IDEA Cellular (IDEA.BO)

Buy: 1QFY08 - Wireless Growth Gaining Traction

- **Operating results in-line, treasury income a positive surprise** — Idea Cellular's 1QFY08 EBITDA at Rs5,127m was slightly ahead of expectations on the back of strong revenue growth and qoq margin expansion though partly helped by launch of new lifetime schemes. Net profit at Rs3,085m was, however, significantly ahead of expectations due to higher treasury and forex income and lower than expected depreciation.

- **Wireless growth on the upswing** — Higher coverage and increased management focus helped Idea add an average of 700K subscribers during the quarter, significantly higher than the 522K achieved in the preceding quarter.

- **New lifetime schemes support ARPU**— Though ARPUs surprised on the positive side by increasing sequentially to Rs320, this was related to the launch of lifetime validity scheme during the quarter for which Idea books revenues (Rs499/sub) upfront rather than amortizing it over the life of the subscriber. Even the rev/min improved slightly to Rs0.84 as a result.

- **Idea spins off the tower assets too** — Idea plans to spin off its passive infrastructure into a separate subsidiary. Though it has not disclosed any plans, we believe it makes sense for Idea to sell out to another towerco (third party or Bharti/RCOM) in the medium term while continuing to remain a tenant.

- **Unutilized cash from IPO, rupee appreciation aids other income** — The investment income arising from the unutilized proceeds from IPO (Rs14.2bn) and forex gains led to higher than expected treasury income at Rs788m.

Buy/Low Risk	**1L**
Price (24 Jul 07)	Rs132.25
Target price	Rs140.00
Expected share price return	5.9%
Expected dividend yield	0.0%
Expected total return	**5.9%**
Market Cap	Rs342,906M
	US$8,545M

Figure 1. Statistical Abstract

	EBITDA (Rs m)	Net Profit (Rs m)	FD EPS (Rs)	EPS Growth (%)	P/E (x)	EV/EBITDA (x)	Price/CEPS (x)
2005P	8,210	760	0.1		1,308.0	40.7	58.1
2006P	10,674	2,118	0.7	637%	177.6	30.9	40.1
2007P	14,637	5,033	1.9	161%	68.1	24.8	29.2
2008E	23,301	8,371	3.2	64%	41.6	16.6	18.0
2009E	32,153	10,649	4.0	27%	32.7	12.5	13.5

Source: Citigroup Investment Research

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See Appendix A-1 for Analyst Certification and important disclosures.

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Figure 2. Financial Statement

Rs m	Jun-06	Sep-06	Dec-06 (est.)	Mar-07	Jun-07
Service Revenue	8,939.9	10,013.0	11,463.3	13,084.2	14772.9
qoq growth (%)	9.4	12.0	14.5	14.1	12.9
Sales of Trading Goods	62.4	83.0	18.4		
Total Income	**9,002.2**	**10,096.0**	**11,481.6**	**13,084.2**	**14,772.9**
Cost of Trading Goods	(20.0)	(28.0)	(13.4)		
Personnel Expenditure	(554.0)	(600.0)	(759.0)	(684.7)	(708.0)
Network Operating Exp	(1,045.0)	(1,144.0)	(1,410.2)	(1,680.0)	(1,895.5)
License & WPC Charges	(909.0)	(995.0)	(1,172.1)	(1,410.9)	(1,598.6)
Access & Interconnect Charges	(1,513.0)	(1,622.0)	(1,949.6)	(2,202.5)	(2,396.1)
Subscriber Acquis & Servicing Exp	(1,093.0)	(1,341.0)	(1,420.7)		
Advert & Business Promotion Exp	(443.0)	(395.0)	(565.9)	(2,179.2)	(2,283.4)
Administration & Other Exp	(395.0)	(432.0)	(486.5)	(564.0)	(763.7)
Total Opex	(5,972.0)	(6,557.0)	(7,777.2)	(8,721.3)	(9,645.3)
Impact of Restatement	4.0	(3.0)			
Restated Total Opex	**(5,976.0)**	**(6,554.0)**	**(7,777.2)**	**(8,721.3)**	**(9,645.3)**
EBITDA	**3,026.2**	**3,542.0**	**3,704.4**	**4,362.9**	**5,127.6**
Margin %	*33.6%*	*35.1%*	*32.3%*	*33.3%*	*34.7%*
Depreciation	(1,197.9)	(1,432.0)	(1,523.9)	(1,761.3)	(1,886.8)
Amortisation of Intangible Assets	(258.5)	(268.0)	(276.6)		
	17.7%	15.8%	15.4%		
EBIT	1,569.9	1,842.0	1,903.9	2,601.60	3,240.80
Interest & Financing Charges	(737.1)	(774.0)	(805.4)	(974.7)	(143.4)
Other Income	19	11	108.9	326.4	3.5
PBT	851.8	1,079.0	1,207.4	1,953.3	3,100.9
Tax	(4.0)	(6.0)	(30.7)	(19.1)	(15.7)
PAT	**847.7**	**1,073.0**	**1,176.7**	**1,934.2**	**3,085.2**
PAT Margin (%)	*9.4*	*10.6*	*10.2*	*14.8*	*20.9*

