AXIS DIRECT

BHARTI INFRATEL

TELECOMMUNICATIONS

15 MAY 2017 — Quarterly Update

BUY

Target Price: Rs 423

Upsides from tower industry consolidation

Bharti Infratel (BHIN) recorded strong tenancies (7K gross) on accelerated ramp-up in data networks by Top 3 incumbentsand material benefits from RJio roll-outs for BHIN standalone.Revenue and EBITDA were higher than our estimates but higher tax rate led to lower PAT.

BHIN may augment market share through tower industry consolidation: Where ongoing telco consolidation will be negative, the consolidation in tower industry will be positive for BHIN. Management shared it will evaluate opportunities given the high cash generation and low leverage. Further, market share gain by BHIN and accelerating data rollouts by telcos augur well for momentum in tenancy growth. Other triggers include growth prospects from Smart Cities, Wi-Fi etc.

CMP	: Rs 366
Potential Upside	: 16%

MARKET DATA

No. of Shares	: 1,850 mn
Free Float	: 38%
Market Cap	: Rs 676 bn
52-week High / Low	: Rs 413 / Rs 283
Avg. Daily vol. (6mth)	: 6.4 mn shares
Bloomberg Code	: BHIN IB Equity
Promoters Holding	: 62%
FII / DII	: 34% / 2%

Concall highlights

- Management outlined majority of impact (Rs 1.8 bn) under new MSA has been absorbed in FY17. The impact will neutralize in Year 3 (FY19) and expected to tick up from Year 4 (FY20). New MSA has been signed with 75% of operators
- **Outlook on tower industry**: Tower growth to be 2-3% and tenancy growth expected at 7-8%
- Indus has declareddividend of Rs 24 bn in Q1FY18; BHIN's 42% share to fetch ~Rs 10 bn
- Energy margin to continue in the range of 3-5%

Financial summary (Consolidated)

Y/E March	FY16	FY17	FY18E	FY19E
Sales (Rs bn)	123	134	147	161
Adj PAT (Rs bn)	22	28	30	32
Con. EPS* (Rs)	-	-	16	18
EPS (Rs)	12	15	16	17
P/E (x)	31	24	23	21
RoE (%)	13	17	18	18
RoCE (%)	15	18	19	21
EV/ E (x)	11.6	10.3	9.6	8.3
FCF Yd(%)	2	7	1	6
DPS (Rs)	3.0	16.0	9.7	10.4

Source: *Consensus broker estimates, Company, Axis Capital

Key drivers

	FY16	FY17	FY18E
Standalone tenancy (x)	2.12	2.28	2.47
Indus tenancy (x)	2.25	2.35	2.54
Consol rental YoY (%)	1.2	0.4	0.9
EV/ Tower (Rs mn)	7.1	6.8	6.8

Price performance

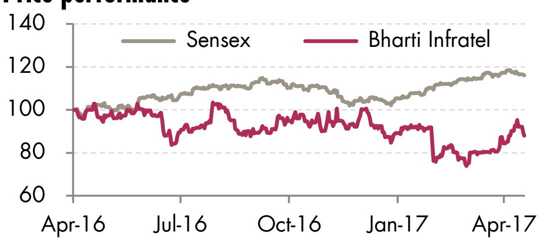


Exhibit 1: Results update

	Quarter ended					12 months ended		
(Rs. mn)	Mar-17	Mar-16	% Chg	Dec-16	% Chg	FY18E	FY17	% Chg
Net Sales	**35,204**	**31,817**	**10.6**	**34,007**	**3.5**	**147,244**	**134,236**	**9.7**
EBITDA	15,846	14,687	7.9	14,955	6.0	65,621	59,420	10.4
Other income	291	241	20.7	203	43.3	7,898	1,456	442.5
PBIDT	**16,137**	**14,928**	**8.1**	**15,158**	**6.5**	**73,519**	**60,876**	**20.8**
Depreciation	5,684	5,697	(0.2)	5,664	0.4	26,693	22,625	18.0
Interest	287	(1,029)	(127.9)	(947)	(130.3)	1,362	(4,413)	(130.9)
PBT	**10,166**	**10,260**	**(0.9)**	**10,441**	**(2.6)**	**45,464**	**42,664**	**6.6**
Tax	4,200	3,076	36.5	4,237	(0.9)	15,685	14,742	6.4
Adjusted PAT	**5,966**	**7,184**	**(17.0)**	**6,204**	**(3.8)**	**29,779**	**27,922**	**6.7**
No. of shares (mn)	1,850	1,897	(2.48)	1,850	0	1,850	1,850	-
EBIDTA margin (%)	45.0	46.2	-	44.0	-	44.6	44.3	-
PBIDT margin (%)	45.8	46.9	-	44.6	-	49.9	45.3	-
EPS - annualized (Rs)	**12.9**	**15.2**	**(14.8)**	**13.4**	**(3.8)**	**16.1**	**15.1**	**6.7**

