

BHARTI AIRTEL

TELECOMMUNICATIONS

BUY

Target Price: Rs 700

Conference call takeaways

We hosted the senior management of Bharti Airtel for a conference call. Key takeaways: **(i)** Expects further tariff hike (including postpaid), though timing remains uncertain; **(ii)** Rs 50-70 increase in tariff likely to be absorbed; **(iii)** Coverage and experience is key differentiator; **(iv)** Company exploring options in devices; **(v)** 5G will require ecosystem; **(vi)** Sees opportunities in enterprise & homes business; and **(vii)** Capex requirement to be modest in medium term.

Operating leverage benefit to play out, as ARPU improves led by mix change (shift to 4G). We continue to like its competitive positioning. We believe that early success of digital platform initiatives could attract new genre of investors similar to RJio. Maintain **BUY** with SoTP-based TP of Rs 700 (Jun-22x).

CMP : Rs 434
 Potential Upside : 61%

MARKET DATA

No. of Shares : 5,456 mn
 Free Float : 44%
 Market Cap : Rs 2,367 bn
 52-week High / Low : Rs 612 / Rs 326
 Avg. Daily vol. (6mth) : 23.9 mn shares
 Bloomberg Code : BHARTI IB Equity
 Promoters Holding : 56%
 FII / DII : 20% / 18%

Tariff hike and enterprise growth to be key growth drivers

Next tariff hike timing remains uncertain: Airtel expects ARPU to increase from ~Rs 160 to ~Rs 200 in the short term and ultimately to Rs 300. However, tariff hike will not be unilateral and timing remains uncertain. Rs 50 to Rs 70 increase in tariff expected to be easily absorbed. ARPU in postpaid segment to be at a marginal premium to prepaid and is expected to rise in future tariff hikes. Focus on 4G and quality customers has worked well. We remain positive on Airtel given its **(a)** strong competitive positioning, **(b)** turnaround in the sector and **(c)** strong performance in Africa.

Excited about enterprise business; 5G will require ecosystem: Airtel sees enterprise as a huge opportunity. It aims to help them **(i)** grow their businesses; **(ii)** reduce cost; and **(iii)** protect against cyber security threats. It also sees Homes as a big opportunity and plans to expand to 200/1,000 towns by March-2021/March-2022. It is trying to bring broadband, DTH and mobility together under 'One Airtel' plan through Xtreme box. Its family plans with low churn have played pivotal role in its portfolio. 5G will require ecosystem and viable economic case. Capex requirement to be modest in the next 18 to 24 months. 5G is likely to start after 2 years though capex for 4G will be behind by that time.

Financial summary (Consolidated)

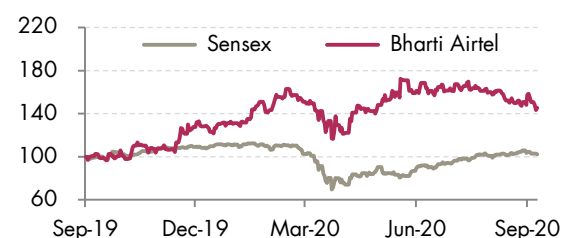
Y/E March	FY20	FY21E	FY22E	FY23E
Sales (Rs bn)	875	1,034	1,217	1,354
Adj PAT (Rs bn)	(39)	7	54	95
Con. EPS* (Rs)	-	(5.6)	14.2	23.6
EPS (Rs)	(7.6)	1.2	10.0	17.5
Change YOY (%)	9.4	(116.1)	716.4	75.3
P/E (x)	(57.4)	355.4	43.5	24.8
RoE (%)	(5.3)	1.0	8.4	13.3
RoCE (%)	4.1	7.1	10.2	11.7
EV/E (x)	10.7	8.1	6.1	4.9
DPS (Rs)	2.0	1.8	1.8	1.8

Source: *Consensus broker estimates, Company, Axis Capital

Key drivers

	FY20	FY21E	FY22E	FY23E
Revenue (Rs bn)	875	1,034	1,217	1,354
Growth	8.0%	18.1%	17.8%	11.3%
EBITDA (Rs bn)	371	480	604	692
EBITDA margin	42.4%	46.4%	49.7%	51.1%

