

November 3rd, 2009

Key Data	INR
CMP	292
Target Price	321
Bloomberg Code	BHARTI IN
Reuters Code	BRTI.BO
BSE Code	532454
NSE Code	BHARTIARTL
Face Value (INR)	5
Market Cap (INR Bn)	1108
52 Week High (INR)	495
52 Week Low (INR)	272
Avg. Daily Volume (6m)	9517553
F & O	
Market Lot	500
Turnover (INR Mn)	5340

Shareholding	%
Promoters	67.7
Mutual Funds / Bank/ FI	3.5
Foreign Institutional Investors	18.4
Insurance Companies	4.6
Bodies corporate/Individuals/others	5.8
Total	100.0

Bharti Airtel Ltd (Bharti Airtel)

Change recommendation from "BUY" to "BUY at DECLINES" for target of INR321

Bharti Airtel's consolidated total revenue increased 16% to INR104 billion for the quarter ended September 2009, as against INR89 billion in 2Q FY09. Sequentially, net sales declined 0.7%. Consolidated EBIDTA rose 17.6% to INR42.6 billion vs. INR36.2 billion in 2Q FY09. Bharti Airtel achieved its EBIDTA guidance of 40%. Net profit grew 35.1% to INR22.5 billion in 2Q FY10 and mobile subscribers stood at 110 million as of September 2009. The company continues to be a leader with an increased market share of mobile subscribers across India at 23.5% as of September 2009.

KEY HIGHLIGHTS FOR 2Q FY10:

- In 2Q FY10, Bharti Airtel's revenue increased 16% to INR103.6 billion led by 82% contribution from mobile services. The company improved its revenue share by 90 basis points QoQ to 32.7%.
- EBIDTA rose 17.6% to INR42 billion. Although network operating cost increased to 21% of revenue in 2Q FY10 from 16.1% in 2Q FY09, reduction in access charges offset the increase. This was mainly due to higher on-network calls and shift from voice to data in the telemedia segment, which led to lower access charges. This along with other cost reduction initiatives helped the company achieve its 40% EBIDTA guidance
- Net profit grew 35.1% in 2Q FY10 to INR26,542 million. Net profit margin was 22%.
- Management has maintained its capex guidance of \$2.2 billion in FY10, excluding 3G. For towercos, the management has planned capex of \$700 mn, including capex for Bharti Infratel and Bharti's share of capex for Indus.

Valuation and recommendation

We expect price wars to become more intense with incumbents launching competitive tariff plans. Along with declining MOU elasticity, these price wars have the potential to impact top line of the operators. Further, the impact of tariff cuts is uncertain and will be visible only in 3QFY10. Many new players are expected to launch services in the near term. With mobile number portability being implemented as the same time, this would increase uncertainty in the sector. Therefore we are cautious on the telecom sector and we expect near-term volatility in stock prices. However we believe Bharti Airtel is fundamentally strong and is well positioned to sustain in this competitive environment. We maintain our positive outlook on the

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stock from a long-term perspective. Even after a 7-15% fall in ARPU, Bharti trades at a forward PE of 11X its FY11E EPS, which is not expensive in our view. We change our recommendation from “BUY” to “BUY at DECLINES” for a target price of INR321.

Segmental Analysis

MOBILE SEGMENT

- The mobile services segment was the major revenue contributor with 82% share.
- Of the 110 million mobile customers, pre-paid customers accounted for 95.2% and post-paid customers accounted for the remaining 4.8%.
- Bharti Airtel covers ~83% of the population as of September 2009.
- Heightened competition has led to 9% decline in ARPU's to INR252.
- MOU has declined significantly by 14% YoY and 6% sequentially. Bharti Airtel has experienced such a significant fall in the MOU for the first time. Multiple SIM, low rural usage, and the second quarter being the weakest quarter are some of the major factors responsible for the drop in MOU.
- Revenue per minute declined 10.4% YoY to INR0.56 in 2QFY10 vis-à-vis INR0.63 in 2QFY09 .Consequently, the mobile segment's revenue increased 11.2% to INR80, 994 million, as against INR72, 843 million in 2Q FY09.

