

SELL

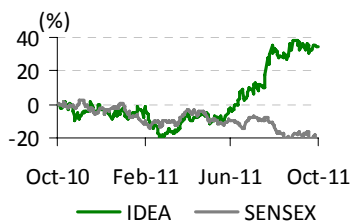
Company Update

Analyst

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Price Rs97
Target Rs68
BSE Index 15,865

Historical Chart



Performance	1m	3m	6m
Absolute (%)	-3	23	44
Relative (%)	3	39	63

Stock Information

Ticker code	IDEA
Market cap (US\$m)	6.6
52-week high (Rs)	104
52-week low (Rs)	56
Shares issued (bn)	3.3
6m avg d.vol (US\$m)	12.8
Free float (%)	53.0
Major shareholders (%)	
Aditya Birla Group	47.0

Statutory Auditor

Deloitte Haskins & Sells

Key Indicators (FY12F)

ROE (%)	6.7
Net D/E (%)	0.9
Interest cover (x)	1.9

Idea Cellular (IDEA)

Earnings growth hinges on tariff increase

In the past 6 months, IDEA's share price performed well on expectations that tariff increases undertaken in Q2 would be extended nation wide. We disagree with this because competition for new subs has not subsided enough to allow tariff increases. New tariffs, limited to a few markets, add 35% to FY13 earnings. Our TP of Rs68/sh is based on 'sum-of-the-parts' valuation (core business: Rs48/sh based on PER of 18x FY12F; towers: Rs20/sh). SELL.

Slowdown in subs addition to restrict FY12F revenue growth to 12%

IDEA increased call tariff by 20% in 7 circles in Q2. If the tariff increase is fully accepted by subs, our FY13F EBIT for IDEA would increase 9%. It is premature to assume that the increase is a success and would be extended to all circles because subs growth is slowing due to rise in churn. Our FY12F subs base is 104m, up 16% (subs base grew 6% in Q1).

Losses on 3G, new markets to limit profit this year

Break-even level for 3G operations of IDEA is 8m subs vs. current base of 2m. We expect 8m level to be achieved in 12 months. Operations in new markets (2G) are currently losing Rs5bn pa at the EBITDA level, and will not be profitable until Mar '13 due to ongoing CAPEX. For our FY13 forecast, we assume that tariff increase will not be extended to other circles.

One-time fee of Rs30bn is a potential risk

Gov't will decide in Dec on the pending issue of charging a one-time fee on spectrum allocated to telcos at no cost in the past 8 years. (It is known to investors and any adverse ruling could hit earnings hard and take away 60% of a year's earnings).

Consensus of 70% EPS growth for FY13 seems exuberant

Investors are optimistic on tariff increase as reflected in big EPS upgrades for FY13 by a few analysts. We believe it is premature to be optimistic because rate hikes can be successful only if subs growth reduces to minimal, eliminating fight for subs. We maintain SELL as IDEA is now trading at 3-year high and double the PER of Bharti Airtel.

Year to March 31	FY09	FY10	FY11	FY12F	FY13F
Revenue (Rsbn)	101.3	124.0	152.3	182.0	211.4
Net profit (Rsbn)	8.8	9.5	8.4	8.4	11.8
EPS (Rs)	2.8	2.9	2.5	2.6	3.6
EPS growth (%)	-28.1	1.7	-12.3	0.9	40.0
PER (x)	34.1	33.6	38.3	37.9	27.1
P/BV (x)	2.3	2.8	2.6	2.5	2.2

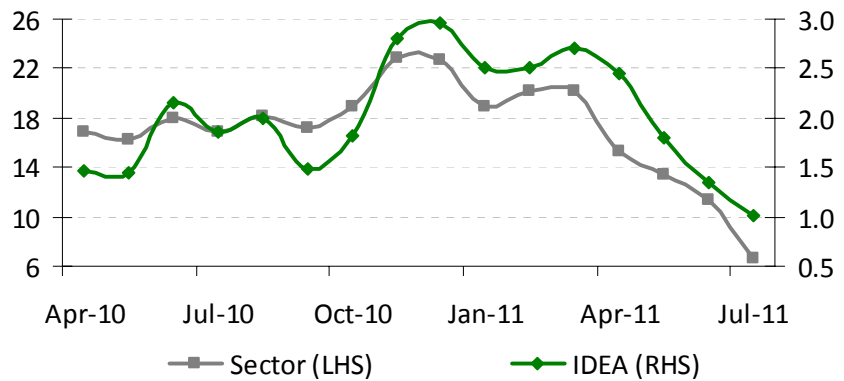
SEE APPENDIX I FOR IMPORTANT DISCLOSURES AND ANALYST CERTIFICATIONS

Subs addition could slow down further due to tariff increase

Subs addition slowed down in M5FY12

Sector subs addition reduced 70% to 7m in July from 23m in Dec'10. This was due to lack of new offers to attract subs and due to saturating mobile penetration of 74%. Tariff increase by telcos would reduce subs addition further.

