NewStreet Research

Bharti Airtel

Marginal margin continuing to drive upside

16th February 2024

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Consumer margins still likely to surprise. Buy, pt to INR 1,500 (from INR 1,400)

16th February 2024

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What's new: Following a very strong H2 2023, Bharti has retraced nearly INR 100/share. We remain bullish and would see the sell-down as a buying opportunity. Consensus forecasts continue to look too low to us; in this note we focus on the consumer margin, which we think is likely to surprise to the upside. In this short piece we roll forward our DCF, and our price target rises to INR 1,500. Recommendation remains Buy.

Thesis: We continue to like Bharti's ability to execute across all its business lines. As we have previously pointed out, the group's focus on costs means Bharti's consumer margins are rising rapidly, with a marginal margin of over 70%. The marginal margin actually increased during FY 24, despite a lack of price increases. This has been a good guide in the past to positive margin surprises and we think that will continue. We think the market misunderstands how to read Bharti's consumer margin; both the fact that Indian mobile operates under a Bill & Keep regime, and high impact of IFRS-16 in India mean, plus high historic capital intensity means that a 55% EBITDA margin only translated into a 22% EBIT margin in Q3. As a result, we see the potential for margins to head to 60%+ which is well above consensus expectations. Rising margins and stable capex in absolute terms suggest ROIC should continue to increase and makes a strong case for the stock to continue to perform well.

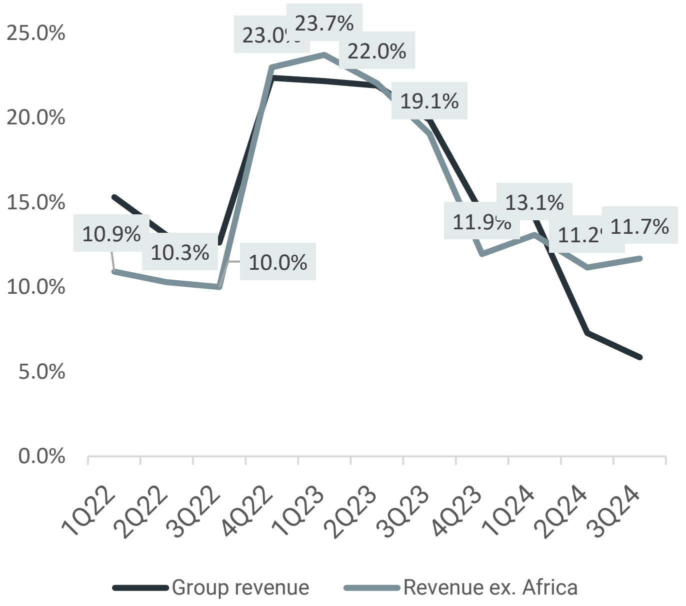
Valuation: We continue to see value in Bharti. The stock is likely to continue to generate double digit revenue growth for several years, alongside rising returns and as a result, grows into its multiple over the next 2-3 years. We continue to rate the shares a Buy. On rolling forward our price target rises to INR 1,500 from INR 1,400.

Bharti – growth remains decent, still driven by consumer mobile

Bharti's revenue growth has remained strong through FY 24. So far in FY 24 Enterprise has slowed, partly as the company has focused on profitability but also due to weaker demand from international corporates. Our thesis is that medium term Enterprise will become a bigger driver, although this has clearly not happened in FY 24 so far, with consumer continuing to be the major driver of revenue growth for the group.