Sequentially, mobile revenue declined 1.6%. The mobile segment's EBIDTA margin however improved to 31.9% in 2Q FY10 vs. 30.2% in 2Q FY09.

Mobile Segment – Performance					INR Mn	
	2Q FY10	2Q FY09	Y-o-Y Chg %	FY10E#	FY11E#	
Subscriber Base (Nos)	110.5	77.5	42.6	118.0	138.4	
Net Revenue	80994	72843	11.2	327780	358500	
*ARPU	252	331		231	216	
EBITDA	25860	22009	17.5	104234	112569	
EBITDA Margin	31.9%	30.2%		31.8%	31.4%	

Source: Company and ACMIL estimates.

#Revised estimates

***ARPU: Average revenue per user per month (net revenue / number of subscribers/12).**

TELEMEDIA SEGMENT (broadband and fixed line)

- During 2Q FY10, the telemedia segment's revenue was flat at INR8,544 million. This was primarily because the fixed line business, a major revenue contributor of the segment, faced pricing pressure.
- EBITDA declined marginally by 0.8% to INR3,667 million. EBITDA margin declined to 42.9% as of Sept 2009 from 43.6% as of Sept 2008.

Telemedia Segment – Performance					INR Mn	
	2Q FY10	2Q FY09	Y-o-Y Chg %	FY10E#	FY11E#	
Net Revenue	8544	8486	0.7%	35311	40184	
EBITDA	3667	3696	-0.8%	14654	16877	
EBITDA Margin	42.9%	43.6%		41.5%	42.0%	

Source: Company and ACMIL estimates.
#Revised estimates

ENTERPRISE SEGMENT

- The enterprise business segment declined 2.5% to INR21,331 million in 2Q FY10. The enterprise corporate segment also faced pricing pressure during the quarter. The wholesale voice business suffered due to reduction in access charges.
- EBITDA margin improved to 51.7% mainly due to phasing out of ADC and reduction in termination charges.

Enterprise Segment – Performance					INR Mn	
	2Q FY10	2Q FY09	Y-o-Y Chg %	FY10E	FY11E	
Net Revenue	21331	21874	-2.5%	96158	107734	
EBITDA	11023	9369	17.7%	45446	50118	
EBITDA Margin	51.7%	42.8%		47.3%	46.5%	

Source: Company and ACMIL estimates.

PASSIVE INFRASTRUCTURE SERVICES SEGMENT

- As of end-June, Bharti Airtel had 29,112 towers in 11 circles. Sharing factor for the quarter ended September 2009 was 1.49x.
- This segment recorded revenue of INR8,586 million and its EBITDA margin was 46.8%. Increase in sharing factor and sharing revenue led to improving margins for the passive infrastructure segment.

Passive Infrastructure Services Segment			INR Mn	
	2Q FY10	FY10E	FY11E	
Net Revenue	8586	19741	34530	
EBITDA	4020	8192	14192	
EBITDA Margin	46.8%	41.5%	41.1%	

Source: Company and ACMIL estimates.

Revision in estimates

- During the quarter, subscriber base continued to grow at a strong pace with Bharti Airtel adding 8.1 million subscribers. We expect the growth momentum to continue. Factoring in Bharti Airtel's net adds, we have raised our FY11 subscriber base projections marginally. We believe that as the company further penetrates the rural areas, it would be able to garner subscribers at a higher pace.

In Mn	FY11		
	Original Estimates	Revised Estimates	% Change
Subscribers	135.4	138.4	2.2%

Source: ACMIIL estimates.

