Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 600**	
Price Target: **Rs. 750**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

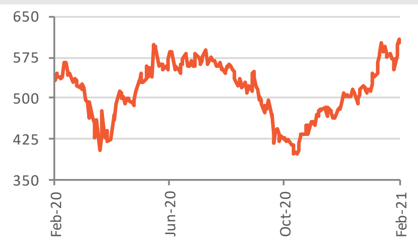
Company details

Market cap:	Rs. 3,27,524 cr
52-week high/low:	Rs. 623 / 381
NSE volume: (No of shares)	225.2 lakh
BSE code:	532454
NSE code:	BHARTIARTL
Free float: (No of shares)	191.4 cr

Shareholding (%)

Promoters	56.2
FII	19.5
DII	22.1
Others	2.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	16.8	31.3	7.4	12.5
Relative to Sensex	12.3	8.8	-27.0	-10.5

Sharekhan Research, Bloomberg

Stock Update

Bharti Airtel

Robust Q3; Digitisation to pave growth path

Telecom	Sharekhan code: BHARTIARTL	Result Update

Summary

- We maintain a Buy on Bharti Airtel with a revised PT of Rs. 750, given favourable market structure, reasonable valuations and strength in core business.
- Stellar performance; ARPU improvement led by strong net 4G subscriber additions; company gained revenue market share in its India wireless business and sees strong traction in broadband & enterprise businesses.
- Strong 4G subscriber addition creates platform for healthy growth of India wireless business; Bharti optimistic that digital services through the partnership-led model would help drive growth.
- Bharti is well-positioned to capitalise opportunities from weakness in competitors and tariff hikes. We expect company to register a 14%/23% growth in revenue/ EBITDA over FY2020-FY2023E.

Bharti Airtel (Airtel) reported better-than-expected performance on both revenue and margin fronts, led by strong addition of 4G customers in India wireless business and healthy performance in Africa business. Further, the company continued to impress us by reporting an improvement in ARPU in India wireless business despite no tariff hike. Consolidated revenue increased by 5.8% q-o-q (up 24% y-o-y) to Rs. 26,518 crore, ahead of our estimates, led by 5.5% q-o-q growth in India business and 7.2% q-o-q growth (in USD terms) in its Africa business revenue. India wireless business revenue grew by 6.8% q-o-q and 32% y-o-y during the quarter. ARPU in India wireless business grew by 2.4% q-o-q (up 23% y-o-y) to Rs. 166 without taking any tariff hike, led by strong addition of quality 4G subscribers. The number of subscribers in India wireless business increased by 14.2 million (up 4.8% q-o-q) during the quarter. EBITDA margin improved by ~128 bps q-o-q to 45.5%, exceeding our estimates, led by the addition of quality 4G customers and cost optimisation. There was an exceptional charge of (Rs. 4,559.9 crore) comprising cost relating to re-assessment of contractual/regulatory levies. Adjusted net loss (excluding exceptional items) came at Rs. 290 crore. Airtel's management stated that ARPUs should improve to Rs. 200 in the short term (from Rs. 166 currently) and, thereafter, should improve to Rs. 300 in the long term for profitable growth. Bharti is ready to take tariff hike once its competitors increase their tariff, as it wants to maintain the premium in pricing with competitors. Apart from tariff hikes, greater 2G to 4G upgrades, digital strategies, higher postpaid subscribers, and bundling of other services (DTH, broadband, and entertainment) would help Airtel drive ARPU. Management believes it has gained life-time high revenue market share of 35% in its India wireless business. The broadband category is at a cusp in terms of growth, as management sees there is a huge need for high-speed internet among customers because of work-from-home and online education. Management remains optimistic that digital services through the partnership-led model and scaling omni-channel would help it drive growth going ahead.

Key positives

- ARPU grew by 2.4% q-o-q to Rs. 166 despite no tariff hike
- Strong addition of 4G subscribers, up 8.5% q-o-q
- Africa, home broadband, and enterprise segment are expected to deliver strong growth going ahead

Key negatives

- Capex increased by 37% y-o-y to Rs. 6,834 crore
- Net debt to EBITDA remained at 3.03x

Our Call

Valuation – Maintain Buy with a PT of Rs. 750: We have raised our earnings estimates for FY2021E/ FY2022E/FY2021E because of impressive operating profitability, market share gains in the India wireless and enterprise business and strong 4G subscribers addition. Further, the fund-raising in the past one year, proceeds from Carlyle fund infusion, dividends from Indus tower and Airtel Africa and improving cashflow in India wireless business alleviate concerns on increased net debt. Notably, Bharti continues to gain market share and manage to grow and execute strategies efficiently even in the absence of tariff increase. Hence, we remain positive on Bharti, considering steady improvement in its core business, market share gains in other businesses, and potential improvement in free cash flows. At CMP, the stock is trading at a reasonable valuation of 7x its FY2023E EV/EBITDA. Given favourable risk-reward balance, we maintain a Buy rating on the stock with a revised price target (PT) of Rs. 750.