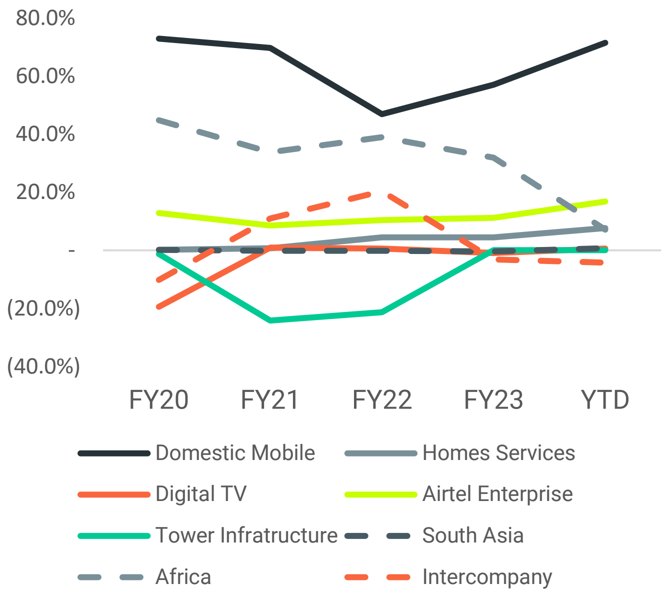
Revenue – YoY growth

%



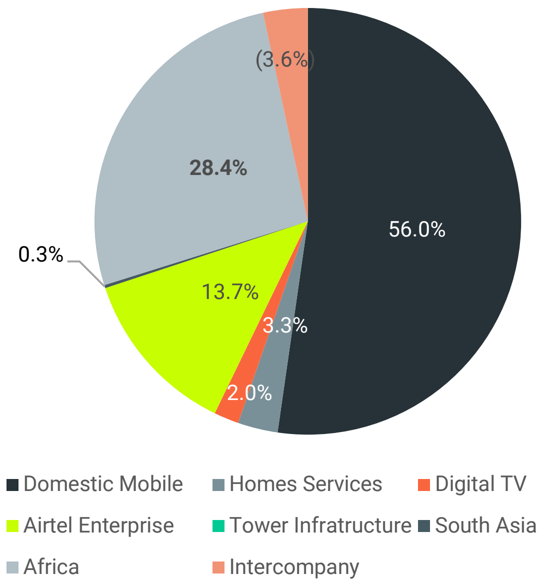
Bharti's incremental growth drivers

Proportion of incremental revenue by segment



Revenue breakdown

FY24 9M revenue breakdown



Source: New Street Research analysis

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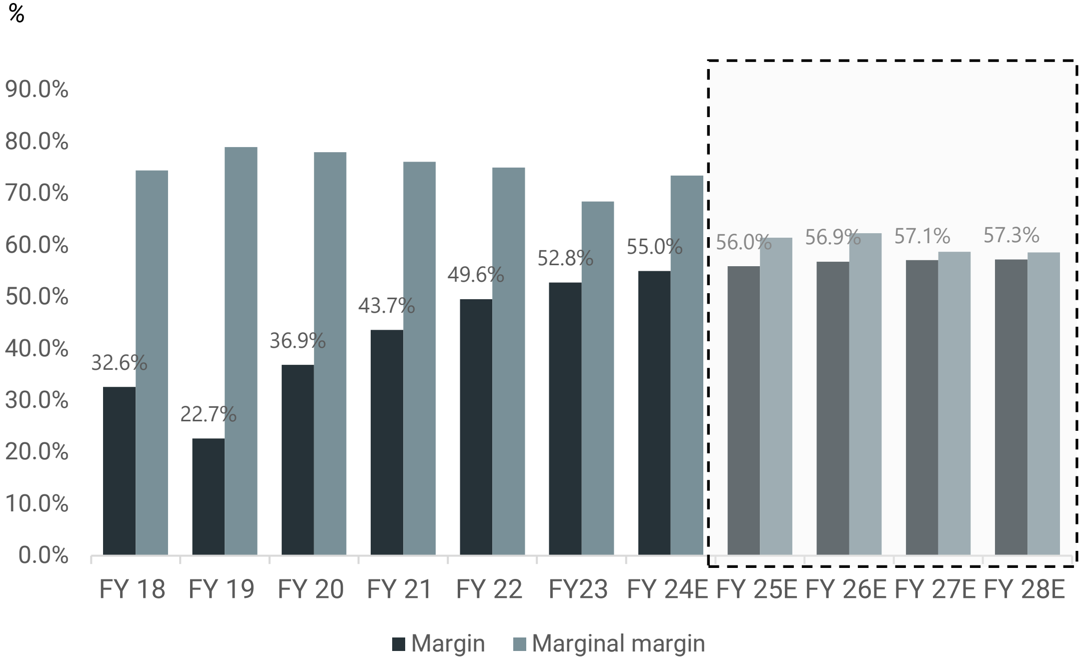
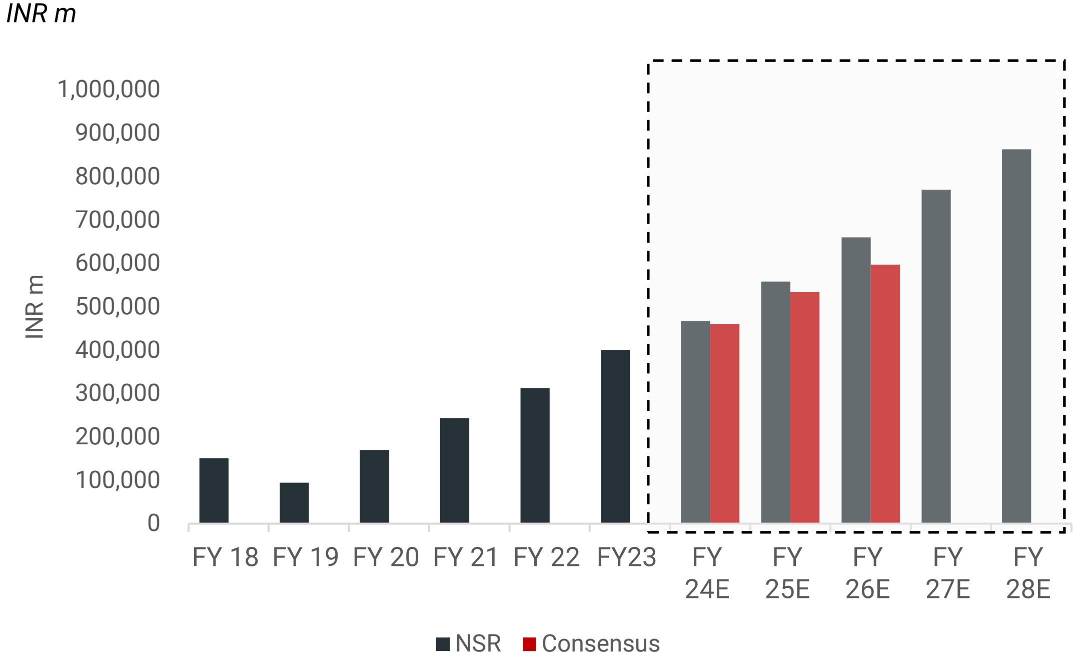
Continue to see consumer margins rising…Bharti remains in earnings upgrade cycle