Source: Company, Axis Capital

Estimates and valuations

Forecasts: We expect 0.34x incremental tenancy and ~8.5% CAGR in total tenancies over FY17-19Eto drive net revenue/EBITDA /PAT CAGR of ~9%/11%/8%. These estimates are prior to any impact from loss of tenancies from ongoing consolidation in the telecom operator industry: (1) Idea and Vodafone merger and (2) Bharti Airtel to acquire Telenor.

Valuations: Incorporating the impact from likely consolidation both in the tower and the telecom industry

- **Consolidation opportunities in the tower industry (positive):** We believe BHIN will consolidate its market share in the tower industry. We reduce our WACC from 10% to 9.5% to incorporate the same. This leads to DCF value of Rs 537. Terminal growth rate assumed at 5%
- **Consolidation opportunities in the telco industry (negative):**
  - Idea, in its analyst meet on formal announcement of merger with Vodafone, highlighted synergies worth Rs 670 bn, with annual savings reaching Rs 140 bn in year 4. On opex synergies, it shared ~20% of co-located sites (~52-54K) are likely to be rationalized following network consolidation. Further, higher spectrum availability and high capacity Single Radio Access Network (SRAN) deployment will lower the capex. Taking cue from Idea's management commentary, we believe, the risk to tenancy losses for BHIN would be ~10% (assuming ~70% of likely redundancies) to 15% (assuming almost 100% of likely redundancies)
  - Bharti Airtel's acquisition of Telenor – with Telenor revenue market shareat 2.5% (Q3FY17) and subscriber market share of ~5% (Q3FY17), loss to tenancies may be limited to 2-3%
  - The two announced mergers/ acquisitionscumulatively imply tenancy loss of 12-18%
  - Incorporating these risks, our scenario analysis indicates that loss to business value will be Rs 97 per share (at 12% tenancy loss) and Rs 131(at 18% tenancy loss). We take the average of the two (15% tenancy loss) and buildin negative effect. Consequently, our DCF value (target price) stands at Rs 423

The stock trades at ~23x FY18E and 21x FY19E EPS of Rs 16.1 and Rs 17.3. **Maintain BUY.**

Q4FY17 performance highlights

- Net rental revenue grew ~3% QoQ on 2.8% QoQ growth in tenancies (strong additions in BHIN standalone)
- **Strong growth in standalone tenancies drive growth**: Closing Q4 tenancy ratio for BHIN consolidated was 2.32x (2.27x in Q3), BHIN standalone was 2.28x (2.21x in Q3) and, Indus Towers was 2.35x (2.32x in Q3)
- **Net co-locations added in Q4** were 5,672 on consolidated basis and 3,151 on standalone basis. This includes the impact of exits during the quarter (1,388 tenancies on consolidated basis and 472 on standalone basis). Consolidated tower and colocation base stands at 90,646 towers and 210,606 colocations respectively
- Due to escalation freeze under the new Master Service Agreement, monthly rentals per tower were flat at Rs 35,029 for BHIN consolidated
- **Consolidated revenue at Rs 35.2 bn (up 3.5% QoQ); 1.5% higher than our estimate.** Revenue growth was driven by 2.8% QoQ growth in tenancies (up 3.7% QoQ for standalone and 2.1% QoQ for Indus). Energy pass-through was up 4.2% QoQ, driving consolidated revenue growth higher to ~3.5% QoQ (in line with our expectation). Energy margin was higher at 10% (7% in Q3FY17) following the seasonal trend of high Q4 margin
- **Consolidated EBITDA at Rs 15.8 bn; 3% higher than our estimate.** Energy margin expanded to 10% (Q3: 7%) owing to strong Q4 seasonality. Standalone EBITDA margin was at 48.3% (up 180 bps) and for Indus was at 42.3% (up 40 bps), leading to consolidated margin expansion of 100 bps to 45% (including energy margin) led by strong tenancy growth and higher energy margin
- **Consolidated PAT at Rs 6 bn (down ~3% QoQ); 18% lower than estimate,** led by lower other income from mark-to-market reporting of investments and higher-than-expected tax rate
- Operating free cash flow was strong at Rs 10.3 bn (Q3FY17: Rs 8 bn)
- The Board has recommended a final dividend of Rs 4 per share, taking the total dividend for FY17 to Rs 16 per share