Telecom: Subs addition (m)



Source: COAI, TRAI

Increased tariffs may not be sustainable

At least 3 operators pushed tariff increase recently. IDEA started with a 20% rise in 7 out of total 22 circles. If successful, it would extend the increase to all circles.

We think the increase would not be successful given slowing growth and high proportion of price-sensitive rural subs. Competition to increase subs base has not eased yet with cheaper offer from newer telcos.

2/3 of IDEA's subs addition is price sensitive rural subs

Nearly 52% of IDEA's subscribers (up from 46% a year ago) are from rural regions. They account for 40% of revenue and are price sensitive, which limits upgrading to 3G services. For competitors, subs in rural area comprise about 38%.

IDEA has only 6.5% market share in new subs added in urban markets.

IDEA: FY11 subs addition by market

(Yr to Mar)	Subs addition (m)	Subs addition market share (%)
Urban	9.5	6.5
Rural	16.2	19.6
Total	25.7	11.3

Source: TRAI

IDEA's subs have cheaper options in 5 out of 7 markets

We believe that the subs have options to change to other telcos with lower tariffs. If this happens, IDEA has to cut tariffs. We await further confirmations on successful implementation of increased tariffs before we include them in our forecasts.

Tariff comparison in markets where IDEA increased tariffs (paise/ second)

Markets	IDEA		Bharti		Vodafone		RCOM		Tata		Uninor	
	Local	STD	Local	STD	Local	STD	Local	STD	Local	STD	Local	STD
Delhi	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	NA	NA	NA	NA
Gujarat	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1	1
Maharashtra	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1	1	1	1
Kerala	1.2	1.2	1	1	1.2	1.2	1.2	1.2	1	1	1	1
Punjab	1.2	1.5	1	1	1	1	1.2	1.2	1	1	NA	NA
UP (West)	1.2	1.2	1	1	1	1	1.2	1.2	1	1	1	1
J&K	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	NA	NA	NA	NA

Source: Company data *STD – long distance calling within India

FY11 MoU growth of 46% may not be sustained in FY12/13

In FY11, IDEA's MoU grew 46% due to 40% increase in subs, 14% decline in tariffs and gaining back the usage from old subs who were using more than one SIM (active subs increased to 93.1% of total subs in Mar '11 from 87.9% in Sept '10).

Slow down in subs addition may restrict MoU growth

For FY12, increased tariffs in 7 markets and slow down in subs addition in India would restrict MoU growth. In M5FY12, IDEA added avg. 1.8m subs per month vs. avg. 2.2m subs in FY11. In M5FY12, IDEA's subs base grew 10%.

Impact of tariff increase – not in our forecast

Our FY13F EPS of Rs3.6 is 40% higher than FY12 but 18% below consensus because our forecast does not include the impact of tariff increases. IDEA confirmed that it will take a year if full increase has to be absorbed by the market. We believe, IDEA's subs have cheaper options and reducing growth will not allow such price increases to go thru. We await confirmation on successful implementation of the tariff increases.

Successful implementation of tariff increase would increase FY13F EPS by 15% to Rs4.2**IDEA: Impact of tariff increase, if successful**

Particulars	Impact on FY13F
FY13F subs in 7 markets (m)	48
Subs shifting to new tariff plans by mid-FY13 (%)	60%
Subs in new tariff (m)	29
Assumed decline in MoU per sub (%)	10
Net change in MoU (m)	115,776
Increase in avg. revenue per min (Rs)	0.07
Increase in Revenue (Rsm)	7,873
% of FY13F revenue	3.7
Increase in EBITDA (Rsm)	2,047
Increase in EPS	0.53
% of FY13F EPS	14.6

Source: KESI estimates

FY13F EPS would increase 28% to Rs4.6, if IDEA is able to shift 100% of its existing and new subs to new tariff by mid-FY13 without any decline in MoU.