Bharti's "war on waste" has driven the domestic mobile marginal margin to very high levels, averaging 76% in first 9m of FY 24, and actually above FY 23's level of 70%, despite a lack of price increases. With the company expected to put through like for like price increases in H2 CY 24, and continuing to cut costs, we see little reason why the marginal margin should fall from here. Yet our model, which sees the pace of margin upside slowing as absolute margins rising to high 50s implies the marginal margin declining to 60%. Despite this apparent conservatism, our margins are significantly higher than consensus and in FY 25 & FY 26 which is largely why, our consumer mobile EBITDA forecasts are well ahead of consensus in 1-2 years.

Bharti's Domestic Mobile Margin and Marginal Margin %



Domestic Mobile EBITDA forecast, NSR vs Consensus



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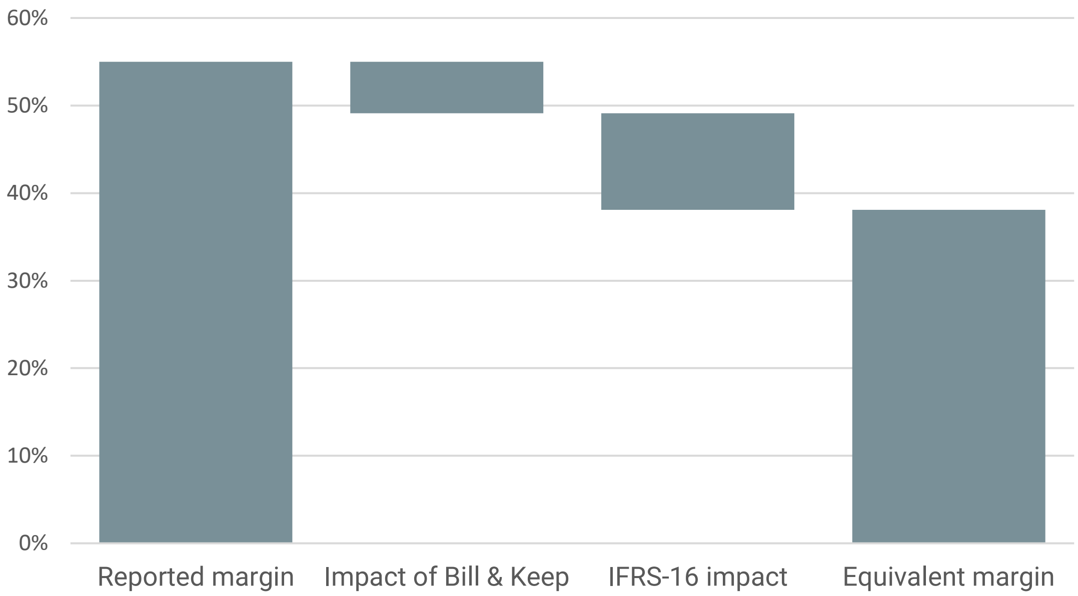
Why are Bharti's margins so high, and why are 65% EBITDA margins plausible?

