

Bharti Airtel

Q3FY10 Update

25 January 2009

Buy

Target Price: Rs400

CMP: Rs321*

Upside: 25%

*as on 22 January 2010

Return of minutes growth

Bharti's Q3 performance remained flat due to fall in RPM by 7.8% QoQ to 52p. However, mobile minutes registered growth of 6.7% to Rs153bn on the back of elasticity from lower tariffs. Reiterate Buy on the stock with target price of Rs400/sh.

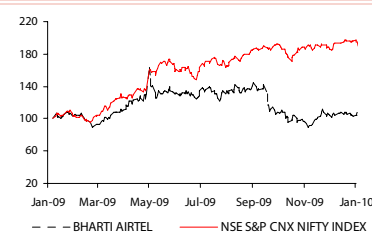
- **Revenue flat on improvement in minutes growth:** Bharti's Q3 performance remained flat due to fall in RPM by 7.8% QoQ to 52p. However, mobile minutes registered growth of 6.7% to Rs153bn on the back of elasticity from lower tariffs. Revenue declined 0.7% QoQ and grew 1.4% YoY to Rs97.7bn.
- **Margins depressed:** EBITDA fell 6% QoQ to Rs39bn. EBITDA margin contracted 204bp QoQ to 40.0% on the back of increase in network and SG&A expenses. We expect Q4 revenue to remain subdued, as RPM has not yet bottomed.
- **Passive infrastructure revenue surges:** Revenue in passive infrastructure grew 8% QoQ owing to increase in tenancy from 1.49 in Q2FY10 to 1.57 in Q3FY10. Growth momentum in the passive infrastructure segment will likely continue on the back of new launches.
- **Reiterate Buy:** At CMP, the stock trades at 12.1x FY11E EPS and 6.8x FY11E EV/EBITDA. Reiterate Buy on the stock with target price of Rs400/sh.

Key Data

Bloomberg Code	BHARTI IN
Reuters Code	BRTI.BO
Current Shares O/S (mn)	3,796.8
Diluted Shares O/S(mn)	3,800.9
Mkt Cap (Rsbn/USDbn)	1,223.2/26.5
52 Wk H / L (Rs)	518/230
Daily Vol. (3M NSE Avg.)	8,674,952
Face Value (Rs)	5

1 USD = Rs46.2

One year Indexed Stock Performance



Price Performance (%)

	1M	6M	1Yr
Bharti	0.3	(22.6)	5.1
NIFTY	(2.7)	10.2	88.0

Source: Bloomberg, Centrum Research
*as on 22 January 2010

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Y/E March (Rsmn)	Q3FY10	Q3FY09	YoY (%)	Q2FY10	QoQ (%)
Net sales	97,723	96,334	1.4	98,455	(0.7)
Access charges	11,166	13,426		10,699	
% of sales	11.4	13.9		10.9	
License fees and spectrum charges	9,935	10,030		10,222	
% of sales	10.2	10.4		10.4	
Network operations cost	19,813	15,734		18,638	
% of sales	20.3	16.3		18.9	
SGA, employee cost and other exp	17,696	17,694		17,480	
% of sales	18.1	18.4		17.8	
Operating profit	39,113	39,450	(0.9)	41,416	(5.6)
OPM (%)	40.0	41.0	(93) bp	42.1	(204) bp
Depreciation and amortisation	15,403	12,702		14,796	
Interest	579	973		734	
EBT	23,131	25,775		25,886	
Other income	2,527	(695)		712	
Share of profits(losses) in joint ventures	58	(451)		(8)	
PBT	25,716	24,629	4.4	26,590	(3.3)
Provision for tax	3,192	2,558		2,873	
-effective tax rate	12.4	10.4		10.8	
Minority interest	426	478		506	
PAT (reported)	22,524	21,593		23,211	
Exceptional item (adj-post tax)	981	(1,466)		(448)	
PAT (adjusted)	21,543	23,059	(6.6)	23,658	(8.9)
NPM (%)	22.0	23.9	(189) bp	24	(198) bp