- Further, given the magnitude of the ongoing price wars, Bharti has also introduced competitive tariff plans recently. We believe that these tariff structures will result in steeper decline in ARPUs. We therefore factor in ARPU decline in of 7–15% for FY10E and FY11E. Due to revision in our ARPU estimates, we expect Bharti Airtel's mobile business to register single-digit growth for FY10 and FY11.
- Due to pricing pressure in the fixed line business, we have also revised our Telemedia segment projections downwards.
- We expect pressure on the topline to impact margins. We expect EBIDTA margins to decline to 39.9% in FY10E and to 39.6% in FY11E.
- In line with 1HFY10 results, we have lowered our interest cost estimates.

Our revised estimates are as follows:

Particulars	FY10			FY11		
	Original Estimates	Revised Estimates	% Change	Original Estimates	Revised Estimates	% Change
Revenues	436430.5	428850.4	-1.7	488328.3	484800.3	-0.7
EBITDA	175776.9	171095.7	-2.7	192259.1	192130.2	-0.1
Net Profit	90610.1	87644.3	-3.3	102601.7	100458.7	-2.1
EBITDA Margin	40.3%	39.9%	-0.4	39.4%	39.6%	0.3
NPM	20.8%	20.4%	-0.3	21.0%	20.7%	-0.3
EPS	23.9	23.1	-3.3	27.0	26.5	-2.1

Source: ACMIIL estimates.

Outlook on Bharti Airtel

□ **Talks with MTN have failed.**

After negotiation of more than four months and two deadline extensions, the proposed \$23-billion cash-and-share-swap deal between Bharti Airtel and South Africa's MTN has been called off. The Bharti Airtel management has indicated that the reason for the deal not going through was the inability of the South African government to "accept the deal in the current form".

The deal, had it happened, would have given Bharti Airtel access to the fast-growing African market. With the Indian market saturating, as visible in declining ARPU and MOU, the pace of growth has slowed down for Bharti Airtel. Given a mature urban market, future growth for Bharti Airtel is expected to come from higher penetration into rural areas. In such a scenario, a merger with MTN would have enabled Bharti Airtel to address these concerns.

□ **Competitive pressures building up**

Pricing pressures are mounting with new players such as Tata DoCoMo and Aircel offering per second billing tariff plans.

RCom also has launched a 50 paise tariff plan for its users across the board. Bharti Airtel has also launched similar plans. However the company's plans differ from that of RCom because they are applicable only for on-network calls.

The Telecom Regulatory Authority of India (TRAI) is also planning to make the one-second pulse a mandatory tariff option for all operators to bring in transparency into the tariff plans. Although this is beneficial for the subscribers, such a ruling may hurt ARPUs of incumbent operators. Moreover, an increase in MOU cannot offset the ARPU decline and would therefore impact margins of telecom operators.

Mobile number portability coming into force from Jan 1 would aggravate competitive intensity. With aggressive price war and declining MOU elasticity, we believe the ARPU and margins will come under pressure in the near term.

HOWEVER.....

We believe that Bharti Airtel's cash outlook is strong and the balance sheet reflects strength. The management has indicated that it would continue to scout for inorganic growth opportunities. Furthermore, with strong subscriber adds each month, the company has maintained its leadership position in this competitive environment.

Bharti Airtel is well positioned with a strong balance sheet for the 3G auctions. We believe that the company will be in a position to profit from the first-mover advantage. The increase in data revenue from 3G will to some extent be offset the saturation in voice market.

However, we expect price wars to get aggressive with incumbents also launching competitive tariff plans. These price wars, along with declining MOU elasticity, have the potential to impact topline of the operators. Further, the impact of tariffs cuts is uncertain and will be visible only in 3QFY10. Many new players are expected to launch services in the near term; with mobile number portability being implemented as the same time, this increases uncertainty in the sector. Therefore, we are cautious on the telecom sector and we expect near-term volatility in stock prices. However we believe Bharti Airtel is fundamentally strong and is well positioned to sustain in this competitive environment. We maintain our positive outlook on the stock from a long-term perspective. Even after a 7–15% fall in ARPU, Bharti trades at a forward PE of 11X its FY 11 EPS, which is not expensive in our view. We change our recommendation from “BUY” to “BUY at DECLINES” for a target price of INR321.

