

Company update

Telecom

Target price: Rs960

Shareholding pattern

	Jun '22	Sep '22	Dec '22
Promoters	55.9	55.1	55.1
Institutional investors	38.8	39.6	39.6
MFs and others	12.2	10.7	10.9
Insurance Cos.	2.3	6.7	6.8
FIIIs	24.3	22.2	21.7
Others	5.3	5.3	5.5

Source: NSE

ESG disclosure score

Year	2021	2022	Chg
ESG score	59.7	63.2	3.5
Environment	40.1	50.7	10.6
Social	51.6	51.6	0.0
Governance	87.4	87.4	0.0

Note - Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures.

Source: Bloomberg, I-sec research

Bharti Airtel

BUY
Maintained

Can Bharti's FCF surprise positively?

Rs767

The biggest disappointment for Bharti we have heard from investors is lack of FCF generation in the past, which has capped shareholder value creation. In this note, we highlight the reasons for Bharti's lack of FCF generation, which includes competitive intensity, costs of building spectrum portfolio, leapfrogging in technology adoption, regulatory payouts and Africa acquisition. The heavy-lifting on most investments is behind except for 5G network rollout. Thus, we have come a long way, and are close to crossing the line from where Bharti can possibly generate cashflow equivalent to 10% of its current market capitalisation, and this, we believe, is just two years away. We maintain our BUY rating on Bharti with an unchanged SoTP-based target price of Rs960.

Bharti's FCF generation has been disappointing for long. The single-biggest disappointment for Bharti since FY10 has been its inability to generate healthy FCF. It has barely registered any FCF after interest payments, which has capped value creation for shareholders through dividends, buybacks or simple net-debt-reduction, which boost equity value. We analyse the data from FY10 to reckon what went wrong for Bharti. Below are a few major factors that adversely impacted FCF generation:

- ▶ **Rise in competitive intensity** – India's telecom industry had seen unreasonable competitive intensity, which is the prime factor for low cashflow from operations. The number of players in the industry went up to 14-15 per circle leading to massive price erosion. Reliance Jio (RJio) foray completely shook up the industry forcing it to restructure, though it also helped consolidate. Nonetheless, despite investment across technologies, ARPUs have remained lower than anticipated. Notably, Bharti's ARPU in FY10 was Rs240 (including contribution from IUC) compared to FY23 ARPU estimated at Rs190, which implies hardly any growth.
- ▶ **Investment to augment spectrum portfolio** – Indian government allocated spectrum through the administrative process till CY08 for small licence fees. Therefore, spectrum cost was negligible for telcos in the 2G era. While cost was negligible, spectrum availability was unpredictable and use cases were restricted. Administratively allocated spectrum had defined technology attached to it, thus restricting spectrum use. India moved to spectrum allocation via auctions, but the spectrum prices were most expensive globally, and legacy telcos also ended up paying huge spectrum payments to renew administratively-allocated spectrum. Bharti has invested ~Rs1,600bn for spectrum purchases since FY10.
- ▶ **AGR dues and penalties** – Telcos lost their AGR definition case against the government in Oct'19. This resulted in creation of huge AGR dues and penalties. Bharti has amassed payment of ~Rs420bn towards AGR dues.

Market Cap	Rs4277bn/US\$52.2bn
Reuters/Bloomberg	BRTI.BO / BHARTI IN
Shares Outstanding (mn)	5,575.8
52-week Range (Rs)	877/629
Free Float (%)	44.9
FII (%)	21.7
Daily Volume (US\$/'000)	49,643
Absolute Return 3m (%)	0.4
Absolute Return 12m (%)	3.6
Sensex Return 3m (%)	0.5
Sensex Return 12m (%)	4.9

Year to Mar	FY22	FY23E	FY24E	FY25E
Revenue (Rs bn)	1,165	1,381	1,559	1,712
Net Income (Rs bn)	26	70	180	261
EPS (Rs)	4.7	12.6	30.2	43.9
% Chg YoY	207.6	170.9	139.1	45.5
P/E (x)	99.0	60.8	25.4	17.5
CEPS (Rs)	51.0	62.5	80.0	93.0
EV/E (x)	11.2	9.3	8.0	6.7
Dividend Yield (%)	0.4	0.8	1.6	2.3
RoCE (%)	6.9	9.3	11.4	14.0
RoE (%)	6.8	9.3	19.4	23.9

