

## Idea Cellular

 BSE code: 532822  
 NSE code: IDEA

**CMP: Rs 133**
**Target: Rs 147**
**BUY**

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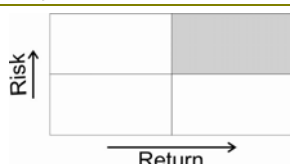
### Company data

Particulars	
Market cap (Rs bn / US\$ mn)	350.6/9,034.0
Outstanding equity shares (mn)	2,636.1
52-week high/low (Rs)	161/84
2-month average daily volume	2,009,502

### Financial snapshot

Particulars	FY07	FY08E	FY09E
Sales (Rs mn)	43,663.9	65,783.2	88,447.8
Growth (%)	47.2	50.7	34.5
Adj net profit (Rs mn)	5,031.5	10,581.8	15,040.5
Growth (%)	137.6	110.3	42.1
FDEPS (Rs)	2.2	4.0	5.7
Growth (%)	134.7	82.5	41.9
P/E (x)	61.4	33.6	23.7
ROE (%)	23.1	32.2	31.4

### Risk-return profile



### Shareholding pattern

(%)	Sep-07	Jun-07
Promoters	57.7	57.7
FIIs	6.7	7.1
Banks & FIs	1.8	1.5
Public	33.8	33.7

### Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
Idea	133	4.3	7.3	15.98
Sensex	19,724	13.8	31.6	42.2
BSETECK	3,936	4.1	7.7	5.7

 Company website [www.ideacellular.com](http://www.ideacellular.com)

## Results below expectations but maintain positive outlook

Idea Cellulars' Q2FY08 results are below our estimates with revenue growth of 5.7% QoQ as against 11.8% estimated. The subdued performance is attributed to a sharp 10% QoQ decline in average revenue per user (ARPU) during the quarter as against our estimate of a 4.5% dip. The deterioration in ARPUs as well as higher network costs has caused the EBITDA margin to dip 200bps QoQ to 32.8% as against our expectation of a flattish trend. Net profit for the quarter has declined 28.6% QoQ to Rs 2.2bn, substantially lower than estimated.

On the back of the disappointing Q2FY08 performance, we are decreasing our revenue and EPS estimates for FY08 and FY09. We continue to believe that the margin scenario has further room to improve from current levels and expect EBITDA margins to expand by 290bps in FY09. Considering this, we are maintaining our target price unchanged at Rs 147 and continuing with our Buy recommendation on the stock.

### Actual vs estimated performance

(Rs mn)	Actual	Estimated	% Variance
Net sales	15,622.0	16,512.0	(5.4)
EBIDTA	5,106.0	5,762.0	(11.4)
PAT	2,202.0	3,103.0	(29.0)
EPS (Rs)	0.8	1.2	(29.0)

Source: Company, Religare Research

### Quarterly results

(Rs mn)	Q2FY08	Q2FY07	% Chg QoQ
Revenues	15,622.0	14,773.0	5.7
Operating expenses	10,516.0	9,646.0	9.0
<b>EBITDA</b>	5,106.0	5,127.0	(0.4)
EBITDA margin (%)	32.7	34.7	-
Depreciation	2,007.0	1,887.0	6.4
<b>EBIT</b>	3,099.0	3,240.0	(4.4)
EBIT margin (%)	19.8	21.9	(9.6)
Interest expenses	641.0	143	-
Other income	21.0	3.0	-
Profit before taxes	2,479.00	3,100.0	(20.0)
Provision for taxes	277.0	16.0	-
<b>Net profit</b>	2,202.0	3,084.0	(28.6)
NPM margin (%)	14.1	20.9	-

Source: Company, Religare Research

## Result highlights

**Fall in ARPUs coupled with higher network operating costs shrinks EBITDA margin**

### EBITDA margin shrinks 200bps

Idea has recorded muted revenue growth of 5.7% QoQ during Q2FY08 largely due to a steep decline in ARPU during the quarter. The fall in ARPU coupled with higher network operating costs has led to a 200bps QoQ contraction in EBITDA margin to 32.8%. Excluding the three new circles (Himachal Pradesh, Uttar Pradesh (E) and Rajasthan), the EBITDA margin has improved to 35.9%.