Key Risks

Increasing competition could keep up the pressure on realisations. Any slowdown in data volume growth could affect revenue growth.

Valuation Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenue	80,780.2	86,231.5	1,01,936.4	1,16,254.7	1,27,010.7
OPM (%)	32.0	41.1	44.8	47.7	51.5
Adjusted PAT	-3,977.8	-3,630.4	222.6	5,561.2	11,615.6
% YoY growth	*NM*	*NM*	*NM*	*NM*	*108.9*
Adjusted EPS (Rs.)	-10.0	-7.0	0.4	10.2	21.3
P/E (x)	NM	NM	1,470.7	58.9	28.2
P/B (x)	4.6	4.2	5.3	4.4	2.8
EV/EBITDA (x)	17.0	11.7	10.4	8.3	6.8
RoNW (%)	NM	NM	0.3	7.6	11.6
RoCE (%)	2.4	4.1	7.4	10.1	13.0

Source: Company; Sharekhan estimates

Impressive margin performance

Bharti reported better-than-expected performance on both its revenue and margin fronts, while its reported net profit (profit from the Indus Tower de-merger) turned positive during the quarter. We note that the company continued to surprise us by reporting improvement in ARPU despite no tariff hike. Consolidated revenue increased by 5.8% q-o-q (up 24% y-o-y) to Rs. 26,518 crore, ahead of our estimates, led by 5.5% q-o-q growth in India business and 7.2% q-o-q growth (in USD terms) in its Africa business revenue. India wireless business revenue grew by 6.8% q-o-q and 32% y-o-y during the quarter. ARPU in India wireless business grew by 2.4% q-o-q (up 23% y-o-y) to Rs. 166, without taking any tariff hike, led by strong addition of quality 4G subscribers. The number of subscribers in India wireless business increased to 14.2 million (up 4.8% q-o-q) during the quarter. EBITDA margin improved by ~128 bps q-o-q to 45.5%, exceeding our estimates, resulting in 8.9% q-o-q/38.3% y-o-y growth in EBITDA. EBITDA margin of Africa business expanded by 161 bps q-o-q during the quarter. There was an exceptional charge of (Rs. 4,559.9 crore) comprising cost relating to re-assessment of contractual/regulatory levies. Reported net profit was at Rs. 854 crore. Adjusted net loss (excluding exceptional items and profit from the Indus Tower de-merger) came at Rs. 290 crore.

Expect to maintain a premium on ARPU; Digitisation initiatives to drive growth

Management reiterated its earlier stance that ARPU should improve to Rs. 200 in the short term from the current level of Rs. 162 and, thereafter, it should improve to Rs. 300 in the long term for profitable growth. Improvement in ARPU in the coming quarters would be supported by continued upgradation from 2G to 4G, increasing post-paid subscribers, segmentation price hike for premium users, and bundling of multiple services. Management indicated that it would immediately take tariff hike after an increase in tariff by its competitors as it wants to maintain the premium in tariff with competitors. We anticipate telecom operators would take another round of tariff hike in the next 12 months, given increased base of smartphone users, a higher focus on profitability, and the largest subscriber base of Reliance Jio. We believe the bundling of home broadband, DTH, and wireless services under one-bill initiative would help the company improve its ARPU going forward. Management highlighted that its digital capabilities have been helping the company to acquire quality customers, increase wallet share, reduce churn rate, and eliminate waste.