We show below why Bharti's EBITDA margins are not as high as they appear. Firstly, India operates a Bill & Keep regime. Prior to this, interconnect was c. 15% of revenues. Since then, the impact would be lower but were interconnect to still be being charged the impact would be for reported margins to be several % lower. Similarly, because of the extent of tower sharing (and tower rents vs revenue and high interest rates), the effect of IFRS-16 is higher in India than elsewhere. When introduced margins rose by c. 11-12%. Thus, a reported margin of 55% in India is equivalent to 38-39% elsewhere. We think this means that it is plausible that Bharti's margins rise to 65% (equivalent to 45-50% elsewhere).

Bharti's Domestic Mobile Margin and Marginal Margin %

%



Source: New Street Research analysis

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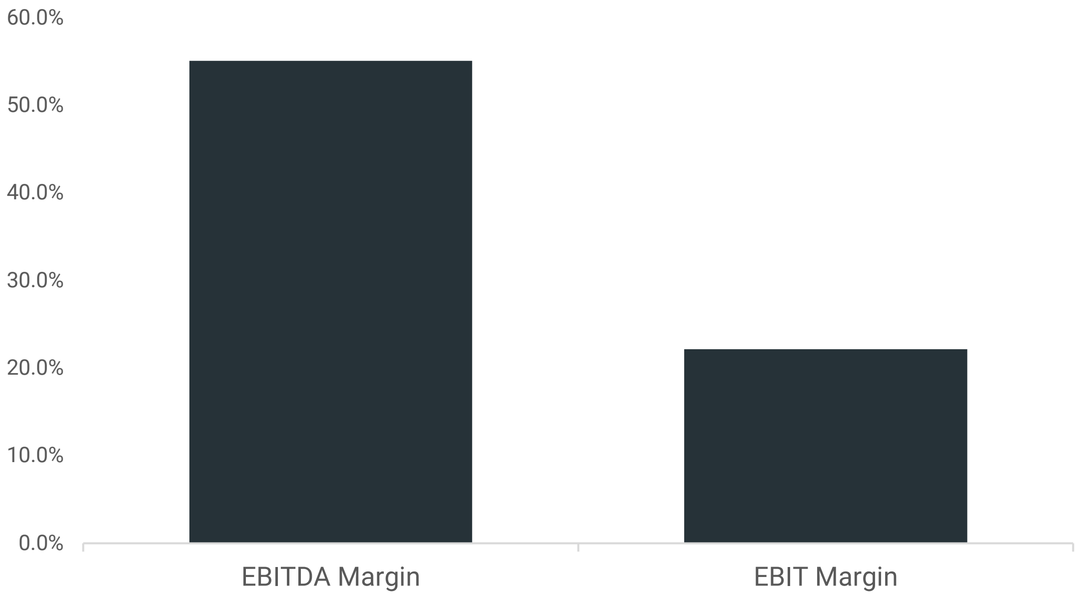
High capex also supports high EBITDA margins

With very high capex historically, a 55% EBITDA margin only equates to a 22% EBIT margin currently. And of course, the other reason is that at 55% margins ROIC is still only 10%, just above Bharti's cost of capital. Thus, we continue to think that the market is not fully reflecting the likely long-term direction of margins required for Bharti given the issues on the previous page and the need to generate a return above its cost of capital.

