6 August 2010 | 13 pages

OnMobile Global (ONMO.BO)

Upgrade to Buy: Pain Is In; Play for the Gain

Equity ☑
Rating change ☑
Target price change ☑
Estimate change ☑

- **Business momentum has restarted** — FY10 saw earnings collapse 50% as: 1) domestic revenues were hit from rev share shrinkage, unfavorable regulations and a service agreement termination; and 2) EBITDA margins contracted 13% on upfront costs on Telefonica deal, resulting in 40% stock underperformance in the last six months. We believe these issues are now behind as: 1) domestic growth is gaining momentum; and 2) execution of Telefonica deal is on track.
- **Domestic growth has rebounded** — Domestic revenues grew 7% QoQ in 1QFY11 and 9% in 4Q FY10. The issues that had hurt domestic growth in FY10: 1) revenue share shrinkage; 2) TRAI's directive on "press * to copy" for CRBT; and 3) termination of service agreement are now behind us. We forecast domestic revenue growth at a CAGR of 16% FY11-13E.
- **International revenues should be the kicker** — OnMobile continues to show a good execution track record and has rolled out services in two of the 13 Telefonica markets. Mgmt expects to go live across the remaining countries by end-FY11E with a full ramp-up in FY12E.
- **Significant growth ahead** — While we cut FY11-12E earnings ~45% to factor in higher-than-expected FY10 rev and cost pressures, given the strong business momentum detailed above, we now estimate total revenue, EBITDA and earnings CAGRs of 27%, 47% and 57% respectively over FY10-13E.
- **Upgrade to buy with a TP of Rs395** — TP based on 25x Sep-11 PE (in line with global comps with similar growth) offers 38% upside from current levels. Premium to market justified by premium growth profile and PEG of 0.5.
- **Key risks** — Unfavorable regulations, slower-than-expected international ramp-up and further shrinkage of rev share in the domestic market are key downside risks.

Buy/Medium Risk	1M
from Sell/Medium Risk	
Price (06 Aug 10)	Rs285.30
Target price	Rs395.00
from Rs370.00	
Expected share price return	38.5%
Expected dividend yield	0.0%
Expected total return	**38.5%**
Market Cap	Rs16,725M
	US$363M

Price Performance (RIC: ONMO.BO, BB: ONMB IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2009A	852	14.77	27.0	19.3	2.4	13.0	0.0
2010A	424	7.24	-51.0	39.4	2.3	5.9	0.0
2011E	721	12.31	70.1	23.2	2.1	9.3	0.0
2012E	1,258	21.50	74.6	13.3	1.8	14.4	0.0
2013E	1,653	28.25	31.4	10.1	1.5	16.2	0.0

