AVENDUS

April 21, 2010

ADD

Target Price (INR) 78

Idea Cellular

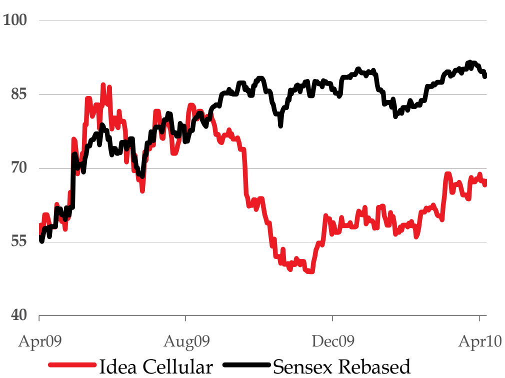
Rural presence, emerging cash surplus are key positives

Company Report

Last Price (INR)	67.4
Bloomberg code	IDEA IN
Reuters code	IDEA.BO
Avg. Vol. (3m)(mn)	4.9
Avg. Val.(3m)(INRmn)	307
52-wk H/L (INR)	91.8 / 47.1
Sensex	17460.6
MCAP (INRbn/USDbn)	222.2 / 5.0

Shareholding (%)	09/09	12/09
Promoters	57.7	49.1
MFs, FIs, Banks	11.3	9.4
FIIs	5.4	5.8
Public	24.8	2.8
Others	0.8	33.1

Stock Chart (Relative to Sensex)



Stock Perfm. (%)	1m	6m	1yr
Absolute	-2.2	11.2	15.3
Rel. to Sensex	-1.5	9.9	-43.7

Financials (INRmn)	03/09	03/10f	03/11f
Sales	101,313	125,807	160,204
y-o-y (%)	51	24	27
EBITDA (%)	27.8	25.8	23.5
A.PAT	8,816	7,986	8,167
Sh o/s (diluted)	3,100	3,236	3,236
A.EPS (INR)	2.8	2.5	2.5
y-o-y (%)	-28	-13	2
D/E (x)	0.2	0.3	0.2
P/E (x)	23.7	27.3	26.7
EV/E (x)	8.2	8.1	6.8
RoCE (%)	11	7	6
RoE (%)	10	6	5

Quarterly Trends	03/09	06/09	09/09	12/09
Sales (INRmn)	29,240	29,748	29,682	31,358
PAT (INRmn)	2,743	2,971	2,202	1,701

IDEA is likely to generate aggregate operating cash flow of cINR83bn in the next two years, even after a small decline in the EBITDA margin. Capex is forecast to decelerate as expansion has been completed in most circles and legacy assets are being transferred to a joint-venture tower company. IDEA's competitive edge stems from the relatively large proportion of spectrum in the 900MHz band. It is also growing in the less competitive rural market where its market share has risen to 15%. Its established presence in seven circles and the base of high-ARPU customers provide a ready platform to leverage a potential win in the ongoing 3G auction. Stability in its 2G business and the strong balance sheet can support aggressive bids in the auction. We initiate coverage with an Add rating and a Mar11f target price of INR78.

Decrease in capital expenditure likely to lead to positive cash flows

Capex is forecast to decelerate as expansion has been completed in most circles and legacy assets are being transferred to Indus Towers. However, EBITDA margins are likely to decline, albeit at a slower pace. Margins are likely to stabilize after FY11f on lower competition and stable tariffs. The reducing need for capex and the 16% CAGR in EBITDA during FY10f-FY12f are likely to generate aggregate operating cash flow of cINR83bn in the next two years.

Spectrum and rural presence provide a cushion

IDEA's competitive edge stems from the relatively large proportion of spectrum in the 900MHz band. It is also growing in the less competitive rural market through investments in strong network infrastructure; its market share in rural subscribers has risen from 10% in 1QFY09 to 15% in 3QFY10. Five service providers, namely BHARTI, IDEA, Vodafone Essar, RCOM and BSNL, control 87% of the rural market as of 3QFY10. The strong rural presence and spectrum in 900MHz band provide a cushion to earnings.

Potential win in 3G auctions may add a competitive edge

Its established presence in seven circles and the base of high-ARPU customers provide a ready platform to leverage a potential win in the ongoing 3G auction. IDEA would, thus, be able to transition a fraction of its existing customers to the 3G network. This is likely to create additional capacity on the 2G network. The seven incumbent circles contributed 37% of the industry's revenue and 70% of IDEA's revenues in 2QFY10. Stability in its 2G business and the strong balance sheet can support aggressive bids in the 3G auction.

Initiate coverage with an Add rating and a Mar11f target of INR78

We have valued IDEA using a combination of DCF and sum-of-parts for individual businesses and we arrive at a Mar11 target price of INR78. Our target price values the stock at FY11f EV/EBITDA of 7.7x and P/E of 30.9x and FY12f EV/EBITDA of 6.4x and P/E of 24.8x. We initiate coverage on the stock with an Add rating The key risks to our estimates are aggressive bidding in the 3G auctions and higher-than-expected decline in tariffs.

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Please refer to the disclaimer towards the end of the document.

Table of Contents

Investment Summary

IDEA is likely to generate aggregate operating cash flow of an estimated INR83bn in the next two years, even after a small decline in the EBITDA margin. Capital expenditure (capex) is forecast to decelerate as expansion has been completed in most circles and legacy assets are being transferred to Indus Towers, a joint-venture tower company. IDEA's competitive edge stems from the relatively large proportion of spectrum in the 900MHz band. It is also growing in the less competitive rural market where its market share has risen to 15%. Its established presence in seven circles and the base of high-ARPU customers provides a ready platform to leverage a potential win in the ongoing 3G auction. Stability in its 2G business and its strong balance sheet can support aggressive bids in the auction. We value the stock using a combination of DCF and a sum-of-parts and arrive at a Mar11 target price of INR78. We initiate coverage with an Add rating.

Decrease in capital expenditure likely to lead to positive cash flows

Reducing need for capex and 16% CAGR in EBITDA during FY10f-FY12f are likely to generate higher operating cash flow.

