June 23, 2009

Morning Note

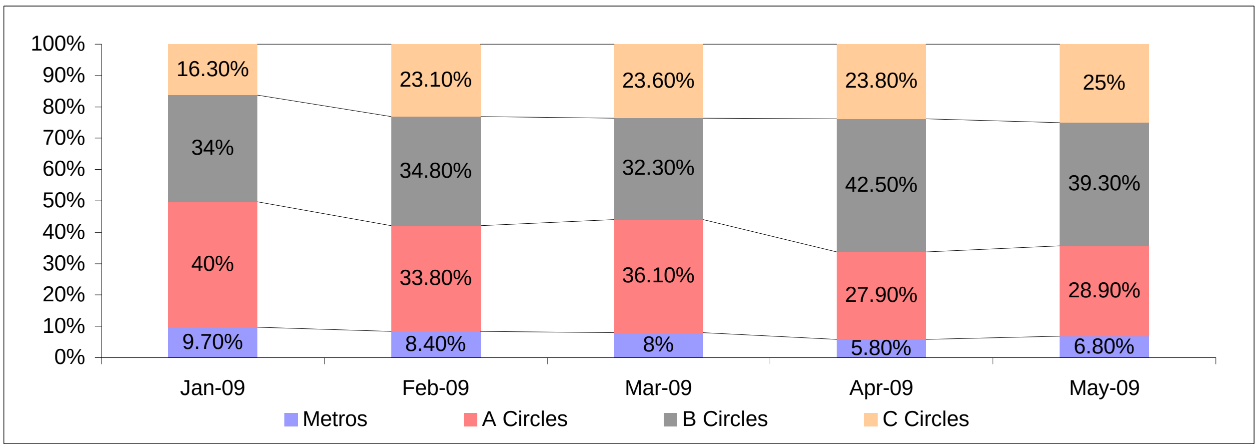
CMP (Rs): 792
Mkt Cap (Rs Bn):1,502
Mkt Cap ($ Mn): 31.02

FOCUS OF THE DAY: BHARTI AIRTEL LTD. (Bharti)

Bounce back in net subscriber addition improves outlook

After slipping to second position in monthly net subscriber additions behind Vodafone in March, Bharti has recorded its highest ever net subscriber addition of ~ 2.8 mn in April and May each against our expectation of 2.3 mn per month. In spite of attractive launches by Vodafone, expansion of Aircel and Idea in various circles, Bharti's excellent execution of its services mainly in the B and C circles resulted in handsome growth in May. Moreover, in the highly saturated metros, Bharti was able to expand its share of net additions to 6.8% in May from 5.8% in April 2009, when other players like Idea had a contribution of 0% in May, down from 2.2% in April.

Exhibit :- Bharti's net addition break-up in May 2009



Source – COAI, HDFC Sec research

MTN deal a long term positive, sweetening of deal is a concern

As discussed, Bharti will benefit if it is able to crack the MTN deal at the price fixed earlier. The earnings are expected to be impacted by 4-5% in FY 2010, and the Capex savings of up to Rs 5 bn is expected in the next five years. The entry of Bharti into the scarcely penetrated African wireless markets will lead to a surge in its subscriber growth rate. Furthermore, MTN's ability to maintain healthy return ratios, as reflected in its high ARPUs will augment Bharti's profitability post deal. Additionally, as there is no equipment vendor base in India or Africa, cost can be saved through single contracts with vendors. It will also benefit from cheaper rates in both markets. However, sweetening of the bid is a concern for Bharti. Resistance from existing vendors seeking to modify their contracts may lead to disputes between the two. Overseas transportation cost, customs duty, and local transportation costs may limit operational synergies. Lower population density in Africa could limit economies of scale. Lack of infrastructure could also increase costs substantially for MTN, with some costs getting transferred to Bharti. Raising debt will not be an issue for Bharti, as its balance sheet is the most comfortable among all the telecom players (Net debt to equity of 0.23 x, as compared to 0.3x for Idea and 0.64x for RCOM).

Increase in 3G and WiMax reserve prices a concern for telcos, Bharti to suffer least

The government has raised the 3G reserve price to Rs 40.4 bn from Rs 20.2 bn. However, there are talks on addition of one slot per circle for the 3G auctions. But, There is little clarity on this issue as there are spectrum constraints in some of the 3G circles. For WiMax also, the prices have been doubled to Rs 20.2 bn. For a long time, the 3G auctions were an overhang on the telcos as the companies were unable to plan their cash outflows. Above that, the increase in 3G pricing is a negative for the industry. However, rational bidding could occur if the number of slots per circle is increased as already 1 slot in each circle has been allotted to BSNL/MTNL. 3G will initially (2-3 years) be used for voice services and will only offer limited revenues in that period. We reiterate here that with Bharti's strong cash position of ~ Rs 55 bn and extremely low leverage Bharti is well poised to bid for 3G.

