MOTILAL OSWAL

30 August 2021
Company Update | Sector: Telecom

Bharti Airtel

BSE SENSEX	S&P CNX
56,890	16,931

airtel

Bloomberg	BHARTI IN
Equity Shares (m)	5,456
M.Cap.(INRb)/(USDb)	3407.5 / 46.5
52-Week Range (INR)	644 / 394
1, 6, 12 Rel. Per (%)	2/-5/-26
12M Avg Val (INR M)	10364
Free float (%)	44.2

Financials & Valuations (INR b)

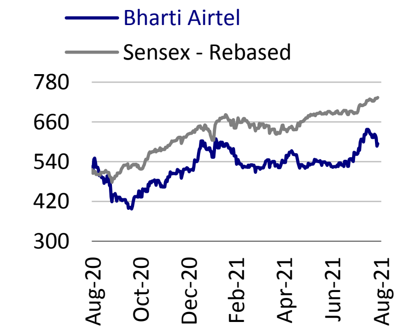
	FY21	FY22E	FY23E
Net Sales	1,006	1,127	1,287
EBITDA	454	542	632
Adj. PAT	-7	28	53
EBITDA Margin (%)	45.1	48.1	49.1
Adj. EPS (INR)	-1.3	5.1	9.7
EPS Gr. (%)	-82	-489	91
BV/Sh. (INR)	107	112	122
Ratios			
Net D:E	2.5	2.3	1.4
RoE (%)	-1.1	4.6	8.3
RoCE (%)	12.8	7.0	9.4
Div. Payout (%)	0.0	0.0	0.0
Valuations			
EV/EBITDA (x)	10.4	8.5	6.9
P/E (x)	NM	113	59
P/BV (x)	5.3	5.1	4.7
Div. Yield (%)	0.0	0.0	0.0
FCF Yield (%)	3.1	4.1	9.1

Shareholding pattern (%)

As On	Jun-21	Mar-21	Jun-20
Promoter	55.9	55.9	56.2
DII	20.6	20.4	18.4
FII	18.2	18.6	20.2
Others	5.3	5.2	5.2

FII Includes depository receipts

Stock performance (one-year)



CMP: INR 620 | TP: INR 720(+16%) | Buy

Building war chest for upcoming growth opportunities

Bharti hosted a concall (chaired by Mr Sunil Bharti Mittal) to discuss the INR210b rights issue. The specific use of the rights issue money may not be clear, given that Bharti remains a healthy FCF-generating company. Nonetheless, the call revealed the management's thought process towards the market outlook, 5G, capital allocation, and leverage strategy, along with tariff outlook.

Building a war chest

The EBITDA growth of 40% in Bharti's India Mobile business in the last four years has created a healthy INR120–150b FCF-generating capability, which partly questions the need for a capital raise. However, the Indian Telecom market is evolving rapidly, offering Bharti the opportunity to gain disproportionately – with only two strong players in the mix and a huge populace jumping on the Digital bandwagon, coupled with multiple new monetization avenues. Therefore, it has become important for the company to build a war chest to be prepared for (a) the upcoming 5G and related fiber investments, (b) the Digital foray, and (c) RJio's fiercely competitive approach, with a well-capitalized balance sheet, to ensure it does not miss out on the growth opportunity.

Key takeaways from the concall

- **Market outlook:** Strong growth is seen across the Wireless, FTTH, Enterprise, and Digital verticals. Airtel, with its deep expertise and strong right-to-win, is therefore ramping up its network capabilities to drive growth.
- **5G to come in 2HFY22:** The ecosystem development (device, spectrum, and network) is gaining momentum. The spectrum auction could happen next year, and gradual deployment could begin by 2HFY22 with 100x capacity. However, Airtel plans to deploy capital judiciously.
- **Why a rights issue?** The leverage position at 3x is comfortable for the normal business, but does not offer comfort to fuel growth through debt. The rights issue would provide a war chest for future growth, and as it would be in tranches, it would be callable as per the requirement. The funds would not be used to acquire stake in Indus Tower or One Web.
- **No change in asset monetization plans:** The stake in Indus Tower, fiber assets, and Airtel Africa may be liquidated at the opportune time and price.
- **Tariffs to go up:** Airtel would work to gradually improve pricing with the aim to reach ARPU of INR200 by the end of the fiscal and INR300 over the long term.