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- ▶ **Technology transition** – India has leapfrogged in technology-adoption from being a laggard to being an early adopter. India's 3G spectrum auction was conducted in CY10 while globally 3G rollout started in CY02/CY03. First 4G-LTE was launched in CY10, but it became popular in CY13 with launch of services by China Mobile (TD-LTE). India launched commercial 4G services in CY16. First 5G was launched in CY19, but India is among the countries that are rolling out 5G fastest (5G spectrum auctions took place in CY22). Refer to article ([link](#)) - 'India ahead of world in 5G rollout, growing 'extremely fast', say Ericsson, Nokia'.
- ▶ **Leveraged buyout of Zain Africa didn't work out as anticipated** – Bharti bought Zain's Africa operation in CY10 for an enterprise value of US\$10.7bn. It was a leveraged buyout. Two aspects impacted Bharti from the Africa acquisition: 1) significant under-performance (the asset was under-invested, and Bharti misread the market and implemented India-based learning in Africa which didn't work), and 2) significant depreciation of African currencies, and the INR. The debt was largely USD-denominated.

Where are we in each of these aspects? The situation has undergone massive / rapid repair in each of the five aspects discussed above, which provides huge comfort.

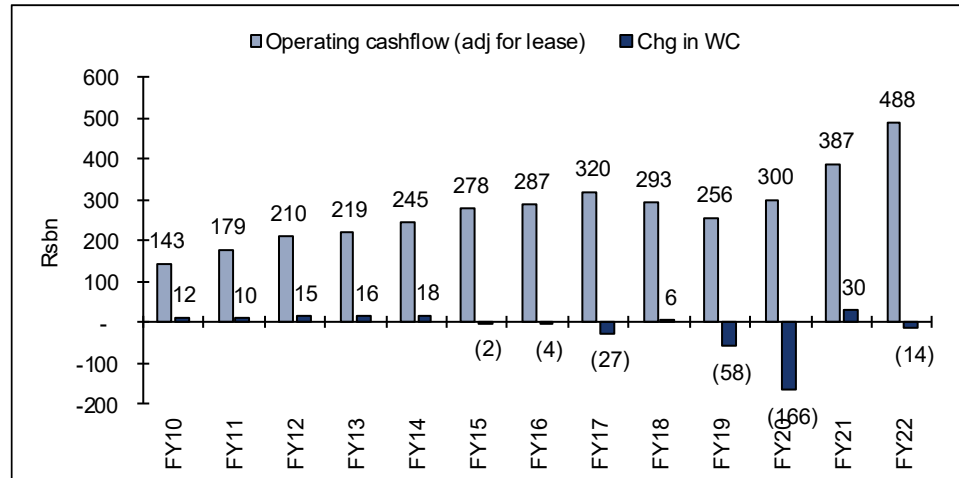
- ▶ **Consolidation and acceleration in revenue growth** – India's telecom industry has now consolidated into three private players, wherein one player faces a risk to its 'going concern' status. Further, new player(s) entry has largely been during technology transition, and Bharti / RJio have rapidly progressed on 5G deployment. The risk of new entrant is now pushed to 6G. India has also started taking large tariff interventions supporting revenue growth. Bharti's ARPU (adjusted for IUC) has seen a CAGR of 15% over FY20-FY23E. We expect an ARPU CAGR of 9-10% at least over the next two years as well.
- ▶ **Spectrum investments to be very limited** – Bharti has built a very large spectrum portfolio across technologies. These spectrums should take care of 5G rollout and, in worst case, the company may be forced to buy some sub-GHz spectrum (we assign **low** probability to it). The next big spectrum payout may only be in CY30 when its 2100MHz and 2300MHz band spectrum comes for renewal.
- ▶ **Regulatory payouts** – The only large dispute pending with the government is about one-time-spectrum-charges.
- ▶ **Technology transition** – India has become an early adopter on the technology front, which means technology transition will coincide with industry hereon. In fact, India is ahead in SA-5G (standalone 5G) while a developed market such as UK is planning for ubiquitous rollout only by 2030 ([link](#)). We estimate 4G and 5G to coexist for next 8-10 years before we adopt 6G as the mainstream technology. Globally, 5G investments are not justified by mobile services; therefore, telcos are targeting to develop new enterprise use cases. It would require an ecosystem to evolve for telcos to realise the benefit of 5G investments.
- ▶ **Africa contributing to FCF** – Airtel Africa has smartly turned around in past few years. Its EBITDA grown >2.5x to US\$2.5bn in FY23E since FY18. Despite significantly increasing dividend payout, its net debt stands at only US\$1.6bn.

