

# BHARTI AIRTEL

## Confident on growth and profitability

India Equity Research | Telecom

We recently met Mr. Manik Jhangiani, Global CFO, Bharti Airtel (Bharti). Management highlighted improving business fundamentals in the domestic market and seemed confident of achieving its Africa business 2013 financial targets with a marginal 6-9 month delay.

### Tariff hikes not impacting usage, another round though not imminent

Management stated that the recent tariff hikes have had no significant impact on minutes growth so far and is confident that existing usage will largely remain intact. However, though Q2 is the first quarter post the tariff hikes, being a seasonally slow quarter, it may not reveal the true picture. Notably, management ruled out any further tariff hikes in the near term as usage could get impacted.

### Data key growth driver for India business

Bharti highlighted that GPRS/EDGE services (currently comprising only 4% of its mobility revenues) is growing at a fast clip and will be a significant revenue driver for the India 2G business. 3G uptake is at a nascent stage with most users yet in the trial mode, but with proliferation of cheaper 3G handsets and 3G network expansion, the company expects 3G usage to also pick up pace.

### Africa business FY13 'targets' achievable albeit with a 6-9 months lag

Management indicated that Bharti would achieve its stated financial targets for the Africa business (USD 5 bn revenue and USD 2 bn EBITDA) with a marginal delay of 6-9 months. With most cost saving initiatives in place, Africa business margin, Bharti expects, would expand to 40% (from 27% in Q1FY12) in the next eight-nine quarters. It also plans to reinstate tariff cuts in the African market to drive usage elasticity.

### Outlook and valuations: improving fundamentals; maintain BUY

The draft NTP 2011 is expected to be announced soon and will lend the much needed regulatory clarity to the sector. The stock has underperformed in the recent past as the INR depreciation against the USD would lead to losses on restatement of foreign currency loans, which are notional. At 5.9x FY13E EV/EBITDA, we maintain 'BUY/Sector Outperformer' recommendation/rating on the stock.

#### Financials

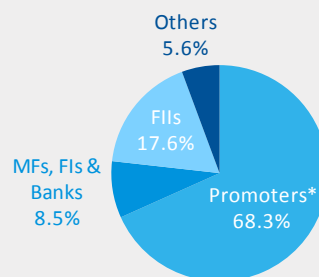
Year to March	FY10	FY11	FY12E	FY13E
Revenue (INR mn)	418,472	594,948	732,311	844,978
Rev. growth (%)	13.2	42.2	23.1	15.4
EBITDA (INR mn)	167,633	199,996	261,247	328,895
Net profit (INR mn)	89,768	60,803	82,514	116,044
Diluted EPS (INR)	23.6	16.0	21.7	30.6
EPS growth (%)	6.0	(32.3)	35.7	40.6
Diluted P/E (x)	16.0	23.7	17.4	12.4
EV/ EBITDA (x)	8.9	10.3	7.8	5.9
ROAE (%)	24.7	13.4	15.9	19.1
ROACE (%)	23.5	12.1	11.5	15.4

EDELWEISS 4D RATINGS	
Absolute Rating	BUY
Rating Relative to Sector	Outperformer
Risk Rating Relative to Sector	Low
Sector Relative to Market	Overweight

#### MARKET DATA (R: BRTI.BO, B: BHARTI IN)

CMP	: INR 379
Target Price	: INR 274
52-week range (INR)	: 448 / 303
Share in issue (mn)	: 3,797.5
M cap (INR bn/USD mn)	: 1,440 / 29,555
Avg. Daily Vol.BSE/NSE('000)	: 5,150.0

#### SHARE HOLDING PATTERN (%)



\* Promoters pledged shares : NIL  
(% of share in issue)

#### PRICE PERFORMANCE (%)

	Stock	Nifty	EW Telecommunication Index
1 month	2.0	6.1	3.5
3 months	0.5	(2.2)	3.3
12 months	7.1	(14.0)	(1.8)