Large-scale opportunity over next 2–4 quarters; Bharti well-placed to gain; Maintain Buy

We see a strong earnings growth opportunity over the next 12 months. We value BHARTI on an FY23E basis, assigning an EV/EBITDA of 11x to its India Mobile business and 5x to its Africa business, arriving at a SoTP-based TP of INR720. However, this does not factor in the near-term triggers of INR90–100b EBITDA potential from the market consolidation. This could drive double-digit RoCE and strong FCF generation. Bharti India Mobile's ~500bp revenue market share driving ~40% EBITDA growth in the last four quarters is a validation of this thesis. Maintain Buy.

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DETAILED NOTES

MARKET OUTLOOK – GROWTH OPPORTUNITY

Opportunity to drive significant growth and market share increase in each business, viz., Wireless, FTTH, Enterprise, Data Centers

a. The brand is resonating very well with customers. Consumers, enterprises (large and MSME), and others categories of customers are driving strong growth and market share. It would be a grave mistake for the company not to leverage the opportunity and just remain on the business path as usual.
b. **Seeing accelerated pent-up growth in Data:** India is accelerating into the digital world. All businesses, consumers, public services, and each touchpoint are growing digitally. Even rural and fringe societies are now moving to Digital, and COVID has accelerated this phenomenon.
c. **Data Center:** Airtel has better know-how to run data centers very efficiently owing to its long presence, with submarine cables built long ago. Airtel has a significantly higher chance of gaining market share in this area via exponential growth.

Digital business

a. Airtel's Digital business has picked up gradually. The core network and services are now digital, and customers/enterprises are experiencing this. Digital services such as *Wynk and Airtel Thanks* have been seeing record customer growth. The digital opportunity is big, and Airtel has the right-to-win in this area. Verticals such as Entertainment, Payments Bank, and so on, could drive healthy growth.
b. **DTH stake buyback:** Digital businesses and entities need to have full control. Therefore, it is important to own 100% of all these businesses to ensure seamless decision-making and investments, with no related-party issues and requirements of approval from multiple sets of investors. **Hence, in the future, if any strategic stake sale happens, it would be in Bharti Airtel Ltd and not at the subsidiary level.**

Need for government support: It needs government to respond to the industry's growth opportunity and investment requirements. In India, out of every INR100 spent by the consumer, INR35 goes to the government as levies, which is far too high and needs to be reduced.

Handset subsidiary avoidable:

a. The Indian Telecom industry has historically escaped from providing handset subsidies. Globally as well, it is now clear that this is value-destructive. Post the two-year lock-in period, the customer has the option to switch networks, giving rise to the need to provide subsidies perennially. Airtel is working with device vendors to offer low-cost devices and with credit companies to make it affordable – it is closely watching this space. However, it is **not keen on offering handset subsidies.**
b. **Low-cost handsets in the price range of INR4,000–6,000 have the lowest share** in the markets, as customers are looking at a better experience and better quality of device when upgrading from 2G to 4G.

Vouching for a three-player market: India should be a three-player market. Airtel would actively support this even if the third player in the market is weak.

GUNNING FOR 5G OPPORTUNITY

- **5G rollout to start by 2HFY22:** It would start the rollout slowly in some cities and then ramp this up pan-India over time. The spectrum auction is likely to happen sometime next year, and post the spectrum acquisition, the network rollout would be done. It hopes that the 5G spectrum pricing is made attractive so India benefits from it.
- **5G investment will gradual:** 5G growth will substitute the 4G investment, and capex will not be significant in the initial phase. It will track the ecosystem development minutely and tower-wise, viz., 5G devices, capacity, data demand, and network requirements, and accordingly invest as per the growth potential.
- **Spectrum requirement:** Airtel has the largest spectrum pool in the country, with the acquisition of spectrum from other telcos, coupled with the spectrum picked up at the auction. This should serve as the bedrock for exponential growth. Hence, apart from 5G, it has no more spectrum requirements.
- **Device ecosystem:** The device ecosystem has seen very positive signs. Presently, 15% of the devices in India are 5G-enabled. By the time that the spectrum auction happens next year, this will increase further. The price points also are coming down significantly.
- **Fiber investment:** Before the 5G investment, Bharti will need to ramp up backhaul capacity by rolling out the fiber network extensively – as it has a long lead time and needs to be well-prepared before the 5G deployment. The fiber investment has already picked up pace, but there is need to further accelerate the deployment. This will also allow connecting multiple homes and offices via backhaul connectivity. This will require higher capital investment.
- **The 4G network rollout is largely complete,** barring some network bottlenecks and data requirements in pockets. India has done well by investing extensively in the 4G network rollout and building a high-quality data network. Over the last 3–4 years, it has seen exponential growth in the network. Airtel has led from the front and remains a leading player in driving network growth.