Price performance



Key management comments

- ◆ **Structure of industry and what has worked for company:** Industry has been turbulent in last 3-4 years. Shrank from 11-12 players to 3 players + BSNL. It has seen the worst and is now better placed than three years ago. Airtel is now at lifetime high in terms of revenue market share at 34% (which is important as per the company). Three things that have worked for Airtel: **(i)** Bet on 4G and stepped-up capex for ~2 years that paid off; **(ii)** Keeping the brand truly aspirational; and **(iii)** Focused strategy on winning quality customers by shedding low ARPU 40-45 mn customers, which helped improve revenue with fewer customers.
- ◆ **Postpaid – premium segment with high inertia:** Customers in postpaid segment look for (i) best service and network experience, especially indoors and (ii) aspirational value (~30 to 40 mn consumer want to associate themselves with brands). The segment has exceptionally high inertia which was tested during demonetization and pricing war. In the aftermath of demonetization, prepaid revenues dropped ~25% while postpaid were relatively resilient.
- ◆ **Postpaid ARPU to rise in future tariff hikes:** Management expects ARPU in postpaid segment to be at a marginal premium to prepaid. During the past 2 to 3 years, the postpaid premium increased due to reduced prepaid prices. Thus, in current round of tariff hikes, postpaid ARPU were stable. Currently, the postpaid to prepaid premium is optimum and company expects postpaid ARPU to rise in the future tariff hikes.
- ◆ **Expects tariff hike; timing uncertain:** Airtel expects ARPU to increase from ~Rs 160 to ~Rs 200 in short term and ultimately to Rs 300. It expects further tariff hike though it will not increase prices unilaterally (as may lose market share). However, it is uncertain about the timing of the tariff hike. As per the management, pricing will go up for sure and is the question of when and not if.
- ◆ **Covering gaps in rural:** Coverage and experience will be a key differentiator in sector. Company is covering gaps in coverage in rural and aggressively deploying towers there. It sees this as a better place to deploy capital. Experience is important, as discerning customer will be ready to pay additional Rs 15-20 for better experience. Company has done adjustment in pricing in last few years and it is now at a place where it should be.
- ◆ **Device strategy – exploring options:** Airtel is exploring two options to deal with possible launch of low-priced smart phones: **(a)** launching own device or launching it in partnership; and **(b)** ecosystem of partners that can bring down price of device. It will still have to decide the final approach.
- ◆ **Price elasticity – tariff hike likely to be absorbed:** Indian market is more stratified than other markets, though device market acts differently. Smallest segment in smart phone is below Rs 6,000. Contribution of this segment is negligible relative to Rs 6,000 to 10,000 which is the biggest segment. Phone is an integral part of life and people spend ~4 hours per day on mobile device. It is also a right of passage for customers. Data has become integral to life and elasticity is lower vs other categories. As mobility category is integral part of life now, Rs 50-70 increase in tariff will not be a problem. Last time when there was tariff hike in December 2019, flow-through to revenue was complete (~100%) with no customer erosion. Airtel remains hopeful that price absorption

will not be an issue and the real issue is only the ambition and relative perception of equilibrium in the market. The price was is over and the industry is well on its path to recovery, as per the company.

- ◆ **5G will require ecosystem:** 5G has to happen. If new technology is not deployed, companies will fall behind. 5G needs large chunks of spectrum (~100 MHz). The cost of the spectrum is Rs 500 bn which is unsustainable and there will not be any business case at this price. So, the company will not bid at this price and will wait and see. 5G will also require ecosystem which is still at nascent stage. 4G experience in India is currently not comparable to other markets, as networks are congested. 4G technology created lot of new businesses like ride applications, food delivery, OTT, etc. A lot of ecosystem and applications needs to be built. As long as ARPU is sustainable, investments should be made and will be made. 4G capex cycle is largely over now and after next 1 or 2 years less capex will be made in 4G and next technology cycle will commence. However, this will require viable economic case.
- ◆ **Excited about enterprise business:** Company sees enterprise as a huge opportunity. Airtel serves 2k large companies, 50-60k medium sized enterprises and over half a million small enterprises. Trust and relationship is imperative for large and medium sized enterprises. Airtel has deep relationship with these companies and built lot of trust and relationships. The key questions these enterprises ask: **(i)** How can Airtel help them grow their business by allowing engaging digitally with customers? **(ii)** How can Airtel help attack their cost base? and **(iii)** How does Airtel protect from cyber security threats. Airtel's enterprise strategy is based on these three points.
 - **Engaging digitally with customers:** Full-fledged omni channel customer relationship management product built by the company's engineers has been launched a year back. Company is seeing good early results and will launch it nationally in few weeks.
 - **Attacking the cost base:** Though data centres, looking into applications to reduce cost, hosting them on private Cloud. Also, converged networks for companies by providing 2 networks, but providing through one stop shop using product "Office in a box" that will take care of all the costs and in process save cost.
 - **Protecting from cyber security threats:** For cyber security, company has Airtel Secure in alliance with Palo Alto networks, Semantic, Radware, Cisco. Company also has its own cyber security intelligence centre at Manesar which monitors cyber security threats for customers. It has already 20 customers for this cyber security and plans to put more energy behind it.
- ◆ **Opportunity to resell:** Once the company has relationships, data of customers, payment method, access to customers (distribution), network and location APIs of customers, company can use this to resell the products both in B2B and B2C. Bluejeans (in collaboration with Verizon) is an example of reselling with deep partnership, customizing it for the Indian markets. It also has partnership with Cisco for routing solutions packaged into the network. The company is doing it by creating a technology layer that allows quick integration and partnership that help create new revenue streams.