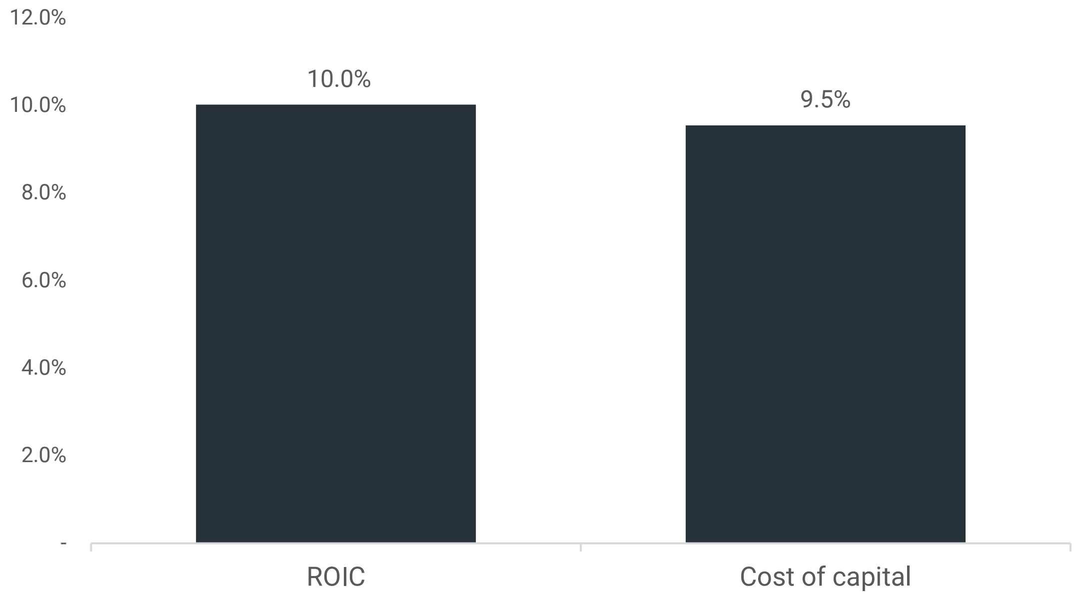
55% EBITDA margin equates to 22% EBIT margin

%



Domestic Mobile ROIC vs Bharti cost of capital.

%



Source: New Street Research analysis

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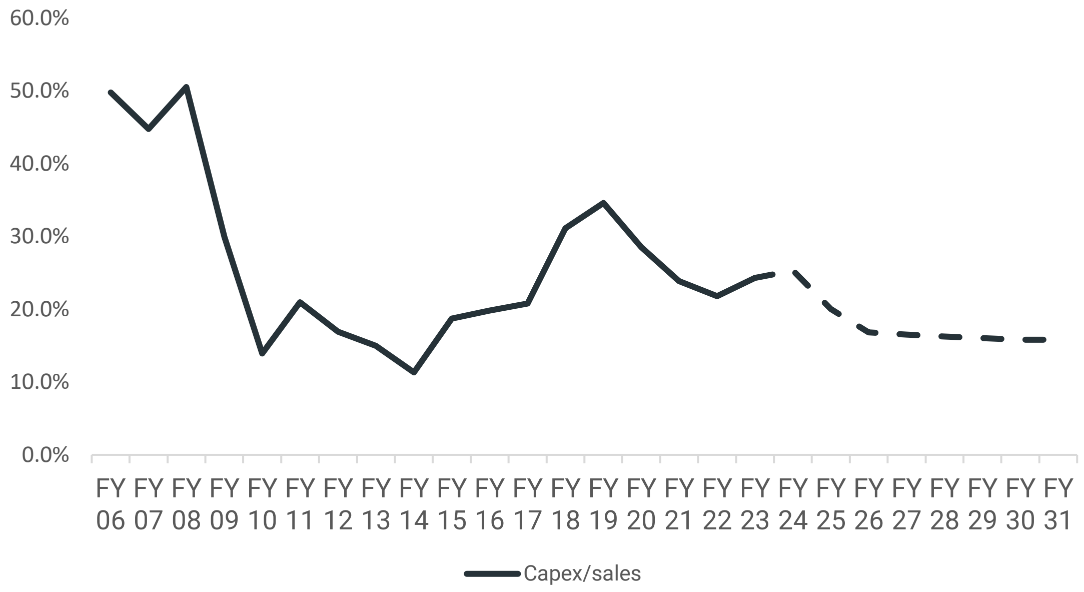
Capex is likely to be stable, and therefore ROIC accelerates

And with Capex/sales likely to “moderate“ (ie decline), we see strong upside in cash flow and ROIC, with growth remaining above 10% to the end of the decade on our numbers. We continue to think that this combination of revenue growth and rising returns is not fully appreciated by the market.

