

Research Update:

Bharti Airtel Outlook Revised To Stable On Strengthening Operations And Leverage Management; 'BBB-' Rating Affirmed

September 9, 2021

Rating Action Overview

- Bharti Airtel Ltd.'s improving operating fundamentals should improve its margins and EBITDA and mitigate the potential effect on leverage from expected 5G spectrum investments.
- The India-based telecommunications operator's recently-announced rights issue of up to Indian rupee (INR) 210 billion also mitigates this risk.
- On Sept. 9, 2021, S&P Global Ratings revised the outlook on Bharti Airtel to stable from negative. At the same time, we affirmed our 'BBB-' long-term issuer credit rating on Bharti Airtel and the 'BBB-' issue rating on the company's senior unsecured notes. We also affirmed the 'BB' issue rating on the subordinated perpetual securities (PERPS) it guarantees.
- The stable outlook reflects our view that Bharti Airtel will actively manage its leverage such that its ratio of funds from operations (FFO) to debt will stay well above 20% on a sustained basis, while maintaining its competitive position.

Rating Action Rationale

We believe Bharti Airtel will continue improving its operational performance. The company's adjusted EBITDA should rise 16%-18% in fiscal 2022 (year ending March 31, 2022), and 9%-11% in fiscal 2023, according to our estimates.

Bharti Airtel's Indian mobile segment is likely to continue growing at a healthy rate but, in the absence of across-the-board tariff hikes, at a slower pace than in fiscal 2021. We project the segment's EBITDA, which accounts for about half of the company's reported EBITDA, will rise about 25% in fiscal 2022 and in the low teens in fiscal 2023, given increases in subscribers and average revenue per user (ARPU). This compares with reported EBITDA growth of 43% for the segment in fiscal 2021. Any regulatory support from the government as part of any potential relief package for the industry could further boost profitability, although we have not factored this into our base-case scenario.

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Momentum in Bharti Airtel's Indian mobile ARPU growth may pick up after slowing in recent quarters. Other than customers upgrading to higher-tariff plans over time amid growing data demand, Bharti Airtel has recently ceased its lowest-priced prepaid, postpaid, and corporate tariff plans. These factors should translate to higher ARPU. The potential for tariff increases is supported by a more rational competitive landscape and financial difficulties faced by the third-placed player in India, Vodafone Idea Ltd.

Bharti Airtel's African operations will continue to strengthen, in our view. The segment's reported EBITDA increased 24% in fiscal 2021, and we estimate annual expansion in the low to mid-teens over the next two years. The expansion of the company's customer base, data demand, digital wallet adoption and even voice revenues underpin our assessment. We also expect Bharti Airtel's enterprise business to expand with reported EBITDA growth of 10%-12% in fiscal 2022 on the back of growing digitalization, accelerated by the pandemic.

The company's rights issue should alleviate the likely impact from upcoming 5G spectrum liabilities, which are necessary for Bharti Airtel's competitiveness. India's 5G roadmap and Bharti Airtel's corresponding 5G spectrum investments remain uncertain. We expect any 5G investments to weigh on the company's credit metrics, given the lag between investment and returns. The 5G spectrum auction is likely to happen in the first half of 2022, and at current reserve prices, it could cost the company close to INR500 billion for an entire spectrum block of 100 megahertz.

However, the actual spend could be lower; telecom operators have stated unwillingness to bid for the 5G spectrums at the current reserve prices. In our opinion, spending may be lower in the event of a reduction in reserve prices, or a reduced requirement for the minimum quantity of 5G spectrum to be bought, which would support a phased rollout.

In our base case, we assume about INR140 billion of proceeds from the rights issue through fiscal 2024, representing the first instalment of 25% in full, and only the promoter group's aggregated 56% share for the remaining two installments. Excluding any 5G investments, we estimate the company's FFO-to-debt ratio to be around 30% by fiscal 2023. This could be higher if the full INR210 billion of rights issue proceeds are eventually received, i.e., the rights are fully subscribed and the balance installments are received in full as and when called by the company.