We remain optimistic on Bharti's FCF generation. Our confidence in FCF generation emanates from the following factors: 1) India, at worst, will remain a 3-private-player market for the foreseeable future limiting competitive intensity; 2) telcos will keep playing with tariffs, but we expect ARPUs to grow at least 10% p.a. for the next few years as operators focus on FCF generation vs market share in prepaid 4G / 5G segments. Bharti has taken unprecedented tariff hikes in its base voice plans in the past two years moving from Rs75 to Rs155 (for 28 days); 3) network capex likely to peak in FY24, and progressively reduce as 5G coverage layer reaches ~75% of the population; and 4) spectrum investment to be limited; large spectrum renewal expected only in CY30.

- ▶ Bharti's cashflow will also benefit from steady growth in non-mobile services including FTTH and enterprise. Dividends from Airtel Africa and Indus will add to India FCF generation. Spectrum moratorium is due to end in FY26 and this will increase cash outflow towards government payment from FY27.
- ▶ Our estimates suggest FCF generation (after interest cost) of >Rs400bn for Bharti in FY25E, which is 10% of its current market capitalisation. Bharti has set a good precedent of paying dividends in its two related companies – Indus Towers (erstwhile Bharti Infratel), and Airtel Africa. We remain hopeful of Bharti generously rewarding shareholders from FY25.

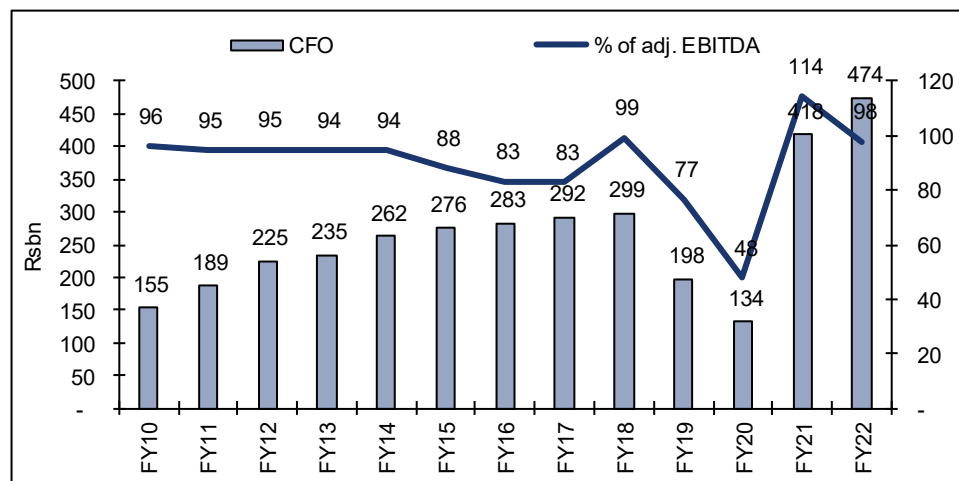
Bharti's FCF generation has been disappointing for long

Chart 1: Despite acquisition of Africa operations, and 3G rollout, operating cashflow only doubled in FY17 vs FY10



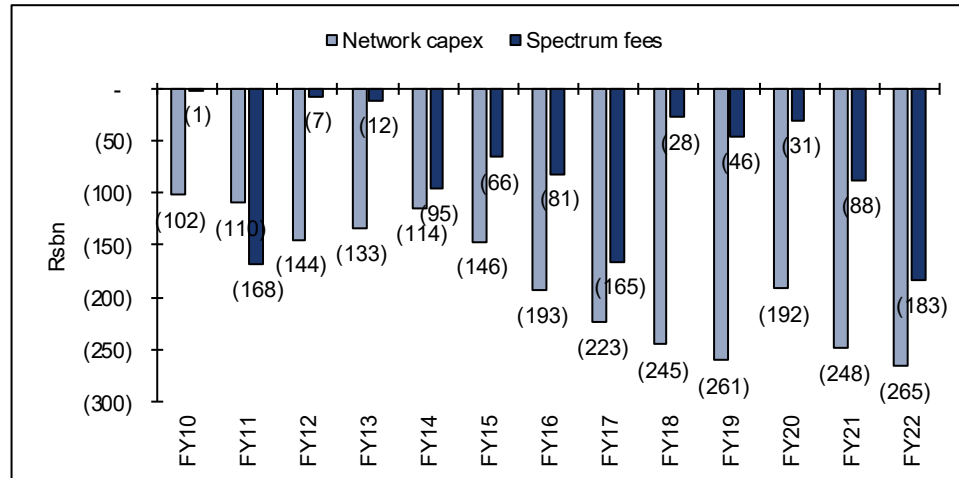
Source: I-Sec research, Company

Chart 2: CFO (after lease payments) has struggled from FY10-FY20; however, it bounced remarkably from FY21