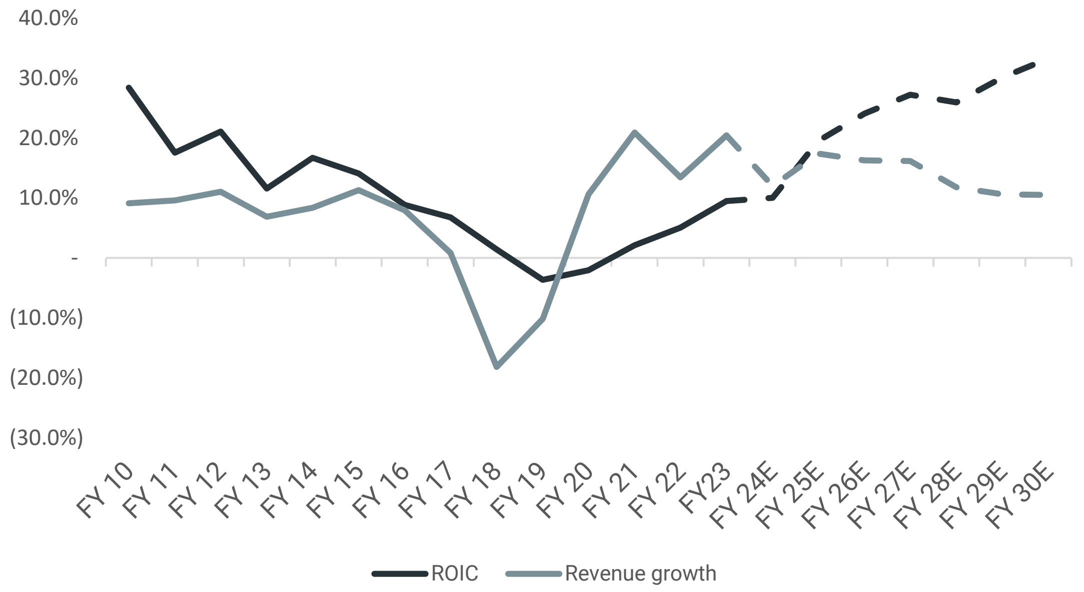
Capex intensity

% of sales



Post-tax ROIC and Revenue Growth

%



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Company forecasts and valuation

Bharti Airtel (Buy, TP: INR 1,500 from 1,400, +34%)

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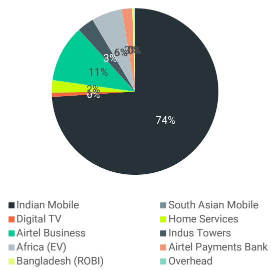
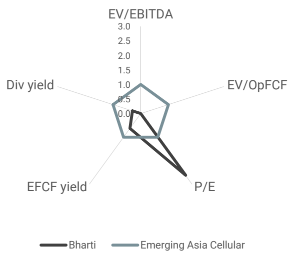
EV CALCULATION (INRm)	Mar-24E	Mar-25E	Mar-26E	Mar-27E	24E-27E
Share price, INR	1,122				
Number of shares	6,017	6,017	6,017	6,017	
Market cap.	**6,751,074**	**6,751,074**	**6,751,074**	**6,751,074**	
Plus: Net debt (Cash)	1,994,618	1,715,583	1,370,131	994,755	
Plus: Other financial liabilities	0	0	0	0	
Less: Associates	342,447	342,447	342,447	342,447	
Plus: Minorities	505,955	505,955	505,955	505,955	
Less: Cumulative dividends	0	48,136	168,476	291,825	
Less: NPV YE tax credit	0	0	0	0	
Enterprise Value	**8,909,201**	**8,582,029**	**8,116,237**	**7,617,512**	-5.1%

MULTIPLES & RATIOS	Mar-24E	Mar-25E	Mar-26E	Mar-27E	CAGR 24E-27E
EV/Revenue	5.9	5.1	4.2	3.4	13.9%
EV/EBITDA	11.3	9.5	7.7	6.3	15.3%
EV/OpFCF	21.7	15.2	11.2	9.0	27.3%
EV/FCF	27.2	19.0	13.9	11.3	27.3%
EV/Invested capital	3.1	3.0	3.0	2.9	5.0%
EV/NFA	5.6	5.6	5.7	5.6	16.2%
P/EFCF	51.1	27.0	17.6	14.3	53.0%
Adjusted P/E	53.1	37.2	23.9	17.3	45.5%
Dividend yield	0.7%	1.8%	2.7%	3.9%	75.8%
EFCF yield	2.0%	3.7%	5.7%	7.0%	53.0%
Net debt/EBITDA	2.5	1.9	1.3	0.8	-31.2%
OpFCF/Net interest	1.8	2.6	3.6	4.5	34.8%