Source: Company, Centrum Research Estimates

Y/E March (Rsmn)	Revenue	YoY (%)	EBITDA	EBITDA (%)	Adjust. PAT	YoY (%)	Fully DEPS	RoE (%)	RoCE (%)	P/E (x)	EV/EBITDA (x)
FY07	185,196	59.4	74,508	40.2	42,572	88.6	11.2	37.4	27.3	28.6	17.0
FY08	270,250	45.9	113,715	42.1	66,299	55.7	17.5	37.3	27.2	18.4	11.2
FY09	369,616	36.8	151,678	41.0	92,571	39.6	24.4	35.5	25.8	13.2	8.6
FY10E	402,391	8.9	167,003	41.5	93,091	0.6	24.5	26.8	20.7	13.1	7.4
FY11E	438,150	8.9	174,590	39.8	100,806	8.3	26.5	23.0	18.8	12.1	6.8

Source: Company, Centrum Research Estimates

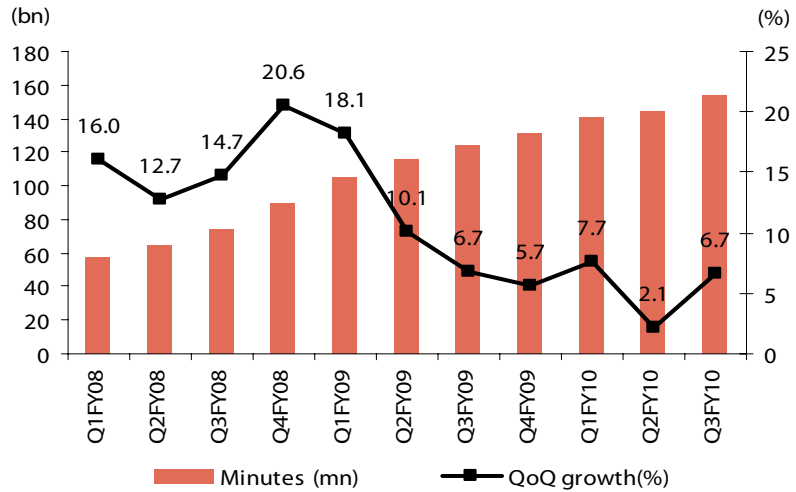
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Minutes growth improved due to lower base effect & elasticity from lower tariffs

Bharti reported flat Q3, due to fall in RPM to 52p (7.8% QoQ decline). Minutes on mobile network registered healthy 6.7% QoQ growth to Rs153bn due to lower minutes base in Q2FY10 (minutes grew 2.1% in Q2FY10) and elasticity from fall in tariffs.

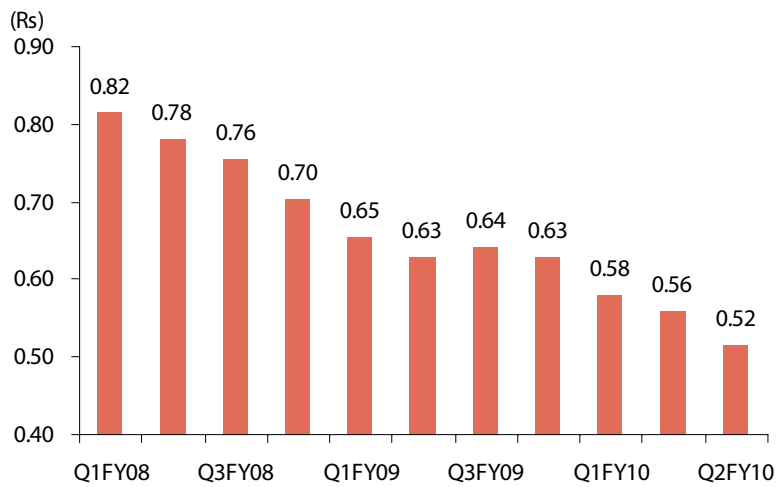
Bharti witnessed the return of minute growth due to the various schemes launched by the company (Airtel Advantage scheme, per second plan and reduction in roaming tariffs). We believe Q4 revenue performance will remain subdued on the back of fall in RPM & lower minutes growth due to new launches by Uninor, Etislate & STele.