The ratio could decline to 20%-25% for fiscals 2022 and 2023, assuming 5G investments in the INR300 billion–INR400 billion range. We typically add the full amount of spectrum liabilities to adjusted debt, as we consider these as debt-like obligations, despite the typical staggering of spectrum payments.

In our view, the rights issue signals proactive leverage management. We believe the rights issue aims to preemptively build financial capacity for Bharti Airtel ahead of the upcoming 5G investments, given the absence of other immediate funding needs.

While the rights issue has yet to conclude, it is highly likely to materialize, in our assessment. Bharti Airtel's announcement has stated that the promoter and promoter group will collectively subscribe to the full extent of their aggregate rights entitlement, and to any unsubscribed shares.

The company also has a good track record of capital raising. Bharti Airtel had investor support even during periods of weakness, such as during fiscal 2020 when the company raised equity to repair its balance sheet after making provisions for a lawsuit over adjusted gross revenue (AGR) dues to the regulator. Thus, we believe that a high level of support is likely given that Bharti Airtel's results have been improving.

The company also has other options to manage its leverage. These include asset monetization,

such as further divestments of its shares in mobile money business Airtel Mobile Commerce BV, after Bharti Airtel sold an 18% stake for US\$500 million over the last few months to three investors. Other potential monetization opportunities include listed assets such as Indus Towers Ltd., in which Bharti Airtel's stake has a market value of about INR270 billion.

Outlook

The stable outlook reflects our view that Bharti Airtel will actively manage its leverage such that its FFO-to-debt ratio will stay well above 20% on a sustained basis. We also expect Bharti Airtel to maintain its competitive position.

Downside scenario

We may lower the rating if Bharti Airtel's leverage rises to the point where we don't expect its FFO-to-debt ratio to stay above 20%. This may happen due to: (1) the company undertaking debt-funded investments and capital expenditure (capex) beyond our expectations, (2) its profitability falling below our current forecasts, or (3) the company incurring unforeseen material regulatory costs.

A negative rating action on the sovereign rating of India could also result in a downgrade of Bharti Airtel.

Upside scenario

We view the prospects of an upgrade as remote. An upgrade would likely be contingent on a similar action on the sovereign rating of India.

We may revise Bharti Airtel's stand-alone credit profile upwards if regulatory uncertainty in India substantially diminishes, or if we expect the company to significantly deleverage such that its ratio of FFO to debt sustains above 30%.

Company Description

Bharti Airtel is the second-largest provider of telecom services in India, with a diversified presence in 16 countries across Asia and Africa, and a joint venture in another country. The promoter group, India-based Mittal family, and Singapore Telecommunications Ltd. (Singtel) jointly owned 55.86% of Bharti Airtel as of March 31, 2021.

Our Base-Case Scenario

Assumptions

- India's real GDP to grow 9.5% in fiscal 2022 and 7.8% in fiscal 2023. Real GDP growth in Nigeria, Bharti Airtel's largest contributor country in Africa, to be 1.8% in 2021 and 2.2% in 2022.
- The performance of the telecommunications sector is moderately linked to GDP growth. We believe local competitive dynamics and the regulatory landscape play a bigger role in Bharti Airtel's performance in its respective markets.

- Bharti Airtel's adjusted revenue to rise 9%-11% in fiscal 2022 and by a high single-digit percentage in fiscal 2023. Strong growth momentum in the Indian mobile market and the company's African operations will drive this improvement.
- Strong topline growth to lead an improvement in the company's adjusted EBITDA margin to 52%-54% through fiscal 2023.
- We assume INR52.5 billion in proceeds from the rights issue in fiscal 2022, representing the 25% upfront payment. We have also assumed proceeds of INR44 billion annually in fiscals 2023 and 2024, representing the aggregated 56% promoter group's share of the remaining 75% of the rights issue.
- Annual capex that we forecast at INR250 billion-INR260 billion through fiscal 2023.
- We have not included potential 5G spectrum investments in our base case due to uncertainty in the timing and amount. We have, however, considered various scenarios of 5G investment and their impact on leverage.
- Our adjusted debt estimate for Bharti Airtel includes about INR400 billion for the litigation-related provision and associated accrued interest.
- Annual dividend payout of INR25 billion-INR30 billion, including interest payments on the US\$1.5 billion PERPS. We consider 50% of the PERPS as equity.

