Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Bharti Airtel

Strong Q2, Maintain Buy

Telecom	Sharekhan code: BHARTIARTL

Reco/View: Buy	↔	CMP: Rs. 810	Price Target: Rs. 1,010	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING Updated Oct 08, 2022	19.61

Low Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

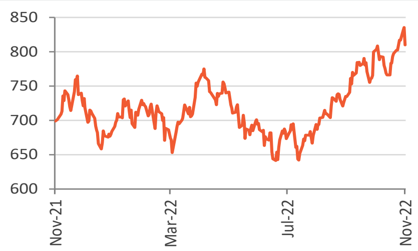
Company details

Market cap:	Rs. 4,50,566 cr
52-week high/low:	Rs. 841 / 629
NSE volume: (No of shares)	80.0 lakh
BSE code:	532454
NSE code:	BHARTIARTL
Free float: (No of shares)	267.2 cr

Shareholding (%)

Promoters	55.1
FII	21.9
DII	18.8
Others	4.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	0.8	16.9	9.2	15.9
Relative to Sensex	-6.4	12.5	2.3	14.0

Sharekhan Research, Bloomberg

Summary

- Bharti Airtel reported strong revenue performance beating our revenue and EBITDA estimates led by strong growth in India Wireless and Africa Business revenues which grew 4% each q-o-q. India Wireless EBITDA margin at 52.4% was up 116 Bps q-o-q due to strong jump in ARPU up 3.7% q-o-q and lower SUC charge.
- Company reported strong Revenue growth in India Non mobile Business with Home Services and Enterprise growing 6.8% each q-o-q. Home Services business added 4,17,000 customers in Q2FY23and reached the total customer base of 5.2 million broadband customers. The company continued to deliver strong ARPU at Rs 190 for Q2FY23 from Rs183 in Q1FY23. 5G rollout is expected to boost the company's long-term growth and further support ARPUs. However, the rollout would lead to increase in capex and lead to an uptick in near term debt levels.
- FCF remained healthy (up 4.6% q-o-q) at Rs. 10,674 crores, led by decent growth in EBITDA. Company said for the next 2-3 years it will use its operating cash flows to retire debt, make prepayments and for capex requirements.
- We maintain a Buy with a revised PT of Rs. 1010, owing to robust growth potential, strong FCF generation, market share gains in its key portfolios and reasonable valuation.

Bharti Airtel (Airtel) reported strong revenue growth for Q2FY23, at Rs 34,526 crore, up 5.2% q-o-q and 21.9%, y-o-y beating our estimates led by strong performance in Enterprise, Home services, Wireless India and Africa business growing at 6.8%/6.8%/4% and 4% on q-o-q respectively. EBITDA margin at 51%, up 57 Bps also beat our estimates. Q2FY2023 saw healthy improvement in ARPU, which grew 3.7% q-o-q to Rs 190 in its India wireless business, decent performance in its Home services business and strong FCF generation. Moderation continued in 4G subscriber addition with 5 million q-o-q additions owing to increase in prices of entry-level smartphones and inflation. India wireless business revenue growth was led by 2.5% q-o-q growth in 4G subscribers and 3.7% q-o-q growth in ARPU. The Africa business revenue growth accelerated to 4% q-o-q (versus 2.8% q-o-q in Q1FY2023) in USD terms at $1,308 million. Management expects capex to increase in FY24-25 due to 5G rollout and expansion of rural coverage. The management expressed confidence in 5G rollout over competitors as they have a high-value customer base and greater compatibility with leading handset makers. We believe the company is well-positioned to capture market share gains from the 5G rollout and its strategy of rural expansion. 5G rollout is expected to boost the company's long-term growth and further support ARPUs. However, capex would increase due to the rollout and would lead to an uptick in near term debt levels.