Key result highlights from Concall

- **Strong performance continued:** Management indicated that it has gained revenue market share in each market, given its focus at sites level. Consolidated revenue increased by 6% q-o-q and 24% y-o-y to Rs. 26,518 crore, led by broad-based growth across segments. Both India and Africa business grew by 6% and 7% q-o-q during the quarter. Consolidated EBITDA margin expanded by 128 bps q-o-q to 45.5%, led by healthy operating leverage in India wireless and Africa businesses. EBITDA grew by 9% q-o-q/38% y-o-y during the quarter.
- **India wireless business reported strong performance despite no tariff hike:** India wireless business revenue grew by 6.8% q-o-q and 32% y-o-y to Rs. 14,779 crore, led by strong 4G net subscriber additions of 13 million. Over the past 12 months, the company has added around 42 million customers over its 4G networks. The company has also added 6,96,000 subscribers in the post-paid segment during the quarter. Overall, customer net ads remained at 14.2 million and churn remains at 1.9%. ARPU improved from Rs. 162 to Rs. 166 because of quality customer additions in the 4G segment. ARPU has increased by 7.8% from March 2020, without taking any price hike. EBITDA margin of India wireless business improved by 111 bps q-o-q to 43.7%, while EBIT increased by 1.6x q-o-q. Management believes that it has gained market share in this segment and it could be at lifetime high of 35% revenue market share.
- **Healthy India wireless operating metrics:** Data subscribers increased by 12.6 million at 174 million, an increase of 7.7% q-o-q and 26.2% y-o-y. The number of 4G subscribers increased by around 12.9 million to 166 million, 9% q-o-q and 34% y-o-y growth. Management highlighted that 4G customer additions were driven by upgradation of its 2G customers to 4G and shifting of subscribers from competitors. Overall data usage on the network was up by 11% q-o-q/52% y-o-y, while usage per customer grew by 2% q-o-q/20% y-o-y, respectively, to 16.8 GB per subscriber due to work-from-home (WFH) modes and online educations. There was strong growth (up 7% q-o-q/22% y-o-y) in voice traffic to 924 billion minutes.

- **Expect strong growth in home broadband going ahead, ARPU likely to decline:** The broadband category is at a cusp in terms of growth as management sees there is a huge need for high-speed internet among customers. The company added 1.45 million home passes during the quarter. The company is also in the process of rapidly upgrading legacy copper assets to fiber for better experience and cost efficiencies. The company expects to completely shut down the copper infrastructure in the coming 2-3 years. With the outbreak of COVID-19 crisis, there is strong demand for broadband services led by WFH, online education, streaming services, and reduction in pricing. To drive growth in home business, the company adopted four strategies – (1) rapid expansion of its own coverage. The company added one million home passes in the cities during the quarter. (2) Acceleration of LCO partnership model. During the quarter, the company expanded to new cities with the help of LCO partnership model, taking total cities to 120. (3) Bringing full power of Airtel services as well as partnership services to deliver integrated converged offer encompassing connectivity, entertainment and more. Airtel Xstream bundle now combines Xstream fibre, unlimited data, Airtel Xstream Android 4K TV box, and access to OTT content. These approaches helped the company to drive its home business during the quarter, resulting in 2,15,000 net ads. We believe the decline in ARPU in the broadband segment would continue in Q4FY2021. Management indicated that it focuses on (1) rapidly expanding its presence in existing cities and (2) scaling its LCO model to acquire more customers to drive growth of the home broadband business. Revenue from broadband declined by 3.4% q-o-q despite strong subscriber addition, owing to 10% q-o-q decline in APRU in the broadband category. EBITDA margin of the broadband segment declined by 277 bps q-o-q to 55.5% owing to lower revenue and pricing pressure. Lower revenue and margin were attributed to flow through the impact of pricing decisions taken in Q2FY2021. The acquisition ARPU remains healthy.
- **Implementing strategies to drive growth in the DTH business:** Revenue in the DTH business grew by 4.6% q-o-q during the quarter. The company added 4,85,000 customers during the quarter and management believes its position remains at #2 in the Indian DTH market. Management believes that it has outperformed its competitors in terms of growth during the quarter. Management highlighted that it would continue to focus on this strategy to drive growth of its DTH business. Management indicated that there is huge scope for growth in the DTH segment because of 1) lower pricing of DTH services compared to average rate of global DTH services, 2) lower penetration, 3) poor quality of services by cable operators, and 4) lack of broadband penetration across the country (limits technological disruptions).
- **Huge growth opportunity in the enterprise business:** Airtel business revenue grew by 1.1% q-o-q and 9.2% y-o-y during the quarter. The company highlighted that it continues to witness strong demand from its enterprise customers and is consistently gaining market share among its peers. This segment has industry leading margin of 38.7% in Q3FY2021. Hence, the company focuses on - (1) core is connectivity, which will continue to grow because of increased requirement of capacity in large businesses and growing need of connectivity in small businesses. There is huge opportunity to grow market share as a disproportionate amount of its business comes from the top 20% of its customers. Hence, the company is revamping its go-to-market strategy in the entire market with equal emphasis to both hunting and farming. 2) The company is making substantial investments in the adjacencies i.e., data centre and Airtel IQ. Data centre business continues to grow with the hunting 20 hyper data centres and the company has a leadership position in this space. The company is setting up two data centres in Pune and Mumbai to serve the hyperscalers. Airtel IQ would enable enterprises to deepen engagement with customers through timely and secure communication. Airtel IQ was launched last quarter and has acquired 45+ customers till date. We believe that Airtel IQ is well positioned to become a key player in the $1 billion cloud communication market, which is growing at a rapid pace. 3) Partnership led model – the company has partnership with companies such as Cisco to drive connectivity solutions bundled with routing. The company's management sees strong traction for its partnership- led model. Airtel secure and Airtel Cloud are two services launched during Q3FY2021. Management indicated strong growth in order booking in these two areas. This is built through strategic partnerships with global leaders such as Cisco, Radware, VMWare, and Forcepoint.
- **Digital revenue is considered to be the heart of the business:** Digital revenue is considered the heart of the business as it complements the core business and helps in enhancing the overall business and profitability. Management highlighted that its digital capabilities have been helping the company to