### Break-up of revenues and EBITDA for Q2FY08

(Rs mn)	8 established circles	3 new circles	Total
Revenues	14,795.0	848.0	15643.0
EBITDA	5,311.0	(183.0)	5128.0
EBITDA margin (%)	35.9	(21.6)	32.8

Source: Company, Religare Research

### ARPU on a downward trend

Increased competitive pressures have led to a steady decline in Idea's ARPUs. A part of the fall in tariffs is attributed to the reduction in regulatory charges related to interconnection usage and access deficit charge (ADC). In addition, Idea has witnessed a marked increase in prepaid customers (as a percentage of total subscriber base) over the years. Since prepaid connects bring in lower revenues, this has led to a reduction in the company's blended ARPUs. During the quarter, ARPUs have declined by 10% QoQ against our estimate of a 4.5% QoQ dip.

**Higher prepaid client adds are pulling down blended ARPUs**

### Prepaid subscriber trend

Particulars	Q2FY07	Q3FY07	Q4FY07	Q1FY08	Q2FY08
Subscriber base ('000)	10,363	12,442	14,011	16,126	18,672
Prepaid subscribers (%)	86.1	88.0	88.9	90.5	91.8
% of prepaid in net additions (%)	96.0	96.5	96.2	100.1	99.5

Source: Company, Religare Research

### ARPU and AMPU trend

Particulars	Q2FY07	Q3FY07	Q4FY07	Q1FY08	Q2FY08
ARPU (Rs)	335	322	317	320	288
AMPU (minutes)	344	369	387	381	360
Average revenue per minute (Rs)	0.98	0.87	0.82	0.84	0.80

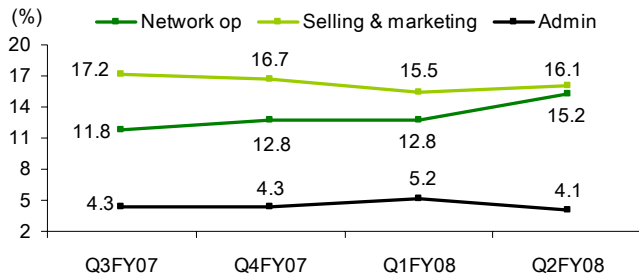
Source: Company, Religare Research

### Network cost rises due to coverage expansion

Idea's network operating cost has shown a sharp increase of 240bps during the quarter to 15.8% of sales as against 12.8% in Q1FY08. The company has recorded the highest cell site additions in the last six months, accounting for close to 60% of the cell sites added in the history of the company. The total number of cell sites as on Q2FY08 stood at 17,137.

Record cell site additions have raised network operating costs from 12.8% of sales to 15.8%

Operating costs as a percentage of sales



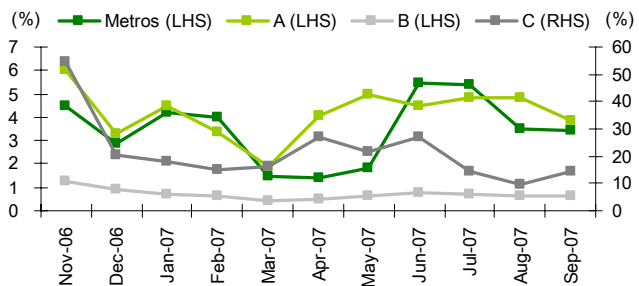
Source: Company, Religare Research

Steady subscriber growth

Idea has ended the quarter with a cumulative subscriber base of 18.7mn, of which 2.6mn subscribers were added during the quarter. This takes its subscriber market share to 15.6% at the end of Q2FY08 as against 15.4% as at end-Q1FY08. The company is awaiting allocation of spectrum to launch operations in the Mumbai and Bihar service areas.

2.6mn subscribers added during the quarter taking its subscriber market share to 15.6%

Subscriber growth trend MoM



Source: Company, Religare Research

Future outlook

Focus on B and C circles

With intensifying competitive pressures in A circles, we expect Idea to venture deeper into the B and C circles. However, the lower spending power in these cities implies a greater number of prepaid connects, placing further downward pressure on ARPUs. We thus expect ARPUs to remain depressed in the near term. In the medium to long term, one can expect stability since the usage of value-added services by the expanded customer base would move up.