Key positives

- Africa business revenue growth accelerated to 4.0% q-o-q (versus 2.8% q-o-q in Q1FY2023)
- ARPU grew by 3.7% q-o-q to Rs. 190 due to upgradation of customers from feature to smartphones, from prepaid to postpaid and the ability of the company to win quality customers.
- Number of 4G subscribers increased by ~5 million q-o-q to 210 million, 2.5% q-o-q and 9.2% y-o-y growth.
- Airtel's business revenue grew by 6.8% q-o-q and 16.8% y-o-y driven by demand for connectivity, Communication Platform as a Service (CPaaS) across global and domestic businesses, IoT, cybersecurity, cloud, and data centers.

Key negatives

- Revenue in the DTH business declined by 2.6% q-o-q, owing to 1.9% q-o-q fall in ARPU due to regulations and high competition from FTA and OTT platforms
- Net debt to annualised EBITDA (including the impact of leases) increased to 2.96x in Q2FY2023 from 2.52x in Q1FY2023.

Management Commentary

- The management stated concerns about the low RoCE that its business delivers due to pricing that is the lowest in the world. Given the large investments required to drive digital adoption in India, they believe there is a need for tariff correction
- Management expressed confidence in 5G rollout over peers as they have a high-value customer base and greater compatibility with leading handset makers
- The management indicated that ARPU grew by 3.7% q-o-q to Rs. 190 due to upgradation of customers from feature to smartphones, from prepaid to postpaid and the ability of the company to win quality customers.
- The management expects capex to increase in FY24-25 due to 5G rollout and expansion of rural coverage
- Management cited that subscriber growth was muted due to elevated prices for lower end smartphones on account of higher semiconductor prices and inflation.

Revision in estimates – We have fine-tuned our earnings estimates for FY2023E/FY2024E, to factor H1FY23 performance.

Our Call

Valuation – Strong Q2, Maintain BUY: At CMP, the stock is trading at a reasonable valuation of 10x/8.7x its FY2023E/FY2024E EV/EBITDA. We continue to prefer Airtel, given an improving 4G subscriber mix, astuteness in spectrum acquisition approach, healthy network capacity and strong free cash flow (FCF) generation. We maintain our Buy recommendation on the stock with a revised price target (PT) of Rs. 1010.

Key Risks

Increasing competition could keep up the pressure on realisations. Continued decline in data volume growth could affect revenue growth. Slowdown in Africa operations could affect its revenue growth.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenue	1,00,615.8	1,16,546.9	1,39,784.6	1,57,103.9
OPM (%)	45.1	49.4	51.7	53.3
Adjusted PAT	-1,468.5	4,865.5	8,865.2	12,621.2
% YoY growth	NM	NM	82.2	42.4
Adjusted EPS (Rs.)	-2.7	7.6	12.7	18.0
P/E (x)	NM	106.1	64.0	44.9
P/B (x)	8.1	7.2	6.0	4.1
EV/EBITDA (x)	13.0	11.6	10.0	8.7
RoNW (%)	-2.0	6.3	8.2	12.2
RoCE (%)	8.3	11.5	11.9	10.9

