Stock Update

Impressive margin execution despite challenges

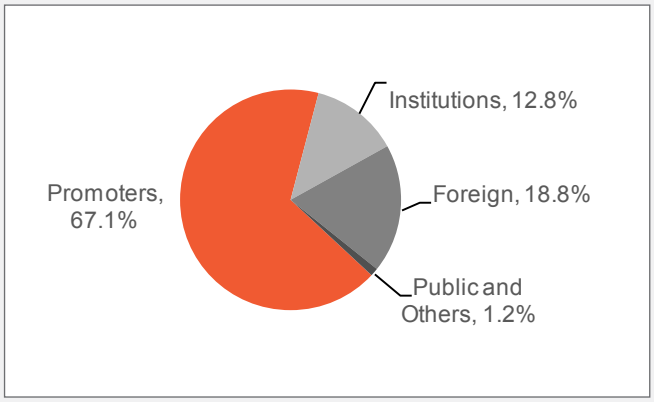
Bharti Airtel

Reco: Buy | CMP: Rs498

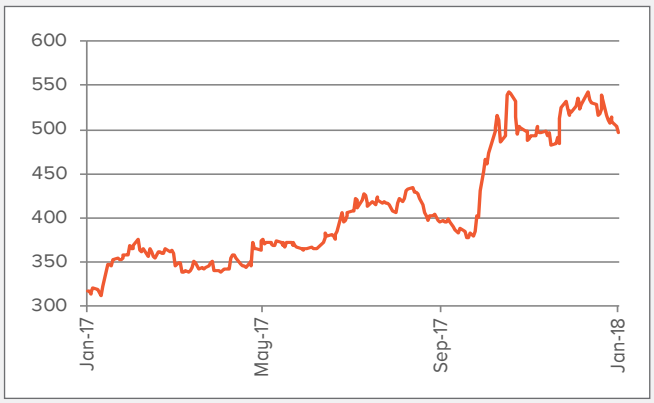
Company details

Price target:	Rs600
Market cap:	Rs198,971 cr
52-week high/low:	Rs565/304
NSE volume: (No of shares)	64.6 lakh
BSE code:	532454
NSE code:	BHARTI
Sharekhan code:	BHARTI
Free float: (No of shares)	131.4 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-5.9	7.2	21.2	58.1
Relative to Sensex	-10.4	-1.1	8.7	20.6

Key points

- **Soft quarter, slash in IUC rates impacted India business:** Consolidated revenue of Bharti Airtel (Airtel) declined by 6.6% on a sequential basis (down 12.7% y-o-y) to Rs. 20,388 crore in Q3FY2018. The decline in overall revenue was mainly due to the ongoing tariff war with RJio and a 8.6% q-o-q/15.1% y-o-y drop in India business, which is partially being offset by 2.4% q-o-q (flat y-o-y) revenue growth in African business and decent growth (2.0% q-o-q/6.3% y-o-y) in non-India wireless business (home, digital TV, enterprise business and infrastructure services). Revenue of the India wireless business declined by 12.2% q-o-q/22.2% y-o-y to Rs. 10,751 crore (below our estimates), owing to cut in IUC rates (57% cut in IUC to 6 paise a minute, effective October 1, 2017) by the regulator. Slash in IUC rates impacted revenue by Rs. 1,061.5 crore, resulted in ARPU decline of Rs. 16. ARPU for the quarter declined by 15.2% q-o-q/28.6% y-o-y to Rs. 123, owing to competitive tariff to retain revenue market shares and IUC rate cut. India mobile voice traffic increased by 13.1% q-o-q/49.8% y-o-y to 495 billion minutes. India data usage on its network grew by 41% q-o-q/544% y-o-y in Q3FY2018, while usage per customer grew by 31% q-o-q/450% y-o-y to 5.3 GB per customer.