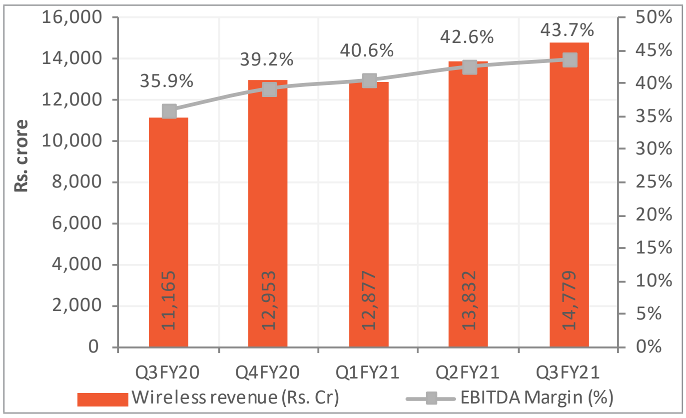
acquire quality customers, increase wallet share, reduce churn rate, and eliminate waste. It highlighted that the company is consistently growing its business online, which helps for better experience and lower costs. The company launched Airtel pay safe. There is sustained growth of digital assets. The company has monthly active users (MAUs) of 190 million in Q3FY2021, with 67 million MAUs in Wynk. Airtel Xstream is at 40 million MAUs, addition of ~6 million users during the quarter. The company continues to build momentum in Airtel Secure and Airtel Cloud. Management remains optimistic that digital capabilities, digital services though partnership, and scaling omni-channel would help it drive growth going ahead.

Results Rs cr

Particulars	Q3FY21	Q3FY20	YoY %	Q2FY21	QoQ %
Net sales	**26,517.8**	**21,343.6**	**24.2**	**25,060.4**	**5.8**
License fees and spectrum charges	2,295.2	1,787.5	28.4	2,235.5	2.7
Employee expenses	1,026.0	891.4	15.1	1,017.2	0.9
Access and interconnection charges	3,063.2	2,710.9	13.0	2,922.9	4.8
Network operating expenses	5,547.9	4,984.9	11.3	5,419.8	2.4
Other expenses	1,480.1	1,354.6	9.3	1,523.2	-2.8
Operating profit	**12,053.0**	**8,716.4**	**38.3**	**11,069.6**	**8.9**
Interest expenses	3,971.9	3,289.3	20.8	3,791.4	4.8
Depreciation	7,503.1	6,817.8	10.1	7,286.2	3.0
Tax	4,306.7	-1,163.7	-	413.5	941.5
Reported net income	**853.6**	**-1,035.3**	-	**-763.2**	-
Adjusted net income	**-290.0**	**-1,112.3**	-	**-713.9**	-
EPS (Rs.)	-0.5	-2.2	-	-1.3	-
Margins (%)					
OPM	45.5	40.8	461	44.2	128
NPM (adjusted)	-1.1	-5.2	412	-2.8	176

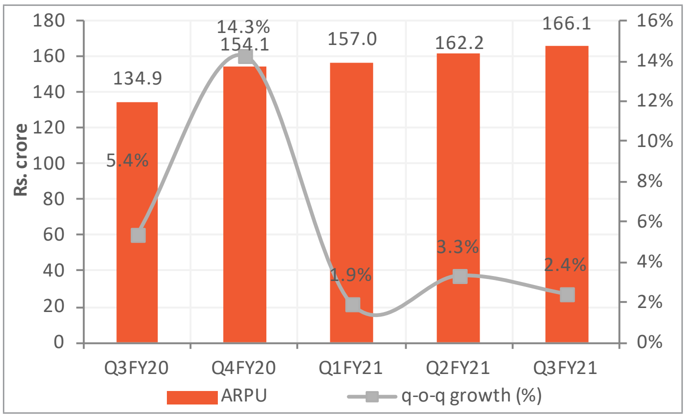
Source: Company; Sharekhan Research

India wireless EBITDA grew 10% q-o-q, exceeding our estimates



Source: Company, Sharekhan Research

ARPU was up 2.4% q-o-q, led strong 4G subs adds



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view – Large addressable market