Exhibit 2: Update on gross additions

	Q1'17	Q2'17	Q3'17	Q4'17
Consolidated				
Net co-locations	1,367	2,393	6,139	5,672
Exits	1,179	186	271	1,388
Gross additions	2,546	2,579	6,410	7,060
Standalone				
Net co-locations	267	1,177	3,027	3,151
Exits	729	73	83	472
Gross additions	996	1,250	3,110	3,623

Source: Company

Exhibit 3: Operating metrics trends – Bharti Infratel standalone

Bharti Infratel Standalone	Q4'16	Q1'17	Q2'17	Q3'17	Q4'17
Total Towers (Nos)	38,458	38,642	38,832	38,997	39,099
Total Co-locations (Nos)	81,632	81,908	83,085	86,112	89,263
Key Indicators					
Average sharing factor (x)	2.11	2.12	2.13	2.17	2.25
Closing sharing factor (x)	2.12	2.12	2.14	2.21	2.28
Sharing revenue per tower p.m. (Rs)	78,455	79,801	80,646	81,366	84,238
Sharing revenue per sharing operator p.m. (Rs)	37,128	37,622	37,868	37,428	37,512

Source: Company

Exhibit 4: Operating metrics trends – Indus Towers

Indus Towers	Q4'16	Q1'17	Q2'17	Q3'17	Q4'17
Total Towers (Nos)	119,881	120,739	121,330	122,044	122,730
Total Co-locations (Nos)	270,006	272,603	275,499	282,909	288,913
Key Indicators					
Average sharing factor (x)	2.25	2.26	2.26	2.29	2.34
Closing sharing factor (x)	2.25	2.26	2.27	2.32	2.35
Sharing revenue per tower p.m. (Rs)	75,254	74,902	74,587	76,223	77,661
Sharing rev per sharing operator p.m. (Rs)	33,519	33,215	32,941	33,221	33,244

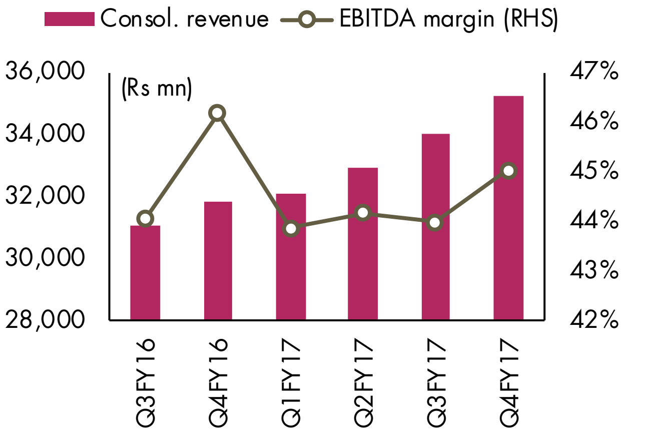
Source: Company

Exhibit 5: Operating metrics trends – Bharti Infratel consolidated

Bharti Infratel Consolidated	Q4'16	Q1'17	Q2'17	Q3'17	Q4'17
Total Towers (Nos)	88,808	89,352	89,791	90,255	90,646
Total Co-locations (Nos)	195,035	196,401	198,795	204,934	210,606
Key Indicators					
Average sharing factor (x)	2.19	2.20	2.21	2.24	2.30
Closing sharing factor (x)	2.20	2.20	2.21	2.27	2.32
Sharing revenue per tower p.m. (Rs)	76,602	76,983	77,197	78,407	80,464
Sharing rev per sharing operator p.m. (Rs)	35,012	35,039	34,994	34,966	35,029