We reduce estimates...

In view of the disappointing Q2FY08 results, we have reduced our revenue estimates for FY08 and FY09 by 3% and 8% respectively. Despite decrease in estimates we continue to believe that the margins would expand in FY08 and FY09. However, due to revenue estimates decreasing our EPS estimates accordingly stand reduced by 11% and 15% respectively for FY08 and FY09.

EPS estimates for FY08 and FY09 reduced by 11% and 15% respectively

Revised estimates

(Rs bn)	FY08			FY09		
	Earlier	Revised	Change (%)	Earlier	Revised	Change (%)
Revenues	67.6	65.7	(2.8)	96.5	88.5	(8.3)
Net profit	11.9	10.6	(10.9)	17.6	15.0	(14.8)
EPS (Rs)	4.5	4.0	(11.1)	6.7	5.7	(14.9)

Source: Religare Research

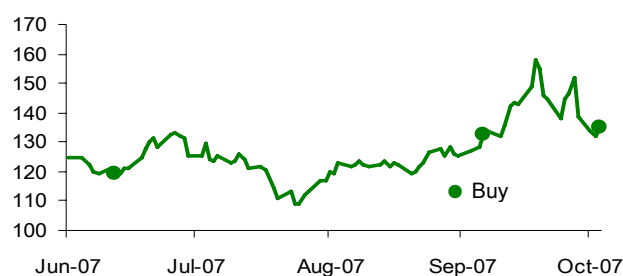
**...but maintain target price and Buy rating**

At the current price of Rs 133, the stock is trading at 33.6x and 23.7x its expected FY08 and FY09 earnings of Rs 4.0 and Rs 5.7 respectively. We continue to believe that there is further scope of margin improvement in the company. We expect the EBITDA margins to expand by 40bps and 290bps in FY08 and FY09 respectively. Our one-year target price for the stock is Rs 147. At this price, the stock would trade at 13x on EV/EBITDA basis on FY09 and 25.8x the FY09 earnings of Rs 5.7. We maintain our Buy recommendation.

**Recommendation history**

Date	Event	Reco price	Tgt price	Reco
10-Jul-07	Quarterly Preview	119	134	Buy
05-Oct-07	Quarterly Preview	132	147	Buy
02-Nov-07	Results Updates	133	147	Buy

Source: Religare Research

**Stock performance**

Source: Religare Research

## Consolidated financials

### Profit and Loss statement

(Rs mn)	FY06	FY07	FY08E	FY09E
Revenues	29,654.9	43,663.9	65,783.2	88,447.8
Growth (%)	31.5	47.2	50.7	34.5
EBITDA	10,673.8	14,635.6	22,321.0	32,562.1
Growth (%)	30.0	37.1	52.5	45.9
Depreciation	5,495.1	6,717.8	8,975.5	13,709.7
EBIT	5,178.7	7,917.8	13,345.5	18,852.4
Growth (%)	36.9	52.9	68.6	41.3
Interest	3,224.5	3,291.5	2,271.0	3,243.9
Other income	243.9	464.9	124.0	335.0
EBT	2,198.1	5,091.2	11,198.6	15,943.5
Growth (%)	187.2	131.6	120.0	42.4
Tax	80.5	59.7	616.8	903.0
Effective tax rate	3.7	1.2	5.5	5.7
Adj net income	2,117.7	5,031.5	10,581.8	15,040.5
Growth (%)	197.4	137.6	110.3	42.1
Shares outstanding (mn)	2,259.5	2,287.0	2,636.1	2,639.9
FDEPS (Rs)	0.9	2.2	4.0	5.7
DPS (Rs)	-	-	-	-
CEPS (Rs)	3.4	5.1	7.4	10.9