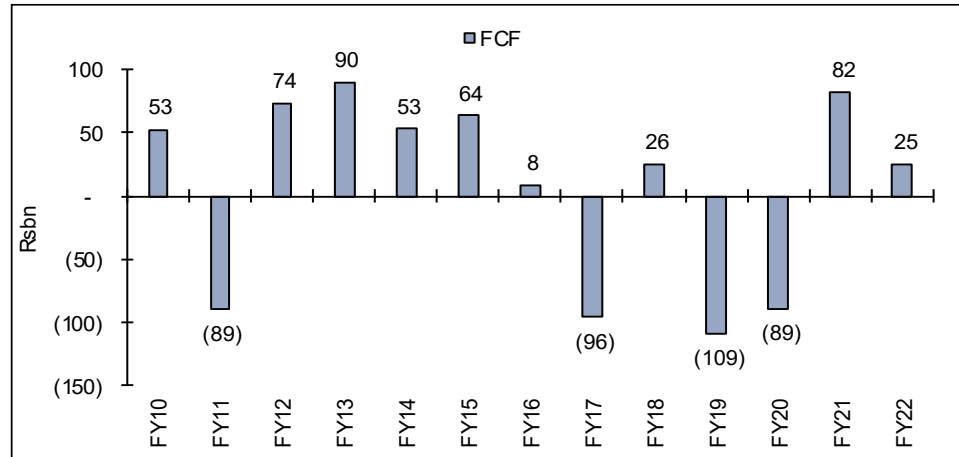
Source: I-Sec research, Company

Chart 3: Bharti has significantly invested in spectrum and capex for technology transition...



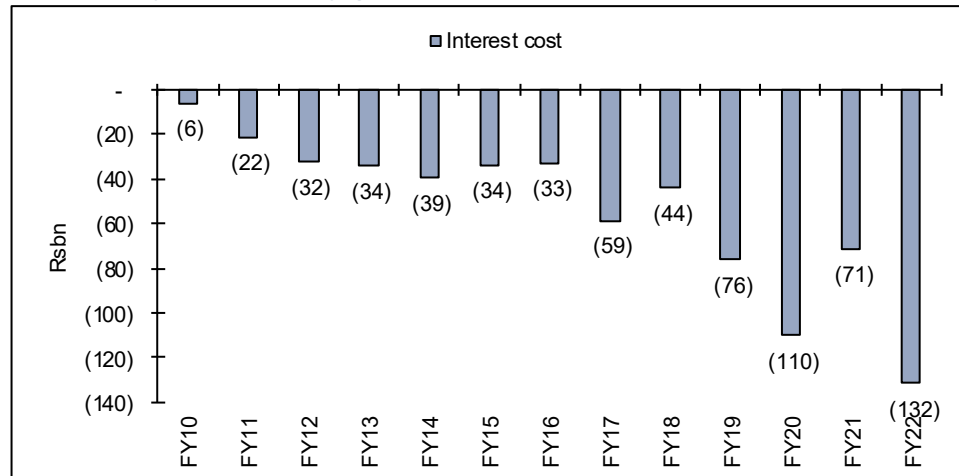
Source: I-Sec research, Company; Note: Bharti did prepayment of spectrum dues (refinanced at lower interest rate) in FY22 which lead to significant spectrum and interest payment