- **Africa and India enterprise business profitability continued to improve:** For Q3FY2018, operating profit margin (OPM) of the company improved by 44 BPS q-o-q (up 55 BPS y-o-y) to 37%, a tad ahead of our expectations, on account of continued healthy OPM performance in African business and cost-control measures. For consecutive five quarters, OPM of the African business has shown improvement from 24.9% in Q4FY2017 to 35.5% in Q3FY2018. Africa's EBITDA grew by 9.2% q-o-q/42.6% y-o-y in Q3FY2018, resulting in 220 BPS q-o-q/1,050 BPS y-o-y margin expansion to 35.5% (higher margin than India wireless business). Improvement in Africa's margin performance was mainly supported by conscious effort of the company in divesting low-margin operations in Africa. India wireless EBITDA declined by 16.6% q-o-q/33.8% y-o-y, owing to lower revenue (taking aggressive tariff plan route) and reduction in 57% cut in MTR (impact of Rs. 338.7 crore on overall EBITDA). For India non-wireless business, OPM of home (up 729 BPS q-o-q), digital TV (up 92 BPS q-o-q) and Airtel business (up 518 BPS q-o-q) improved on a sequential basis. Improved profitability along with lower tax rate (6.3% in Q3FY2018 versus 48% in Q2FY2018) helped to moderate the fall in net profit during Q3FY2018, a decline of 10.8% q-o-q to Rs. 306 crore.

- **Outlook: Pressure on ARPU to continue for some time, Africa business looks strong:** Management highlighted that it is unlikely to see further ARPU erosion going forward, though the international

IUC cut would be the last leg of regulatory change to negatively impact ARPU. To improve ARPU in the next 9-12 months, the company will focus on (a) upgradation of 2G customers to 4G in its own network; (b) capture fair share of 4G feature phones; and (c) strive to get in the primary slot in 4G devices (40-50% market share of dual SIM). However, Airtel also plans to increase bundled services to 50% of its existing customers in the next 2-4 quarters from 20% currently of its total customers. In addition, management sees traction in bundle plan with smart phones with the disproportion increase in the share of these devices in its network. We believe increased adoption of the bundled plan will prolong ARPU recovery for the incumbent. Management will continue to focus sharply on increasing retail ARPU, enhancing African operations, non-mobile services (enterprise services) and value-added services (Airtel TV and music) to boost revenue and reduce churn rate. The company expects healthy performance to continue in its African operations, led by data, Airtel money penetration and strengthening distribution model. Management highlighted an additional capex of Rs. 1,000 crore-3,000 crore could happen on its earlier capex guidance of Rs. 25,000 crore for FY2018, as the company is improving network quality of its coverage area and building additional capacity.

- **Valuation - Maintain Buy with a PT of Rs. 600:** We have broadly maintained our estimates for FY2019/FY2020 on account of healthy performance in African and enterprise business and strong cost-control measures, while the largest revenue contributor, India wireless business, is facing regulatory challenges coupled with intense competition from RJio. Nevertheless, with favourable earnings traction in the African market, more value-added services to higher ARPU customers and bottoming out of sector headwinds in India, Airtel will emerge stronger with its balance sheet strength coupled with industry consolidation (three-player market, with the exit of smaller players). This would also help Airtel to maintain its revenue market share with improving profitability. We maintain our Buy rating on the stock with an unchanged price target of Rs. 600.

Valuations Rs cr

Particulars	FY17	FY18E	FY19E	FY20E
Revenue	95,468.3	84,938.3	96,112.6	1,07,102.1
EBITDA margin (%)	37.1	36.6	37.0	37.5
Net profit	4,969.5	1,385.5	3,814.7	6,096.5
EPS (Rs)	12.4	3.5	9.5	15.2
P/E	40.1	143.7	52.2	32.7
EV/EBITDA (x)	6.5	7.4	6.5	5.7
RoCE (%)	10.7	7.4	9.6	11.2
RoE (%)	6.8	2.4	5.5	8.1