BREAKDOWN OF VALUE

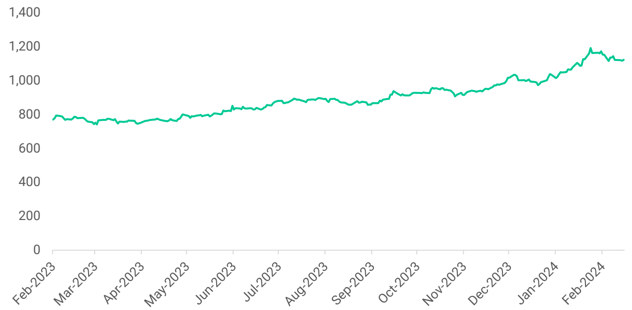


RELATIVE VALUATION (2024E)



FINANCIALS (INRm)	Mar-23A	Mar-24E	Mar-25E	Mar-26E	Mar-27E	24E-27E
Revenue	1,400,814	1,502,665	1,698,086	1,947,184	2,218,481	13.9%
EBITDA	717,331	790,025	905,996	1,054,841	1,211,764	15.3%
Capex	340,433	380,157	340,218	327,253	366,194	-1.2%
OpFCF (EBITDA - capex)	376,898	409,868	565,778	727,587	845,570	27.3%
FCF (OpFCF * (1-tax rate))	301,518	327,894	452,623	582,070	676,456	27.3%
EFCF	114,042	132,106	249,851	382,728	473,066	53.0%
Adj net Income	90,157	126,525	181,305	282,080	390,089	45.5%
Clean EPS	15.22	21.12	30.13	46.88	64.83	45.3%
DPS	4.00	8.00	20.00	30.00	43.43	75.8%
			0.6637452			
Cash flow						
OpFCF	**376,898**	**409,868**	**565,778**	**727,587**	**845,570**	
Less: Interest payments	-142,879	-224,082	-215,210	-204,057	-188,803	
Less: Tax paid	-37,915	-40,553	-82,238	-120,270	-161,016	
Less: Change in WC	-31,120	-15,476	6,373	10,064	2,973	
Less: Restructuring payments	0	0	0	0	0	
Less: Other	-709,520	-21,611	0	0	0	
Sub total	**-544,535**	**108,145**	**274,703**	**413,323**	**498,725**	
Less: Disposals/acquis.	0	0	0	0	0	
Less: Dividends paid	-35,898	-23,968	-48,136	-120,340	-123,349	
Less: Share buyback/ special	52,242	52,468	52,468	52,468	0	
Chg in Net debt/Cash	**-528,191**	**136,646**	**279,035**	**345,452**	**375,377**	
Net debt (Cash)	2,131,264	1,994,618	1,715,583	1,370,131	994,755	