Source: Company, Religare Research

### Cash flow statement

(Rs mn)	FY06	FY07	FY08E	FY09E
Net income	2,117.7	5,031.5	10,581.8	15,040.5
Depreciation	5,495.1	6,717.8	8,975.5	13,709.7
Other adjustments	1,731.9	10,873.0	7,464.4	4,715.1
Changes in WC	57.0	-	-	-
Operating cash flow	9,401.7	22,622.3	27,021.7	33,465.3
Capital expenditure	(5,258.4)	(27,872.1)	(47,276.0)	(40,000.0)
Investments	-	(16,995.0)	9,500.0	2,500.0
Other investing inc/(exp)	37.3	(825.0)	-	-
Investing cash flow	(5,221.1)	(45,692.1)	(37,776.0)	(37,500.0)
Free cash flow	4,180.6	-	-	-
Issue of equity	-	24,437.5	600.0	600.0
Issue/repay debt	(4,459.6)	9,649.1	8,560.0	6,000.0
Dividends paid	-	-	-	-
Others	-	(825.0)	-	-
Financing cash flow	(4,459.6)	33,261.6	9,160.0	6,600.0
Beg. cash & cash eq	1,771.5	1,492.5	4,807.9	3,213.6
Chg in cash & cash eq	(279.0)	3,315.4	(1,594.3)	2,565.3
Closing cash & cash eq	1,492.5	4,807.9	3,213.6	5,778.9

Source: Company, Religare Research

### Balance sheet

(Rs mn)	FY06	FY07	FY08E	FY09E
Cash and cash eq	1,492.5	4,807.9	3,213.6	5,778.9
Accounts receivable	1,456.6	1,675.0	2,523.5	3,393.0
Inventories	114.4	156.9	236.4	317.9
Others current assets	2,923.2	4,008.2	6,038.7	8,119.2
Current assets	5,986.7	10,648.0	12,012.2	17,608.9
LT investments	-	16,995.0	7,495.0	4,995.0
Net fixed assets	38,768.9	61,100.0	99,400.5	125,690.8
CWIP	11,604.7	61.0	61.0	61.0
Total assets	56,360.3	88,805.0	118,969.7	148,356.7
Payables	11,044.9	22,041.9	31,547.6	39,023.4
Others	1,227.2	2,449.1	3,505.3	4,335.9
Current liabilities	12,272.1	24,491.0	35,052.9	43,359.4
LT debt	32,856.0	42,505.0	51,065.0	57,065.0
Other liabilities	-	11.0	-	-
Equity capital	27,425.3	25,929.0	26,401.1	26,441.1
Reserves	(16,193.0)	(4,131.0)	6,450.8	21,491.3
Net worth	11,232.3	21,798.0	32,851.9	47,932.4
Total liabilities	56,360.3	88,805.0	118,969.7	148,356.7
BVPS (Rs)	5.0	9.5	12.5	18.2

Source: Company, Religare Research

### Financial ratios

	FY06	FY07	FY08E	FY09E
EBITDA margin (%)	36.0	33.5	33.9	36.8
EBIT margin (%)	17.5	18.1	20.3	21.3
Net profit margin (%)	7.1	11.5	16.1	17.0
FDEPS growth (%)	197.4	134.7	82.5	41.9
Receivables (days)	17.9	14.0	14.0	14.0
Inventory (days)	1.4	1.3	1.3	1.3
Payables (days)	135.9	184.3	175.0	161.0
Current ratio (x)	0.5	0.4	0.3	0.4
Interest coverage (x)	1.7	2.5	5.7	5.6
Debt/equity ratio (x)	2.9	1.9	1.6	1.2
ROE (%)	18.9	23.1	32.2	31.4
ROCE (%)	12.1	12.9	15.3	17.4
ROAE (%)	9.5	9.4	10.8	12.3
EV/Sales (x)	13.3	9.0	6.0	4.4
EV/EBITDA (x)	36.9	26.9	17.6	12.1
P/E (x)	144.0	61.4	33.6	23.7
P/BV (x)	27.2	14.2	10.8	7.4
P/CEPS (x)	40.1	26.3	18.2	12.4

Source: Company, Religare Research

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**Recommendation parameters**

<b>Large-caps*</b>	> 10%	< - 5%	<b>Returns</b>	<b>Absolute</b>
	BUY	SELL		
<b>Mid-caps**</b>	> 25%	< 10%		

*\*Market cap over US\$ 1bn \*\*Market cap less than US\$ 1bn*

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