



March 25, 2010

The Deal

The board of Kuwaiti telecoms operator Zain has approved a US\$ 9 billion sale (Plus liabilities of US\$ 1.7 billion) of most of its African assets except Sudan and Morocco to Bharti Airtel. The deal is expected to be signed within few days.

Investment

Investment of US\$ 10.7 billion, to acquire assets of Zain's Africa operations, to be made as follows:

- Upfront payment of US\$ 8.3 billion
- Payment of US\$ 700 million after one year
- Taken liabilities of US\$ 1.7 billion

Funding

Bharti is looking to finance the Zain deal from a US\$ 7.5 billion dollar loan, US\$ 800 million from rupee loan.

Analysis

Increased Interest Burden: To fund the deal, the company is taking a major chunk of the required fund by way of loan in dollar as well as rupee denomination. The interest rate on dollar loan will be linked to the LIBOR rate.

The 10 year average of LIBOR is close to 4% while the current LIBOR rate is at its all time low of close to 1%, however we are not expecting these low LIBOR rates to last long. Assuming a 2% of LIBOR and a 300 bps premium and 8% for the Rupee denominated finance, Bharti needs to pay US\$ 440 million per year in interest. This implies that Bharti has to improve EBIDTA by US\$ 440 million only to pay for the deal. In other words, at the presents EBITDA of sround US\$ 1.3 billion, the company needs another 35% EBITDA.

Furthermore, the assets that Bharti is buying, at this point are incurring losses at net level, implying that Bharti will have to absorb these African losses from its profitable Indian operations, thereby adversely impacting the bottomline and EPS.

Expensive Valuations: The price offered in the deal translates into an EV/EBITDA of 10x, which is higher in comparison to industry average.

Country to Focus: Out of the total assets purchased by Bharti, Nigeria has a scope to grow. The company in this region has a customer base of 14.9 million in a population of 155.8 million. The region accounts for around 35% of Zain Africa's revenues. However, the region has witnessed a loss of US\$ 88 million on revenues of US\$ 986 million. The market penetration of the region is just 45% and Zain has only 25% market share.



Further, Average Revenue Per User (ARPU) in Nigeria is at \$7 while that of Africa ranges from \$3 to \$10. This compares favourably with India where Airtel's ARPU is \$5 (Rs. 230).

Increased Access: With the deal, Bharti would now have access to 15 African countries with about 42 million subscribers. Bharti already has 125 million Indian subscribers.

Weak Performance of Zain: Zain's business operation is not doing well as witnessed from the facts that the first nine months of 2009 have seen a 17% drop in net profits from US\$ 878 million in 9MCY08 to US\$ 677 million in 9MCY09. Furthermore, net margins badly hit from 16.3% to 11.0% during the same period. Apart from this, in Nigeria, the company has lost 6% of their customers during the first nine months of 2009.

Views

We at RR feel that the deal is an expensive one and has an adverse impact on the financials of company, making it a negative for the short term.

However, it is a good strategy to enter the potential market of Africa when the growth in domestic market is unlikely to pick up. This strategy is likely to pay Bharti in the long term. .

About Bharti

Bharti is one of Asia's leading providers of telecommunication services with presence in all the 22 licensed jurisdictions (also known as Telecom Circles) in India, and in Srilanka. The company has an aggregate of 121,852,576 customers as of December 31, 2009, in India; of whom 118,864,031 are GSM subscribers and remaining 2,988,545 uses it's Telemedia Services either for voice and/or broadband access delivered through DSL. Based on the number of customers as of December 31, 2009, the company is the largest wireless service provider in the country. Bharti offer an integrated suite of telecom solutions to our enterprise customers, in addition to providing long distance connectivity both nationally and internationally. The company also offers DTH and IPTV Services.

About Zain

Zain is an emerging telecoms player operating in 24 countries in the Middle East and Africa, serving over 71.8 million active customers. The company is the leading mobile telecom operator in 16 of its markets, while holding second position in 4 of its markets. The company derives 50%-53% of revenue from Africa region and remaining 47%-50% from Middle East. The company earned a revenue of US\$ 6,169 million; EBITDA of US\$ 2,624 million and Net Income of US\$ 677 million during the 9 months of 2009.



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NSE - INB 231219636, INF 231219636 BSE - INB 011219632