Capex is forecast to decelerate as expansion has been completed in most circles and legacy assets are being transferred to Indus Towers. However, EBITDA margins are likely to decline, albeit at a slower pace. Margins are likely to stabilize after FY11f on lower competition and stable tariffs. The reducing need for capex and the 16% CAGR in EBITDA during FY10f-FY12f are likely to generate operating cash flow of INR40bn and INR43bn in FY11f and FY12f, respectively.

Spectrum and rural presence provide a cushion

Spectrum in the 900MHz band and 15% share in rural India put IDEA in a strong position.

IDEA's competitive edge stems from the relatively large proportion (44%) of spectrum in the 900MHz band. It is also growing in the less competitive rural market through investments in strong network infrastructure; its market share in rural subscribers has risen from 10% in 1QFY09 to 15% in 3QFY10. Five service providers, namely BHARTI, IDEA, Vodafone Essar, RCOM and BSNL, control 87% of the rural market as of 3QFY10. The rural presence and spectrum in 900MHz band provide a cushion to earnings.

Potential win in 3G auctions may add a competitive edge

Transitioning a part of the existing 2G subscribers to the 3G network is likely to create additional capacity on the 2G network.

Its established presence in seven circles and the base of high-ARPU customers provide a ready platform to leverage a potential win in the ongoing 3G auction. IDEA would, thus, be able to transition a fraction of its existing customers to the 3G network. This is likely to create additional capacity on the 2G network. The seven incumbent circles contributed 37% of the industry's revenue and 70% of IDEA's revenues in 2QFY10. Stability in its 2G business and the strong balance sheet can support aggressive bids in the 3G auction. However, cash outflow for the auction is likely to impact earnings in the near term. Our estimates exclude any impact from the auctions.

Initiate coverage with an Add rating and a Mar11f target of INR78

We have valued IDEA using a combination of DCF and sum-of-parts for individual businesses and we arrive at a Mar11 target price of INR78. Our target values the stock at FY11f EV/EBITDA of 7.7x and P/E of 30.9x and FY12f EV/EBITDA of 6.4x and P/E of 24.8x. We initiate coverage on the stock with an Add rating. The key risks to our estimates are aggressive bidding in the 3G auctions and higher-than-expected decline in tariffs.

Exhibit 1: Valuation summary

(INRmn)	Net Sales	EBITDA	Net Profit	EPS (INR)	P/E (x)	EV/EBITDA (x)	EV/Sales (x)	P/B (x)
Mar08	67,200	22,518	10,423	4.0	17.0	10.0	3.4	5.0
Mar09	101,313	28,134	8,816	2.8	23.7	8.2	2.3	1.6
Mar10f	125,807	32,509	7,986	2.5	27.3	8.1	2.1	1.4
Mar11f	160,204	37,631	8,167	2.5	26.7	6.8	1.6	1.3
Mar12f	187,627	43,629	10,160	3.1	21.5	5.6	1.3	1.3

Source: Company, Bloomberg, Avendus Research

Decrease in capital expenditure likely to lead to positive cash flows

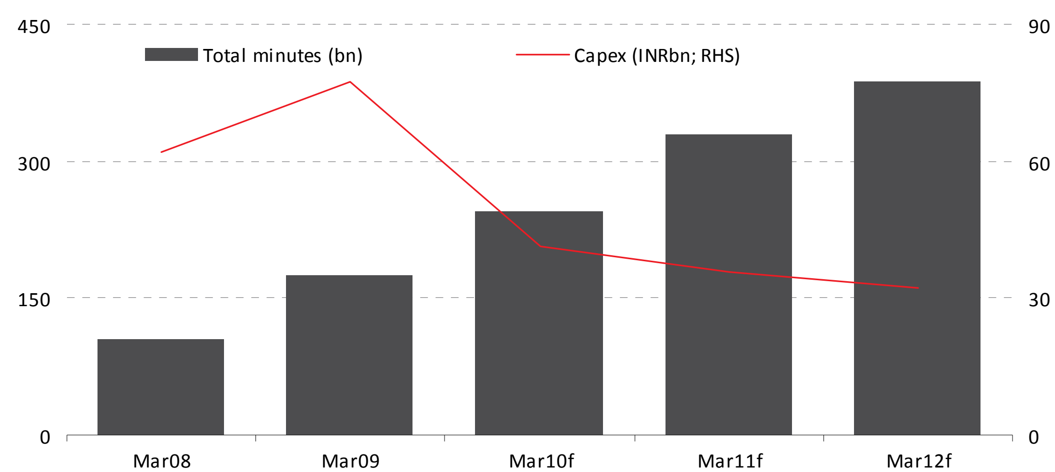
Capex is forecast to decelerate as expansion has been completed in most circles and legacy assets are being transferred to Indus Towers. However, EBITDA margins are likely to decline, albeit at a slower pace. Margins are likely to stabilize after FY11f on lower competition and stable tariffs. The reducing need for capex and the 16% CAGR in EBITDA during FY10f-FY12f are likely to generate operating cash flow of INR40bn and INR43bn in FY11f and FY12f, respectively.

Capex has leveled off, though minutes continue to rise

Slowing minutes growth, end of the pan-India expansion and transfer of passive infrastructure capex to Indus Towers are likely to lower capex.

Aggressive expansion through nine circle launches in the past eight quarters and deeper penetration in existing circles led to the gross block reporting a CAGR of 43% during FY07-FY10f. Idea Cellular (IDEA) is estimated to carry 246bn minutes through its c63,000 sites in FY10f. Total minutes on the network are expected to grow to 422bn by FY12f. While Bharti Airtel (BHARTI IN, Hold) had 102,190 sites, with c568bn total minutes as of Dec09 (LTM), its annual capex for the wireless business was cINR40bn (excluding passive infrastructure). We estimate IDEA's capex at INR36bn in FY11f and INR32bn in FY12f (excluding 3G and passive infrastructure). Slowing minutes growth, the end of the pan-India expansion and transfer of passive infrastructure capex to Indus Towers are likely to lower the capex.