Valuation and Outlook

Bharti's net subscriber addition rate in the last two months has been excellent after it took a beating in March. Bharti has strengthened its position in the metros and continues to gain a solid market share in B & C circles. This has helped it to maintain leadership position by a robust margin of more than 25 mn customers over its closest rival. We believe the election results were positive for the telecom industry, as changes to the existing policies are unlikely. However, the 3G auction is a negative. With a strong balance sheet and its ability to raise debt, Bharti is best among its peers. Bharti will also benefit if one more slot is added in 3G auctioning per circle. In spite of intensifying competition, Bharti will benefit from economies of scale, as its extensive presence in all the 23 circles will save its network opex to a good extent. Bharti's EBITDA margins will remain flattish at 41%, as the benefits of network opex reduction will come down due to CTR reduction. MTN deal will yield strong synergies in the long term, but the sweetening of the bid remains a concern.

At the CMP of 792, Bharti is trading at 8.8x FY10E EV/EBITDA. The leadership position of the company, expected stability in EBITDA margins, steady addition of subscriber base in 1-2 years, extremely low leverage among its peers, strong cash position and strength in execution lead us to raise the target price from Rs 702 to Rs 894 on FY 2010E EV/EBITDA multiple of 10x. We are thus upgrading Bharti from Market performer to Outperformer, as we foresee a 13% upside from current levels.

FINANCIAL HIGHLIGHTS

All particulars in mn	Q4 FY09	Q4 FY08	% yoy	Q3 FY09	% qoq	FY09A	FY 10E
Revenues	98,245	78,191	25.65	90,203	8.92	369,615	422,685
Operating expenditure	58,231	45,673	27.50	52,676	10.55	217,764	244,965
EBITDA	40,014	32,518	23.05	36,993	8.17	151,678	174,101
EBITDA Margin	40.73%	41.59%	(86 bps)	41.01%	(28 bps)	41.04%	41.19%
Depreciation & amortisation	13,285	9,702	36.93	11,549	15.03	47,581	51,692
EBIT	26,729	22,816	17.15	25,444	5.05	104,097	122,409
Finance cost (net) *	2,136	2,157	-0.97	5,741	-62.79	11613	7412
Share of profit in associates and JVs	(56)	(2)	2700.00	(93)	-39.78	(713)	(600)
Other income	425	683	-37.77	274	55.11	1,522	860
Non-operating expenses	(56)	(208)	-73.08	(160)	-65.00	(220)	(150)
Tax	2,022	2,085	-3.02	1,247	62.15	6,615	10,373
PAT	22,393	18,529	20.85	20,463	9.43	84,699	104,883
Adjusted PAT	24755.00	19793.00	25.07	26325.00	-5.96	96,624	104,883
Adjusted NPM	25.2%	25.3%	(10 bps)	29.2%	(400 bps)	26.1%	24.8%

	BSE	NIFTY
Close	14326	4235
Change	-195.67	-78.35
52 Week High / Low	15600/7697	4693/2253

Other Markets	Close	Change
Dow Jones	8339	-200.72
FTSE 100	4234	-111.88
Nasdaq	1766	-61.28

Trade Data 22/06	BSE	NSE
Turnover (Rs. Bn)	51.44	165.60
Change	-8.16	-20.77
Adv/ Dec/ Unchanged	16/22/1	11/17/1
	Buying	**Selling**
FII's (Rs. bn) 19/06	18.94	18.21
MF's (Rs. bn) 19/06	8.48	4.40

Interbank Closing	Close	Change
Rs/US $	48.61	-0.52
Rs/UK £	79.92	-0.73
Rs/EURO	67.27	-0.28

10 year G-Sec yield : 6.95%

BSE Sectoral Indices	Days' close	Previous close	% Change
Automobiles	4671	4724	-1.11
Capital Goods	12304	12260	0.36
Metal	10776	11039	-2.38
FMCG	2273	2261	0.49
IT	3245	3277	-0.97
Realty	3213	3290	-2.33

ADR / GDR	Latest	Previous	Change
Infosys	35.07	36.15	-1.08
ICICI Bank	28.20	29.83	-1.63
Wipro	10.66	11.35	-0.69
Tata Motors	9.13	9.70	-0.57
Dr. Reddy's	15.24	15.30	-0.06
HDFC Bank	97.06	104.41	-7.35

Commodity Prices	Close	Change
Crude ($/Bbl)	66.41	-0.52
Copper ($/tn)	4820	-195
Gold Std (Rs/10GM)	14530	-15
Silver (Rs / 1 kg)	22650	-150
Aluminium ($/tn)	1584	-57
Zinc ($/tn)	1490	-70