Assumptions	
Risk Free rate	8%
Beta	0.9
Risk Premium	6%
Cost of equity	13.2%
Cost of Debt	9.0%
Terminal growth rate	3%
WACC	11.5%

INR Mn	Mar-10	Mar-11	Mar-12	Mar-13	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19
EBITDA	171,096	192,130	212,942	231,915	241,829	251,862	263,623	271,029	294,101	302,293
Tax	12,434	14,814	18,100	21,336	24,425	31,986	39,807	48,243	59,997	68,016
Capex	150,500	125,500	62,500	59,500	55,100	49,200	47,500	49,200	47,500	45,501
Change in NWC	5,765	-4,044	15,332	18,553	19,830	22,164	24,253	26,290	29,410	30,229
FCF	2,397	55,860	117,010	132,525	142,474	148,511	152,062	147,296	157,194	158,547

Source: ACMIIL estimates

Valuations	Amount (INR Mn)
PV of cash flows	622,357
PV of terminal value	647,190
Value	1,269,547
Net Debt (loan funds-Cash balance)	52,104
Value of Equity	1,217,444
No of Shares	3,796
Fair Value (INR per share)	321

Source: ACMIIL estimates.

Interim Results						INR Mn
Particulars	2QFY10	2QFY09	% Growth	1HFY10	1HFY09	% Growth
Net Sales	103,551.6	89,235.7	16.0	207851	174295.7	19.3
Total Expenditure	61,325.2	53,284.4		123315.8	103659.2	
Operating Profits	42,226.4	35,951.3	17.5	84,535.2	70,636.5	19.7
Other Income	379.0	291.6		566.5	907.4	
EBDIT	42,605.4	36,242.9	17.6	85,101.7	71,543.9	19.0
Depreciation	14,996.8	11,021.8		29368.6	20993.4	
EBIT	27,608.6	25,221.1		55,733.1	50,550.5	
Interest	1,591.0	10,995.6		-1964.4	10050.3	
Share of loss/gain in associate	6.1	0.0		6.1	0	
PBT	26,011.5	14,225.5		57,691.4	40,500.2	
Taxes	2,960.8	-2,921.1		7689.8	1253.6	
Profit before Minority Interest	23,050.7	17,146.6		50,001.6	39,246.6	
Minority Interest	509.0	465.3		980.4	898.5	
Net Profit	22,541.7	16,681.3	35.1	49,021.2	38,348.1	27.8
Equity Share Capital	18,983.7	12,980.2		18982.4	18979.1	
EPS	7.0	8.3		20.7	16.8	
CEPS	10.8	12.2		33.0	26.3	
Profitability Ratios						
Operating Profit Margin (%)	40.6	40.8		40.1	41.3	
EBIDT Margin (%)	40.7	41.5		40.5	42.3	
PAT Margin (%)	25.4	25.5		21.0	23.7	

Source: Company.

#FY08 and FY09 numbers adjusted for Split in face value of shares

Earnings Summary				INR Mn
Particulars	FY08	FY09	FY10E	FY11E
Net Sales	270,122.4	373,520.8	428,850.4	484,800.3
Total Expenditure	158,610.2	223,794.0	259,255.7	294,609.3
Operating Profits	111,512.2	149,726.8	169,594.7	190,191.0
Other income	2,796.1	1,523.8	1,501.0	1,939.2
EBDIT	114,308.3	151,250.6	171,095.7	192,130.2
Depreciation	35,914.1	46,727.7	58,625.9	62,239.5
EBIT	78,394.2	104,522.9	112,469.8	129,890.7
Interest	5,278.7	18,612.8	6,432.8	8,726.4
PBT	73,115.5	85,910.1	106,037.1	121,164.3
Taxes	8,161.5	5,468.3	16,145.4	18,129.8
Profit after tax	64,954.0	80,441.8	89,891.6	103,034.5
Minority Interest	1,000.2	1,852.3	2,247.3	2,575.9
Net Profits	63,953.8	78,589.5	87,644.3	100,458.7
Growth in sales (%)	45.8%	38.3%	14.8%	13.0%
Operating Profits Growth (%)	47.8%	34.3%	13.3%	12.1%
PAT Growth (%)	57.4%	22.9%	11.5%	14.6%
Operating Profit Margin (%)	41.3%	40.1%	39.5%	39.2%
Net Profit Margin (%)	23.7%	21.0%	20.4%	20.7%

Source: Company reports and ACMIIL estimates.

