It’s always foolhardy to bet against Sunil Mittal, considering he’s always come up trumps and built a powerhouse in just 15 years. At a time when the industry was up in arms against Reliance Industries Limited (RIL) being allowed a backdoor entry into the mobile phone market, Mittal used the ensuing disarray to snap up licences and ramp up his empire; at a time when people were finding it tough to handle one foreign partner, Mittal kept rotating partners. So, when Mittal plans to buy up Zain’s Africa business for $10.7 billion, there must be something to it even though his stock continues to tank. There are good reasons for why the market doesn’t like the deal, though the severity of the fall makes you wonder if there’s more to it:

While Zain’s overall revenues rose 14 per cent and ebitda grew 26 per cent in the first nine months of 2009, its Africa revenues fell from $3,067 million in the first nine months of 2008 to $2,697 million in the same period of 2009 and ebitda dropped from $1,046 million to $900 million.

**ZAIN MATHS**
ANNUALISED BASIS

**Bharti**

**Rs cr**

**Ratio***

**Idea**

**Rs cr**

**Ratio***

Revenues

39,412

2.7

Revenues

12,133

1.5

Ebitda

16,273

6.5

Ebitda

3,312

5.5

Net profit

9,394

11.2

Net profit

916

19.9

Market cap

105,650

Market cap

18,260

**RCom**

**Rs cr**

**Ratio***

**Zain****

**$ mn**

**Ratio***

Revenues

22,877

1.5

Revenues

2,923

3.7

Ebitda

8,380

4.0

Ebitda (2009)

961

11.1

Net profit

4,646

7.2

Ebitda (2011)#

2,000

6.7^

Market cap

33,395

Net profit

-32

Market cap @

10,700

** Market cap to revenues/ebitda/net profit;   ** Taken on the bas*

If, as Airtel officials say, this is due to sharp currency fluctuations, it underlines the seriousness of the task ahead since depreciating currencies mean Mittal's outgo on future capex expenses will rise in local currency terms.

Nigeria is Zain Africa's biggest market and its revenues fell from $1,194 million in 2008 to $986 million in 2009 (first nine months for both) and ebitda slid from $399 million to $331 million. Subscriber numbers also fell 6 per cent. The dispute over whether Zain can sell its Nigerian operations can queer the deal, though in India, it has to be pointed out, firms that have bought licences with court cases going on have only prospered.

Bharti will have to deal with 15 different regulatory regimes in Africa as opposed to just one in India.

But, and this is why Bharti first bid for MTN and now for Zain, Africa represents the unexplored continent, full of opportunities. If Bharti can lower Zain's costs, it can replicate its Indian model — lower tariffs to get customers to talk more, resulting in higher ARPU (average revenue per user). As compared to India where customers talk for around 400 minutes a month, talk time in Africa is around 150 minutes, around the same it was in India seven-eight years ago.

The caveat here is that Zain's biggest market, Nigeria, already had a market penetration of 45 per cent and an ARPU of $7. In other words, ARPUs are likely to fall since the best customers have already been snapped up.

The flip side is you have hugely under-penetrated markets like the Democratic Republic of Congo which have a lower penetration (14 per cent) and a higher ARPU ($8) despite a much lower per capita income (in PPP dollars, Congo is 340 versus Nigeria's 2,142).

There are no simple correlations between income levels and ARPUs — Niger has a third of Nigeria's per capita income but ARPUs are 42 per cent higher.

Unlike India, which has 12-13 operators in each area, Africa has three-four.

Fixed lines in Africa are even less than in India, so as incomes rise, mobile phones are really the only communication option.

The crux is Bharti's skill in shaking up Zain's operations. Bharti cannot hope to get Indian-style capital efficiencies in Africa since these are driven by population densities — one phone tower can service a lot more customers in densely-populated India than it can in the sparsely-populated Africa. Even so, Bharti insiders are sure they can shave off 20-30 per cent from Zain's costs and use this to stimulate ARPUs.

At current valuations, Zain is overpriced — as compared to Bharti's ebitda multiple of 6.5 and Idea's 5.5, Zain is 11.1 (this falls to 8.9 if you take Zain Africa's entire ebitda instead of just that part which accrues by virtue of its share in each African country's telcos). But if ebitda rises to $2 billion in 2011, as Bharti expects, multiples come down to 6.7 (5.5 if you take the entire ebitda as accruing to Bharti-Zain). Eventually, the Zain play is a bet on Africa's growth and Bharti's ability to turn Zain around. Right now, the markets aren't believing either.