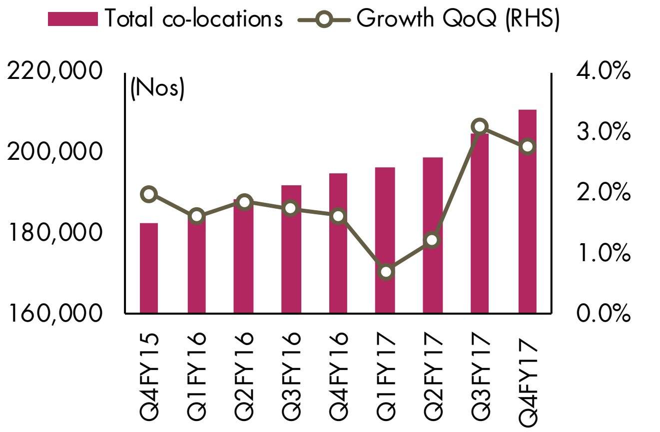
Source: Company

Exhibit 6: Consol.revenue and EBITDA margin



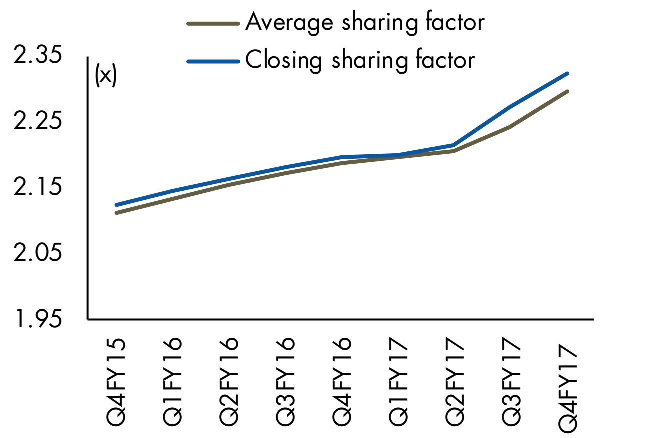
Source: Company, Axis Capital

Exhibit 7: Consolidated co-locations



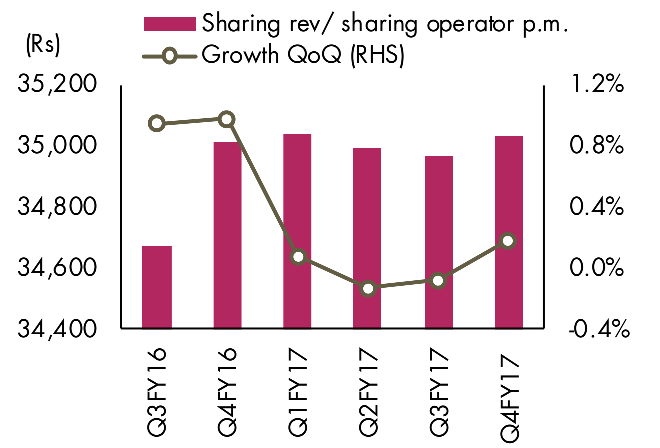
Source: Company, Axis Capital

Exhibit 8: Closing tenancies surge in Q4



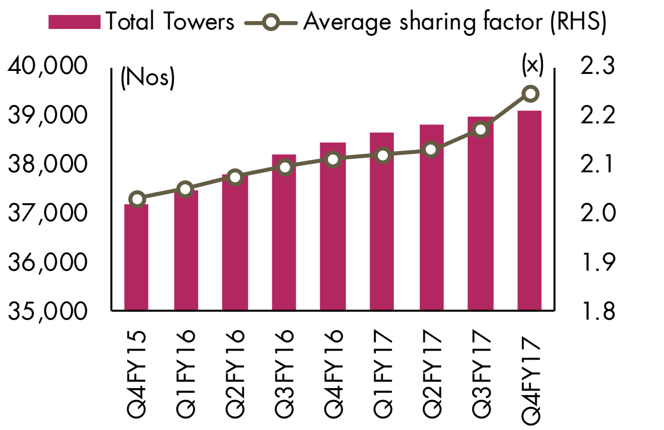
Source: Company, Axis Capital

Exhibit 9: Consol. sharing revenue and growth



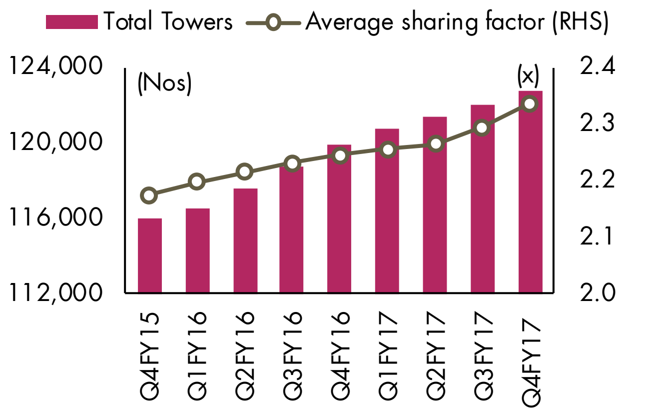
Source: Company, Axis Capital

Exhibit 10: Standalone: Towers and tenancy trends



Source: Company, Axis Capital

Exhibit 11: Indus: Towers and tenancy trends



Source: Company, Axis Capital

Financial summary (Consolidated)

Profit &loss (Rs bn)