Source: Company reports

Launch of life time validity schemes supported ARPU during the quarter

Figure 3. Quarterly KPIs

	Jun-06	Sep-06	Dec-06 (est.)	Mar-07	Jun-07
ARPU	362	335	322	317	320
MOU	342	344	369	387	381
Revenue per min	1.06	0.98	0.87	0.82	0.84
Subscribers ('000)	8535	10362	12442	14010	16126
Pre-paid as % of total	84%	86%	88%	89%	90.5%
Total MOU (mn min)	8097	9736	12629	15469	17100
Post-paid churn %	4.7%	4.8%	4.4%	4.2%	4.1%
Pre-paid churn %	5.3%	4.3%	3.6%	4.2%	4.2%

Source: Company reports

Unexpectedly low depreciation and high treasury gains aid bottom line

Figure 4. Operating results in-line with expectations

Rs.m	Estimates	Actual	% difference
Sales	14,183	14,773	4.2
EBITDA	4,822	5,128	6.3
PAT	1,965	3,085	57.0

Source: Citigroup Investment Research, Company reports

IDEA Cellular

Company description

Idea Cellular, a pure play wireless provider, is the fifth-largest cellular operator in India. It has licenses to provide cellular-phone services in 13 of the 23 telecom circles in India and an active presence in 11 of them. The company listed on the Indian bourse in March 2007 and is part of the Aditya Birla Group.

Investment thesis

We rate Idea Buy/Low Risk. Continued robust wireless market expansion and Idea's ability to regain its growth potential following its restructuring and full control by Aditya Birla Group are key factors in our investment argument. The company's IPO provided sufficient funding flexibility to pursue its growth plans. Idea's strong competitive position in its existing circles and comparable operational parameters provide us sufficient comfort in management's ability to execute its plans. Given the spectrum issues facing potential new entrants, Idea should remain relatively unconstrained for the next 12-18 months. As a result, we estimate earnings CAGR of 37% over FY07-10E, ahead of peers and more than double that of the broader market. In addition, we believe that Idea's GSM footprint in a spectrum-scarce market with 6-7 players offers M&A potential in the long run. From an industry perspective, we believe that low revenue yields and moderate EBITDA margins leave little room for disruptive pricing. Additionally, most regulatory concerns are now addressed and potentially costly 3G auctions cannot derail it from its growth path, in our view.

Valuation

We have set our 12-month target price at Rs140 based on core DCF of Rs128 and an M&A premium of 10%. Though the Aditya Birla Group has ruled out any potential M&A transaction soon, we believe that M&A potential exists in the long run, especially as spectrum constraints hinder new GSM entrants. We prefer DCF as our primary valuation methodology due to the back-ended nature of free cash flows given the new circle roll-outs. Our DCF assumes a WACC of 10.8% at a target debt to capital of 50.0% and terminal growth rate of 4.0% (similar to Bharti). Our DCF is based on explicit forecasts for FY07-16E with a terminal year EBITDA margin at 41.1% (~400bps below Bharti) and capex/sales of ~8% (in line with Bharti). The target price implies an EV/EBITDA of 12.2x, a slight premium to Bharti's target multiples (for the ex-towerco portion of Rs890), which we believe is supported by 1) higher EBITDA growth rates for Idea and 2) liquidity overflow from Bharti's foreign limit constraints

Risks

Our quantitative risk rating system assigns a default Speculative Risk rating to Idea due its trading history of less than 12 months. We see a Low Risk rating as more appropriate due to the higher visibility of Indian wireless growth, Idea's reasonably competitive position, strong parentage and lower financial leverage post-IPO. Operationally, the risks facing Idea are slightly higher than its more established peers given the roll out in new circles. Project cost over-runs, delays in spectrum allocation and hence commercial launches could affect the value accretion opportunity in new circles. Idea will also face competition from established players in new circles and market share gains may be lower than expected. Idea will incur higher capex requirements in the new circles due to the coverage compulsions, which may depress return parameters in the initial years. Any rollout plans beyond 13 circles may also require a fresh equity infusion. These risk factors could impede the stock from reaching our target price.

Appendix A-1

Analyst Certification

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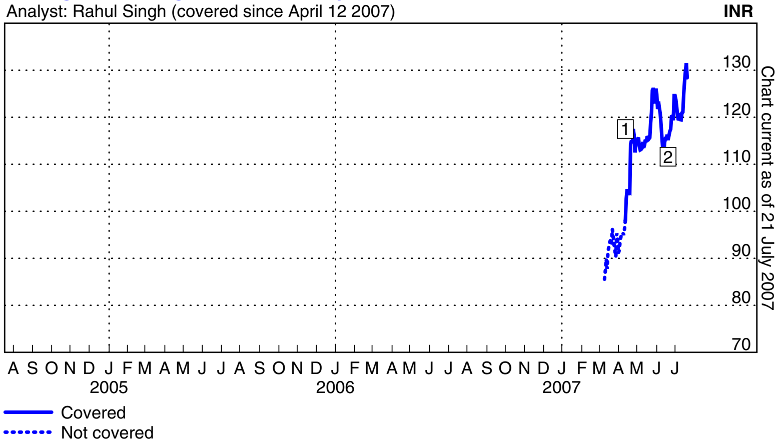
IDEA Cellular (IDEA.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Rahul Singh (covered since April 12 2007)



#	Date	Rating	Target Price	Closing Price
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2:	20 Jun 07	1L	*140.00	115.15

*Indicates change.

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