- ◆ **Homes also to be a big opportunity:** Homes is operating in 70 to 80 cities on its own network. Company has ramped up investments in last one year and has been collaborating with local operators for last mile connectivity. Company expects it to expand to 200 towns by March-2021 and 1,000 towns by March 2022. It is expanding in home broadband using fiber and this will become the main layer for connectivity along with fiber for small enterprises.
- ◆ **Bringing broadband, DTH, mobility together:** It is trying to bring broadband, DTH and mobility together under 'One Airtel' plan through Xstreme box that allows to stream linear content through DTH technology and also has ethernet port to allow use of OTT applications like Netflix, Amazon Prime, etc. all bundled together under Xstream brand. It has one unified interface with single sign-on and unified search bundled together with family plan.
- ◆ **Family plans have low churn:** Family plans have been most pivotal in last 5 years for the company in its portfolio. Churn is low for such plans as the cost of shifting/leaving increases. Selling it is not easy and takes time to convert.
- ◆ **Full-fledged Cloud strategy:** Airtel's full-fledged Cloud strategy has 3 parts to it: (i) Private Cloud which is the largest; (ii) Public Cloud in partnership with AWS and Google; and (iii) Edge Cloud with 200 data centres which are used by its own applications at the edge and content players (OTT) like Hotstar, Zeel, etc.
- ◆ **Digital technology has to serve customers:** Digital technology to be at the core of everything. Anything Airtel does, the priority is to (i) add customer; (ii) get more lifetime value; and (iii) eliminate waste. Data with most telcos cannot be used, as one application does not interact with other. Airtel has the advantage as (a) It has one massive data layer across the network; (b) Payments is a big problem which Airtel can solve and (c) distribution and network KPI based on location (omni channel) is the other strength. Airtel has stripped out digital asset in a digital company (with all its digital assets). These applications require little capital and high digital talent. Airtel is using these foundation layers to acquire customers, increasing lifetime value and reducing waste. This has to work for the core business before working for the digital business. In the core business, 50% of the business is through online channels and 30-40% of the post-paid and broadband acquisitions are sourced through online channels. Calls into the calls centers have plummeted ~50% because of new technologies. On top of this, there is capability to build: (i) own products (omni channels, etc.); (ii) partnering with other companies to create digital commerce (content, insurance, lending, other financial services, other verticals); and (iii) create advertising stream of revenue (ad tech platform). Conversion of customers on its platform is more and that is helping add quality customers. Its digital technology will help create sticky customers with minimal capex.
- ◆ **Cost of data to be lower for 5G vs 4G:** Cost per GB to be low in 5G as new technology using more spectrum to use more GB. It is also a function of usage (in full network to have lower cost). 5G have open RAN having separate hardware and software that has the capacity to reduce cost. Airtel has developed its own small cell that can work on any network (based on RAN). It has already deployed 4,500 small cells. It is also working on its 5G solution. It is trying to develop a complete eco-system. Costing likely to be lower in the 5G ecosystem, but it is still work in progress. Still early days for 5G, as the ecosystem is in early days.

- ◆ **Capex requirement to be modest in medium term:** Capital requirement in the industry to be modest in the next 18 to 24 months. There will be a round of capex to connect rural India, add capacities and spectrum wherever required and add fiber. After 2 years, capex for 5G will start though capex for 4G will be behind by that time. Capex will also be function of ARPU and tariff improvement. Airtel believes that its balance sheet is strong and its performance will remain robust for couple of years.
- ◆ **Some Covid-19 impact; growth in other areas:** Company has been resilient during Covid-19. There was slowdown in recharges earlier on, but digital capabilities with easing of recharge features helped 60% of recharges going through online channels. Some challenge in the lower end base. In the enterprise, there was increase in churn in small and medium enterprise. Larger enterprise services were impacted by reduction in offices amid work from home. However, there has been growth in capacities, Cloud, video conferencing, strong surge in home broadband, etc.