Jio's entry in the Indian telecom space led to the reversal of pricing paradigm that benefited incumbent telecom players. After extensive consolidation, structure of the telecom industry has changed from more than eight players to now a structure of three private and one government operator. The momentum has now shifted towards data, led by 4G services, although voice will continue to grow in underpenetrated areas in rural India. As smartphones are becoming more affordable, the uptake of data services is increasing. India has become the second largest telecommunication market and has the second highest number of internet users in the world. We believe higher bundling with home entertainment, partnerships with content providers, and increasing data consumption due to WFH could be major drivers for price hikes going ahead.

■ Company outlook - Resilient performance amid uncertainty

Though Bharti Airtel will be able to withstand competition, we believe the company's capex intensity will rise in its wireless business and investments in content would create differentiation in the market. Further, its free cash flow is set to improve going ahead with increased ARPU and better cost management. Higher digitisation would enable the company increase monetisation of digital assets and value-added services, a reduced churn rate across verticals, and improved wallet share from subscribers. With a comparatively strong balance sheet and adequate network investments, Bharti is well placed to grow in its core business going ahead.

■ Valuation - Best play in the telecom space

We have raised our earnings estimates for FY2021E/FY2022E/FY2021E because of impressive operating profitability, market share gains in the India wireless and enterprise business and strong 4G subscribers addition. Further, the fund-raising in the past one year, proceeds from Carlyle fund infusion, dividends from Indus tower and Airtel Africa and improving cashflow in India wireless business alleviate concerns on increased net debt. Notably, Bharti continues to gain market share and manage to grow and execute strategies efficiently even in the absence of tariff increase. Hence, we remain positive on Bharti, considering steady improvement in its core business, market share gains in other businesses, and potential improvement in free cash flows. At CMP, the stock is trading at a reasonable valuation of 7x its FY2023E EV/EBITDA. Given favourable risk-reward balance, we maintain a Buy rating on the stock with a revised price target (PT) of Rs. 750.

One-year forward EV/EBITDA (x) band

Source: Sharekhan Research

About company

Established in 1995, Bharti is one of the leaders in the Indian mobile telephony space with operations in 18 countries across Asia and Africa. The company ranks among the top three mobile service providers globally in terms of subscribers. Airtel is a diversified telecom service provider offering wireless, mobile commerce, fixed line, home broadband, enterprise, and DTH services. The company expanded into Africa by acquiring Zain's Africa operations in 2010 and is present in 14 African markets. Bharti had over 420 million customers across its operations at the end of March 2020. The company owns a 53.51% stake in Bharti Infratel, which in turn owns a 42% stake in Indus Towers.

Investment theme

Revenue accretion from the 4G upgrade, minimum-ARPU plans (rolled out across India), and recent tariff hike helped the company to report improvement in ARPU. Further, the government's data localisation policies with an increasing penetration of smartphones are likely to boost strong demand for data over the medium-to-long term. Despite a predatory pricing strategy from new entrants since its commercial launch in September 2016, Bharti has been resilient in sustaining its revenue market share (RMS) as it has been drastically standardising its plans to retain customers and acquiring subscribers through M&A activities. In DTH, Bharti expects to maintain steady growth by adding new subscribers in rural areas by launching USB-enabled STBs, increasing reach in cities taking advantage of flat-screen TV upgrades, and driving up ARPUs by selling OTT boxes and hybrid HD STBs. We believe the company is well poised to deliver strong multi-year EBITDA growth phase given recent developments in the Indian wireless industry.

Key Risks

1) Increasing competition could pressurise realisations; and 2) Slower growth in data volumes could affect data revenue growth.

Additional Data

Key management personnel

Sunil Mittal	Chairman
Gopal Vittal	MD & CEO (India and South Asia)
Raghunath Mandava	CEO (Africa)
Badal Bagri	Chief Financial Officer
Pankaj Tewari	Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	ICICI Prudential Asset Management	3.01
2	SBI Funds Management Pvt Ltd	2.32
3	Capital Group Companies	1.61
4	GIC Pte Limited	1.34
5	HDFC Asset Management Pvt Limited	1.19
6	ICICI Prudential Life Insurance Co	1.16
7	Vanguard Group Inc/The	1.15
8	BlackRock Inc	1.13
9	Nippon Life India Asset management	1.10
10	Aditya Birla Sun Life Asset Management	0.85

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

Sharekhan

by BNP PARIBAS

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