Source: Company; Sharekhan estimates

Key result highlights

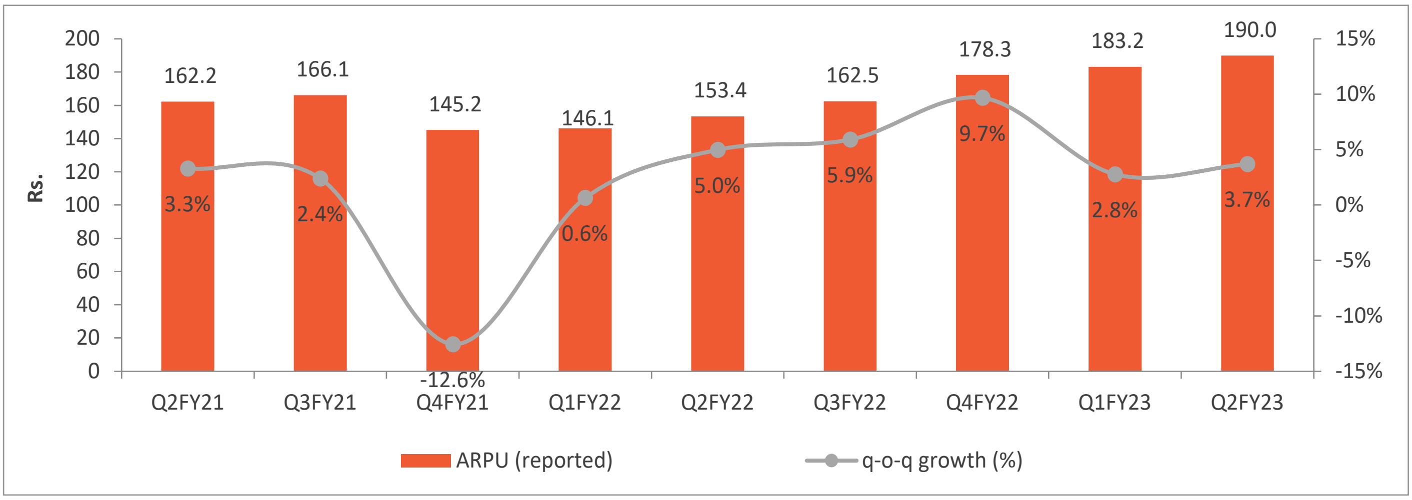
- **Africa business:** Africa business revenue growth accelerated to 4.0% q-o-q (versus 2.8% q-o-q in Q1FY2023) in USD terms at $1,308 million. EBITDA margin was at 50.7% for the quarter, up 186 bps q-o-q. Africa business generated free cash flow (FCF) of $494 million up 3.3% q-o-q.
- **Strong performance from of India wireless business:** Revenue of India wireless business grew by 4% q-o-q and 24.8% y-o-y to Rs. 18,958 crore, led by increase in tariffs and 4G subscriber additions of 5 million q-o-q (constitute 67% of the overall India wireless customer base). Over the past 12 months, the company has added around 17.8 million customers over its 4G networks. The company has also added over 2.5 lakh subscribers in the postpaid segment. Overall, customer net additions came at 0.5 million q-o-q and churn ratio increased to 3.3%. ARPU grew by 3.7% q-o-q to Rs. 190 due to upgradation of customers from feature to smartphones, from prepaid to postpaid and the company's ability to win quality customers. Going forward, the company will continue to focus on increasing ARPUs to increase the present low ROCE of ~8.4%. EBITDA margin of India wireless business improved 116 bps q-o-q basis to 52.4% and EBITDA increased by 6.4% q-o-q.
- **Improvement in India wireless operating metrics:** Data subscribers increased by 5.8 million q-o-q to 219 million, an increase of 2.7% q-o-q and 9.5% y-o-y. The number of 4G subscribers increased by ~5 million q-o-q to 210 million, 2.5% q-o-q and 9.2% y-o-y growth. Overall data usage on the network was up 7.4% q-o-q/19.6% y-o-y, while usage per customer grew by 4.2% q-o-q (up 8.9% y-o-y) to 20.8GB per subscriber. Voice traffic came at 1,063 billion minutes. (Down 1.5% q-o-q, up 4.2% y-o-y).
- **Growth momentum continued for Enterprise business:** Airtel's business revenue grew by 6.8% q-o-q and 16.8% y-o-y during the quarter to Rs 46,646 million driven by demand for connectivity, Communication Platform as a Service (CPaaS) across global and domestic businesses, IoT, cybersecurity, cloud, and data centers. EBITDA stood at Rs 18,293 million during the quarter as compared to Rs 15,922 million in the corresponding quarter last year (growth of 14.9% y-o-y) and Rs. 17,011 Mn in previous quarter. EBITDA margin stood at 39.2% in the current quarter, as compared to 39.9% in the corresponding quarter last year.
- **5G market share to increase:** Management said they have a good track-record in increasing its market share in the last 8-10 quarters and are confident to continue it in 5G. They have an advantage over Jio in rural connect, high value customer base and 5G compatibility with Xiaomi, Oppo, Vivo and Redmi. Compatibility with Samsung and OnePlus phones will be ready in the next couple of weeks and that with Apple by Mid-December 2022. Their plan is to rollout 5G in all towns and key rural areas by March 2024.
- **Growth in home broadband business to continue:** The company added 77 cities (versus 136 cities in Q1FY2023) through its LCO partnership model. During Q2FY2023, the business added 4,17,000 customers and reached the total customer base of 5.2 million broadband customers. Further, the company would continue to step-up investments to cover over 40 million home passes by 2025. Revenue from home broadband grew by 6.8% q-o-q, led by strong 8.7% q-o-q growth in subscriber addition. EBITDA margin of home broadband segment declined by 284 bps q-o-q to 50.3%. The company incurred capex of Rs. 589 crore during the quarter (down 11% q-o-q). We believe the company is well poised to gain significant share of growth in the home broadband segment, given its sharp focus on high-quality urban homes, digital partnership model with LCOs, and Airtel Black.
- **Poor performance of DTH:** The company's DTH revenue has been declining sequentially for the past five consecutive quarters. This segment continues to see headwinds given excessive regulations and higher competition from FTA and OTT platforms. Revenue in the DTH business declined by 2.6% q-o-q, owing to 1.9% q-o-q fall in ARPU.
- **Healthy FCF generation; high borrowings in Q2:** Capex increased by 10.1% q-o-q to Rs. 7,047 crore in Q2FY2023. FCF remained healthy (up 4.6% q-o-q) at Rs. 10,674 crore, led by decent growth in EBITDA. Consolidated net debt excluding lease obligations increased by 31.6% q-o-q to Rs. 157 billion. Net debt to annualised EBITDA (including the impact of leases) increased to 2.96x in Q2FY2023 from 2.52x in Q1FY2023. Company said for the next 2-3 years it will use its operating cash flows to retire debt, make prepayments and for capex requirements.
- **Others:** 1) Initially, 5G pricing will be kept at the same level as 4G. 2) Company said the key risks to the business are geopolitical risks, high attrition rates and shortage of talent pool

