

Idea Cellular (Rs73)

Under performer

Target Price: Rs66

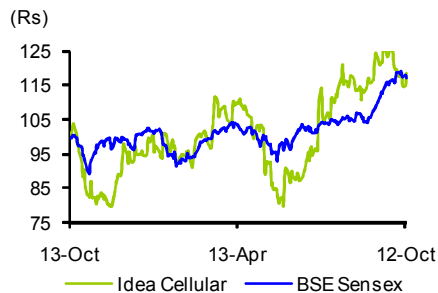
Institutional Equities

India Research

Stock Data

Bloomberg Code	IDEA IN
Market Cap. (Rs bn / US\$ bn)	241 / 5.4
52-week High/Low (Rs)	80 / 47
Shares Outstanding (mn)	3,300
Avg. daily volume ('000)	7,320
Avg. daily value (Rs mn)	448
Promoter holding (%)	47.0
Free float (%)	53.0
FII holding (%)	40.1

Relative Performance



BSE Sensex	20,203
------------	--------

Harit Shah

 harit.shah@karvy.com
 +91-22-22895030

Stretched valuations, no positive triggers in sight

- Valuations at 7.5x EV/EBITDA at a premium to Bharti, little scope for upside:** Idea's stock trades at an EV/EBITDA of 7.5x FY12E EBITDA, an 8% premium to Bharti (6.9x EV/EBITDA). We believe this is not justified owing to Bharti's superior operating metrics. Bharti reported EBITDA margins of 36.1% v/s 24.3% for Idea (1QFY11), return on equity of 16.6% v/s 7.7% for Idea (FY11E) and had a net-debt equity ratio of 0.1x at the end of FY10 (0.6x for Idea). Even post-Zain and debt taken on for 3G spectrum, we expect Bharti's net debt-equity ratio to stand at 0.9x and 0.6x in FY11 and FY12, respectively as compared with 1x and 0.8x, respectively for Idea Cellular.
- 3G service launch unlikely to have significant impact on financials:** We have factored in 3G revenues for Idea post receipt of 3G spectrum last month. We forecast 1.6 mn 3G subscribers in FY12 and ARPU of Rs 600/month, leading to 7% and 6% increases in FY12E top-line and EBITDA, respectively. Owing to higher amortisation costs of Rs 2.9 bn (20-year amortisation period for 3G spectrum costs), net profit falls by 19% v/s earlier estimates. We believe it could take 3-4 years before Idea can witness returns on its 3G investments.
- MNP, another headwind:** Mobile number portability (MNP) is to be launched in India on October 31, 2010, which is likely to be another headwind for the sector. MNP is likely to lead to a price war in the post-paid segment of the market and could hurt margins going forward by 100 bps.
- Maintain 'Under performer':** We maintain an 'Under performer' rating on Idea Cellular owing to expensive valuations with a target price of Rs 66, implying an EV/EBITDA multiple of 7x FY12E EBITDA.

Y/E March (Rs mn)	FY2008	FY2009	FY2010	FY2011E	FY2012E
Net Sales	67,200	101,313	123,979	153,155	189,504
EBITDA	22,518	28,134	33,580	38,820	47,763
Net Profit	10,423	8,816	9,539	9,047	10,904
EPS (Rs)	3.2	2.7	2.9	2.7	3.3
EPS Growth (%)	107.6	(15.4)	8.2	(5.2)	20.5
EBITDA margin (%)	33.5	27.8	27.1	25.3	25.2
PER (x)	23.1	27.3	25.2	26.6	22.1
P/BV (x)	6.8	1.8	2.1	2.0	1.8
Price/sales (x)	3.6	2.4	1.9	1.6	1.3
EV/EBITDA (x)	13.3	10.6	9.4	9.6	7.5
ROE (%)	36.4	10.5	7.7	7.7	8.5
ROCE (%)	22.4	13.5	12.7	13.2	13.8

Source: Company & Karvy Institutional Research

Exhibit 1: Bharti, Idea operating metric comparison - The leader comes out on top

Particulars	Bharti Airtel	Idea Cellular
Mobile Subscriber Base (August 2010, mn)	141.3	72.7
Mobile ARPU (1QFY11, Rs/month)	215	182
EBITDA margins (1QFY11, %)	36.1	24.3
RoE (FY11E, %)	16.6	7.7
Net debt-equity ratio (FY10, x)	0.1	0.6
Net debt-equity ratio post-Zain and 3G (FY11E, x)	0.9	1.0
Net debt-equity ratio post-Zain and 3G (FY12E, x)	0.6	0.8
EV/EBITDA (FY12E EBITDA, x)	6.9	7.5

Source: Cellular Operators' Association of India (COAI), Respective companies, Karvy Institutional Research

MNP - A headwind likely to shift focus to the post-paid market

MNP introduction is likely to result in higher subscriber acquisition and retention costs for operators. As opposed to the erstwhile focus on the pre-paid segment, MNP implementation is likely to witness a greater focus on post paid subscribers by operators. Post-paid subscribers are high usage customers that generate higher ARPUs, have higher usage of value-added services and are typically stickier in nature as compared with pre-paid subscribers. Even though these users account for a fairly low proportion of overall subscribers (around 4% for the industry), they contribute more significantly to revenues.