**Ganesh Duvvuri**  
 +91 22 4040 7586  
 ganesh.duvvuri@edelcap.com

**Devyani Javeri**  
 +91 22 6623 3360  
 devyani.javeri@edelcap.com

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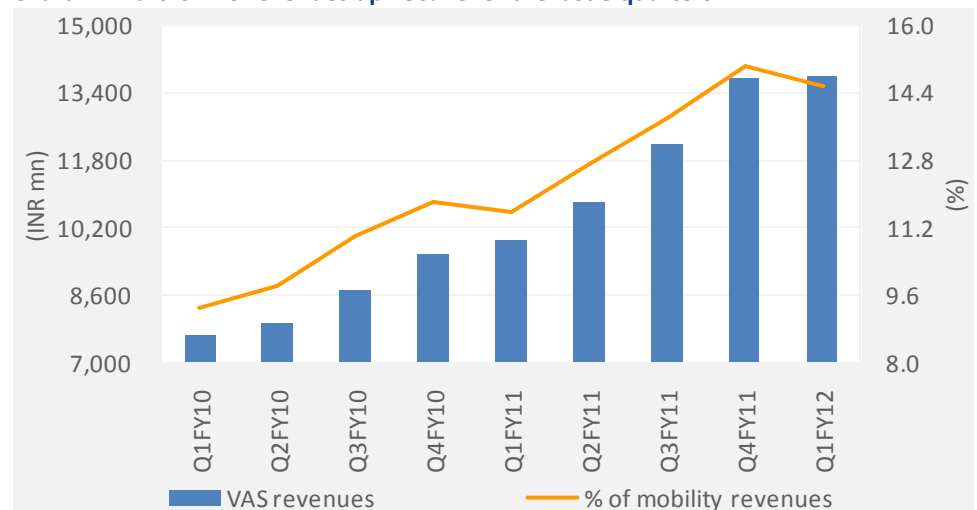
### Tariff hikes not impacting usage, another round though not imminent

Management highlighted that the recent tariff hikes have had no significant impact on minutes' growth so far and the company is confident that existing usage will largely remain intact. However, though Q2 is the first quarter post the tariff hikes, being a seasonally slow quarter, it may not reveal the true picture. The company also attributed the recent subscriber growth slowdown to seasonality and industry's focus on 'paying' customers, but did not believe that the reduction in dealer commissions had a material impact on subscriber adds. It expects net additions to improve from the next quarter. Management ruled out any further tariff hikes in the near term as usage could get impacted.

### Data key growth driver for India business

Management highlighted that both 2G and 3G data usage has strong growth potential. Bharti's VAS revenues have jumped ~80% over the past eight quarters (versus estimated 9% growth in voice revenues) and constituted ~14.6% of its mobility revenues. VAS revenues include revenues from SMS (5%), GPRS/EDGE services (4%) and other VAS including CRBT, ring tones etc., (6%). The company sees strong growth potential from the GPRS/EDGE services segment and highlighted it as a significant revenue driver for the India 2G business.

**Chart 1: Bharti's VAS revenues up ~80% over the last 8 quarters**



Source: Company, Edelweiss research

Bharti launched 3G services in February 2011 and is present in 150 cities so far. Currently, around 12% of the company's 160 mn plus subscriber base has 3G-enabled handsets and it claims that since launch, around 6 mn of its subscribers have tried/activated 3G service. The average usage is about 250-300 MB with an incremental ARPU of INR -130-160 per subscriber. However, most users are yet in trial mode and the proportion of paid subscribers is much lower. With proliferation of cheaper 3G handsets (company expects 3G handset prices to dip to USD 50-60 over the next few quarters from the current USD 100) and 3G network expansion, Bharti expects 3G usage to also pick up pace. In an earlier interaction, Bharti had indicated that based on the current incremental 3G ARPU, ~5-6 mn subscribers is potentially the threshold base, post which 3G margin could exceed its current wireless EBITDA margin, as the incremental 3G opex comprises only the loading charges of ~INR 10k/tower.

We estimate 3G subscriber base of 14.8 mn for FY12 and 22.7 mn for FY13 (7.7% and 10.8%, respectively, of Bharti's total wireless subscriber base) contributing 2.7% and 5.6%, respectively, to the company's FY12-13 mobility revenue.