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Fiscal year end 31-Mar	**2009**	**2010**	**2011E**	**2012E**	**2013E**
Valuation Ratios					
P/E adjusted (x)	19.3	39.4	23.2	13.3	10.1
EV/EBITDA adjusted (x)	10.8	18.2	11.5	7.2	5.2
P/BV (x)	2.4	2.3	2.1	1.8	1.5
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Per Share Data (Rs)					
EPS adjusted	14.77	7.24	12.31	21.50	28.25
EPS reported	14.77	7.24	12.31	21.50	28.25
BVPS	121.14	126.38	138.70	160.19	188.44
DPS	0.00	0.00	0.00	0.00	0.00
Profit & Loss (RsM)					
Net sales	4,064	4,544	5,648	7,580	9,337
Operating expenses	-3,222	-4,154	-5,004	-6,310	-7,604
EBIT	**842**	**390**	**644**	**1,270**	**1,733**
Net interest expense	310	226	203	245	333
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	**1,151**	**616**	**848**	**1,515**	**2,066**
Tax	-299	-193	-127	-258	-413
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**852**	**424**	**721**	**1,258**	**1,653**
Adjusted earnings	852	424	721	1,258	1,653
Adjusted EBITDA	1,281	831	1,333	2,075	2,658
Growth Rates (%)					
Sales	55.2	11.8	24.3	34.2	23.2
EBIT adjusted	6.3	-53.6	65.1	97.1	36.4
EBITDA adjusted	22.3	-35.1	60.4	55.7	28.1
EPS adjusted	27.0	-51.0	70.1	74.6	31.4
Cash Flow (RsM)					
Operating cash flow	**516**	**470**	**882**	**1,453**	**2,023**
Depreciation/amortization	440	441	688	805	925
Net working capital	-540	-168	-324	-364	-222
Investing cash flow	**2,774**	**-3,013**	**-679**	**-612**	**-612**
Capital expenditure	-572	-2,712	-887	-857	-945
Acquisitions/disposals	0	62	0	0	0
Financing cash flow	**3**	**72**	**-92**	**0**	**0**
Borrowings	-1	40	-87	0	0
Dividends paid	0	0	0	0	0
Change in cash	**3,293**	**-2,471**	**111**	**842**	**1,411**
Balance Sheet (RsM)					
Total assets	**9,250**	**11,827**	**12,760**	**14,580**	**16,467**
Cash & cash equivalent	2,942	2,560	2,653	3,472	4,857
Accounts receivable	1,445	1,690	2,207	3,022	3,419
Net fixed assets	1,047	3,386	3,603	3,678	3,724
Total liabilities	**2,260**	**4,431**	**4,644**	**5,206**	**5,440**
Accounts payable	845	1,032	1,301	1,830	2,027
Total Debt	46	87	0	0	0
Shareholders' funds	**6,990**	**7,396**	**8,116**	**9,374**	**11,027**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	31.5	18.3	23.6	27.4	28.5
ROE adjusted	13.0	5.9	9.3	14.4	16.2
ROIC adjusted	13.0	3.5	8.0	14.5	17.9
Net debt to equity	-41.4	-33.4	-32.7	-37.0	-44.0
Total debt to capital	0.7	1.2	0.0	0.0	0.0

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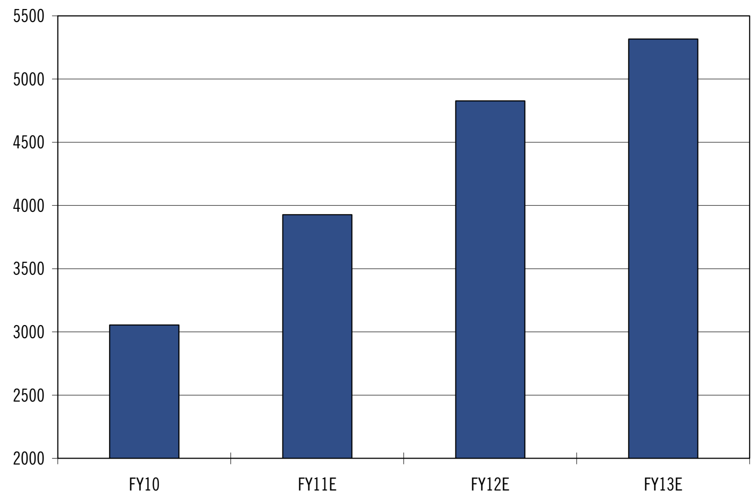
Powered by: dataCentral

Upgrade to Buy – on the cusp of growth

We upgrade OnMobile to Buy/Medium Risk (1M) from Sell/Medium Risk (3M). The last two quarters saw domestic business stabilizing after remaining flat/declining in the previous three quarters. Domestic revenues had taken a hit in FY10 due to 1) revenue share pressure from operators as their profitability took a hit from intense competition and 2) unfavorable regulations related to "press * to copy" for CRBT. Domestic revenues have now rebounded with a 7% QoQ growth in 1QFY11E on the back of 9% growth in 4QFY10. We estimate revenues to grow at a CAGR of 16% over FY11-13E.