Results (Consolidated) Rs cr

Particulars	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)
Net Sales	**34,526.8**	**28,326.4**	**21.9**	**32,804.6**	**5.2**
License fees & Spectrum charges	2,951.1	2,679.4	10.1	3,130.6	-5.7
Employee expenses	1,208.6	1,101.0	9.8	1,123.5	7.6
Access & InterConnection Charges	1,931.0	1,670.8	15.6	1,869.8	3.3
Network Operating Expenses	7,130.3	6,178.8	15.4	6,682.8	6.7
Other Expenses	1,929.7	1,618.9	19.2	1,901.6	1.5
Operating Profit	**17,593.8**	**13,810.5**	**27.4**	**16,529.4**	**6.4**
Net Finance Charges (Including Exchange Fluctuation)	4,940.3	3,964.1	24.6	4,510.9	9.5
Depreciation & Amortisation	8,946.8	8,247.2	8.5	8,781.4	1.9
Tax Expense	1,286.4	1,030.8	24.8	1,123.3	14.5
Reported Net Income	**2,145.2**	**1,134.0**	**89.2**	**1,606.9**	**33.5**
Adjusted Net Income	**2,145.2**	**593.6**	**261.4**	**1,606.9**	**33.5**
EPS	3.1	1.0	196.5	2.5	24.6
Margins (%)					
OPM	51.0	48.8	220	50.4	57
NPM (Adj)	6.2	2.1	412	4.9	131
Tax rate	32.9	42.4	-951	32.8	16