Exhibit 2: Total minutes and capex



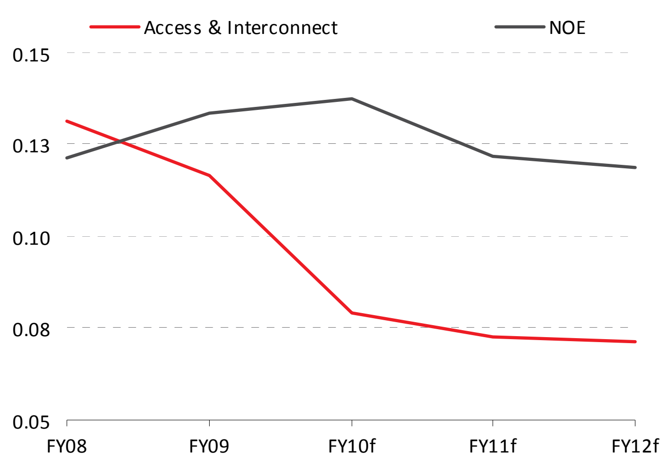
Source: Company, Avendus Research

Growth in costs slows

Benefits through lower network operating expenditure and access charges are offset by higher SG&A costs.

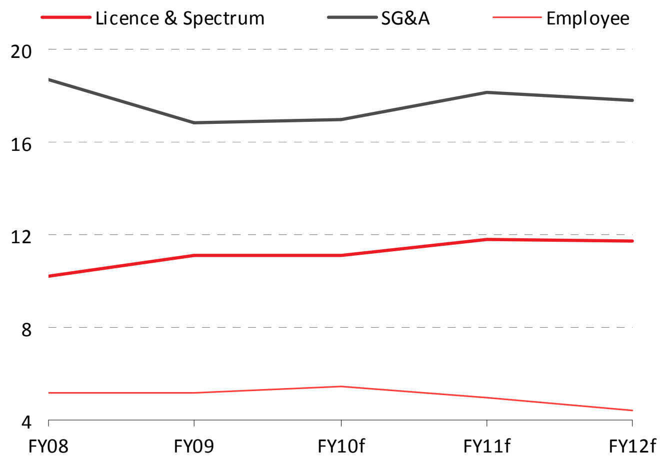
During the past eight quarters, IDEA's rented sites have seen a five-fold increase on account of entry into nine additional circles, higher coverage in existing circles and acquisition of Spice Communications. The transfer of passive infrastructure for 16 circles to Indus Towers, it joint-venture tower company, also led to an increase in rented sites. This led to Network Operating Expenditure (NOE) reporting a CQGR of 15% during 4QFY07-3QFY10. Higher utilization of current network sites is likely to lead to lower NOE/min. Also, the growing subscriber base across the 23 circles and higher proportion of National Long Distance (NLD) minutes on the captive network are likely to lead to lower access and interconnect charges per minute. However, SG&A costs as a percentage of sales are likely to increase due to the rise in competition. The government has hiked spectrum charges from 1 Apr10. However, the Telecom Disputes Settlement & Appellate Tribunal (TDSAT) has issued a stay on the order. We have included the impact of the hike in spectrum charges in our estimates.

Exhibit 3: Costs per minute (INR)



Source: Company, Avendus Research

Exhibit 4: Costs as a percentage of sales



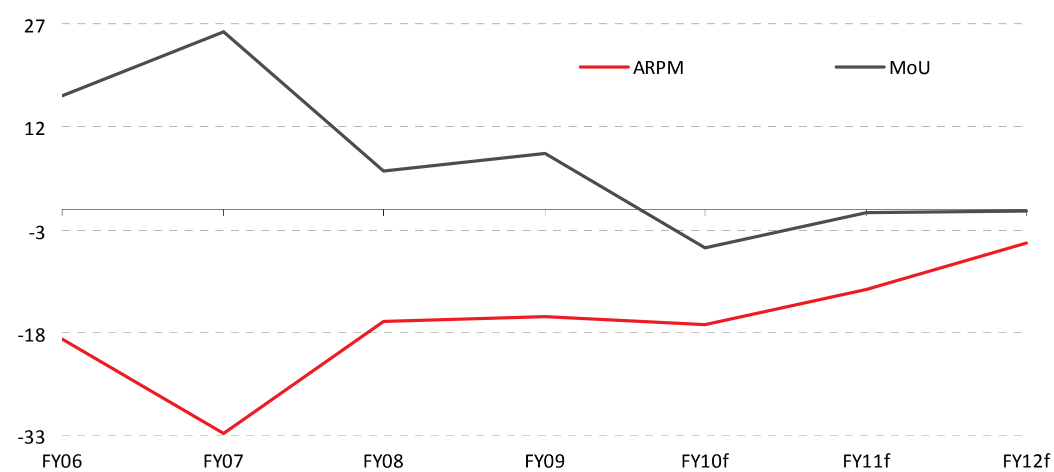
Source: Company, Avendus Research

ARPM and MoU are likely to be under pressure

New entrants use drop in tariff as a tool to acquire a higher share of incremental subscribers.

The launch of GSM operations by Reliance Communications (RCOM IN, Hold); Tata DoCoMo, Uninor; S Tel; and Aircel in India was accompanied by a drop in tariffs; IDEA also followed suit. This led to a 19% decrease in the average revenue per minute (ARPM) in 2009. In 2010, Datacom, Uninor, Swan and other operators are likely to complete their pan-India launch. This is likely to maintain the pressure on ARPMs. Additionally, the contraction in the minutes of usage per subscriber per month (MoU) for a per-unit drop in tariff is likely to impact revenue growth. Spectrum crunch and multiplicity of SIM cards are likely to add to the woes.

Exhibit 5: y-o-y growth in ARPM and MoU (%)