Domestic growth looks to have rebounded after a tough FY10

Figure 1. Domestic revenues are estimated to grow at a CAGR of 16% over FY11-13E

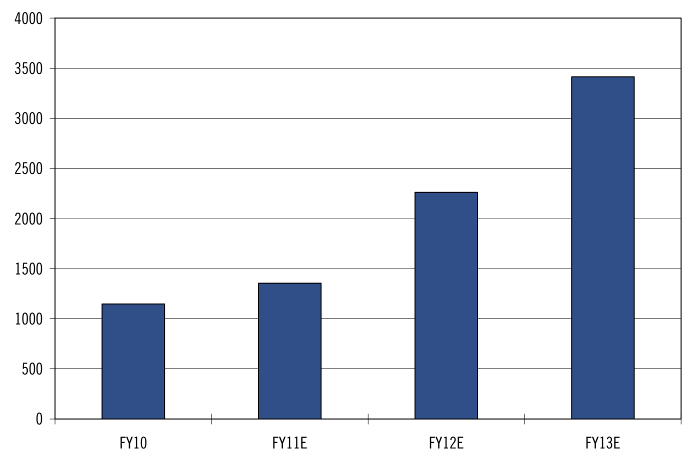


Source: Citi Investment Research and Analysis estimates

In addition, the international expansion remains on track with roll-out in two of the 13 Telefonica countries to date. Management expects to complete the roll-out in the remaining countries by end FY11E. We expect full ramp-up of revenues in FY12E and a CAGR of 59% over FY11-13E.

International execution remains on track and is likely to be a significant revenue kicker in FY12E

Figure 2. Full ramp-up of revenues from the Telefonica deal likely to occur in FY12E

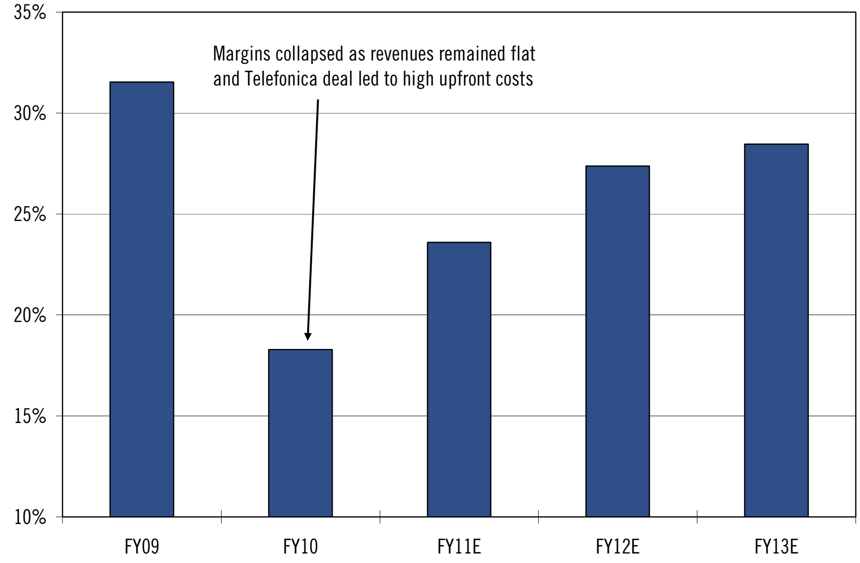


Source: Citi Investment Research and Analysis estimates

We also expect EBITDA margins, which had collapsed by13% in FY10E primarily on account of upfront costs related to Telefonica roll-out, to recover on the back of the strong topline growth and rising scale. We estimate 530bps margin expansion in FY11E and a further 380bps in FY12E.

Strong topline growth with majority of the upfront costs of Telefonica deal behind will help to expand EBITDA margins

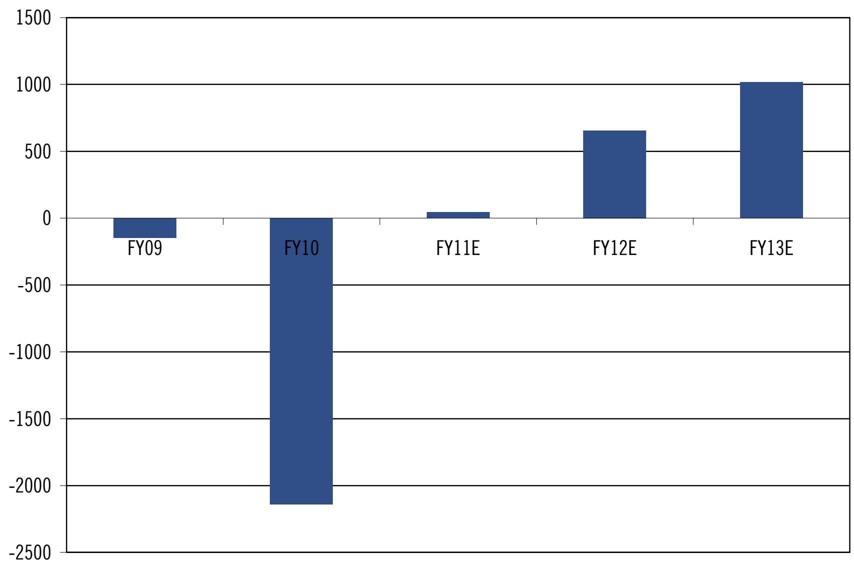
Figure 3. EBITDA margins which had collapsed in FY10 are likely to recover