**Table 1: Edelweiss FY12-13 estimates for Bharti's 3G business**

	FY12E	FY13E
Total wireless subscribers (mn)	192.2	211.1
3G subscribers (mn)	14.8	22.7
Above as % of total subscribers	7.7	10.8
Average 3G subscribers (mn)	7.5	18.8
Incremental 3G ARPU (INR)	125	125
Bharti's 3G revenues (INR bn)	11.3	28.1
Above as % of total wireless revenues	2.7	5.6

Source: Edelweiss research

Bharti holds BWA spectrum in four circles currently. While the company has finalised LTE as the preferred technology for BWA and will be commencing network trials towards the year-end, there is no visibility yet on the timeline for commercial launch of services.

### Africa business 'targets' achievable with a minor delay

Management indicated that the company would achieve its stated financial target for the Africa business of USD 5 bn revenue and USD 2 bn EBITDA by 2013, albeit with a potential 2-3 quarter lag. It believes that 40% EBITDA margin is not only achievable but also sustainable.

Q1FY11 EBITDA margin for the Africa business was 27%, thus implying a 13% improvement to 40% in next 7-8 quarters. We note that Bharti's closest competitor in Africa, MTN is currently reporting EBITDA margin of ~41%. With various cost rationalization initiatives in place, the company believes that Africa business margins are set to expand over the next few quarters.

Bharti also plans to reinstate tariff cuts in the African market to test usage elasticity and believes that its strategy will be successful given that Africa's tariffs are 6x plus and usage is a fourth of that in India. Since Q3FY11, BHARTI has been reporting MOU growth and margin expansion in alternate quarters, thus balancing both growth as well as margins in Africa.

**Table 2: Edelweiss FY12-13 estimates for the Africa business**

	FY12E	FY13E
Subscribers (mn)	53	65
ARPU (USD)	7.4	7.0
Total revenues (INR bn)	191	222
EBITDA (INR bn)	53	73
EBITDA margin (%)	27.9	33.0

Source: Edelweiss research

### Low possibility of near-term monetisation of towerco

Recent media reports indicate that Bharti is considering an IPO of its towerco Bharti Infratel (BIL) in the near future. However, under the current market conditions, management is not in a hurry since BIL is FCF positive and has net cash on balance sheet and no immediate funding requirement. On the operations front, it is looking to improve tenancy through 'physical' consolidation of towers by discarding overlapping towers and moving tenants to common towers, thereby improving tenancy and rationalising costs.

### Keen to augment spectrum inventory

Management indicated that Bharti will actively participate in any future spectrum auction (2G/3G/BWA) and is keen to complete its pan-India 3G and BWA spectrum profile. It will also invest to acquire additional 3G spectrum in metros and other key circles where it currently already has spectrum. Bharti currently has 3G spectrum in 13 circles and BWA spectrum in four circles. In our earlier note, Bharti Airtel – Investments to dent free cash flows dated May 12, 2011, we had highlighted that Bharti will need to invest USD 3.2 bn to become a pan-India 3G and BWA player (based on prices 'discovered' in the last auction) and may have to invest up to USD 7 bn if it acquires additional spectrum in key circles.

**Table 3: Potential investments to acquire additional spectrum**

	(USD mn)	Comments
Acquisition of Qualcomm's BWA company	1,200	As per media reports
Acquisition of 20 Mhz BWA spectrum in rest of the circles	1,027	To complete pan-India BWA presence at prices 'discovered' in the last auction
Acquisition of 5 MHz 3G spectrum in rest of the circles	990	To complete pan-India 3G presence at prices 'discovered' in the last auction
<b>Outgo to complete pan-India 3G &amp; BWA presence</b>	<b>3,217</b>	
Acquisition of 2MHz of 2G spectrum in Metros and A category circles	862	Outgo if Bharti acquires additional 2G spectrum to meet its capacity requirements in high usage circles; cost of 2G spectrum assumed at 30% discount to 3G price
Acquisition of 5MHz 3G spectrum in Metros and Category A	2,959	Outgo if Bharti acquires additional 3G spectrum to meet its capacity requirements in high usage circles
<b>Total cash outflow</b>	<b>7,038</b>	