Chart 4: ...therefore, adversely impacting FCF generation



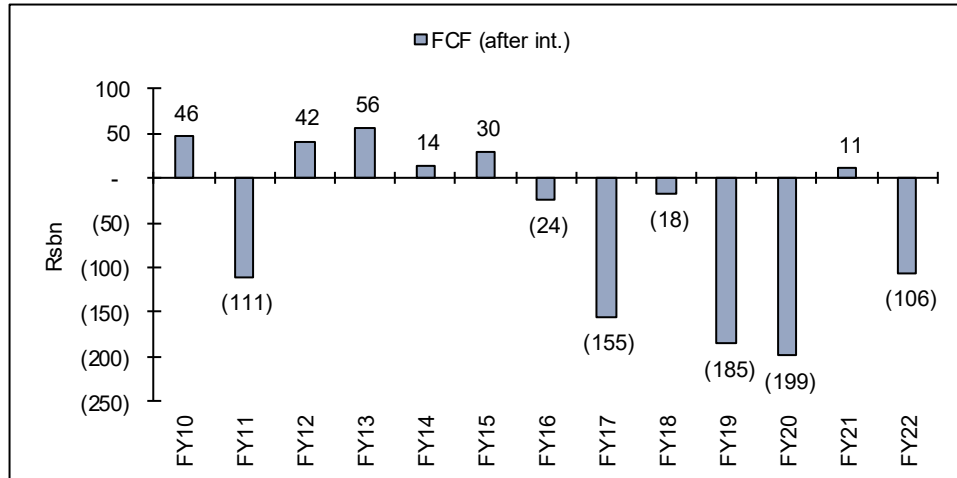
Source: I-Sec research, Company

Chart 5: Interest payment has increased significantly with rise in net debt – albeit partly alleviated by government moratorium from CY20



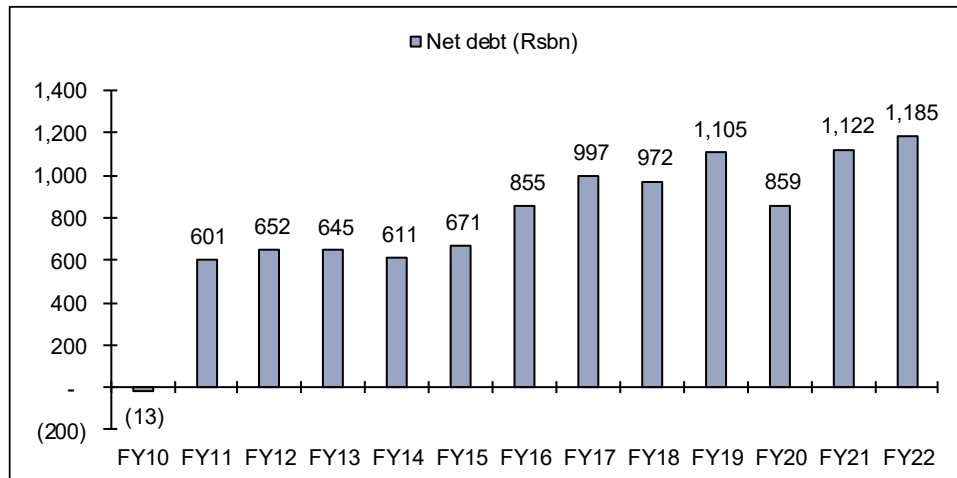
Source: I-Sec research, Company. Note: Bharti did prepayment of spectrum dues (refinanced at lower interest rate) in FY22 which led to significant spectrum and interest payment

Chart 6: Bharti has barely generated any FCF post interest payment since FY10



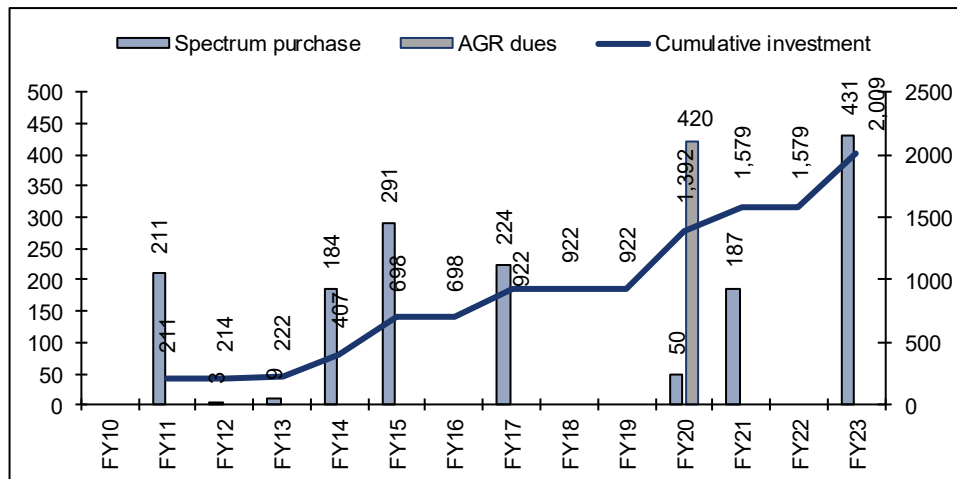
Source: I-Sec research, Company

Chart 7: Bharti's net-debt-free balance sheet in FY10 amassed large debt...