Exhibit 1: Minutes growth improved during Q3



Source: Company, Centrum Research

Exhibit 2: RPM will continue to fall on price war



Source: Company, Centrum Research

Exhibit 3: Bharti's total minutes profile

Segmental minutes (mn)	Q3FY09	Q4FY09	Q1FY10	Q2FY10	Q3FY10	Remarks
Mobile Services	123,626	130,669	140,713	143,680	153,241	
QoQ (%)		5.7	7.7	2.1	6.7	Growth in mobile minutes accounted by lower minutes base in Q2FY10 and elasticity from fall in tariffs.
Broadband & Tele. Serv.	4,750	4,737	4,746	4,796	4,576	
QoQ (%)		(0.3)	0.2	1.0	(4.6)	Minutes growth from fixed line subs continue to decline
NLD Serv.	11,609	11,690	11,781	12,417	13,944	
QoQ (%)		0.7	0.8	5.4	12.3	NLD minutes continue to grow due to elasticity from fall in STD tariffs.
ILD Serv.	2,603	2,772	2,869	3,181	3,100	
QoQ (%)		6.5	3.5	10.9	(2.6)	
Total Minutes	142,588	149,867	160,109	164,073	174,861	
QoQ (%)		5.1	6.8	2.5	6.6	

Source: Company, Centrum Research

Revenue growth muted across segments with the exception of tower business

Q3 revenue fell 0.7% QoQ and 1.4% YoY to Rs97.7bn and EBITDA margin at 40.2% fell 200bp QoQ. The tower segment registered 8% QoQ revenue growth owing to increase in tenancy from 1.49 in Q2FY10 to 1.57 in Q3FY10. We expect growth momentum in this segment to continue on the back of new launches.

Revenue in the mobile services segment declined 1.7% QoQ and EBITDA fell 6.5% QoQ to Rs24bn owing to fall in RPM.

Exhibit 4: Revenue growth muted across segments with the exception of tower business

	Q2FY08	Q3FY08	Q4FY08	Q1FY09	Q2FY09	Q3FY09	Q4FY09	Q1FY10	Q2FY10	Q3FY10	QoQ (%)	YoY (%)
Mobile services												
Revenue	50,579	56,105	64,201	69,150	72,843	79,392	82,216	82,285	80,994	79,618	(1.7)	0.3
EBITDA	20,728	22,887	22,779	21,218	22,009	24,963	25,860	27,183	25,860	24,178	(6.5)	(3.1)
EBITDA margin (%)	41.0	40.8	35.5	30.7	30.2	31.4	31.5	33.0	31.9	30.4		
Telemedia												
Revenue	7,023	7,307	7,641	7,988	8,486	8,458	8,585	8,550	8,544	8,550	0.1	1.1
EBITDA	2,790	3,173	3,344	3,367	3,696	3,531	3,614	3,463	3,667	3,944	7.6	11.7
EBITDA margin (%)	39.7	43.4	43.8	42.2	43.6	41.7	42.1	40.5	42.9	46.1		
Enterprise Segment												
Revenue				19,572	21,874	21,808	21,628	21,333	21,331	20,546	(3.7)	(5.8)
EBITDA				8,655	9,369	9,799	9,920	10,468	11,023	10,035	(9.0)	2.4
EBITDA margin (%)				44.2	42.8	44.9	45.9	49.1	51.7	48.8		
Passive infrastructure												
Revenue			6,023	10,563	11,983	12,702	7,241	8,020	8,586	9,267	7.9	(27.0)
EBITDA			2,236	3,870	3,991	4,258	2,903	3,557	4,020	4,269		
EBITDA margin (%)			37.1	36.6	33.3	33.5	40.1	44.4	46.8	46.1		

Source: Company, Centrum Research

Telemedia segment reported flat revenues during the quarter but the exception of 3.2% QoQ improvement in EBITDA margin owing to improving costs by the outsourcing model (deal with Alcatel-Lucent)

The enterprise segment registered 3.7% QoQ and 5.8% YoY decline in growth. We observe continued growth in NLD minutes (12.3% QoQ) owing to elasticity from fall in STD tariffs.