Source: Citi Investment Research and Analysis estimates

Will also help to generate positive free cash flows

Figure 4. OnMobile is estimated to turn FCF positive in FY12E



Source: Citi Investment Research and Analysis estimates

Earnings revision

FY11-12E earnings cut by ~45% on higher-than-expected topline/cost pressure in FY10E. We however expect earnings to show a healthy 57% CAGR over FY10-13E.

Figure 5. Earnings revisions

	FY11E			FY12E			FY13E		
	Old	**New**	**Change**	**Old**	**New**	**Change**	**Old**	**New**	**Change**
EPS (Rs)	21.9	12.3	-44%	37.4	21.5	-43%	NA	28.3	NA

Source: Citi Investment Research and Analysis estimates

New TP of Rs395

New TP is based on 25x Sep-11 PER (17x Mar-10E earlier). The target multiple is in-line with global peers with similar growth profiles and imputes a reasonable PEG of 0.5x.

Figure 6. Peer comparison

	RIC code	Rating	Prc Crcy	Price 06 Aug 10	Mkt cap US$m	P/E (x) 2010E	P/E (x) 2011E	P/E (x) 2012E
China Internet								
51job	JOBS.CN	1M	USD	26.0	715	22.1	20.4	17.9
Alibaba	1688.HK	1L	HKD	15.4	9,994	39.5	30.6	24.5
Baidu	BIDU.CN	1L	USD	85.6	29,738	62.4	41.2	29.2
Ctrip	CTRP.CN	1L	USD	42.0	6,210	37.9	29.6	23.7
Sina	SINA.CN	1L	USD	45.7	2,782	26.0	21.5	18.7
Tencent	0700.HK	1L	HKD	152.7	35,999	30.0	22.9	18.0
Average						36.3	27.7	22.0
US Internet								
Amazon	AMZN.US	1H	USD	127.8	57,245	52.6	34.0	23.9
eBay	EBAY.US	2H	USD	21.1	27,647	13.0	11.9	11.1
Expedia	EXPE.US	1H	USD	24.3	6,905	15.1	13.0	11.6
Google	GOOG.US	1H	USD	508.1	161,935	18.8	16.4	14.9
Priceline	PCLN.US	1H	USD	292.7	14,161	24.3	19.6	17.1
Yahoo	YHOO.US	2H	USD	14.2	19,612	17.8	15.5	13.2
Average						23.6	18.4	15.3
Overall Average						**31.6**	**24.4**	**18.6**
OnMobile at current price			INR	286.0		23.2	13.3	11.1
OnMobile at target price			INR	395.0		32.1	18.4	15.4

Source: Citi Investment Research and Analysis

Figure 7. OnMobile – 1 Yr forward PE band chart

Source: Citi Investment Research and Analysis

Figure 8. OnMobile's premium to the market has come down significantly and is no longer expensive