JUDICIOUS CAPITAL ALLOCATION STRATEGY – LEVERAGE POSITION

- **Existing business well-capitalized:** For business as usual, Airtel's balance sheet and cash flow position are well-placed. Airtel does not need capital to run the regular course of its business. Telecom growth can be modular – unlike a manufacturing setup, where you need to put capacity upfront. Therefore, Airtel plans to spend judiciously, as per growth in data.
  a) **It should be able to achieve return on capital in the healthy teens** in the near future with the strong growth opportunity. It may not achieve IRR of >30% – as in the first decade of the 2000s – but return on capital should certainly not remain in the low single digits.
- **Growth opportunity: It is seeing** strong growth opportunities across businesses and wants to be geared up to capitalize on these. While it will not invest 10 years ahead, it will certainly not leave the opportunity visible over the next 1–2 years. This is a once-in-a-lifetime opportunity to invest in the business. Companies that have not raised capital in time have failed to take advantage of the growth opportunity.

   a. It will be watchful of the capex and opex requirements. Airtel operates with a high sense of war-on-waste and would ensure that capital is used judiciously.

- **Why a rights issue?** Instead of a rights issue, Airtel could have raised from banks, which are running low lines of credit and seeing good demand from banks. The bond market is also upbeat. However, it wants to ensure the right balance of debt to equity and is therefore looking to raise equity.
   a. Justification for calling rights issue in tranches: The total amount will be called in tranches to align this with the capital raise as per its capex plans. It will also give a better time value return for investors. The rest of the amount may not be called over the next six months.
- **Leverage is concerning:** The leverage position is concerning due to the extraordinary government debt. Nevertheless, Airtel will be fine to manage this for business as usual. However, it would not be comfortable to grow on borrowed capital going forward. For this purpose, it needs to be well-capitalized.
   a. **Targeting 2x net debt to EBITDA:** It will be comfortable with net debt to EBITDA of 2x and aims to achieve this. It has a monetization opportunity, through Africa, Indus, etc. and increasing cash flow from growth in the existing business. So, in the next 2–3 years, Airtel's debt profile should become much better.
   b. **Monetization of assets:** Airtel is committed to monetization, but at the right time and price. The decision to do a rights issue has not changed the management's view on monetizing its assets. The Indus investment is not a core one as it is not at the front end, but it is at the heart of the underlying business and cannot be taken lightly. Also, fiber assets are available.
   c. **Indus Tower – important asset, but monetizable**: Indus is a very strategic asset as the life of the business is run by tower companies. It cannot have a weak tower company, which may impact Bharti Airtel's growth. So, it will be conscious of the monetization opportunity to ensure that it does not suffer. It has seen independent tower cos facing challenges in the past and impacting the growth of the telcos.
- **Prompt in keeping balance sheet well-capitalized:** It should be credited for raising capital in the good times, instead of waiting for the bad times. The large capital raise has put the company in a formidable position. It has seen companies that wait too long and then find it difficult to raise capital at a later stage. If the previous fundraise would not have happened, Bharti could have been facing major capital-related issues. It is better to be early to raise capital, but did not wish to be late and face backlash from the investment community.
- **Capital raise not for Indus stake or One Web:**
   a. There is no allocation of the rights issue for the Indus Tower stake sale or One Web. It wishes to have a higher influence in Indus Tower, and the recent 5% increase in the Indus stake has bagged the board a seat and a stronger influence.

   b. Airtel has no investments in One Web, and there is no correlation. Airtel would be the partner of choice for India. It needs hardly USD30–40m, i.e., INR2.5–30b, which could be through debt by One Web. Airtel does not plan to buy the Bharti Enterprise's stake in One Web or put in any additional money.

