Company

22 July 2010 | 7 pages

IDEA Cellular (IDEA.BO)

Equity

Sell: 1Q – Traffic Growth Offsets Tariff Decline; Margins Contract

- **Operationally mixed** — Topline at Rs36.9bn (+5% QoQ adj for Spice) was ahead, despite a higher-than-expected fall in rev/min, on strong traffic growth (13% QoQ). EBITDA at Rs7.9bn (-5%) however came in slightly below as margins fell 260bps due to 1) full-quarter consolidation of Spice, 2) diesel price hike (20bps) and 3) higher spectrum charges. Losses in the new circles were contained at Rs1.4bn (flat QoQ). PAT came in at Rs1.9bn.

- **Traffic growth in incumbent circles continues to remain strong** — Standalone Idea (ex-Spice) grew a strong 13% QoQ on the back of 13.5% in 4Q indicating 1) leakage of mins to new entrants has reduced considerably in incumbent circles, post tariff cuts in Oct-Nov-09 and 2) some benefit of elasticity from lower rev/min. Idea's weaker/new circles however, similar to the other new entrants, would have been hit too by tariff retaliation by incumbents, as is indicated by the lackluster 3% mins growth in Karnataka/Punjab (Spice circles). This is also witnessed with pre-paid churn remaining high at 8.4% (7.9% in 4Q).

- **Rev/min down sharply ... yet again** – 3p rev/min decline was more than expected, esp. coming after the 5p decline in 4Q on sub transition to lower tariffs and given that new circles launched in the previous 12-15 months would have already been on lower tariffs similar to other new entrants. However, we expect the decline in rev/min to moderate significantly over the next two quarters as bulk of the migration to new tariffs in its incumbent circles took place by 1Q.

- **B/S details** — Standalone net debt jumped to Rs96.6bn post 3G with Net debt/EBITDA at 3.0x. Capex guidance has also been increased to ~Rs42bn (Rs30bn) to include 3G. Idea's leveraged B/S remains exposed to any unfavorable regulations (spectrum charges getting linked to 3G). Maintain Sell.

Sell/Medium Risk	3M
Price (22 Jul 10)	Rs65.40
Target price	Rs50.00
Expected share price return	-23.5%
Expected dividend yield	0.0%
Expected total return	**-23.5%**
Market Cap	Rs215,835M US$4,576M

Price Performance (RIC: IDEA.BO, BB: IDEA IN)

Figure 1. Quarterly Summary

Rs m	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10
Total Income	28,883	28,909	30,610	32,003	36,897
Total Opex	(21,183)	(21,602)	(23,407)	(23,685)	(28,960)
EBITDA	**7,700**	**7,307**	**7,203**	**8,318**	**7,937**
Margin %	*26.7%*	*25.3%*	*23.5%*	*26.0%*[1]	*21.5%*
EBIT	3,636	3,424	2,781	3,548	2,776
Interest cost	-406	-557	-418	-681	-766
PBT	3,230	2,867	2,363	2,867	2,010
PAT	**3,075**	**2,507**	**1,954**	**2,567**	**1,964**

Source: Citi Investment Research and Analysis, [1] Adjusted EBITDA margins was at 24.1%

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

Figure 2. KPI Summary

	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Comments
ARPU	232	209	200	185	182	MoU jump offset by tariff decline
VAS as % of revenue	10.1%	10.6%	11.2%	12.4%	12.6%	Continues to inch up
MOU	399	375	389	398	415	
Revenue per min	0.58	0.56	0.51	0.47	0.44	Higher than expected from subs transition to lower tariffs. Should moderate significantly going forward
Subscribers ('000)	42,769	46,758	52,264	57,920	68,886	
Pre-paid as % of total	95.1%	95.3%	95.8%	95.7%	95.9%	
Total MOU (mn min)	48,729	50,339	57,841	65,672	74,209	13% minutes growth
Post-paid churn %	2.9%	3.0%	3.1%	3.0%	2.9%	
Pre-paid churn %	6.9%	7.4%	9.4%	7.9%	8.4%	Remains high
Blended Churn %	6.7%	7.2%	9.1%	7.7%	8.2%	