Financial summary (Consolidated)

Profit & loss (Rs bn)

Y/E March	FY20	FY21E	FY22E	FY23E
Net sales	875	1,034	1,217	1,354
Other operating income	-	-	-	-
Total operating income	875	1,034	1,217	1,354
Cost of goods sold	(388)	(415)	(452)	(485)
Gross profit	487	619	765	869
<i>Gross margin (%)</i>	<i>55.7</i>	<i>59.8</i>	<i>62.9</i>	<i>64.2</i>
Total operating expenses	(116)	(139)	(161)	(177)
EBITDA	371	480	604	692
<i>EBITDA margin (%)</i>	<i>42.4</i>	<i>46.4</i>	<i>49.7</i>	<i>51.1</i>
Depreciation	(277)	(306)	(353)	(391)
EBIT	94	174	252	301
Net interest	(124)	(125)	(137)	(130)
Other income	5	7	7	7
Profit before tax	(24)	55	122	179
Total taxation	8	(15)	(31)	(45)
<i>Tax rate (%)</i>	<i>31.2</i>	<i>26.2</i>	<i>25.2</i>	<i>25.2</i>
Profit after tax	(17)	41	91	134
Minorities	(23)	(34)	(37)	(38)
Profit/ Loss associate co(s)	-	-	-	-
Adjusted net profit	(39)	7	54	95
<i>Adj. PAT margin (%)</i>	<i>(4.5)</i>	<i>0.6</i>	<i>4.5</i>	<i>7.0</i>
Net non-recurring items	(282)	(154)	-	(12)
Reported net profit	(322)	(148)	54	83

Balance sheet (Rs bn)

Y/E March	FY20	FY21E	FY22E	FY23E
Paid-up capital	26	26	26	26
Reserves & surplus	746	592	650	736
Net worth	771	618	675	762
Borrowing	1,482	1,456	1,456	1,456
Other non-current liabilities	117	131	131	131
Total liabilities	2,621	2,479	2,573	2,698
Gross fixed assets	1,177	1,135	1,040	904
Less: Depreciation	-	-	-	-
Net fixed assets	1,177	1,135	1,040	904
Add: Capital WIP	-	-	-	-
Total fixed assets	1,177	1,135	1,040	904
Total Investment	1,374	1,303	1,233	1,156
Inventory	-	-	-	-
Debtors	46	65	75	82
Cash & bank	136	218	463	786
Loans & advances	-	-	-	-
Current liabilities	987	1,096	1,132	1,097
Net current assets	(434)	(429)	(203)	112
Other non-current assets	505	470	503	525
Total assets	2,621	2,479	2,573	2,698

Source: Company, Axis Capital

Cash flow (Rs bn)

Y/E March	FY20	FY21E	FY22E	FY23E
Profit before tax	(24)	55	122	179
Depreciation & Amortisation	277	306	353	391
<i>Chg in working capital</i>	<i>(11)</i>	<i>19</i>	<i>41</i>	<i>29</i>
Cash flow from operations	179	465	575	636
<i>Capital expenditure</i>	<i>(191)</i>	<i>(197)</i>	<i>(181)</i>	<i>(171)</i>
Cash flow from investing	(305)	(198)	(188)	(178)
<i>Equity raised/ (repaid)</i>	<i>335</i>	<i>-</i>	<i>-</i>	<i>-</i>
<i>Debt raised/ (repaid)</i>	<i>34</i>	<i>(27)</i>	<i>-</i>	<i>-</i>
<i>Dividend paid</i>	<i>(18)</i>	<i>(18)</i>	<i>(11)</i>	<i>(11)</i>
Cash flow from financing	193	(178)	(142)	(135)
Net chg in cash	68	89	245	323