Exhibit 5: Key performance indicators

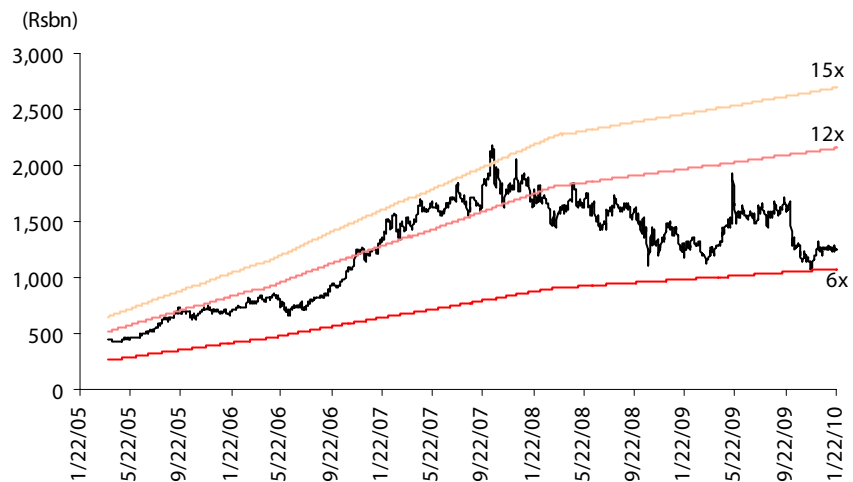
	Q1FY09	Q2FY09	Q3FY09	Q4FY09	Q1FY10	Q2FY10	Q3FY10	QoQ (%)	YoY (%)	Remarks
Mobile Segment										
Mobile subs ('000)	69,384	77,479	85,651	93,923	102,368	110,511	118,864	7.6	38.8	Management indicated 80% of total subs are revenue earning customers (REC)
Net adds ('000)	7,399	8,095	8,172	8,273	8,445	8,144	8,353			
Mobile market share (%)	24.2	24.6	24.7	24.0	24.0	23.5	22.7	-78 bp	-202 bp	
Prepaid subs (% of total subs)	92.3	92.9	93.5	94.2	94.7	95.2	95.3			
Prepaid subs (% of net adds)	97.9	98.4	99.6	100.8	101.1	100.4	97.5			
Blended churn rate (%)	3.7	3.2	2.8	3.2	3.4	4.4	6.3	183 bp	343 bp	Churn in pre-paid segment surged from 4.4% in Q2FY10 to 6.3% in Q3FY10 shows impact of ban on prepaid SIM in J&K.
ARPU (Rs)	350	331	324	305	278	252	230	(8.6)	(29.0)	
MoU	534	526	505	485	478	450	446	(0.9)	(11.8)	MOU growth remain flat due to 6.7% minutes growth on back of elasticity from lower tariffs
Revenue per minute (Rs)	0.65	0.63	0.64	0.63	0.58	0.56	0.52	(7.8)	(19.5)	RPM decline due to launch of new schemes with lower tariffs
EBITDA per minute (Rs)	0.20	0.19	0.20	0.20	0.19	0.18	0.16	(12.2)	(23.2)	
Telemedia Segment										
Subscribers ('000)	2,394	2,509	2,619	2,726	2,828	2,928	2,989	2.1	14.1	
Include broadband subs ('000)	853	921	993	1,071	1,140	1,186	1,240	4.6	24.9	
ARPU (Rs)	1,138	1,147	1,098	1,071	1,027	989	964	(2.6)	(12.2)	ARPU continue to fall during the quarter

Source: Company, Centrum Research

Valuations remain attractive

At CMP, the stock trades at 12.1x FY11E EPS and 6.8x FY11E EV/EBITDA. We reiterate Buy on the stock with target price of Rs400/sh. Bharti is best positioned in the sector to withstand competitive pressures, owing to its scale and low leverage.

Exhibit 6: Bharti's forward EV/EBITDA



Source: Bloomberg, Centrum Research

Key catalysts for company are: (a) Higher-than-expected minutes growth, (b) Consolidation in the industry, (c) Higher-than-expected rural growth, (d) Increase in contribution from value-added-services (VAS) and (e) Higher-than-expected tenancy in Bharti Infratel and Indus Towers.