Source: Edelweiss research

Table 4: Bharti's 3G &amp; BWA spectrum profile

	3G spectrum cost (5 MHz)	BWA spectrum cost (20 MHz)	Bharti's 3G spectrum profile	Bharti's BWA spectrum profile
<b>Metro</b>	<b>71,083</b>	<b>50,572</b>	<b>10</b>	<b>20</b>
Delhi	33,169	22,410	5	-
Mumbai	32,471	22,930	5	-
Kolkata	5,443	5,232	-	20
<b>Category A</b>	<b>67,519</b>	<b>62,013</b>	<b>15</b>	<b>40</b>
Maharashtra	12,578	9,156	-	20
Gujarat	10,761	6,139	-	-
Andhra Pradesh	13,731	10,591	5	-
Karnataka	15,799	15,433	5	20
Tamil Nadu	14,649	20,695	5	-
<b>Category B</b>	<b>24,387</b>	<b>13,302</b>	<b>15</b>	<b>20</b>
Kerala	3,125	2,587	-	-
Punjab	3,220	3,323	-	20
Haryana	2,226	1,199	-	-
UP (E)	3,646	1,425	-	-
UP (W)	5,140	1,839	5	-
Rajasthan	3,210	973	5	-
MP	2,584	1,247	-	-
WB	1,236	710	5	-
<b>Category C</b>	<b>4,518</b>	<b>2,591</b>	<b>25</b>	<b>0</b>
HP	372	207	5	-
Bihar	2,035	993	5	-
Orissa	970	636	-	-
Assam	415	330	5	-
North East	423	213	5	-
J&K	303	213	5	-
<b>Pan-India</b>	<b>167,506</b>	<b>128,478</b>	<b>65</b>	<b>80</b>

Source: DoT, Edelweiss research

### Company Description

Bharti is India's largest integrated telecom operator providing mobile, broadband & telephone (B&T) and enterprise services. It is India's largest wireless operator with a pan-India mobility network spanning all 22 telecom circles; its B&T services are currently available in 87 cities. Bharti had a wireless subscriber base of ~162 mn in FY11, implying wireless subscriber market share of ~20%. The enterprise services division provides carrier (long distance services) and other services to corporates. Bharti launched 2G and 3G services as the fifth mobile operator in Sri Lanka. It also acquired 70% stake in Warid Telecom, Bangladesh's fourth largest telecom operator for USD 300 mn in January 2010. Also, it acquired Zain to operate in the Africa market.

### Investment Theme

Leading operators like Bharti, Vodafone and Idea have raised tariffs. Recently, all the operators unanimously reduced distributor commissions. With focus shifting to operations as against marketing alone earlier, margins are set to rise for the industry.

### Key Risks

Bharti has raised tariffs in almost all circles of operation. If the remaining operators don't raise tariffs then Bharti could lose market share. Potential regulatory costs regarding pricing of spectrum and spectrum re-farming remain a risk for the industry.

## Financial Statements

Income statement					(INR mn)
Year to March	FY09	FY10	FY11	FY12E	FY13E
Gross revenues	468,100	486,904	667,288	810,136	939,909
Inter segment	98,485	68,432	72,340	77,825	94,931
Net revenue	369,615	418,472	594,948	732,311	844,978
Direct costs	151,997	175,712	254,421	315,922	342,863
Employee costs	16,992	19,028	32,784	37,374	42,249
Other Expenses	48,949	56,099	107,747	117,767	130,972
Total operating expenses	217,938	250,839	394,952	471,063	516,084
EBITDA	151,677	167,633	199,996	261,247	328,895
Depreciation & Amortization	47,581	62,832	102,066	129,132	145,528
EBIT	104,096	104,801	97,930	132,115	183,367
Other income	5,319	4,498	2,939	2,937	3,277
Interest expenses	16,343	4,208	23,751	27,997	27,679
Profit before tax	93,072	105,091	77,118	107,055	158,965
Provision for tax	6,615	13,453	17,790	24,345	42,921
Core profit	86,457	91,638	59,328	82,710	116,044
Profit After Tax	86,457	91,638	59,328	82,710	116,044
Minority interest	1,759	1,870	(1,475)	196	-
Profit after minority interest	84,698	89,768	60,803	82,514	116,044
Dividend on Preference shares	-	-	-	-	1
Basic shares outstanding (mn)	3,796	3,798	3,798	3,798	3,798
Basic EPS (INR)	22.3	23.6	16.0	21.7	30.6
Diluted equity shares (mn)	3,796	3,798	3,798	3,798	3,798
Diluted EPS (INR)	22.3	23.6	16.0	21.7	30.6
CEPS (INR)	34.8	40.2	42.9	55.7	68.9
Dividend per share (INR)	1.0	1.0	1.0	1.3	1.3
Dividend payout (%)	5.1	4.8	7.5	7.0	5.0