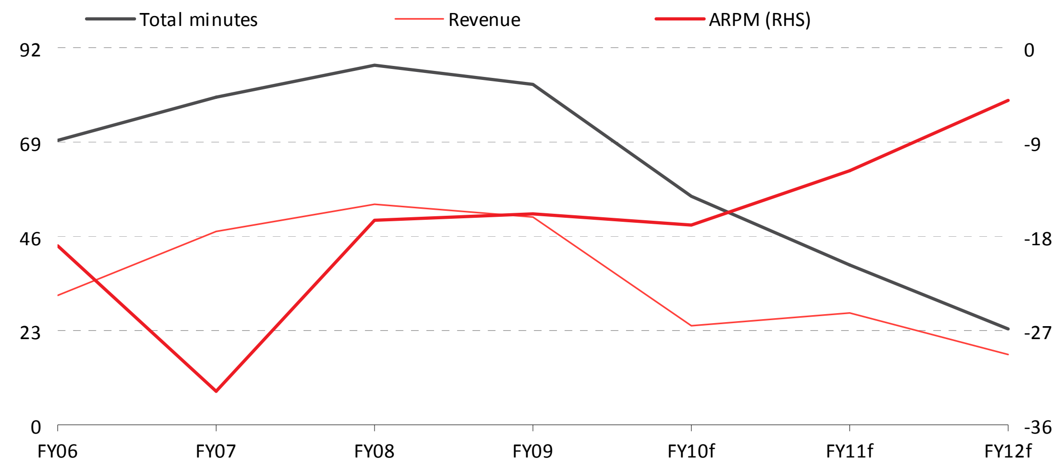
Source: Company, Avendus Research

Slowing minutes growth and continuous drop in tariffs impacts revenue growth

The double whammy of decreasing tariffs and slowing minutes growth, due to the base effect, is likely to lead to slower revenue growth. We forecast the CAGR in revenue at 22% during FY10-FY12. The increasing penetration in rural areas is likely to continue the growth momentum in subscribers; however, the average revenue per user (ARPU) is likely to continue contracting at a compounded annual rate of 9% during FY10f-FY12f.

While decline in ARPM is likely to reduce, the minutes growth is likely to slow further, leading to reducing revenue growth.

Exhibit 6: y-o-y growth in ARPM, total minutes and revenue (%)



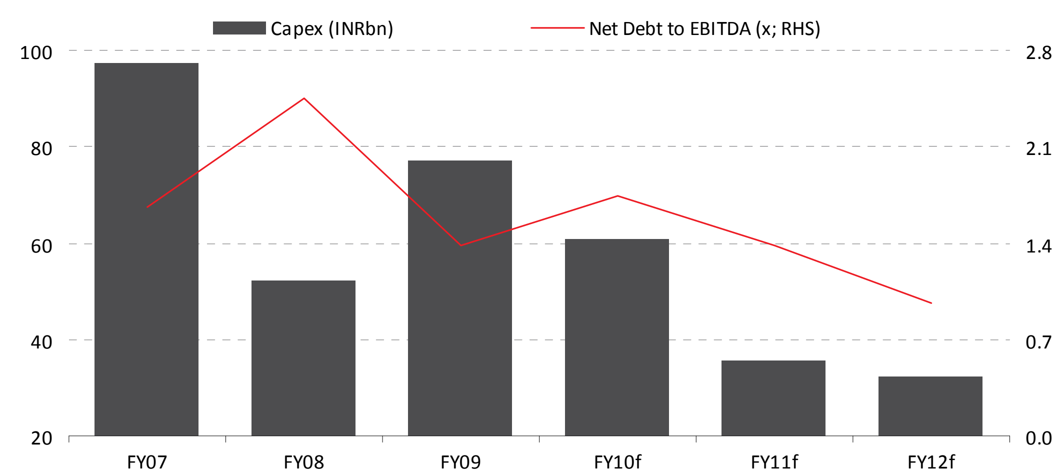
Source: Company, Avendus Research

Higher cash generation to strengthen the balance sheet

Declining capex requirements and a CAGR of 16% in EBITDA during FY10f-FY12f are likely to lead to positive free cash flow generation in FY11f. We forecast the net debt to reduce from INR56bn in FY10 to INR43bn by FY12 and the net debt to equity to reduce from 0.36x to 0.25x. With capex requirements to be funded from internal accruals, funding through raising debt or issuance of equity is less likely. Hence, the increase in interest costs or dilution is less probable.

Reducing capex needs and 16% EBITDA CAGR during Fy10f-FY12f are likely to lead to lower net debt to EBITDA.

Exhibit 7: Capex and net debt to EBITDA



Source: Company, Avendus Research

Spectrum and rural presence provide a cushion

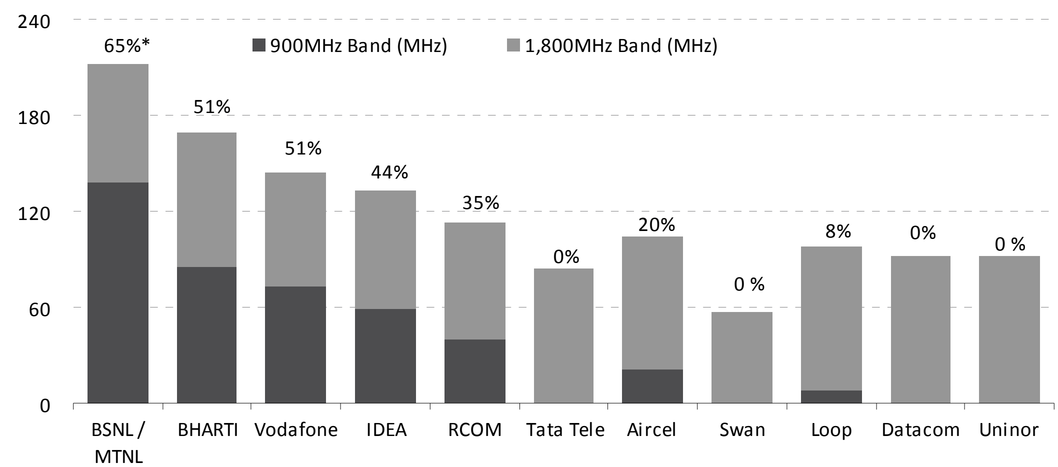
IDEA's competitive edge stems from the relatively large proportion (44%) of spectrum in the 900MHz band. It is also growing in the less competitive rural market through investments in strong network infrastructure; its market share in rural subscribers has risen from 10% in 1QFY09 to 15% in 3QFY10. Five service providers, namely BHARTI, IDEA, Vodafone Essar, RCOM and BSNL, control 87% of the rural market as of 3QFY10. The strong rural presence and spectrum in 900MHz band subscribers provide a cushion to earnings.

Spectrum and scale provides access to large population

44% of spectrum is in the 900MHz band; allows IDEA to provide better service at lower costs.