Y/E March	FY16	FY17	FY18E	FY19E
Net sales	123	134	147	161
Other operating income	-	-	-	-
Total operating income	**123**	**134**	**147**	**161**
Cost of goods sold	(57)	(63)	(69)	(76)
Gross profit	66	71	78	85
Gross margin (%)	*53.6*	*53.2*	*53.0*	*52.9*
Total operating expenses	(12)	(12)	(12)	(13)
EBITDA	**54**	**59**	**66**	**73**
EBITDA margin (%)	*44.2*	*44.3*	*44.6*	*45.1*
Depreciation	(22)	(23)	(27)	(28)
EBIT	**32**	**37**	**39**	**45**
Net interest	2	4	(1)	(1)
Other income	2	1	8	5
Profit before tax	**36**	**43**	**45**	**49**
Total taxation	(13)	(15)	(16)	(17)
Tax rate (%)	*37.2*	*34.6*	*34.5*	*34.5*
Profit after tax	22	28	30	32
Minorities	-	-	-	-
Profit/ Loss associate co(s)	-	-	-	-
Adjusted net profit	22	28	30	32
Adj. PAT margin (%)	*18.2*	*20.8*	*20.2*	*19.8*
Net non-recurring items	-	-	-	-
Reported net profit	22	28	30	32

Balance sheet (Rs bn)

Y/E March	FY16	FY17	FY18E	FY19E
Paid-up capital	19	18	18	18
Reserves & surplus	163	136	151	160
Net worth	182	155	169	179
Borrowing	17	17	17	15
Other non-current liabilities	22	21	23	24
Total liabilities	**222**	**194**	**209**	**218**
Gross fixed assets	298	318	348	363
Less: Depreciation	(158)	(181)	(208)	(236)
Net fixed assets	140	136	140	127
Add: Capital WIP	2	3	3	3
Total fixed assets	142	139	142	130
Total Investment	46	56	44	68
Inventory	-	-	-	-
Debtors	2	2	4	4
Cash & bank	32	23	20	18
Loans & advances	6	9	7	8
Current liabilities	23	53	32	35
Net current assets	22	(13)	7	4
Other non-current assets	12	12	16	17
Total assets	**222**	**194**	**209**	**218**

Source: Company, Axis Capital

Cash flow (Rs bn)

Y/E March	FY16	FY17	FY18E	FY19E
Profit before tax	36	43	45	49
Depreciation & Amortisation	22	23	27	28
Chg in working capital	*(7)*	*27*	*(25)*	*1*
Cash flow from operations	**34**	**72**	**25**	**57**
Capital expenditure	*(22)*	*(22)*	*(16)*	*(16)*
Cash flow from investing	**5**	**(38)**	**4**	**(34)**
Equity raised/ (repaid)	*(4)*	*(26)*	*5*	*-*
Debt raised/ (repaid)	*(6)*	*7*	*(1)*	*(2)*
Dividend paid	*(7)*	*(30)*	*(21)*	*(22)*
Cash flow from financing	**(19)**	**(50)**	**(18)**	**(25)**
Net chg in cash	20	(17)	11	(3)

Key ratios

Y/E March	FY16	FY17	FY18E	FY19E
OPERATIONAL				
FDEPS (Rs)	11.8	15.1	16.1	17.3
CEPS (Rs)	23.6	27.3	30.5	32.4
DPS (Rs)	3.0	16.0	9.7	10.4
Dividend payout ratio (%)	30	106	70	70
GROWTH				
Net sales (%)	6	9	10	10
EBITDA (%)	9	9	10	11
Adj net profit (%)	12	24	7	7
FDEPS (%)	12	27	7	7
PERFORMANCE				
RoE (%)	12.8	16.6	18.4	18.4
RoCE (%)	14.5	17.7	19.3	21.0
EFFICIENCY				
Asset turnover (x)	1.0	1.2	1.4	1.4
Sales/ total assets (x)	0.5	0.5	0.6	0.7
Receivable days	6	6	10	10
Payable days	122	257	143	142
FINANCIAL STABILITY				
Total debt/ equity (x)	0.1	0.1	0.1	0.1
Net debt/ equity (x)	(0.3)	(0.4)	(0.3)	(0.4)
Current ratio (x)	1.9	0.7	1.2	1.1
Interest cover (x)	-	-	28.6	35.3
VALUATION				
PE (x)	30.8	24.2	22.7	21.2
EV/ EBITDA (x)	11.6	10.3	9.6	8.3
EV/ Net sales (x)	5.1	4.6	4.3	3.8
PB (x)	3.8	4.4	4.0	3.8
Dividend yield (%)	0.8	3.8	2.6	2.8
Free cash flow yield (%)	1.7	7.3	1.3	6.0

Source: Company, Axis Capital

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