### Common size metrics - as % of net revenues

Year to March	FY09	FY10	FY11	FY12E	FY13E
Operating expenses	59.0	59.9	66.4	64.3	61.1
Depreciation	12.9	15.0	17.2	17.6	17.2
Interest expenditure	4.4	1.0	4.0	3.8	3.3
EBITDA margins	41.0	40.1	33.6	35.7	38.9
Net profit margins	23.4	21.9	10.0	11.3	13.7

### Growth ratios (%)

Year to March	FY09	FY10	FY11	FY12E	FY13E
Revenues	36.8	13.2	42.2	23.1	15.4
EBITDA	33.4	10.5	19.3	30.6	25.9
PBT	21.6	12.9	(26.6)	38.8	48.5
Net profit	26.4	6.0	(32.3)	35.7	40.6
EPS	26.4	6.0	(32.3)	35.7	40.6

<b>Balance sheet</b>					(INR mn)
<b>As on 31st March</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11</b>	<b>FY12E</b>	<b>FY13E</b>
Equity capital	18,982	18,988	18,988	18,988	18,988
Reserves & surplus	284,963	402,952	468,680	533,001	643,243
Shareholders funds	303,945	421,940	487,668	551,989	662,231
Minority interest (BS)	10,704	25,285	28,563	28,759	28,759
Secured loans	53,993	81,474	532,338	521,691	427,787
Unsecured loans	64,808	20,424	84,370	84,000	84,000
Borrowings	118,801	101,898	616,708	605,691	511,787
<b>Sources of funds</b>	<b>433,450</b>	<b>549,123</b>	<b>1,132,938</b>	<b>1,186,439</b>	<b>1,202,775</b>
Gross block	549,810	678,122	931,873	1,071,373	1,210,873
Accumulated depreciation	140,675	195,493	280,447	386,268	506,828
Net block	409,136	482,629	651,426	685,105	704,045
Total fixed assets	409,136	482,629	651,426	685,105	704,045
Goodwill	40,364	59,890	637,317	614,006	589,037
Investments	38,053	52,419	6,224	6,224	6,224
Inventories	963	484	2,138	2,631	2,867
Sundry debtors	18,262	35,711	54,929	67,611	78,013
Cash and equivalents	11,145	25,323	9,575	20,655	32,688
Other current assets	77,216	41,995	58,393	65,908	84,498
Total current assets	107,585	103,513	125,035	156,806	198,066
Sundry creditors and others	162,942	153,427	312,373	278,312	277,269
Provisions	-	4,243	6,085	28,784	48,723
Total current liabilities & provisions	162,942	157,670	318,458	307,095	325,992
Net current assets	(55,357)	(54,157)	(193,423)	(150,290)	(127,925)
Net Deferred tax	1,254	8,342	31,394	31,394	31,394
<b>Uses of funds</b>	<b>433,450</b>	<b>549,123</b>	<b>1,132,938</b>	<b>1,186,439</b>	<b>1,202,775</b>
Book value per share (INR)	80.1	111.1	128.4	145.4	174.4

<b>Free cash flow</b>					(INR mn)
<b>Year to March</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11</b>	<b>FY12E</b>	<b>FY13E</b>
Net profit	86,457	91,638	59,328	82,710	116,044
Depreciation	47,581	62,832	102,066	129,132	145,528
Others	3,393	(31,098)	(1)	(13,749)	(1)
Gross cash flow	137,430	123,372	161,393	198,093	261,571
Less: Changes in WC	16,931	(12,978)	(123,518)	32,053	10,332
Operating cash flow	120,499	136,350	284,911	166,040	251,239
Less: Capex	136,304	128,312	831,178	139,500	139,500
<b>Free cash flow</b>	<b>(15,805)</b>	<b>8,038</b>	<b>(546,267)</b>	<b>26,540</b>	<b>111,739</b>