IDEA has 44% spectrum in the 900MHz band. Operating in 900 MHz band spectrum requires c50% lower capex than operating in 1,800 MHz band spectrum. Assuming the incremental capex is in setting up c50% more sites, the recurring costs to manage these sites is c50% higher Thus operating in 1,800 MHz band increases the capex and recurring costs by c50%. Many new entrants including RCOM have received 2G spectrum in the 1800MHz band. The 900MHz band requires c50% lower capex than the 1800MHz band as it can carry minutes across a larger area. Thus, IDEA has an early-mover advantage.

Exhibit 8: Spectrum details for wireless service providers



Source: Company, Avendus Research. Note:* Denotes proportion of total allocated spectrum in the 900MHz band.

IDEA has invested in setting up a pan-India network with c63,000 sites. This led to strong population coverage. While the launch of operations in nine circles in the past eight quarters completed the pan-India expansion, network operating expenditure reported a CQGR of 14%. However, the investment in this infrastructure led to creation of scale and a strong rural presence.

Strong rural infrastructure is a defensive feature

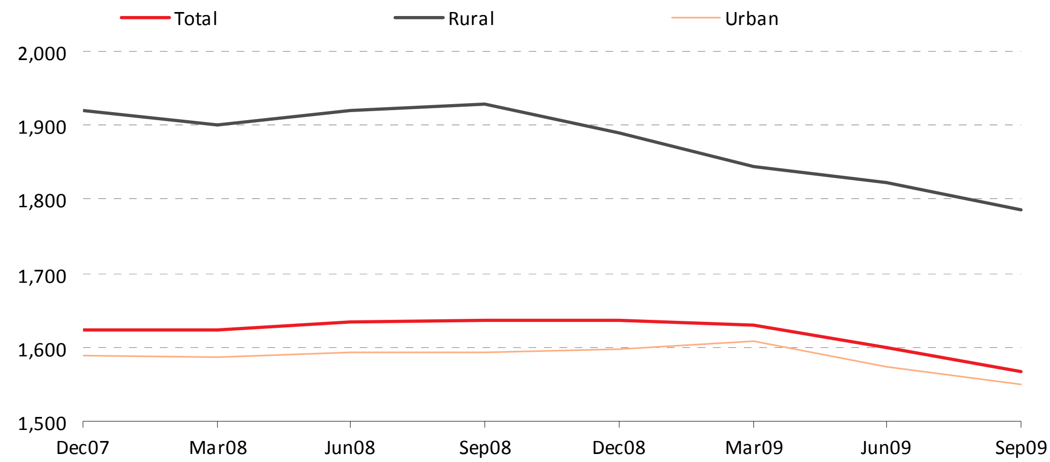
In the rural region, BHARTI, IDEA, Vodafone Essar, RCOM and BSNL control 87% share.

IDEA had 15% market share among rural subscribers. In the rural region, BHARTI, IDEA, Vodafone Essar, RCOM and Bharat Sanchar Nigam (BSNL) control 87% share of the total subscribers as of 3QFY10. Thus, the competition is lesser than that in urban areas, which have more than 10 operators. The entry barriers for the rural region are as follows:

- Creation of infrastructure in the rural region requires higher investments as compared to urban areas. The region requires an extensive tower network to cover areas with low population density.
- Strong distribution channels are required to educate the potential subscriber about the benefits of mobiles and to resolve subscriber complaints.
- Low per capita income limits the ARPU.

Exhibit 9: Herfindahl-Hirschman Index with respect to subscriber market share

Herfindahl-Hirschman Index is much higher in the rural region than urban region, implying significantly lower competition in the rural region.



Source: Company, Avendus Research

Share of rural subscribers has increased from 6% in 4QFY08 to 45% in 3QFY10.

The initial foray in the rural region has led to acquisition of subscribers that are likely to contribute a significant proportion of minutes. The proportion of IDEA's rural subscribers has increased from 7% in 4QFY08 to 45% in 3QFY10. For 3QFY10, we have assumed the contribution from IDEA's rural subscribers at c41% of total minutes.

Exhibit 10: Assumptions for urban and rural subscribers and their usage in minutes

	Mar08	Jun08	Sep08	Dec08	Mar09	Jun09	Sep09	Dec09
Subscribers (mn)								
Rural	1.6	6.9	8.0	12.0	17.2	19.8	22.2	26.1
Urban	22.8	24.9	26.0	26.0	25.8	27.3	29.3	31.5
Total	24.3	31.7	34.0	38.0	43.0	47.1	51.5	57.6
Total minutes (mn)								
Rural	1,630	4,204	6,082	10,334	17,564	18,095	22,354	26,420
Urban	30,974	33,789	35,366	35,380	32,249	36,364	33,720	37,738
Total	32,604	37,993	41,448	45,714	49,813	54,459	56,074	64,158
MoU (min)								
Rural	351	203	254	287	340	305	336	338
Urban	453	453	453	453	417	444	384	399
Total	447	399	407	401	386	385	363	371

Source: Company, Avendus Research, TRAI

Potential win in 3G auctions may add a competitive edge

Its established presence in seven circles and the base of high-ARPU customers provide a ready platform to leverage a potential win in the ongoing 3G auction. IDEA would, thus, be able to transition a fraction of its existing customers to the 3G network. This is likely to create additional capacity on the 2G network. The seven incumbent circles contributed 37% of the industry's revenue and 70% of IDEA's revenues in 2QFY10. Stability in its 2G business and the strong balance sheet can support aggressive bids in the 3G auction. However, cash outflow for the auction is likely to impact earnings in the near term. Our estimates exclude any impact from the auctions.

Exhibit 11: ARPU of service providers as of 2QFY10

	Industry	--------- BHARTI ---------		--------- IDEA ---------		--------- Vodafone ---------		--------- RCOM ---------		------- Tata Tele -------	
	ARPU (INR)	ARPU (INR)	Premium to Industry (%)	ARPU (INR)	Premium to Industry (%)	ARPU (INR)	Premium to Industry (%)	ARPU (INR)	Premium to Industry (%)	ARPU (INR)	Premium to Industry (%)
Metro	288	466	62	308	7	380	32	203	-29	215	-25
Circle A	201	279	39	216	8	220	9	118	-41	171	-15
Circle B	167	235	40	208	24	183	9	105	-37	104	-38
Circle C	168	231	38	140	-17	131	-22	129	-23	131	-22
Total	196	275	40	215	10	225	15	127	-35	156	-20

Source: TRAI, Company, Avendus Research

Existing high-ARPU customers are a positive

ARPUs for all circles except Circle C, at a premium to the industry; implies IDEA's high-ARPU subscriber base.