Valuation premium to BHARTI unjustified

IDEA trading at 2.2x BHARTI on PER basis despite low ROE

IDEA, being a pure play Indian mobile telco, is exposed to risks from tariff changes, slow down in subs addition, and other uncertainties in a highly competitive market with 13 competing telcos. We believe IDEA should trade at a discount to BHARTI due to BHARTI's diversified operations with its India mobile business contributing only 57% of total revenue).

Valuation: IDEA vs. BHARTI (FY12F)

Particulars	IDEA	BHARTI
GM (%)	26.4	35.8
ROE (%)	6.7	17.6
EV/ EBITDA (x)	7.7	8.2
PER (x)	37.9	16.1

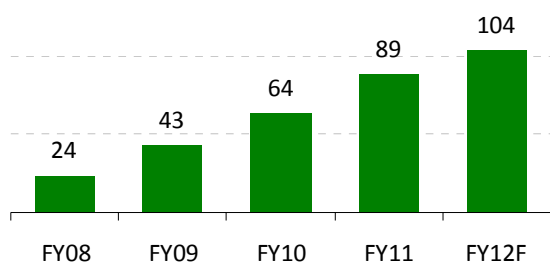
Source: Company data, KESI estimates

Expensive valuation – an opportunity to SELL

Stock price moved up despite no change in fundamentals

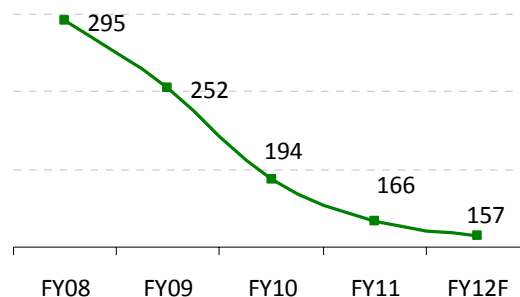
The IDEA stock outperformed SENSEX on: 1) increase in tariffs in few locations; 2) increase in shareholding by Malaysian telco 'Axiata' by 1% to 20%; Axiata may increase stake further to 25% through the secondary market. However, there is no major change in IDEA's fundamentals. Further, we are yet to see confirmation of acceptance of the new tariffs by IDEA's subs.

Subscribers (m)



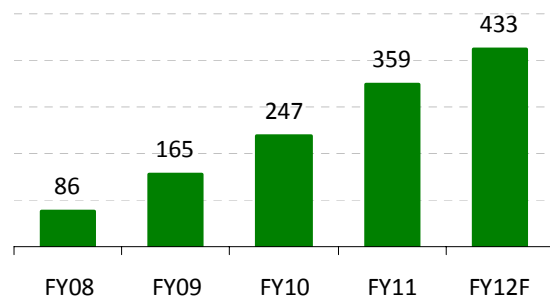
Source: Company data, KESI estimates

Average Revenue per User (Rs/ month)



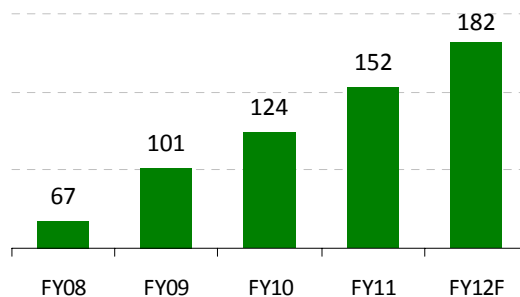
Source: Company data, KESI estimates

Minutes usage (bn)



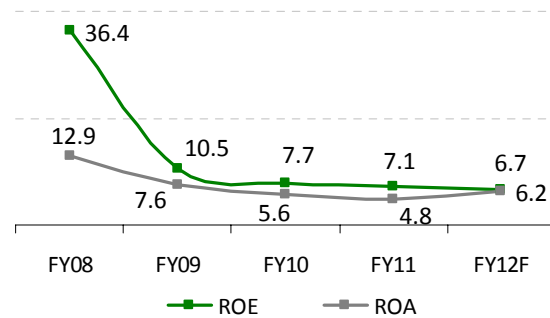
Source: Company data, KESI estimates

Revenue (Rs bn)