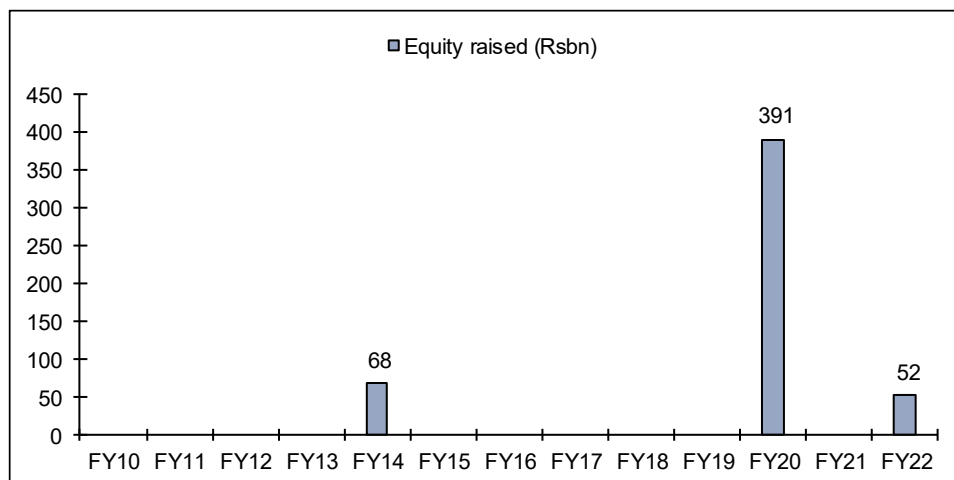


Source: I-Sec research, Company

Chart 8: ...due to Rs2,009bn investment in spectrum purchase and AGR dues



Source: I-Sec research, Company

Chart 9: Bharti has infused equity of Rs512bn since FY10

Source: I-Sec research, Company

Table 1: We remain optimistic on Bharti' FCF generation and net debt reduction through internal accruals

Rs mn	FY23E	FY24E	FY25E	FY26E
CFO (after lease and wc)	571	689	763	765
Capex	(350)	(363)	(255)	(256)
Spectrum	(121)			
FCF	100	327	509	510
Interest	(70)	(70)	(63)	(57)
FCF after interest	30	257	446	453