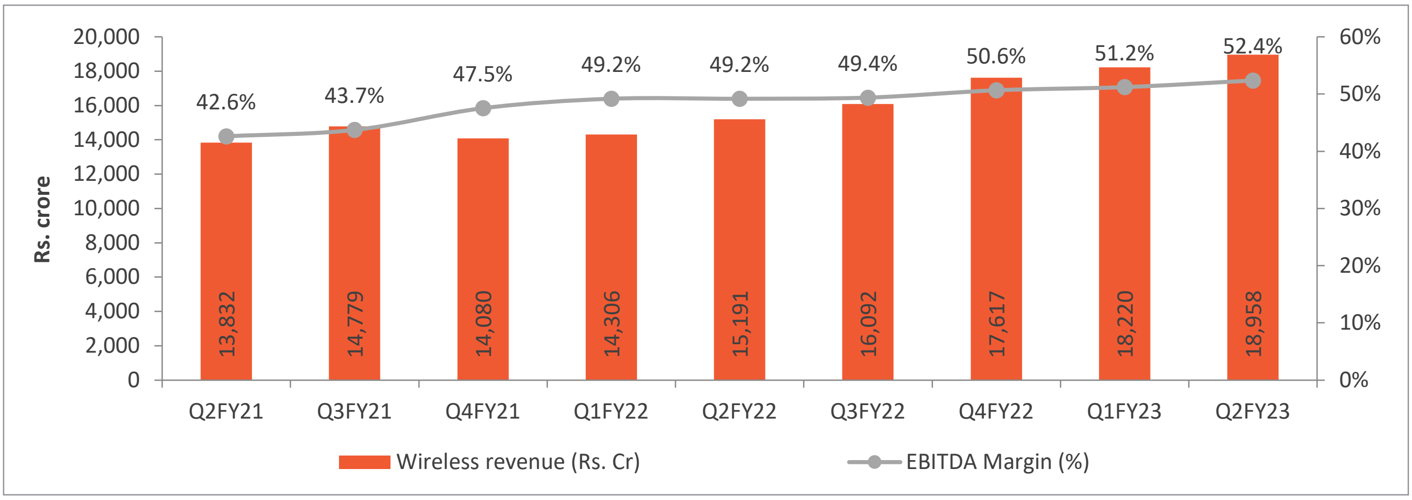
Source: Company, Sharekhan Research

ARPU improved 3.7% q-o-q



Source: Company; Sharekhan Research

India Wireless Business trend



Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view - Large addressable market

Reliance Jio's entry in the Indian telecom space led to reversal of pricing paradigm that benefited incumbent telecom players. After extensive consolidation, the structure of the telecom industry has changed from more than eight players to three private and one government operator now. The momentum has now shifted towards data. As smartphones are becoming more affordable, the uptake of data services is increasing. India has become the second largest telecommunications 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 work for home and online education could be major growth drivers going ahead.