Key ratios

Y/E March	FY20	FY21E	FY22E	FY23E
OPERATIONAL				
FDEPS (Rs)	(7.6)	1.2	10.0	17.5
CEPS (Rs)	(8.6)	29.0	74.6	87.0
DPS (Rs)	2.0	1.8	1.8	1.8
Dividend payout ratio (%)	(3.2)	(6.5)	17.6	11.5
GROWTH				
Net sales (%)	8.0	18.1	17.8	11.3
EBITDA (%)	41.1	29.3	26.0	14.5
Adj net profit (%)	11.1	(116.9)	716.4	75.3
FDEPS (%)	9.4	(116.1)	716.4	75.3
PERFORMANCE				
RoE (%)	(5.3)	1.0	8.4	13.3
RoCE (%)	4.1	7.1	10.2	11.7
EFFICIENCY				
Asset turnover (x)	0.4	0.5	0.6	0.7
Sales/ total assets (x)	0.3	0.3	0.3	0.4
Working capital/ sales (x)	(0.5)	(0.6)	(0.5)	(0.5)
Receivable days	19	23	22	22
Inventory days	-	-	-	-
Payable days	303	313	317	286
FINANCIAL STABILITY				
Total debt/ equity (x)	1.6	1.5	1.5	1.4
Net debt/ equity (x)	1.4	1.3	1.1	0.6
Current ratio (x)	0.6	0.6	0.8	1.1
Interest cover (x)	0.8	1.4	1.8	2.3
VALUATION				
PE (x)	(57.4)	355.4	43.5	24.8
EV/ EBITDA (x)	10.7	8.1	6.1	4.9
EV/ Net sales (x)	4.5	3.8	3.0	2.5
PB (x)	2.9	3.8	3.5	3.1
Dividend yield (%)	0.5	0.4	0.4	0.4
Free cash flow yield (%)	(0.5)	11.3	16.6	19.6

Source: Company, Axis Capital

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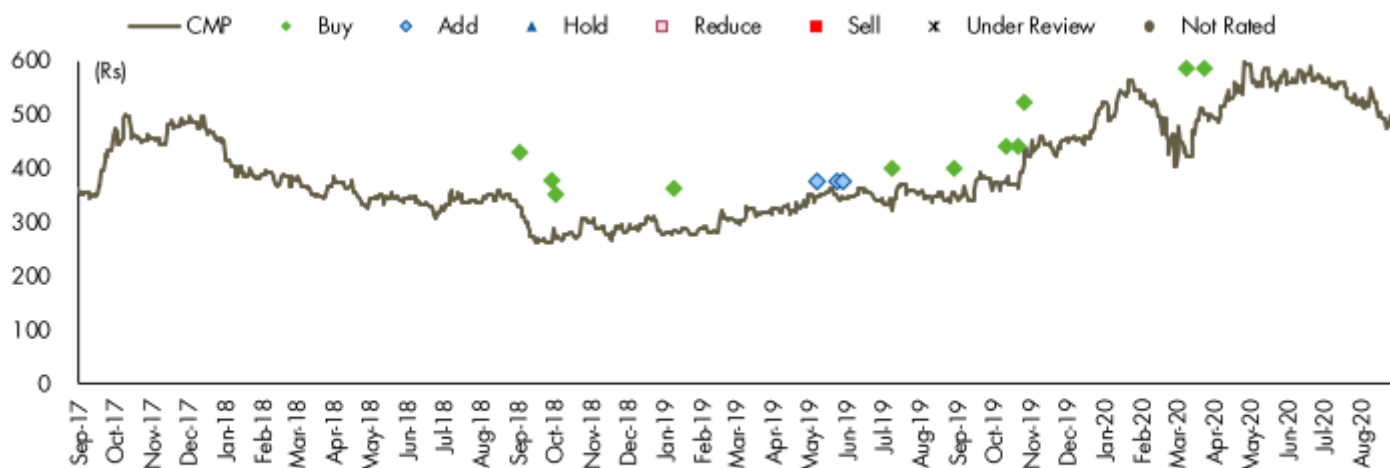
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DEFINITION OF RATINGS

Ratings	Expected absolute returns over 12 months
BUY	More than 15%
ADD	Between 5% to 15%
REDUCE	Between 5% to -10 %
SELL	More than -10%

Bharti Airtel (BRTI.BO, BHARTI IN) Price and Recommendation History



Date	Target Price	Reco	Date	Target Price	Reco
26-Sep-18	430	Buy	5-Feb-20	640	Buy
24-Oct-18	375	Buy	3-Apr-20	585	Buy
26-Oct-18	350	Buy	17-Apr-20	585	Buy
1-Feb-19	360	Buy	19-May-20	700	Buy
31-May-19	375	Add	30-Jul-20	700	Buy
17-Jun-19	375	Add	21-Sep-20	700	Buy
21-Jun-19	375	Add			
2-Aug-19	400	Buy			
23-Sep-19	400	Buy			
4-Nov-19	440	Buy			
14-Nov-19	440	Buy			
19-Nov-19	520	Buy			

Source: Axis Capital