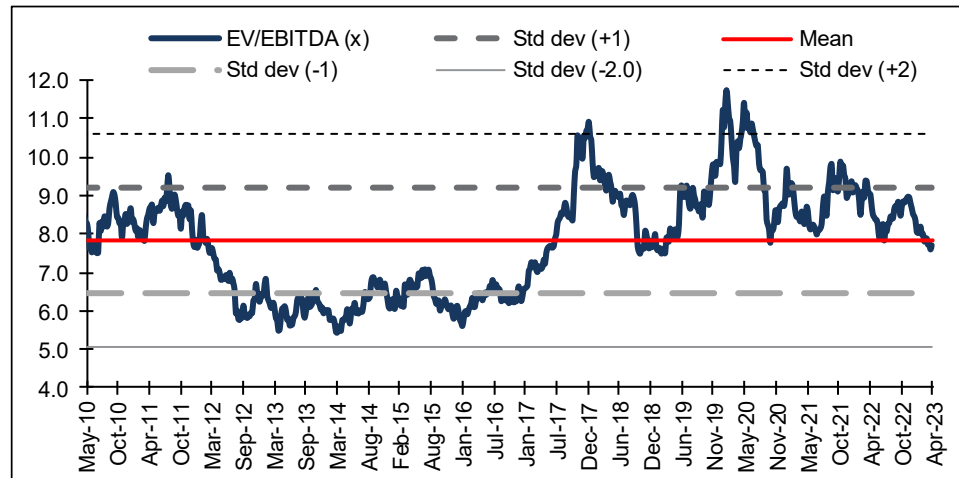
Source: I-Sec research, Company

Table 2: Bharti's SoTP-based valuations

Rs mn	FY25E
India business (ex Tower)	
EBITDA (adj Ind-AS 116)	6,29,115
<i>Multiple (x)</i>	<i>9.5</i>
EV	59,76,589
Less net debt	11,44,447
Equity value...(a)	48,32,142
Tower business (DCF from Indus model)	
EV	6,00,520
Less net debt	31,227
Equity value	5,69,293
Stake (%)	47
Attributable Equity value...(b)	2,68,137
Airtel Africa	
EBITDA (adj Ind-AS 116)	2,10,054
<i>Multiple (x)</i>	<i>5.0</i>
EV	10,50,268
Less net debt	(95,266)
Equity value	11,45,534
Stake (%)	53
Bharti attributable Equity value...(c)	6,09,424
Bharti Airtel Equity value	57,09,704
<i>Outstanding shares (mn)</i>	<i>5,955</i>
Equity value per share (Rs)	960
Equity value per share (Rs)	960

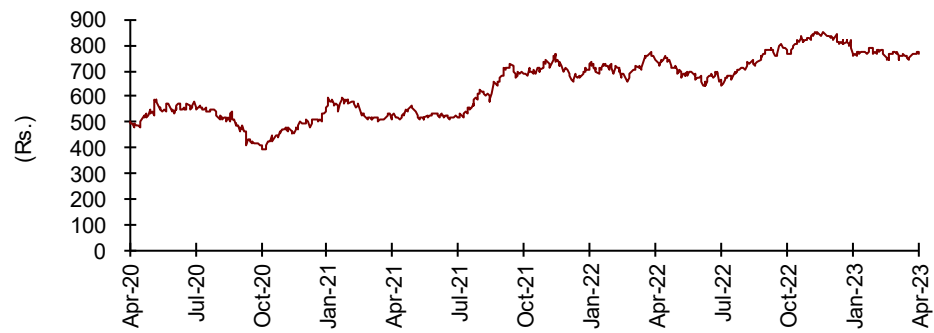
Source: I-Sec research, Company

Chart 10: Bharti's 1-year forward EV/EBITDA



Source: I-Sec research, Company

Price chart



Source: Bloomberg

Financial summary

Table 3: Profit & Loss statement

(Rs mn, year ending March 31)

	FY22	FY23E	FY24E	FY25E
Operating Income (Sales)	11,65,469	13,80,889	15,58,998	17,11,995
Operating Expenses	5,90,130	6,68,597	7,21,688	7,73,821
EBITDA	5,75,339	7,12,292	8,37,310	9,38,173
% margins	49.4	51.6	53.7	54.8
Depreciation & Amortisation	3,30,907	3,57,414	3,79,066	3,77,303
Net Interest	1,66,162	1,88,104	1,55,335	1,43,980
Other Income	24,232	6,481	23,831	26,078
Recurring PBT	1,07,845	1,73,255	3,26,741	4,42,968
Add: Extraordinaries	3,85,358	1,10,567	-	-
Less: Taxes	41,779	60,710	1,01,791	1,33,539
- Current tax				
- Deferred tax				
Less: Minority Interest	40,503	42,395	45,371	48,077
Net Income (Reported)	42,549	70,151	1,79,579	2,61,352
Recurring Net Income	25,563	70,151	1,79,579	2,61,352

Source: Company data, I-Sec research

Table 4: Balance sheet

(Rs mn, year ending March 31)

	FY22E	FY23E	FY24E	FY25E
Assets				
Total Current Assets	6,43,439	6,80,415	7,64,387	8,77,262
of which cash & cash eqv.	1,34,943	1,47,066	2,19,151	3,29,355
Total Current Liabilities & Provisions	9,95,943	10,40,830	10,61,219	10,55,754
Net Current Assets	(3,52,504)	(3,60,414)	(2,96,832)	(1,78,492)
Investments	2,93,491	2,84,877	2,84,877	2,84,877
of which				
Strategic/Group	2,84,268	2,84,268	2,84,268	2,84,268
Other Marketable	9,223	609	609	609
Net Fixed Assets	21,62,067	26,65,449	27,31,455	26,93,814
Goodwill	3,38,313	3,38,313	3,38,313	3,38,313
Total Assets	24,41,367	29,28,225	30,57,813	31,38,512
Liabilities				
Borrowings	16,96,779	19,96,779	18,96,779	17,46,779
Deferred tax liability	(1,74,762)	(1,59,504)	(1,10,182)	(36,295)
Minority Interest	2,53,807	2,53,807	2,53,807	2,53,807
Equity Share Capital	27,460	27,816	29,776	29,776
Face Value per share(Rs)	5.0	5.0	5.0	5.0
Reserves & Surplus	6,38,083	8,09,326	9,87,634	11,44,445
Net Worth	6,65,543	8,37,142	10,17,410	11,74,221
Total Liabilities	24,41,367	29,28,225	30,57,813	31,38,512