PRICE PERFORMANCE, -1Y



DIVISIONAL (INRm)	Mar-23A	Mar-24E	Mar-25E	Mar-26E	Mar-27E	24E-27E
Revenues						
Indian Mobile	759,246	850,366	998,206	1,160,781	1,348,408	16.6%
South Asian Mobile	2,944	2,885	2,885	2,943	3,001	1.3%
Home Services + DTV	69,923	80,227	92,401	104,935	123,476	15.5%
Enterprise	195,296	216,092	248,694	279,743	310,792	12.9%
Infratel	0	0	0	0	0	nm
Africa	422,664	405,959	415,683	467,383	511,009	8.0%
Other	-49,259	-52,864	-59,783	-68,601	-78,205	13.9%
Total	**1,400,814**	**1,502,665**	**1,698,086**	**1,947,184**	**2,218,481**	13.9%
% change		7.3%	13.0%	14.7%	13.9%	
EBITDA						
Indian Mobile	400,751	467,718	558,593	659,907	770,173	18.1%
South Asian Mobile	-518	-346	87	118	150	-175.7%
Home Services + DTV	37,954	42,162	48,485	55,015	64,619	15.3%
Enterprise	74,034	82,690	96,688	110,325	124,224	14.5%
Infratel	0	0	0	0	0	nm
Africa	207,281	200,059	204,619	232,231	255,643	8.5%
Other	-2,171	-2,259	-2,476	-2,754	-3,044	10.5%
Total	**717,331**	**790,025**	**905,996**	**1,054,841**	**1,211,764**	15.3%
% change		10.1%	14.7%	16.4%	14.9%	
EBITDA margin	**51.2%**	**52.6%**	**53.4%**	**54.2%**	**54.6%**	
Capex						
Indian Mobile	204,802	238,103	189,659	162,509	186,889	-7.8%
South Asian Mobile	979	864	777	714	728	-5.5%
Home Services + DTV	35,338	41,285	43,982	46,080	49,877	6.5%
Enterprise	38,913	35,143	40,686	45,964	51,242	13.4%
Infratel	0	0	0	0	0	nm
Africa	60,401	64,762	65,113	71,986	77,457	6.1%
Other	0	0	0	0	0	nm
Total	**340,433**	**380,157**	**340,218**	**327,253**	**366,194**	-1.2%
% change		11.7%	-10.5%	-3.8%	11.9%	
Capex/sales	**24.3%**	**25.3%**	**20.0%**	**16.8%**	**16.5%**	
Indian capex	**279,053**	**314,531**	**274,327**	**254,554**	**288,009**	-2.9%
% change		12.7%	-12.8%	-7.2%	13.1%	

Relevant Research

Additional Research

NewStreet Research

[Bharti Airtel (Buy) – Q3 FY24 Quick Take: In-line, with domestic mobile trends ahead of peers again]

[Private Equity Selling Indus Towers – Quick Thoughts/Implications for Indus and the Indian Telcos]

[Indian Mobile - What to expect in 2024: Jio finally IPOs (?), crunch (again) for VIL, downgrade Indus]

[EM Telcos - Q3 23: Faster again]

[5G FWA in Emerging Markets: Poor Man's Paradise; income and propensity to spend suggests 5G FWA affordability is high in EM - Global Weekly Review]

[5G FWA in EM - Poor man's paradise; income and propensity to spend suggests 5G FWA affordability is high in EM]

[Indian Mobile - Q2 FY24 review: Core mobile still decent, with margin improvement across the board]

[Bharti Airtel (Buy) – Q2 FY24: Thoughts after the call]

[Bharti Airtel (Buy) – Q2 FY24: Enterprise slowdown, but core mobile remains strong]

[Singtel - Bharti proxy means EPS to double in 5 years. Buy, price target S$ 4.4]

[Jio launches 5G FWA – Game changing for Global FWA customer numbers which are set to ramp rapidly]

[EM Telcos - Q2 23: Slightly slower driven by China]

[Indian Mobile - Q1 FY24 review: Outperformance by Bharti]

[Bharti Airtel – Dividend likely to rise rapidly from here]

[GEM Telcos—Are the price wars finally over?]

[Vodafone IDEA – Our Take: Government equity conversion]

[Top Global EM and Developed Asian Telco picks]

[Indian Mobile – What to expect in 2023: Enterprise drives growth]

[EM Telcos – Declining spectrum costs have been one support of the ROIC inflection]

[Bharti Airtel (Buy) – Thoughts after the call: 5G, rural push, B2B, Broadband]

[Asian and EM Telcos – A snapshot of Data Center achievements, future developments and valuation]

[The 5G FWA Opportunity for EM – Connecting a billion homes]

[EM Telcos – Alongside better growth, ROIC is trending higher]

[Both Growth and ROIC have inflected for EM Telcos]

[Bharti making new all time highs says it loud and clear: EM Telcos are in a bull market]

[Indian Mobile – Bharti Airtel: Leading the EM Telco bull market; New all-time high; price target to INR 1,400]

[Jio's 5G FWA plans are game changing for the Fixed Wireless Access industry globally]

[SingTel – Our Take on SingTel's 3.3% direct stake sale of Bharti Airtel]

[Indian mobile – 5G launch imminent, Bharti the likely winner]

[Bharti – Thoughts after the call: Spectrum, 5G & FWA strategy explained, Buy, pt INR 1,300]

[Indian Mobile – 5G auction concludes – Our preliminary thoughts]

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