oper. (a)	**113,314**	**194,813**	**266,449**	**205,184**
Capital expenditure	(143,418)	(182,909)	(785,096)	(175,447)
Change in investments	10,141	(21,851)	25,372	(1,796)
Cash flow from inv. (b)	**(131,156)**	**(203,250)**	**(759,724)**	**(177,244)**
Free cash flow (a+b)	**(17,842)**	**(8,437)**	**(493,275)**	**27,941**
Equity raised/(repaid)	1,904	(17,598)	0	0
Debt raised/(repaid)	21,737	(16,903)	529,834	(8,258)
Dividend (incl. tax)	(4,441)	(4,441)	(4,443)	(4,443)
Others	3,009	11,027	(30,458)	7,780
Cash flow from fin. (c)	**22,210**	**(27,915)**	**494,933**	**(4,921)**
Net chg in cash (a+b+c)	**4,367**	**(36,352)**	**1,658**	**23,020**

Key Ratios

Yr end 31 Mar (%)	FY09	FY10	FY11E	FY12E
Adjusted EPS (Rs)	22.3	23.6	17.6	20.3
Growth	26.3	6.0	(25.6)	15.4
Book NAV/share (Rs)	82.9	117.8	126.2	147.4
Dividend/share (Rs)	1.0	1.0	1.0	1.0
Dividend payout ratio	5.2	4.9	6.7	5.8
Tax	7.1	12.8	23.0	26.4
EBITDA margin	41.0	40.0	34.0	34.1
EBIT margin	28.3	25.2	17.7	17.6
RoCE	26.5	20.0	12.0	10.6
Net debt/Equity	22.1	5.4	121.0	98.0

Valuations

Yr end 31 Mar (x)	FY09	FY10	FY11E	FY12E
PER	15.4	14.5	19.5	16.9
PCE	9.8	8.5	7.8	6.6
Price/Book	4.1	2.9	2.7	2.3
Yield (%)	0.3	0.3	0.3	0.3
EV/Net sales	3.6	3.2	2.2	1.8
EV/EBITDA	8.8	7.9	6.4	5.3

Du Pont Analysis – ROE

Yr end 31 Mar (x)	FY09	FY10	FY11E	FY12E
Net margin (%)	22.9	21.4	11.0	10.5
Asset turnover	0.7	0.6	0.6	0.5
Leverage factor	2.0	1.7	2.3	2.8
Return on equity (%)	31.4	23.6	14.4	14.8

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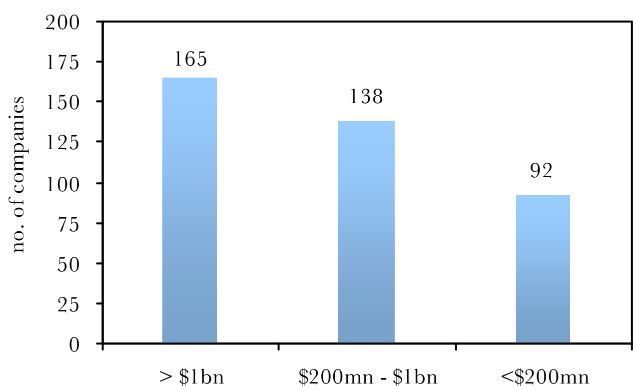
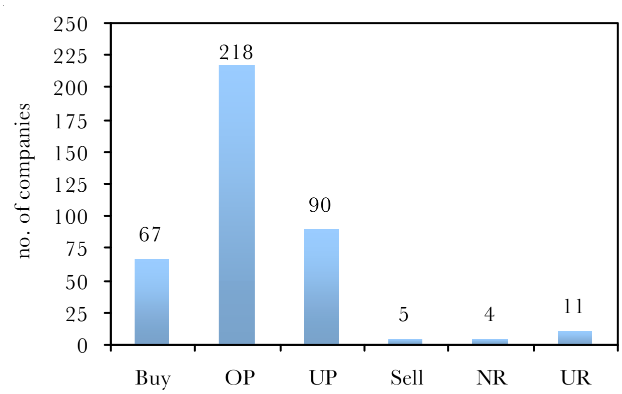
Analyst Declaration: We, Rohit Dokania & Sandhya Pavitrekar, hereby certify that the views expressed in this report accurately reflect our personal views about the subject securities and issuers. We also certify that no part of our compensation was, is, or will be, directly or indirectly, related to the specific recommendation or view expressed in this report.

B&K Universe Profile

By Market Cap (US$ mn)



By Recommendation



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B&K Investment Ratings:

1. **BUY:** Potential upside of > +25% (absolute returns)
2. **OUTPERFORMER:** 0 to +25%
3. **UNDERPERFORMER:** 0 to -25%
4. **SELL:** Potential downside of < -25% (absolute returns)

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