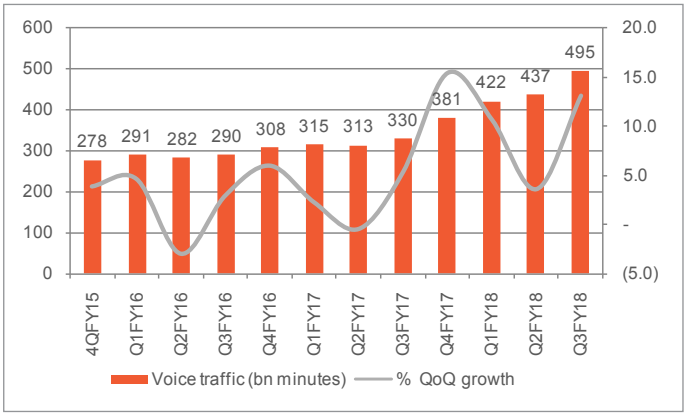
Results Rs cr

Particulars	Q3FY18	Q3FY17	YoY (%)	Q2FY18	QoQ (%)
Net sales	**20,388.2**	**23,363.9**	**-12.7**	**21,832.2**	**-6.6**
License fees & spectrum charges	1,754.2	2,226.8	-21.2	1,972.0	-11.0
Employee expenses	958.6	1,053.2	-9.0	1,008.9	-5.0
Access & interconnection charges	1,953.9	2,438.6	-19.9	2,560.3	-23.7
Network operating expenses	4,736.5	5,571.9	-15.0	5,047.2	-6.2
Other expenses	1,856.4	1,692.2	9.7	1,856.1	0.0
Operating profit	**7,538.4**	**8,509.7**	**-11.4**	**7,977.3**	**-5.5**
Interest expenses	2,088.2	1,935.6	7.9	2,326.6	-10.2
Depreciation	4,837.5	4,835.0	0.1	4,687.3	3.2
Tax	37.9	1,184.1	-96.8	534.1	-92.9
Reported net income	**305.8**	**503.7**	**-39.3**	**343.0**	**-10.8**
EPS (Rs)	0.8	1.3	-39.3	0.9	-10.8
Margins (%)			**BPS**		**BPS**
OPM	37.0	36.4	55	36.5	44
NPM	2.7	3.0	-35	2.4	29

Mobile services India (Rs cr) Rs cr

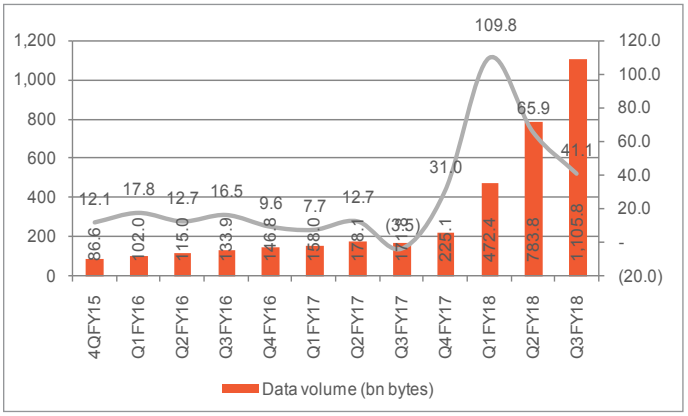
Particulars	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18
Total revenue	**14,653**	**15,053**	**14,735**	**13,836**	**12,972**	**12,915**	**12,245**	**10,751**
EBITDA	**5,847**	**6,388**	**6,249**	**5,255**	**4,787**	**4,428**	**4,209**	**3,509**
EBITDA margin (%)	39.9	42.4	42.4	38.0	36.9	34.3%	34.4%	32.6
EBIT	**3,229**	**3,444**	**3,310.3**	**2,258**	**1,439**	**1,260**	**1,138**	**167**
EBIT margin (%)	22	23	22.5	16	11	10%	9.3%	1.6
Capex	3,381	3,194	3,705	4,410	2,054	5,073	6,105	4,936
Operating free cash flow	2,467	3,193	2,544	846	2,733	-645	-1,897	-1,427
Cumulative investments	149,682	159,544	165,147	184,626	1,86,456	1,90,516	1,98,349	2,02,787

Voice traffic continues to improve



Source: Company, Sharekhan

Data volume shows strong growth



Source: Company, Sharekhan

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