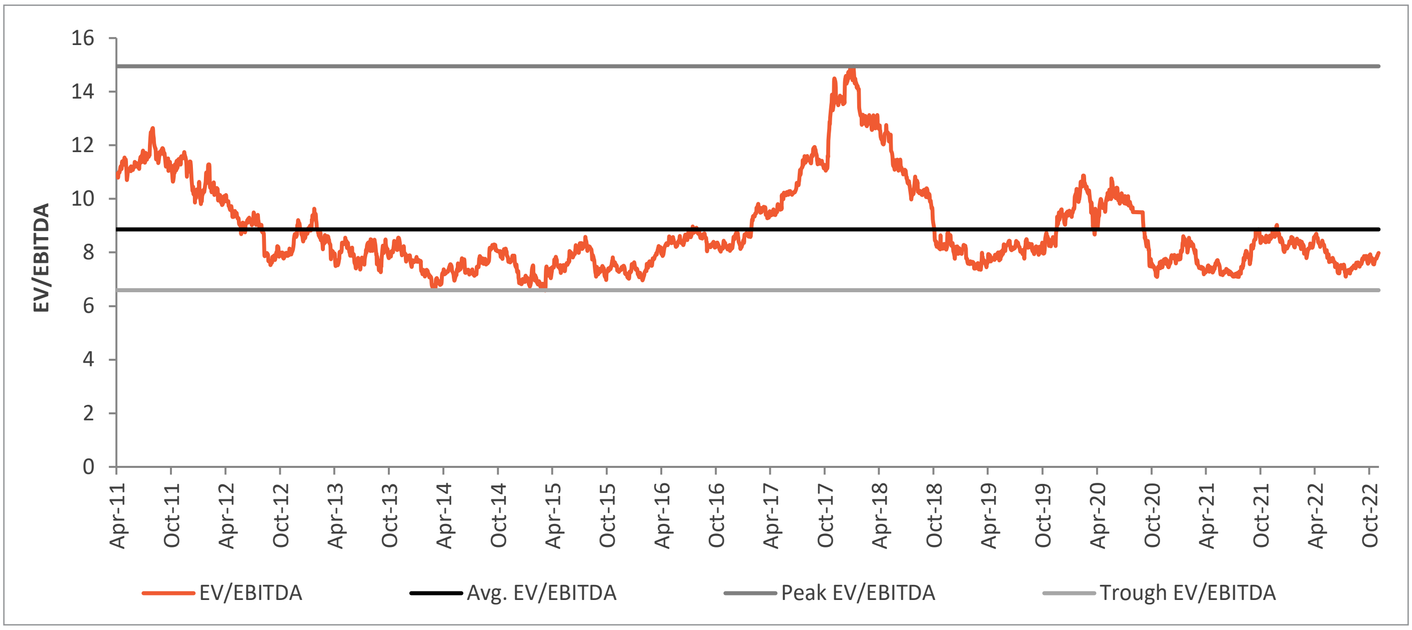
■ Company outlook - Better positioned to gain market share

Though Airtel will be able to withstand competition in the wireless business, we believe the company's capex will be allocated towards the non-wireless business and differentiated digital capabilities to drive its growth going ahead. Further, the company's FCF is set to improve going ahead with the recent tariff increase and better cost management. Higher digitisation would enable the company to increase monetisation of digital assets and value-added services, a reduced churn rate across verticals, and improved wallet share from subscribers. With improving cash flow generation and adequate investments in digital offerings and networks, Airtel is well placed to grow in its core business and gain market share across its portfolio going ahead.

■ Valuation - Strong Q2, Maintain Buy

At CMP, the stock is trading at a reasonable valuation of 10x/8.7x its FY2023E/FY2024E EV/EBITDA. We continue to prefer Airtel, given an improving 4G subscriber mix, astuteness in spectrum acquisition approach, healthy network capacity and strong free cash flow (FCF) generation. We maintain our Buy recommendation on the stock with a revised price target (PT) of Rs. 1010.

One-year forward EV/EBITDA (x) band



Source: Company; Sharekhan Research

About company

Established in 1995, Airtel 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. Airtel had over 485 million customers across its operations.

Investment theme

Revenue accretion from the 4G upgrade, minimum ARPU plans (rolled out across India), and recent tariff hike helped the company to report ARPU improvement. Further, the government's data localisation policies with 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, Airtel 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. We believe the company is well poised to deliver strong multi-year EBITDA growth phase, given recent developments in the Indian wireless industry and market repairs (tariff hike and relief from the government).

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 and CEO (India and South Asia)
Raghunath Mandava	CEO (Africa)
Soumen Ray	Chief Financial Officer
Pankaj Tewari	Company Secretary

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	LIC New Endowment Plus	4.17
2	ICICI Prudential Asset Management	2.82
3	Capital Group Companies	2.80
4	SBI Funds Management Private Limited	2.65
5	Europacific growth fund	1.90
6	Republic of Singapore	1.61
7	The Vanguard Group Inc.	1.35
8	BlackRock Inc.	1.33
9	ICICI Prudential Life Insurance Co.	1.08
10	Government Pension Fund	1.07

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

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by BNP PARIBAS

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