IDEA has a significant advantage over new entrants such as RCOM and Tata Teleservices. The early start helped the company create a brand, distribution channel and network coverage. This led to gain of a significant share of high-ARPU customers. In 2QFy10, IDEA garnered 70% of its revenues from seven circles, namely Maharashtra, Kerala, Andhra Pradesh, Madhya Pradesh and Uttar Pradesh (West), Gujarat and Haryana. It has over 15% share in revenues in these circles; ARPUs in most of them are at a significant premium to the industry.

Higher revenue share than subscriber share implies high ARPU subscriber base in key circles.

Exhibit 12: Revenue and subscriber details in key circles as of 2QFY10

	--------- Subscriber (%) ---------		------------ Revenue (%) -----------		----------- ARPU (INR) ------------	
	Concentration	Share	Concentration	Share	IDEA	Industry
Madhya Pradesh	11	24	10	29	186	153
Maharashtra	16	23	17	28	225	185
Kerala	10	24	11	28	241	217
Uttar Pradesh (West)	9	21	9	28	214	160
Haryana	4	16	4	20	221	169
Gujarat	9	16	8	18	202	185
Andhra. Pradesh	11	15	12	16	225	217
Punjab	5	17	6	18	236	221
Delhi	5	10	7	10	322	321

Source: Company, Avendus Research

Multiple gains due to potential win in 3G auctions

Following are the gains that are likely to accrue in case IDEA wins spectrum in the 3G auction:

- Provide better QoS.
- Spare capacity on the 2G network.
- Provide high-bandwidth applications.
- Reduction in capex in the long term.

Exhibit 13: Assumptions for 3G auction price

Reserve Price (INRbn)	35
Bidding Price (INRbn)	61
3G subscribers in FY11f (mn)	11
3G subscribers in FY20f (mn)	92
Average ARPU during FY11f-FY25f (INR)	481
Terminal growth (%)	6
WACC (%)	13
Long term Debt/Capital (x)	40

Source: Avendus Research

Multiple gains due to likely 3G win may help IDEA generate higher IRR than new entrants that win the 3G auction.

The existing base of high-ARPU subscribers are likely to provide the IDEA a ready market for 3G services as many customers may already own 3G-compatible handsets. Thus, IDEA is likely to have lower 3G subscriber acquisition costs compared to new entrants. Also transitioning part of the customers to 3G network is likely to ease the spectrum crunch on the 2G network. The existing 2G spectrum, wider network coverage and a better brand are likely to boost net additions in incumbent circles for 2G services. Hence, IDEA is likely to generate higher IRR than new entrants from a potential win in 3G auctions. Additionally, potential win of 3G spectrum is likely to significantly reduce the regulatory headwinds with respect to spectrum allocation.

Initiate coverage with an Add rating and a Mar11 target of INR78

We have valued IDEA using a combination of DCF and sum-of-parts for individual businesses and we arrive at a Mar11 target price of INR78. Our target values the stock at FY11f EV/EBITDA of 7.7x and P/E of 30.9x and FY12f EV/EBITDA of 6.4x and P/E of 24.8x. We initiate coverage on the stock with an Add rating. The key risks to our estimates are aggressive overbidding in the 3G auction and higher-than-expected decline in tariffs.

Sum-of-parts value of INR76/share

We have valued IDEA's wireless business, including Spice, at a 5% discount to BHARTI's target EV/EBITDA of 5.8x for non-tower business. We have taken a 5% discount as potential win in 3G auction may impact IDEA's earnings more than that of BHARTI. Also BHARTI has better RoE and larger scale than IDEA. We have valued the Indus Towers stake (considering CCPS issued for 20% stake to Providence Equity Partners) at INR30/share, implying an EV/tower of INR9mn. Our target based on the sum-of-parts method is INR76.

Exhibit 14: Sum-of-parts valuation

(INRmn)	EBITDA	EV/EBITDA (x)	EV	Net debt	INR/share
Wireless business (Idea + Spice)	34,496	5.5	189,728	40,348	46
Indus Towers (13% stake)					30
Total					**76**

Source: Avendus Research

DCF method values IDEA at INR79/share

We have estimated IDEA's fair value at INR79 using the three-stage DCF method. Key assumptions are:

- The first stage in the DCF uses our explicit forecasts during FY10-FY12.
- In the second stage, we have assumed revenue growth to decline to 9% and EBIT margins to decline to 15.5%. The asset turnover is likely to decrease to 0.4.
- In the third stage, we have assumed growth to decline to 7% and EBIT margins to decline to 13.5%. The asset turnover ratio is likely to remain unchanged.

Exhibit 15: DCF assumptions and summary

	---------- Stage-I: 3 years explicit ----------					---------- Stage-II: 12 years ----------				---------- Stage-III: 10 years ----------			
(%)	FY10f	FY11f	FY12f	-- Over stage I --		FY13f	FY24f	-- Over stage II --		FY25f	FY34f	-- Over stage II --	
Sales Growth (%)	24.2	27.3	17.1	22.8	CAGR	9.0	9.0	9.0	CAGR	8.8	7.0	7.9	CAGR
EBIT margins (%)	13.5	10.6	10.7	11.6	Average	11.1	15.5	13.3	Average	15.3	13.5	14.4	Average
Tax Rate (%)	1.0	1.0	15.0	5.7	Average	16.6	34.0	25.4	Average	34.0	34.0	34.0	Average
Gross Turnover (x)	0.5	0.5	0.6	0.5	Average	0.5	0.4	0.5	Average	0.4	0.4	0.4	Average
WCAP (days sales)	-71.7	-73.0	-73.3	-72.7	Average	-69.2	-25.0	-46.8	Average	-25.0	-25.0	-25.0	Average
ROIC (%)	10.5	9.5	9.5	9.8	Average	10.3	13.1	12.7	Average	13.8	26.7	18.8	Average