Source: Citi Investment Research and Analysis

Quarterly Summary

Figure 9. Quarterly summary

Rs m	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	QoQ %	YoY%
Total revenues	**805**	**688**	**778.5**	**974.6**	**1157.2**	**1153.1**	**1,072**	**1,086**	**1,155**	**1,229**	**1,238**	**0.7%**	**15.4%**
Total expenditure	(412)	(517)	(570)	(701)	(752)	(767)	(828)	(951)	(924)	(1,010)	(956)	-5.3%	15.4%
Cost of sales	(96)	(130)	(136)	(182)	(215)	(246)	(298)	(307)	(334)	(386)	(338)	-12.6%	13.1%
Employee cost	(188)	(186)	(244)	(307)	(315)	(338)	(345)	(366)	(377)	(387)	(410)	6.0%	18.8%
Other expenditure	(128)	(201)	(190)	(212)	(223)	(184)	(185)	(279)	(213)	(236)	(208)	-12.0%	12.4%
EBITDA	**393**	**171**	**209**	**274**	**405**	**386**	**244**	**135**	**231**	**219**	**282**	**28.6%**	**15.6%**
EBITDA margins (%)	*48.8%*	*24.9%*	*26.8%*	*28.1%*	*35.0%*	*33.4%*	*22.8%*	*12.4%*	*20.0%*	*17.8%*	*22.8%*	*4.9%*	*0.0%*
PAT	**257**	**45**	**152**	**184**	**276**	**240**	**87**	**107**	**132**	**111**	**184**	**66.2%**	**111.3%**
PAT margin (%)	*31.9%*	*6.5%*	*19.5%*	*18.8%*	*23.9%*	*20.8%*	*8.1%*	*9.9%*	*10.9%*	*8.3%*	*14.3%*	*5.9%*	*6.1%*

Source: Company, Citi Investment Research and Analysis

Figure 10. Quarterly KPIs

	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10
Subscriber reach (m)	550	600	630	687	673	727	786
Unique users (m)	45	57	64	71	77	83	86
Active RBT users (m)	30	33	37	40	42	44	46
% growth		10.0%	12.1%	8.1%	5.0%	4.8%	4.5%
Calls handled (bn)	8	10	10	10			
Number of employee	1,133	1,146	1,154	1,223	1,209	1,236	1,271
Cost per employee pm (Rs)	92,586	98,728	100,000	102,594	103,317	105,494	109,028
Countries live in	22	22	23	23	24	25	26

Source: Company, Citi Investment Research and Analysis

OnMobile Global

Company description

Co-promoted in 2000 by Infosys Technologies, Argo Capital and individuals including Arvind Rao and Mouli Rman, OnMobile is India's leading application service provider (ASP) with market share estimated at 35% as of Mar 09. It develops white label applications and services for telecom operators (carrier customers) who market them to subscribers. It is headquartered in Bangalore, India. Though its genesis lay in developing applications for the US market, OnMobile shifted focus to the domestic market as the worldwide telecom industry went into turmoil in CY00-01. Its early start, success of Caller ringback tones (CRBT) and popularity of voice platform helped it achieve impressive growth with FY05-08 revenue CAGR of 86% and profit CAGR of 62.6%. OnMobile listed on the stock exchange in Feb 08 through a combination of primary and secondary issuance, constituting 18.99% of post-issuance equity.

Investment strategy

We upgrade OnMobile to Buy/Medium Risk (1M) from Sell/Medium Risk (3M). The last 2 quarters saw domestic business stabilizing after taking a hit in the first 9 months of FY10 from 1) revenue share pressure from operators as their profitability took a hit from intense competition post entry of new operators, 2) unfavorable regulations related to “press * to copy” for CRBT and 3) termination of an agreement with an operator in India. Domestic revenues have now rebounded with a 7% sequential growth in 1QFY11E on the back of 9% growth in the previous quarter. We estimate domestic revenues to grow at a CAGR of 16% over FY11-13E. In addition, the international expansion remains on track with roll-out in 2 of the 13 Telefonica countries till date. Management expects to complete roll-out in the remaining countries by end FY11E and we expect full ramp of revenues in FY12E and a CAGR of 59% over FY11-13E. We also expect EBITDA margins to recover, after collapsing by13% in FY10E, primarily on account of upfront costs related to Telefonica roll-out. We estimate 530bps margin expansion in FY11E and a further 380bps in FY12E. We forecast earnings CAGR of 57% over FY10-13E.

Valuation

Our target price of Rs395 is based on 25x Sep-11E EPS. The target multiple is in line with global peers with similar growth profiles and imputes a reasonable PEG of 0.5x. We prefer P/E over DCF as: 1) the nature of the business with high R&D focus makes it difficult for us to incorporate any innovations/new product developments in the revenue stream over a longer time period; 2) OnMobile is in the midst of raising its international presence and it is difficult to accurately estimate the market opportunity and OnMobile's market share in these markets over a longer time period; and 3) OnMobile benefits from incremental market share gains with every new contract from an operator, which can be quite significant and can materially alter EPS estimates due to the low base effect.