Source: Citi Investment Research and Analysis

Figure 3. Coverage details

	Jun-09	Sep-09	Dec-09	Excl. Spice	Jun-10	Comments
Cell sites	48,067	50,915	55,804	66,187	66,725	Includes Spice
Cell sites added	3,837	2,848	4,889	5,347	538	Calibrated rollout in new circles in order to maintain network utilisation
Rent paying sites	40,211	42,882	47,498	57,515	58,006	
Indus component	27,081	28,924	31,873	35,499	35,798	
% of rent paying sites	83.7%	84.2%	85.1%	86.9%	86.9%	
Owned sites	7,856	8,033	8,306	8,672	8,719	
Tenancy - owned towers	1.51	1.53	1.56	1.54	1.54	Healthy rate
Owned towers - IRU	11,094	11,094	11,094	11,094	11,094	

Source: Citi Investment Research and Analysis

Figure 4. EBITDA losses contained with a calibrated roll-out in new circles to maintain high network utilisation

Rs m	Jun-09	Sep-09	Dec-09	Excl. Spice	Jun-10	Comments
Revenue (New circles)	1,427	1,822	2,384	2,761	3,063	
EBITDA (New circles)	(644)	(830)	(1,288)	(1,422)	(1,401)	Losses contained in new circles
EBITDA margin (New circles) - %	-45.1%	-45.6%	-54.0%	-51.5%	-45.7%	

Source: Citi Investment Research and Analysis

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 all of India's 22 telecom circles and an active presence in 14 of them. The company listed on the Indian bourse in March 2007 and is part of the Aditya Birla Group.

Investment strategy

We rate Idea Sell/Medium Risk. Idea has executed well till now; its execution has been aggressive as well as measured at the same time, relying on focused rollouts and selective tariff cuts much more effectively than anyone else. The high leverage level due to aggressive 3G bidding (FY11E net debt/EBITDA at 3.3x) is a particular risk if the regulations make M&A unviable, leaving the sector exposed to high competition for an extended period of time.

Valuation

Our target price of Rs50 is based on (i) core business value at Rs56/share based on Sep-10 DCF. We switch to DCF given that high 3G bidding depresses near-term earnings, plus (ii) the Indus stake valued at Rs11/share minus (iii) Rs17 related to cash outgo related to one-time spectrum charges and license renewals from TRAI recommendations. The DCF imputes FY11E EV/EBITDA of 8.7, a 10% premium to Bharti.

Risks

We assign a Medium Risk rating to IDEA Cellular, as opposed to the High Risk assigned by our quant risk rating system due to: 1) Idea has demonstrated strong execution skills in new launches (Mumbai & Bihar) and operating leverage in the 11 old circles; 2) Improving credit markets helped reduce concerns on the high-leverage balance sheets like Idea Cellular's. Upside risks to our target price include higher-than-expected market share gains, faster EBITDA breakeven in new circles and M&A activity, as we believe that Idea will participate in the sector consolidation. Several downside risks could impede the stock from reaching our target price. Operationally, higher-than-expected competition will impact Idea more than its peers given its smaller scale. A prolonged EBITDA breakeven in new circles raises concerns on NPV accretion.

Appendix A-1

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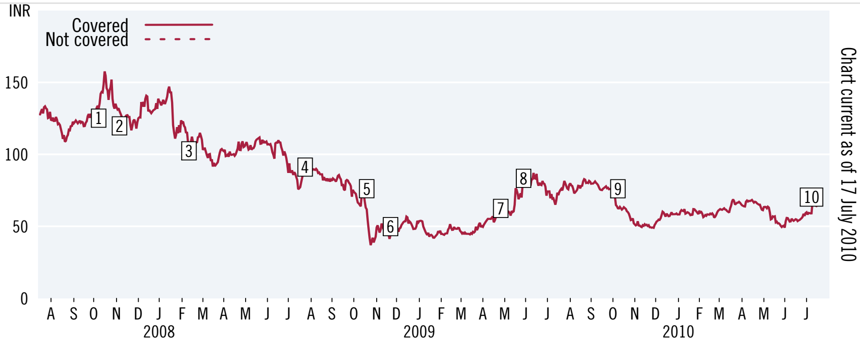
Fundamental Research

Analyst: Gaurav Malhotra, CFA
Covered since June 18 2010



	Date	Rating	Target Price	Closing Price
1	8-Oct-07	1L	*155.00	131.80
2	6-Nov-07	*2L	*140.00	130.10
3	12-Feb-08	*1L	140.00	106.25
4	24-Jul-08	1L	*120.00	87.65
5	20-Oct-08	*2M	*70.00	61.80
6	21-Nov-08	*2H	*56.00	44.20
7	26-Apr-09	*2M	*67.00	60.55
8	28-May-09	*3M	*80.00	78.65
9	8-Oct-09	3M	*55.00	62.50
10	8-Jul-10	3M	*50.00	59.00

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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