Bharti Airtel BRTI.NS BHARTI IN

TELECOMS

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EQUITY RESEARCH

Bharti 2Q – some recovery, some concerns

First Look

Breaking news, market events and company announcements

November 4, 2011

Rating Remains	**Neutral**
Target price Remains	INR 430
Closing price November 3, 2011	INR 393

The broader sentiment going into Bharti's 2Q was weak, due to seasonality and FX concerns, but both domestic and African operating trends appear in line, although reported NPAT is down 14% q-q, which is 12% below consensus. Three key observations:

- **Domestic wireless trends are less pleasing** – with a 1% drop in revenues, a 2% decline in EBITDA and a contraction of 50bps in margins. Although RPM was up 1% q-q, the first increase in ten quarters, volumes declined 2% q-q. This compares to IDEA's 4% increase in prices with a 2% drop in volumes too, and this is likely to be the main gauge for further price increments or reductions even. Surprisingly, VAS as percentage of total revenues fell slightly to 14.5%, implying a 1% drop in data revenues, despite higher 3G subs in the quarter (~7mn). Management attributed this to the correction of an "anomaly" in 3G plans in last quarter, which led to relatively lower 3G driven revenue growth in spite of higher volumes.
- **African trends seem relatively more pleasing, but battles still ahead** – this is the third consecutive quarter of >100bps margin improvement to 26.4%, suggesting c.USD1.1-1.2bn in annualised EBITDA this year. Reported loss for the quarter is USD95mn. Prices were down 5% and volume was up 10%. Capex in Africa is likely to be a key variable, and management has raised its FY12F guidance to US$1.4-1.5bn from US$1.2bn, which is higher than our estimates (EBITDA could be higher too).
- Gearing is high at 3x net debt to EBITDA, and with further spectrum/license payment ahead (along with African capex), ROIC is unlikely to improve significantly in the medium term from the current 11% levels on our estimates.

We maintain our Neutral recommendation on the stock. The shares are now trading at FY12F P/E of 19x, which isn't inexpensive, in our opinion. Apart from the newsflow on domestic price hikes (which we do not believe can be sustained beyond two to three quarters) and a gradual improvement in African earnings, it is difficult to see many other catalysts for further re-rating. Recent TRAI proposals may help sentiment somewhat given positive (although largely expected) pro-M&A regulations, but the rest of the charges on spectrum/ licenses are yet to be finalised.

There is a perception by the market that the pending regulatory decisions are 'all in the price'; which we believe is difficult to gauge. Before the initial TRAI recommendations in July 2010 and revised recommendations in February of this year, the stock was trading around INR280 levels and INR340, respectively – 10-20% below the current share price. We also remain concerned about the possibility of spectrum re-farming.

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ABOVE OR BELOW EXPECTATIONS? Revenue and EBITDA 0-2% below our and consensus expectations, and underlying NPAT is 4% below consensus. This appears largely on account of higher interest expenses – Bharti notes interest expenses were higher by INR1.15bn on account of 3G rollout.

WHAT DO THE RESULTS MEAN?

- Overall, appears to be a broadly in-line result, no fireworks either.
- Wireless revenues went backward by 1% q-q vs. 2% q-q growth for IDEA. Total minutes on the network declined by 2%, although there was sequential RPM improvement of 1% to 43 paisa.
- Wireless margins contracted by 50bps q-q to 33.7%, despite lower net additions and subsequently lower SACs.
- African revenues grew 5% q-q and margins (incl corp costs etc) improved by 110bps to 26%; while this is in line with our expectations, it also highlights that Bharti is making consistent progress in this direction. Annualised, African EBITDA is now tracking at USD1bn, still requiring this to double to get to the US2bn target by 2013F.
- Operational trends in Africa are strong: total minutes continued to rise in Africa q-q by 10%, and MoUs improved by 6% q-q to 128 minutes. RPMs were down 5% q-q and Bharti added another 2mn subscribers.
- Non-wireless business trends were mixed: Telemedia revenue grew 1%, but EBITDA fell 2%; margins down 130bps. Infrastructure revenue and EBITDA rose 4% with 37.5% margin. Enterprise revenue was up 6%, but EBITDA grew 3%, which led to margins dropping by 70bps.

CHANGE TO GUIDANCE? Capex guidance for Africa has been raised to US$1.4–1.5bn from US$1.2bn previously.