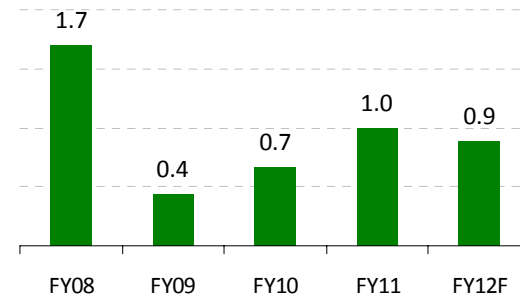
Source: Company data, KESI estimates

ROE and ROA (%)



Source: Company data, KESI estimates

Net D/E (x)



Source: Company data, KESI estimates

Company Description:

IDEA is a pure play mobile service provider. Co-existence of incumbent 2G operations and 3G license in 13 of total 22 telecom markets in India is a major advantage for IDEA. New equity will help IDEA to expand its operations and improve its earnings growth momentum.

Investment Thesis:

However, IDEA do not have 3G operations in top 5 cities which could delay 3G subs addition and 3G break-even. Further IDEA's net debt/ EBITDA of 3x also restricts aggressive expansion plans. Any successful stake sale in its towerco would support its expansion plans.

CONSOLIDATED QUARTERLY FINANCIALS (Year to Mar)

PROFIT & LOSS (Rsm)	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12
Revenue	36,537	36,592	39,556	42,347	45,207
Cost of sales, ex depr	-21,963	-22,346	-22,989	-23,783	-25,891
Depreciation	-5,656	-5,820	-5,925	-6,572	-7,026
Selling and Admin expenses	-5,690	-5,458	-7,085	-7,812	-7,277
Operating profit	3,228	2,968	3,557	4,180	5,014
Interest expense, net	-1,142	-1,028	-941	-854	-2,463
Profit before tax	2,087	1,940	2,616	3,326	2,550
Tax	-73	-143	-186	-581	-778
Minority interest	0	1	2	3	4
Recurring net profit	2,014	1,799	2,433	2,748	1,777
Exceptional items	0	0	0	0	0
Reported net profit	2,014	1,799	2,433	2,748	1,777
Recurring EPS (Rs)	0.61	0.55	0.74	0.83	0.54
Reported EPS (Rs)	0.61	0.55	0.74	0.83	0.54
No. of shares (m)	3,300	3,300	3,300	3,300	3,300
Ratios (%)	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12
Gross margin	24.4	23.0	26.9	28.3	27.2
Net margin	5.5	4.9	6.1	6.5	3.9
SG&A / Sales	15.6	14.9	17.9	18.4	16.1
Effective Tax Rate	3.5	7.4	7.1	17.5	30.5