Sources and Application of Funds				
Particulars	FY08	FY09	FY10E	INR Mn FY11E
Sources of Funds				
Share Capital	18,979.1	18,982.4	18,982.4	18,982.4
Reserves and Surplus	198,264.7	272,296.8	359,941.2	460,399.8
Outstanding Stock Options	217,243.8	291,279.2	378,923.6	479,382.2
Total Shareholders Funds	96,017.5	135,171.5	153,671.5	138,671.5
Total Loan Funds	10,142.2	12,297.5	14,544.8	17,120.7
Net Deferred Tax Liability	2,729.1	-293.0	3,418.3	6,734.3
Total Capital Employed	326,132.7	438,455.3	550,558.2	641,908.7
Application of Funds				
Gross Block	423,224.1	586,616.1	737,116.1	862,616.1
Less: Accumulated Depreciation	97,729.7	147,129.6	205,755.5	267,995.0
Net Block	325,494.5	439,486.4	531,360.5	594,621.0
Capital Work in Progress	35,699.6	41,436.5	48,357.7	53,116.0
Investments	48,097.1	38,104.7	38,104.7	38,104.7
Net Current Assets	-83,160.4	-80,573.2	-67,264.8	-43,933.1
Misc Expenses	2.0	0.9	0.0	0.0
Total Assets	326,132.7	438,455.3	550,558.2	641,908.7
<i>Source: Company reports and ACMIL estimates.</i>				

Cash Flow Statement				
Particulars	FY08	FY09	FY10E	INR Mn FY11E
Pre tax profits	73115.5	85910.1	106037.1	121164.3
Operating Profit before WC changes	118174.4	157333.6	171559.9	190273.9
Cash from Operations	123244.0	137115.6	164890.6	171416.1
Cash from Investment activities	-184826.9	-151753.7	-150500.0	-125500.0
Cash from Finance	59987.4	20648.5	12067.2	-23726.4
Total cash generated	-1595.5	6010.4	26457.9	22189.7
Cash at the beginning	8520.8	7034.1	13044.5	39502.4
Add: Cash acquired on acquisition of networki2i	108.8	0.0	0.0	0.0
Cash Balance	7034.1	13044.5	39502.4	61692.1
<i>Source: Company reports and ACMIL estimates.</i>				

Key Ratios				
Particulars	FY08	FY09	FY10E	FY11E
Profitability Ratios				
Operating Profit Margin (%)	41.3	40.1	39.5	39.2
EBIDTA Margin (%)	42.3	40.5	39.9	39.6
PAT Margin (%)	24.0	21.0	20.4	20.7
RONW (%)	38.5	30.9	26.2	23.4
ROCE (%)	20.9	19.0	16.3	16.0
Per Share Ratios #				
Earnings (INR.)	16.8	20.7	23.1	26.5
Cash Earnings (INR.)	32.3	41.3	49.3	55.4
Book Value (INR.)	57.1	76.4	99.4	125.9
Valuation Ratios				
P/E (x)	-	-	13.9	12.1
Cash P/E (x)	-	-	6.5	5.8
P/BV (x)	-	-	3.2	2.5
Capital Structure Ratios				
Debt/Equity	0.4	0.5	0.4	0.3
Current Ratio	0.4	0.6	0.7	0.8
Turnover Ratios				
Debtors Turnover (x)	12.8	13.0	14.0	14.1
Fixed Asset Turnover (x)	0.8	0.8	0.8	0.8

Source: Company reports and ACMIIL estimates.

#FY08 and FY09 numbers adjusted for Split in face value of shares.

Notes

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