DCF value as on Mar10	(INRmn)	% of EV
Explicit period cash flows	1,945	1
Stage-II cash flows	54,971	21
Stage-III cash flows	77,321	30
Terminal Value	126,707	49
Total EV	**260,944**	**100**
Less: Gross Debt	92,271	
Add: Investments & Cash	35,496	
Equity Value	**219,901**	
No of shares (mn)	3,236	
Value/share (INR) (Apr10)	68	
Value/share (INR) (Apr11)	**79**	

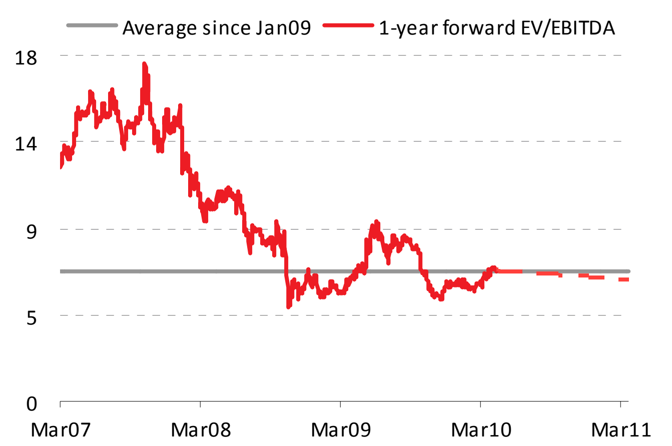
WACC Assumption (%)	
Risk-free rate	7.90
Mkt. risk premium	6.00
Beta (x)	1.10
Cost of equity	14.5
Cost of debt	10.0
Debt/total capital	37.5
WACC	12.1
Terminal growth	6.0

Sensitivity analysis

		WACC (%)		
		11.1	12.1	13.1
Terminal growth (%)	5.0	98	72	55
	6.0	109	**79**	59
	7.0	127	89	64

Source: Avendus Research

Exhibit 16: 1-year forward EV/EBITDA



Source: Company, Bloomberg, Avendus Research

Exhibit 17: 1-year forward P/E

Source: Company, Bloomberg, Avendus Research

Mar11f target of INR78/share; upside of 16%

Our target price is based on the average of the target prices based on the sum-of-parts (INR76) and DCF (INR79) methods. We arrive at a Mar11f price target of INR78, which values the stock at FY12f EV/EBITDA of 6.4x and P/E of 24.8x. We initiate coverage on the stock with an Add rating.

Discount to historical mean caused by earnings growth and risks

Our Mar11f target of INR78 values the stock at FY12f EV/EBITDA of 6.4x and P/E of 24.8x, which are at a 6% and 0% discount to the mean, respectively. This is due to the estimated slowdown in earnings growth. While headwinds such as competition, the 3G and MNP are likely to recede in FY11, the estimated lower capex is likely to lead to lower net debt.

Risks to our estimates

- Higher-than-expected decline in tariffs is likely to impact revenue growth.
- Aggressive overbidding in the 3G auction is likely to impact near-term earnings adversely.

Financials and Valuations

Income statement (INRmn)

Fiscal year ending	03/08	03/09	03/10f	03/11f	03/12f
Gross sales	67,200	101,313	125,807	160,204	187,627
Less: Excise duty	0	0	0	0	0
Net sales	67,200	101,313	125,807	160,204	187,627
Other Operating Income	0	0	0	0	0
Total operating income	**67,200**	**101,313**	**125,807**	**160,204**	**187,627**
Total operating expenses	**44,682**	**73,179**	**93,298**	**122,572**	**143,998**
License and WPC charges	6,851	11,387	14,242	19,191	22,297
Other direct costs	21,805	39,520	50,878	66,390	79,954
Personnel	3,464	5,245	6,816	7,965	8,306
SG&A	12,563	17,027	21,361	29,026	33,441
R&D	0	0	0	0	0
EBITDA	**22,518**	**28,134**	**32,509**	**37,631**	**43,629**
Other income	1,991	4,498	4,626	2,840	2,375
Depreciation	8,768	14,028	20,091	23,557	25,901
EBIT	**15,741**	**18,603**	**17,044**	**16,914**	**20,103**
Interest	4,592	9,212	8,563	8,225	7,403
Recurring PBT	11,148	9,391	8,482	8,688	12,700
Net extra ordinary items	0	0	0	0	0
PBT (reported)	11,148	9,391	8,482	8,688	12,700
Total taxes	725	576	495	521	2,540
PAT (reported)	10,423	8,816	7,986	8,167	10,160
Add: Share of earnings of associate	0	0	0	0	0
Less: Minority interest	0	0	0	0	0
Prior period items	0	0	0	0	0
Net income (reported)	10,423	8,816	7,986	8,167	10,160
Avendus net income	**10,423**	**8,816**	**7,986**	**8,167**	**10,160**
Dividend + Distribution tax	0	0	0	0	0
Shares outstanding (mn)	2,635.4	3,100.1	3,236.4	3,236.4	3,236.4
Avendus diluted shares (mn)	2,635.4	3,100.1	3,236.4	3,236.4	3,236.4
Avendus EPS (INR)	**4**	**3**	**2**	**3**	**3**

Growth ratios (%)

	03/08	03/09	03/10f	03/11f	03/12f
Total operating income	53.9	50.8	24.2	27.3	17.1
EBITDA	53.7	24.9	15.6	15.8	15.9
EBIT	87.7	18.2	-8.4	-0.8	18.9
Recurring PBT	118.9	-15.8	-9.7	2.4	46.2
Avendus net income	107.5	-15.4	-9.4	2.3	24.4
Avendus EPS	104.2	-28.1	-13.2	2.3	24.4

Operating ratios (%)

	03/08	03/09	03/10f	03/11f	03/12f
EBITDA margin	33.5	27.8	25.8	23.5	23.3
EBIT margin	23.4	18.4	13.5	10.6	10.7
Net profit margin	15.1	8.3	6.1	5.0	5.3
Other income/PBT	17.9	47.9	54.5	32.7	18.7
Effective Tax rate	6.5	6.1	5.8	6.0	20.0

Balance sheet (INRmn)