Based on these assumptions, we arrive at the following credit metrics:

- FFO-to-debt ratio of 25%-28% in fiscal 2022 and 29%-32% in fiscal 2023, which could decline to 20%-25% over the same period depending on the level of 5G investments.
- Debt-to-EBITDA ratio of 3.0x-3.2x in fiscal 2022 and below 3x in fiscal 2023.

Liquidity

We assess Bharti Airtel's liquidity as adequate. We expect the company's liquidity sources to be enough to cover uses by 1.4x-1.5x over the next 12 months. Net sources of liquidity should remain positive even if EBITDA declines by 15%.

Bharti Airtel has good access to banks and capital markets in India and abroad, as evident from its consistent capital-raising activities over the past three years. We also view positively management's ability and track record in raising equity capital when the company faced large funding needs, such as alleviating the impact of the AGR lawsuit. Bharti Airtel's financial flexibility is also supported by its strategic relationship with and significant ownership by Singtel.

Principal liquidity sources include:

- Cash and cash equivalents of INR90 billion as of June 30, 2021.
- Cash FFO that we project at INR400 billion-INR420 billion in the 12 months to June 30, 2022.
- Proceeds from rights issue in fiscal 2022 of INR52.5 billion, representing 25% of total issue size.
- Proceeds from the sales of an 18% stake in Airtel Money and a stake in Nextra data center, as well as from a spectrum sharing agreement with Reliance Jio Infocomm Ltd., amounting to about INR60 billion.

Principal liquidity uses include:

- Short-term maturities of INR195 billion as of June 30, 2021.
- Capex that we estimate at INR260 billion over the 12 months to June 30, 2022.
- Cash dividends that we forecast at INR25 billion-INR30 billion over the same period.

Covenants

About 2% of Bharti Airtel's reported debt, particularly its 2023 senior unsecured notes, is subject to incurrence covenants. The incurrence covenants are suspended because the company's senior unsecured notes are rated 'BBB-' or equivalent by at least two rating agencies.

Issue Ratings - Subordination Risk Analysis

Capital structure

As of June 30, 2021, most of Bharti Airtel's reported borrowings of INR1.7 trillion were unsecured. These include deferred payment liabilities (comprising AGR dues and spectrum liabilities) of INR788 billion, capitalized lease obligations of INR331 billion, foreign currency convertible bonds of US\$1 billion, senior unsecured notes of US\$1.75 billion issued by Bharti Airtel, and senior unsecured notes of about US\$1.5 billion issued by Bharti Airtel International (Netherlands) B.V. and guaranteed by Bharti Airtel.

Analytical conclusions

Our issue ratings on the senior unsecured notes issued by Bharti Airtel and Bharti Airtel International (Netherlands) are equalized with our 'BBB-' issuer credit rating on Bharti Airtel. That is because Bharti Airtel's assets and operations are substantially based in India, a jurisdiction where we believe the priority of claims in a theoretical bankruptcy is highly uncertain.

However, we rate the PERPS 'BB' because we notch the rating down by one notch each for contractual subordination and unrestricted coupon deferability.

Ratings Score Snapshot

Issuer Credit Rating: BBB-/Stable/--

Business risk: Satisfactory

- Country risk: Moderately high
- Industry risk: Intermediate
- Competitive position: Satisfactory

Financial risk: Significant

- Cash flow/Leverage: Significant

Anchor: bbb-

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital Structure: Neutral (no impact)
- Financial Policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bbb-

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Telecommunications And Cable Industry, June 23, 2014
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 20, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Bharti Airtel Ltd.		
Issuer Credit Rating	BBB-/Stable/--	BBB-/Negative/--
Senior Unsecured	BBB-	
Bharti Airtel International (Netherlands) B.V.		
Senior Unsecured	BBB-	BBB-
Network i2i Ltd.		
Subordinated	BB	BB
Junior Subordinated	BB	BB

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