Key risks: (a) Regulatory risk surrounding 2G spectrum/other events and (b) overbidding for 3G spectrum.

Financials

Exhibit 7: Income Statement

Y/E March (Rsmn)	FY07	FY08	FY09	FY10E	FY11E
Revenue	185,196	270,250	369,616	402,391	438,150
YoY growth (%)	59.4	45.9	36.8	8.9	8.9
Access charges	31,378	41,110	52,903	45,574	51,550
% of Sales	16.9	15.2	14.3	11.3	11.8
License and spectrum charges	16,953	26,900	38,266	41,331	45,405
% of Sales	9.2	10.0	10.4	10.3	10.4
Network operations cost	21,100	33,002	59,355	74,304	89,387
% of Sales	11.4	12.2	16.1	18.5	20.4
Personnel expenses	12,488	14,768	16,992	18,654	20,597
% of Sales	6.7	5.5	4.6	4.6	4.7
Marketing, Distribution, Admin	28,770	40,755	50,421	55,524	56,621
% of Sales	15.5	15.1	13.6	13.8	12.9
EBITDA	74,508	113,715	151,678	167,003	174,590
EBITDA Margin	40.2	42.1	41.0	41.5	39.8
Depreciation	25,208	37,261	47,581	59,977	60,533
PBIT	49,300	76,454	104,097	107,026	114,057
Interest expenses	3,044	3,240	3,479	4,386	4,473
Share of profits / (losses) in joint ventures and associates	(2)	(1)	(713)	(733)	3,036
PBT from operations	46,253	73,213	99,905	101,908	112,619
Other non operating income	2,607	2,527	(6,832)	5,705	9,555
PBT before extra-ordinary items	48,860	75,740	93,073	107,613	122,174
PBT	48,860	76,535	93,073	107,613	122,174
Provision for tax	5,822	8,378	6,615	13,206	19,361
Effective tax rate	11.9	10.9	7.1	12.3	15.8
Minority Interest	467	1,150	1,759	1,316	2,006
PAT	42,572	67,007	84,699	93,091	100,806
PAT (adjusted)	42,572	66,299	92,571	93,091	100,806
YoY growth (%)	88.6	55.7	39.6	0.6	8.3
PAT margin	23.0	24.5	25.0	23.1	23.0

Source: Company, Centrum Research Estimates

Exhibit 8 Balance Sheet

Y/E March (Rsmn)	FY07	FY08	FY09	FY10E	FY11E
Share Capital	18,959	18,979	18,982	18,990	19,005
Reserves	116,594	198,063	284,963	372,485	467,603
Net worth	135,553	217,042	303,945	391,474	486,607
Debt	52,461	97,063	118,800	115,668	116,312
Minority Interest	1,801	8,556	10,704	12,020	14,026
Deferred Tax Liability	2,432	2,531	(1,254)	(1,254)	(1,254)
Total Capital Employed	192,247	325,192	432,195	517,908	615,691
Gross Block	268,093	396,261	537,521	619,479	605,087
Accumulated depreciation	68,392	105,653	150,214	210,191	256,520
Net Block	199,701	290,608	387,307	409,287	348,567
Capital WIP	25,018	36,003	35,138	16,981	10,247
Total Fixed Assets	224,719	326,611	422,445	426,269	358,814
Goodwill	23,684	27,043	27,054	27,054	27,054
Investments (strategic)	182	108	128	860	77,357
Investments (marketable securities)	2,504	48,086	37,925	87,925	147,925
Inventories	912	1,142	963	975	947
Debtors	13,093	15,986	18,262	17,188	19,028
Cash and cash equivalent	7,651	6,920	11,241	14,503	20,908
Loans and Advances	14,440	23,868	45,078	47,420	50,871
Other current asset	4,890	12,076	21,811	21,657	23,671
Total current assets	40,985	59,992	97,355	101,743	115,425
Current liabilities and provisions	94,981	131,795	152,377	126,210	111,611
Net current assets	(53,996)	(71,803)	(55,023)	(24,467)	3,814
Other non-current assets	3,887	5,041	10,230	11,253	12,153
Other non-current liabilities	8,733	9,894	10,565	10,987	11,427
Miscellaneous expenditure	-	-	-	-	-
Total Assets	192,247	325,192	432,195	517,908	615,691