<b>Cash flow metrics</b>					
<b>Year to March</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11</b>	<b>FY12E</b>	<b>FY13E</b>
Operating cash flow	120,499	136,350	284,911	166,040	251,239
Investing cash flow	(140,191)	(81,875)	(846,347)	(139,500)	(139,500)
Financing cash flow	13,852	(26,217)	510,367	(15,460)	(99,707)
Net cash flow	(5,840)	28,258	(51,069)	11,080	12,033
Capex	(140,171)	(81,831)	(846,347)	(139,500)	(139,500)
Dividends paid	-	-	(4,443)	(4,443)	(5,802)



**Profitability & efficiency ratios**

Year to March	FY09	FY10	FY11	FY12E	FY13E
ROAE (%)	32.5	24.7	13.4	15.9	19.1
ROACE (%)	31.1	23.5	12.1	11.5	15.4
Debtors days	17	24	28	31	31
Current ratio	0.7	0.7	0.4	0.5	0.6
Debt/EBITDA	0.8	0.6	3.1	2.3	1.6
Average working capital turnover	(5.6)	(7.6)	(4.8)	(4.3)	(6.1)
Debt/Equity	0.4	0.2	1.3	1.1	0.8
Adjusted debt/equity	0.4	0.2	1.3	1.1	0.8

**Operating ratios**

Year to March	FY09	FY10	FY11	FY12E	FY13E
Total asset turnover	1.0	0.9	0.7	0.6	0.7
Fixed asset turnover	1.0	0.9	1.0	1.1	1.2
Equity turnover	1.4	1.2	1.3	1.4	1.4

**Du pont analysis**

Year to March	FY09	FY10	FY11	FY12E	FY13E
NP margin (%)	22.9	21.5	10.2	11.3	13.7
Total assets turnover	1.0	0.9	0.7	0.6	0.7
Leverage multiplier	1.5	1.4	1.8	2.2	2.0
ROAE (%)	32.5	24.7	13.4	15.9	19.1

**Valuation parameters**

Year to March	FY09	FY10	FY11	FY12E	FY13E
Diluted EPS (INR)	22.3	23.6	16.0	21.7	30.6
Y-o-Y growth (%)	26.4	6.0	(32.3)	35.7	40.6
CEPS (INR)	34.8	40.2	42.9	55.7	68.9
Diluted PE (x)	17.0	16.0	23.7	17.5	12.4
Price/BV (x)	4.7	3.4	3.0	2.6	2.2
EV/Sales (x)	4.6	4.0	3.8	3.0	2.5
EV/EBITDA (x)	10.0	8.9	10.3	7.8	5.9
Dividend yield (%)	0.3	0.3	0.3	0.3	0.3

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Bharti Airtel	BUY	SO	L	Idea Cellular	BUY	SP	M
Mahanagar Telephone Nigam Ltd	HOLD	SU	M	Reliance Communication	REDUCE	SU	H
Tulip Telecom	BUY	SO	H				

### ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

### RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

### RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

### SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return



**Edelweiss Securities Limited**, Edelweiss House, off C.S.T. Road, Kalina, Mumbai – 400 098.  
Board: (91-22) 4009 4400, Email: [research@edelcap.com](mailto:research@edelcap.com)

Vikas Khemani	Head Institutional Equities	<a href="mailto:vikas.khemani@edelcap.com">vikas.khemani@edelcap.com</a>	+91 22 2286 4206
Nischal Maheshwari	Head Research	<a href="mailto:nischal.maheshwari@edelcap.com">nischal.maheshwari@edelcap.com</a>	+91 22 6623 3411

### Coverage group(s) of stocks by primary analyst(s): Telecom

Bharti Airtel, Idea Cellular, Reliance Communications, Tulip Telecom

#### Recent Research

Date	Company	Title	Price (INR)	Recos
25-Aug-11	Telecom	ARPU decline moderates; <i>Sector Update</i>		
16-Aug-11	Reliance Comm.	Deleveraging is key; <i>Result Update</i>	78	Reduce
03-Aug-11	Bharti Airtel	Strong operational performance ; <i>Result Update</i>	426	Buy

#### Distribution of Ratings / Market Cap

##### Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	119	47	15	184
* 3 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	111	57	16	

#### Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

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