Source: Company data

CONSOLIDATED YEARLY FINANCIALS (Yr To Mar)							
PROFIT & LOSS (Rs bn)	FY07	FY08	FY09	FY10	FY11	FY12F	FY13F
Revenue	43.7	67.2	101.3	124.0	152.3	182.0	211.4
Cost of sales, ex depr	-19.8	-32.1	-56.2	-69.5	-89.4	-104.4	-121.5
Depreciation	-6.7	-8.8	-14.0	-20.1	-24.7	-29.5	-32.8
Selling, Admn. And R&D Expenses	<u>-9.2</u>	<u>-12.6</u>	<u>-17.0</u>	<u>-20.9</u>	<u>-25.4</u>	<u>-29.8</u>	<u>-34.5</u>
Operating Profit	7.9	13.7	14.1	13.4	12.7	18.2	22.6
Other Income / Expense	0.2	0.2	0.2	1.0	0.3	0.3	0.3
Interest Expensed	-3.1	-2.8	-4.9	-3.7	-4.0	-9.6	-9.1
Profit Before Tax	5.1	11.1	9.4	10.8	9.0	9.0	13.9
Tax	-0.1	-0.7	-0.6	-1.2	-0.7	-0.5	-2.1
Minorities	-	-	-	-	-	-	-
Net Profit before extra.	5.0	10.4	8.8	9.5	8.4	8.4	11.8
Extraordinary gain	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net Profit after extra	5.0	10.4	8.8	9.5	8.4	8.4	11.8
EPS (Rs)	1.9	4.0	2.8	2.9	2.5	2.6	3.6
Recurring EPS (Rs)	1.9	4.0	2.8	2.9	2.5	2.6	3.6
Fully diluted no. of share (m)	2,593	2,635	3,100	3,300	3,300	3,300	3,300
KEY ASSUMPTIONS	FY07	FY08	FY09	FY10	FY11	FY12F	FY13F
Sub (m)	14.0	24.0	43.0	63.8	88.8	104.0	120.8
Change (%)	89.3	71.3	79.3	48.3	39.1	17.1	16.2
Sub net adds (m)	7.8	10.0	19.0	20.8	25.0	15.2	16.8
ARPU (Rs)	332.0	295.4	252.3	193.9	166.3	157.3	156.7
Change (%)	-15.1	-11.0	-14.6	-23.2	-14.2	-5.4	-0.4
RATIOS (%)	FY07	FY08	FY09	FY10	FY11	FY12F	FY13F
Gross Margin	39.3	39.2	30.7	27.7	25.1	26.4	27.0
Operating Margin	18.2	20.5	13.9	10.8	8.4	10.0	10.7
Net Margin	11.5	15.5	8.7	7.7	5.5	4.6	5.6
SG&A / Sales	21.1	18.7	16.8	16.9	16.7	16.4	16.3
Book value per share	8.4	13.5	42.8	34.5	37.0	39.6	43.1
ROA	12.2	12.9	7.6	5.6	4.8	6.2	7.5
ROE	30.3	36.4	10.5	7.7	7.1	6.7	8.7
Net Debt/ Equity (x)	1.1	1.7	0.4	0.7	1.0	0.9	0.7
CASHFLOW (Rs bn)	FY07	FY08	FY09	FY10	FY11	FY12F	FY13F
EBITDA	14.9	22.7	28.4	34.6	37.8	48.1	55.7
Accounts receivables	-0.2	-0.5	-1.6	-1.0	-1.1	-1.1	-1.1
Accounts payable	7.6	1.5	8.4	-1.6	3.4	1.0	0.4
Working capital	-0.2	0.4	-5.7	-7.9	2.4	2.3	2.2
Operating cash flow	22.1	24.1	29.4	24.0	42.6	50.3	57.2
Interest	-3.1	-2.8	-4.9	-3.7	-4.0	-9.6	-9.1
TAX	-0.1	-0.7	-0.6	-1.2	-0.7	-0.5	-2.1
Residual Cashflow	18.9	20.6	23.9	19.1	37.9	40.2	46.0
Fixed Assets	-27.9	-61.9	-77.3	-49.4	-87.8	-35.0	-35.0
Change in investments & others	11.7	-4.9	-36.8	32.6	4.0	1.7	2.2
Free Cashflow	2.8	-46.2	-90.2	2.2	-46.0	6.9	13.2
Capital increase	16.8	0.4	88.7	2.0	0.0	0.0	0.0
Dividend payments	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Others	-10.2	-4.3	-4.2	-15.0	0.0	0.0	0.0
Net change in Cashflow	9.4	-50.1	-5.7	-10.8	-46.0	6.9	13.2
Net Debt Beg	-31.4	-24.3	-60.2	-58.3	-75.7	-121.7	-114.8
Net (Debt)/ cash End	-22.0	-74.4	-65.9	-69.0	-121.7	-114.8	-101.5
BALANCE SHEET (Rs bn)	FY07	FY08	FY09	FY10	FY11	FY12F	FY13F
Cash & equivalent	18.2	5.0	30.9	2.9	1.2	2.1	8.3
Receivables	1.5	2.0	3.6	4.7	5.7	6.8	7.9
Inventories	0.2	0.3	0.5	0.5	0.7	0.8	0.9
Other current assets	4.8	8.3	18.7	28.5	28.6	28.7	28.8
Fixed assets (net)	56.0	89.9	145.3	181.7	197.6	248.7	251.0
Investments	0.0	5.6	20.5	11.3	6.3	4.3	4.3
Capital WIP	5.1	17.2	21.4	5.5	52.7	7.0	7.0
Other assets	0.1	0.1	22.5	0.1	0.1	0.1	0.1
Total assets	85.8	128.3	263.3	235.1	292.8	298.6	308.4
Working capital – liabilities	21.5	27.0	40.4	40.7	46.7	50.3	53.1
Debt	42.5	65.2	89.1	78.6	122.9	116.9	109.9
Deferred tax	0.0	0.7	1.1	2.1	1.1	0.8	3.1
Minorities	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Shareholders' Funds	21.8	35.4	132.7	113.7	122.1	130.5	142.3

Source: Company Data, KESI estimates

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+15% and above: BUY

-15% to +15%: HOLD

-15% or worse: SELL

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