Fiscal year ending	03/08	03/09	03/10f	03/11f	03/12f
Equity capital	26,354	31,001	32,364	32,364	32,364
Preference capital	0	0	0	0	0
Reserves and surplus	9,092	101,652	121,612	129,779	139,939
Net worth	**35,446**	**132,653**	**153,976**	**162,143**	**172,303**
Minority interest	0	0	0	0	0
Total debt	65,154	89,122	91,141	82,027	73,824
Deferred tax liability	661	1,130	1,130	1,130	1,130
Total liabilities	**101,261**	**222,905**	**246,247**	**245,300**	**247,257**
Gross block	132,164	205,234	267,006	305,494	339,461
less: Accumulated depreciation	42,219	59,971	89,030	112,587	138,488
Net block	89,945	145,263	177,976	192,908	200,973
CWIP	17,217	21,409	20,611	17,877	16,090
Goodwill	61	22,457	36,875	36,875	36,875
Investments	5,560	20,452	20,452	20,452	20,452
Cash	4,975	30,864	15,044	9,239	10,523
Inventories	276	521	534	723	832
Debtors	1,986	3,618	3,447	4,389	5,140
Loans and advances	8,263	18,682	14,090	17,943	21,014
less: Current liabilities	26,203	38,637	40,971	53,295	62,832
less: Provisions	819	1,724	1,811	1,811	1,811
Net working capital	-11,523	13,324	-9,667	-22,812	-27,133
Total assets	**101,261**	**222,905**	**246,247**	**245,300**	**247,257**

Cash flow statement (INRmn)

Fiscal year ending	03/08	03/09	03/10f	03/11f	03/12f
Net profit	10,423	8,816	7,986	8,167	10,160
Depreciation	8,768	14,028	20,091	23,557	25,901
Deferred tax	650	469	413	434	635
Working capital changes	5,181	10,121	2,931	10,780	8,347
Less: Other income	1,991	4,498	4,626	2,840	2,375
Cash flow from operations	**23,031**	**28,936**	**26,795**	**40,099**	**42,668**
Capital expenditure	-52,180	-77,261	-60,974	-35,755	-32,179
Strategic investments purchased	0	0	0	0	0
Marketable investments purchased	-5,548	-14,892	0	0	0
Change in other loans and advances	-3,743	-9,078	4,240	-3,440	-2,742
Goodwill paid	0	-22,396	-14,418	0	0
Other income	1,991	4,498	4,626	2,840	2,375
Cash flow from investing	**-59,480**	**-119,130**	**-66,526**	**-36,355**	**-32,546**
Equity raised	0	0	0	0	0
Change in borrowings	22,649	23,968	2,019	-9,114	-8,203
Dividends paid (incl. tax)	0	0	0	0	0
Others	574	92,115	21,892	-434	-635
Cash flow from financing	**23,223**	**116,084**	**23,911**	**-9,549**	**-8,838**
Net change in cash	**-13,225**	**25,890**	**-15,820**	**-5,805**	**1,284**

Key Ratios

Fiscal year ending	03/08	03/09	03/10f	03/11f	03/12f
Valuation ratios (x)					
P/E (on Avendus EPS)	17.0	23.7	27.3	26.7	21.5
P/E (on basic, reported EPS)	16.9	21.9	26.7	26.7	21.5
P/CEPS	9.3	9.1	7.8	6.9	6.0
P/BV	5.0	1.6	1.4	1.3	1.3
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Market cap. / FCF	7.7	7.2	8.1	5.4	5.1
Market cap. / Sales	2.6	2.1	1.7	1.4	1.2
EV/Sales	3.4	2.3	2.1	1.6	1.3
EV/EBITDA	10.0	8.2	8.1	6.8	5.6
EV / FCF	-7.7	-4.8	-7.7	58.8	23.2
EV / Total Assets	2.2	1.0	1.1	1.0	1.0
Net Cash / Market cap.	10.3	32.6	22.0	21.0	22.8
Per share ratios (INR)					
Avendus EPS	4.0	2.8	2.5	2.5	3.1
EPS (Basic, reported)	4.0	3.1	2.5	2.5	3.1
Cash EPS	7.3	7.4	8.7	9.8	11.1
Book Value	13.5	42.8	47.6	50.1	53.2
Dividend per share	0.0	0.0	0.0	0.0	0.0
ROE Decomposition (%)					
EBIT margin	23.4	18.4	13.5	10.6	10.7
Asset turnover (x)	0.8	0.6	0.5	0.7	0.8
Interest expense ratio	5.5	5.7	3.7	3.3	3.0
Tax retention ratio	93.5	93.9	94.2	94.0	80.0
ROA	12.6	5.4	3.4	3.3	4.1
Total assets / equity (x)	2.9	1.9	1.6	1.6	1.5
ROE	36.4	10.5	5.6	5.2	6.1
Return ratios (%)					
EBIT / Capital Employed	19.0	11.5	7.3	6.9	8.2
ROCE	17.8	10.8	6.8	6.5	6.5
ROIC	25.7	15.6	9.4	8.2	8.1
FCF / IC	-50.9	-43.2	-20.1	2.2	5.3
OCF/Sales	34.3	28.6	21.3	25.0	22.7
FCF/Sales	-43.4	-47.7	-27.2	2.7	5.6
Turnover ratios (x)					
Gross turnover	0.5	0.5	0.5	0.5	0.6
Net turnover	0.7	0.7	0.7	0.8	0.9
Revenue / IC	1.2	0.9	0.7	0.8	0.9
Inventory / Sales (days)	1.2	1.4	1.5	1.4	1.5
Receivables (days)	9.5	10.1	10.2	8.9	9.3
Payables (days)	300.5	232.4	223.1	201.0	207.3
Working capital cycle (ex-cash) (days)	-117.6	-105.6	-103.9	-97.2	-101.6
Solvency ratios (x)					
Gross debt to equity	1.9	0.7	0.6	0.5	0.4
Net debt to equity	1.3	0.2	0.3	0.2	0.1
Net debt to EBITDA	2.9	3.2	2.8	2.2	1.7
Interest Coverage (EBIT / Interest)	3.4	2.0	2.0	2.1	2.7

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Etisalat	No	No	No	No
Idea Cellular	No	No	No	Yes
Mahanagar Telephone Corporation	No	No	No	No
NTT DoCoMo Inc	No	No	No	No
Reliance Communications	No	No	No	No
Tata tele Maharashtra Ltd.	No	No	No	No
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