- **Promoter stake sale through Bharti Telecom:** It has not reduced the promoter shareholding by choice. A huge capital requirement has been met by the promoters, but in the bargain, it had increased the leverage at the promoter level. After receiving feedback from investors and credit agencies to reduce it, Bharti Telecom sold stake in Bharti Airtel entirely to deleverage the promoter entity – Bharti Telecom. The promoters did not take any cash as dividend from the stake sale. Bharti Telecom is now a zero-debt company and in a good position to subscribe to the rights issue, perhaps much more, without taking on any additional debt.

TARIFF PRICING – ARPU TO GO UP TO INR200 IMMEDIATELY

- **Achieving a viable economic model:** It needs to have a better economic model. The usage of 16GB data/customer does not give the right returns. Hence, tariffs need to be raised. At current ARPU level, offering a large-scale data plan and digital services such as banking, health, and entertainment may not be viable.
- **INR200 ARPU by fiscal end and INR300 in the long term:** It needs to reach ARPU of INR200 within this financial year to become viable and eventually reach INR300.
- **Minimum plan could be increased to INR100:** Airtel has taken some tariff hikes in the lower price plans, increasing the minimum recharge to INR74. This could go up to INR100. However, Airtel cannot be an outlier to hurt market share. It would be vigilant on its tariffs and leverage any opportunity to drive up ARPU.
- **Customer demarcation:** It should create customer demarcation from minimum ARPU of INR100 (where the customer could be connected to data and get some limited usage) to the higher range of INR600–700 (at which level the customer could get digital services).
- Bharti has passed its most fierce competition period and is confident of a tariff hike soon.

AIRTEL AFRICA – SELF-SUFFICIENT AND ON A STEADY PATH

- **Witnessing healthy growth:** The Africa business looks attractive. It has been slow for the last 10-year period. However, over the last four-year period, the performance has been very good. Airtel Africa's growth is outpacing peers in all African countries. It has a clear digital strategy.
- **Self-sufficient, with healthy FCF:** This is an asset that does not depend on the India business and is run independently. The recent investments by TPG, Mastercard, and Qatar Investment Authority show the massive hidden value in Airtel Money. Many more investors are keen on the business. The next 4–5 years could have a multiplier effect. It could be a USD10–15b asset and then explore monetization.

N O T E S

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Registration Nos.: Motilal Oswal Financial Services Limited (MOFSL)*: INZ000158836(BSE/NSE/MCX/NCDEX); CDSL and NSDL: IN-DP-16-2015; Research Analyst: INH000000412. AMFI: ARN - 146822; Investment Adviser: INA000007100; Insurance Corporate Agent: CA0579 ;PMS:INP000006712. Motilal Oswal Asset Management Company Ltd. (MOAMC): PMS (Registration No.: INP000000670); PMS and Mutual Funds are offered through MOAMC which is group company of MOFSL. Motilal Oswal Wealth Management Ltd. (MOWML): PMS (Registration No.: INP000004409) is offered through MOWML, which is a group company of MOFSL. Motilal Oswal Financial Services Limited is a distributor of Mutual Funds, PMS, Fixed Deposit, Bond, NCDs,Insurance Products and IPOs.Real Estate is offered through Motilal Oswal Real Estate Investment Advisors II Pvt. Ltd. which is a group company of MOFSL. Private Equity is offered through Motilal Oswal Private Equity Investment Advisors Pvt. Ltd which is a group company of MOFSL. Research & Advisory services is backed by proper research. Please read the Risk Disclosure Document prescribed by the Stock Exchanges carefully before investing. There is no assurance or guarantee of the returns. Investment in securities market is subject to market risk, read all the related documents carefully before investing. Details of Compliance Officer: Name: Neeraj Agarwal, Email ID: na@motilaloswal.com, Contact No.:022-71881085.

* MOSL has been amalgamated with Motilal Oswal Financial Services Limited (MOFSL) w.e.f August 21, 2018 pursuant to order dated July 30, 2018 issued by Hon'ble National Company Law Tribunal, Mumbai Bench.