Risks

Our quantitative risk rating system, which tracks 260-day historical volatility of the shares, implies a High risk rating. However, we rate OnMobile's shares Medium Risk given the deals with Vodafone and Telefonica, which should help OnMobile build credibility on its execution abilities and ability to manage scale apart from revenue upside. These deals should also help reduce the sales cycle from 1-2 years now. Key downside risks include 1) Indian operators (like their western peers) shifting from revenue share to licensing models as VAS contribution to overall wireless revenues rises. This could result in a cap on OnMobile's revenue stream from any individual customer; 2) any unfavorable regulations; 3) slower than expected international ramp-up and 4) further shrinkage of rev share in the domestic market.

Appendix A-1

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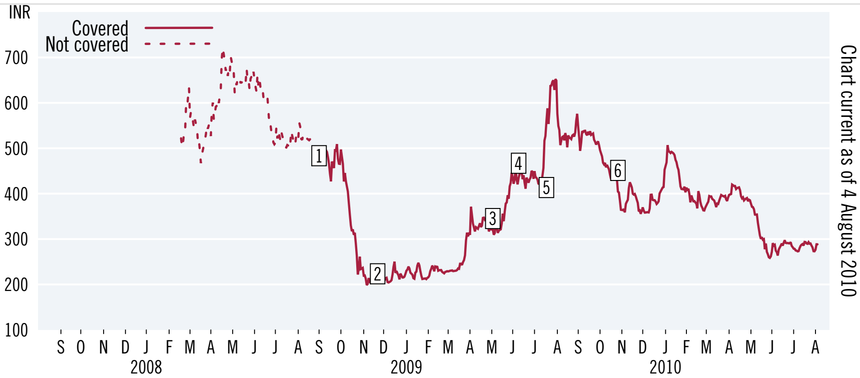
IMPORTANT DISCLOSURES

OnMobile Global (ONMO.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Gaurav Malhotra, CFA
Covered since September 1 2008



	Date	Rating	Target Price	Closing Price
1	31-Aug-08	*1H	*630.00	483.60
2	21-Nov-08	1H	*337.00	205.10
3	4-May-09	1H	*420.00	320.55
4	9-Jun-09	*1M	*515.00	434.90
5	17-Jul-09	1M	*645.00	559.45
6	27-Oct-09	*3M	*370.00	404.60

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Rohini Malkani has in the past worked with the India government or its divisions in her personal capacity.

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Data current as of 30 Jun 2010	**Buy**	**Hold**	**Sell**
Citi Investment Research & Analysis Global Fundamental Coverage	54%	35%	12%
% of companies in each rating category that are investment banking clients	47%	45%	40%

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Investment ratings are a function of CIRA's expectation of total return (forecast price appreciation and dividend yield within the next 12 months) and risk rating.

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For securities in emerging markets (Asia Pacific, Emerging Europe/Middle East/Africa, and Latin America), investment ratings are:Buy (1) (expected total return of 15% or more for Low-Risk stocks, 20% or more for Medium-Risk stocks, 30% or more for High-Risk stocks, and 40% or more for Speculative stocks); Hold (2) (5%-15% for Low-Risk stocks, 10%-20% for Medium-Risk stocks, 15%-30% for High-Risk stocks, and 20%-40% for Speculative stocks); and Sell (3) (5% or less for Low-Risk stocks, 10% or less for Medium-Risk stocks, 15% or less for High-Risk stocks, and 20% or less for Speculative stocks).

Investment ratings are determined by the ranges described above at the time of initiation of coverage, a change in investment and/or risk rating, or a change in target price (subject to limited management discretion). At other times, the expected total returns may fall outside of these ranges because of market price movements and/or other short-term volatility or trading patterns. Such interim deviations from specified ranges will be permitted but will become subject to review by Research Management. Your decision to buy or sell a security should be based upon your personal investment objectives and should be made only after evaluating the stock's expected performance and risk.
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