KEY NUMBERS – (i) Revenue of INR172.6bn is up 2% q-q. EBITDA of INR58bn is up 2 q-q with margins broadly flat at 33.7%. (ii) Wireless revenue of INR98bn is down 1% q-q and EBITDA of INR33bn is down 2% with margins of 33.7%. (iii) Volumes were down 2% but RPM was up1.3% to 43 paisa. ARPUs of INR183 were down 4% q-q and MoUs of 423 were down 5% q-q. Churn rate climbed to 7.2%. Non-voice contributed to 14.5% of revenues (iv) Telemedia grew 1% q-q to INR9.5bn in revenues with margins of 44.2%, down 130 bps q-q. Telemedia's ARPUs have been broadly stable in recent quarters. (v) Enterprise revenues grew 6% q-q, though margins fell to 21.5% from 22.1% in 1Q. Passive infra revenues rose 4% q-q with margins losing 20bps to 37.5%. (vi) Underlying NPAT of INR11.9bn adjusted for forex is down 10% q-q. Tax rate went up to 32%.

Conference call takeaways

- Bharti has expanded 3G coverage across all 13 circles in India. In addition, in the rest of the circles, inter-circle roaming agreements are being used for rolling out services, which are completely legal, management highlighted. 3G subscribers have risen to 7mn; however, only 25-26% of these are active users.
- Tariff hikes have been implemented across all circles in India; however, the bulk of the subscriber base is still not under it. Management believes that gives the seasonality impact, 2Q is the worst quarter to study any impact on elasticity. Overall, a positive impact from tariff hike on revenues/ ARPU is expected by the first quarter next year.
- As per management, Bharti has gained market share in most of the African markets except those where growth was stifled due to macroeconomic issues. Management reaffirmed strong focus on achieving cost efficiencies – all possible cost items are under optimisation, which should lead to margin uplift going forward.

Appendix A-1

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Mentioned companies

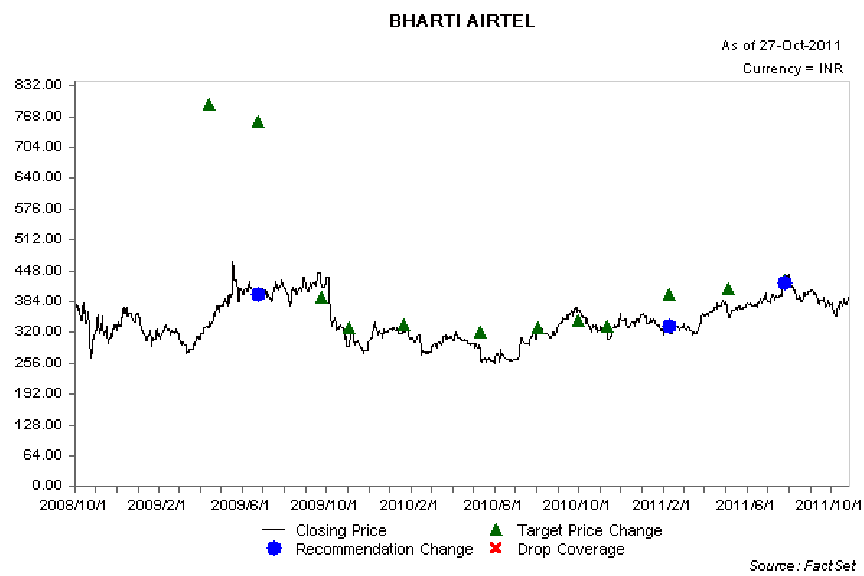
Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Bharti Airtel	BHARTI IN	INR 393	03-Nov-2011	Neutral	Not rated	

Previous Rating

Issuer name	Previous Rating	Date of change
Bharti Airtel	Buy	26-Jul-2011

Bharti Airtel (BHARTI IN) **INR 393 (03-Nov-2011)** Neutral (Sector rating: Not rated)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
26-Jul-2011		430.00	424.15
26-Jul-2011	Neutral		424.15
05-May-2011		412.00	357.60
09-Feb-2011		400.00	332.35
09-Feb-2011	Buy		332.35
11-Nov-2010		332.00	317.45
30-Sep-2010		344.00	365.90
04-Aug-2010		330.00	323.15
11-May-2010		320.00	285.20
22-Jan-2010		335.00	321.30
02-Nov-2009		330.00	292.15
23-Sep-2009		392.00	413.40
25-Jun-2009		758.00	398.95
25-Jun-2009	Neutral		398.95
15-Apr-2009		793.00	342.55

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology Our target price of INR430 is DCF-based, assuming a WACC of 9.2% and a terminal growth rate of 3%. Cash flows are discounted back to FY17F.

Risks that may impede the achievement of the target price Key downside risks: delayed turnaround in Africa; increased competition in India; and unfavourable regulatory conditions. Key upside risks: greater-than-anticipated stability in pricing in India and faster-than-anticipated turnaround in Africa. Tower divestment could be an upside catalyst, too.

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Explanation of Nomura's equity research rating system in Japan published prior to 6 January 2009

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