Source: Company data, I-Sec research

Table 5: Quarterly trend

(Rs mn, year ending March 31)

	Mar-22	Jun-22	Sep-22	Dec-22
Net sales	3,15,003	3,28,046	3,45,268	3,58,044
% growth (YoY)	22.3	22.2	21.9	19.9
EBITDA	1,60,403	1,65,294	1,75,938	1,84,532
Margin (%)	50.9	50.4	51.0	51.5
Other income	(1,225)	(685)	(1,013)	(1,984)
Add: Extraordinaries	9,062	-	-	(6,698)
Net profit	20,078	16,069	21,452	15,882

Source: Company data

Table 6: Cashflow statement

(Rs mn, year ending March 31)

	FY22	FY23E	FY24E	FY25E
Operating Cashflow	5,64,638	6,30,927	7,63,301	8,56,522
Working Capital Changes	(14,472)	20,033	8,502	(8,135)
Capital Commitments	(4,48,481)	(7,80,670)	(3,62,596)	(2,54,767)
Free Cashflow	1,01,685	(1,29,710)	4,09,207	5,93,620
Cashflow from Investing Activities	29,785	8,614	-	-
Issue of Share Capital	52,233	1,36,524	72,520	-
Buyback of shares Inc (Dec) in				
Borrowings	(8,602)	3,00,000	(1,00,000)	(1,50,000)
Dividend paid	(1,95,663)	(3,03,305)	(3,09,642)	(3,33,416)
Extraordinary Items	-	-	-	-
Chg. in Cash & Bank balance	(20,562)	12,123	72,085	1,10,204

Source: Company data, I-Sec research

Table 7: Key ratios

(Year ending March 31)

	FY22	FY23E	FY24E	FY25E
Per Share Data (in Rs)				
Recurring EPS	4.7	12.6	30.2	43.9
Reported EPS	7.7	12.6	30.2	43.9
Recurring Cash EPS	51.0	62.5	80.0	93.0
Dividend per share (DPS)	3.0	6.3	12.1	17.6
Book Value per share (BV)	121.2	150.5	170.8	197.2
Growth Ratios (%)				
Operating Income	15.8	18.5	12.9	9.8
EBITDA	26.8	23.8	17.6	12.0
Recurring Net Income	207.6	174.4	156.0	45.5
Diluted Recurring EPS	207.6	170.9	139.1	45.5
Diluted Recurring CEPS	17.6	22.5	28.0	16.3
Valuation Ratios (% YoY)				
P/E	99.0	60.8	25.4	17.5
P/CEPS	15.0	12.3	9.6	8.2
P/BV	6.3	5.1	4.5	3.9
EV / EBITDA	11.2	9.3	8.0	6.7
EV / Operating Income	4.6	4.2	3.8	3.3
EV / Operating FCF	22.1	16.2	12.8	10.0
Operating Ratios				
Other Income / PBT (%)	22.5	3.7	7.3	5.9
Effective Tax Rate (%)	38.7	35.0	31.2	30.1
NWC / Total Assets (%)	(14.4)	(12.3)	(9.7)	(5.7)
Inventory Turnover (days)	-	-	-	-
Receivables (days)	12.7	12.0	11.2	10.5
Payables (days)	152.6	138.0	127.0	116.1
Net Debt/EBITDA Ratio (x)	2.1	2.1	1.6	1.1
Capex % of sales	38.5	56.5	23.3	14.9
Profitability Ratios (%)				
Rec. Net Income Margins	2.2	5.1	11.5	15.3
RoCE	6.9	9.3	11.4	14.0
RoIC	12.1	15.2	17.8	22.2
RoNW	6.8	9.3	19.4	23.9
Dividend Yield	0.4	0.8	1.6	2.3
EBITDA Margins	49.4	51.6	53.7	54.8

Source: Company data, I-Sec research

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