Source: Company, Centrum Research Estimates

Exhibit 9: Cash flow

Y/E March (Rsmn)	FY07	FY08	FY09	FY10E	FY11E
Cash flow from operating					
Profit before tax	48,393	75,385	91,314	106,297	120,168
Depreciation	25,492	37,261	46,684	59,977	60,533
Other	3,057	7,543	7,645	(4,389)	(7,548)
Interest expenses	3,044	3,240	3,479	4,386	4,473
Cash before WC change	79,986	123,429	149,122	166,270	177,626
Working capital adjustment	(571)	4,763	(11,431)	(9,058)	(2,399)
Gross cash flow from op.	79,415	128,192	137,691	157,213	175,227
Direct taxes paid	5,822	8,378	6,615	13,206	19,361
Cash from operations	73,593	119,814	131,076	144,007	155,865
Cash flow from investing					
Capex	(73,639)	(138,352)	(144,313)	(82,637)	(86,476)
Investments & income for investments	850	(45,582)	13,854	(44,295)	(50,445)
Cash flow from investing	(72,788)	(183,934)	(130,459)	(126,932)	(136,922)
Cash flow from financing					
Proceeds from share capital & premium	110	21,237	198	7	15
Borrowings/ (Repayments)	7,090	45,437	7,031	(3,133)	644
Interest paid	(3,190)	(3,240)	(3,479)	(4,386)	(4,473)
Dividend paid	-	-	-	-	-
Cash flow from financing	4,010	63,434	3,751	(7,511)	(3,815)
Net cash increase/ (decrease)	4,814	(686)	4,368	9,564	15,129
Free cash flow to firm (FCFF)	(4,379)	(25,286)	(20,561)	66,540	78,217
FCFF per share	(1.2)	(6.7)	(5.4)	17.5	20.6

Source: Company, Centrum Research Estimates

Exhibit 10: Key Ratios

Y/E March	FY07	FY08	FY09	FY10E	FY11E
Margin Ratios (%)					
EBITDA Margin	40.2	42.1	41.0	41.5	39.8
PBIT Margin	26.6	28.3	28.2	26.6	26.0
PBT Margin	26.4	28.0	25.2	26.7	27.9
PAT Margin	23.0	24.5	25.0	23.1	23.0
Return Ratios (%)					
ROCE	27.3	27.2	25.8	20.7	18.8
ROIC	27.3	30.1	29.4	23.4	22.9
ROE	37.4	37.3	35.5	26.8	23.0
Turnover Ratios					
Assets Turover Ratio (x)	1.11	1.05	0.98	0.85	0.78
Working capital cycle (days)	(128.9)	(110.4)	(78.5)	(43.9)	(41.0)
Average collection period (days)	63.9	70.1	84.1	78.2	77.9
Average payment period (days)	194.6	182.1	163.5	123.0	119.7
Inventory holding (days)	1.8	1.5	1.0	0.9	0.8
Per share (Rs)					
Basic EPS	11.2	17.7	24.4	24.5	26.6
Fully diluted EPS	11.2	17.5	24.4	24.5	26.5
CEPS	17.9	27.3	36.9	40.3	42.4
Book Value	35.7	57.2	80.1	103.1	128.0
Solvency ratios					
Debt/ Equity	0.4	0.5	0.4	0.3	0.2
Interest Coverage	16.2	23.6	29.9	24.4	25.5
Valuation parameters (x)					
P/E	28.6	18.4	13.2	13.1	12.1
P/BV	9.0	5.6	4.0	3.1	2.5
EV/ EBITDA	17.0	11.2	8.6	7.4	6.8
EV/ Sales	6.8	4.7	3.5	3.1	2.7
M-Cap/ Sales	6.6	4.5	3.3	3.0	2.8

Source: Company, Centrum Research Estimates

Appendix A

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