In 4QFY10, as per TRAI data overall blended ARPUs of the GSM segment stood at Rs 131 per user per month. However, post-paid GSM ARPUs stood at a significantly higher Rs 503 which is 345% of the pre-paid GSM ARPUs of Rs 113. The share of post-paid subscribers as per TRAI stood at 4.2%, or 20.2 mn out of the total GSM subscriber base of 478.7 mn at the end of 4QFY10. Calculations show that the revenue share of these subscribers is considerably higher than the subscriber share, at 16.4%, as compared with 83.6% revenue share for pre-paid subscribers. Thus, the revenue share divided by the subscriber share of the post-paid segment, which gives an indication about the quality of subscribers of the segment, stands at 3.9x (16.4 divided by 4.2), as compared with just 0.9x for the pre-paid segment (83.6 divided by 95.8). This is a reflection of the fact that post-paid users contribute more substantially to revenues as compared with their subscriber share, thus underlining the significant importance of these users.

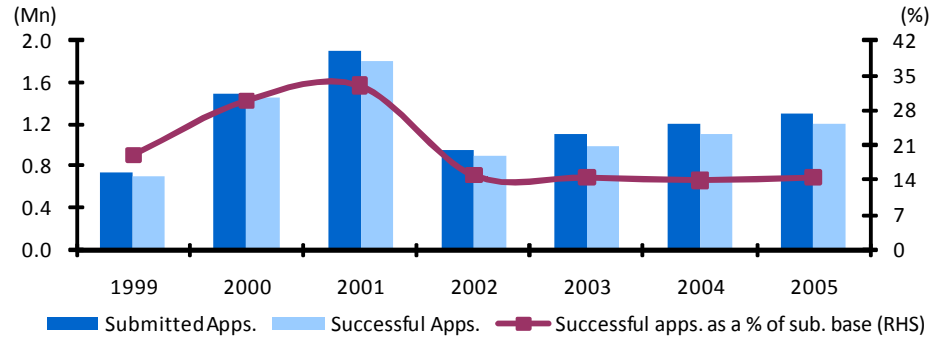
Exhibit 2: Post-paid and pre-paid subscriber, revenue share - Post-paid=High quality

(GSM segment, 4QFY10)	Post-paid	Pre-paid
ARPUs (Rs/user/month)	503	113
Subscriber share (SS, %)	4.2	95.8
Subscribers (Mn)	20.2	458.5
Revenues (Rs mn)	30,482	155,425
Revenue share (RS, %)	16.4	83.6
Quality of subscribers (RS/SS, x)	3.89	0.87

Source: Telecommunications Regulatory Authority of India (TRAI), Karvy Institutional Research

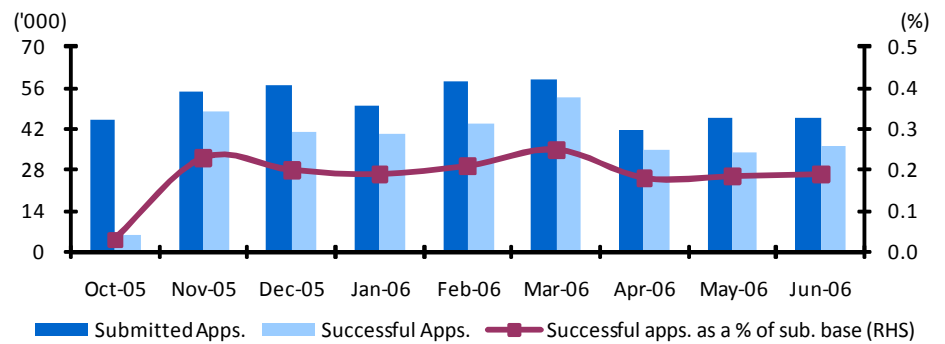
Consequently, to ensure that such users stay connected to their networks, mobile operators including Idea will have to slash rates, offer more freebies and resort to large-scale bundled offerings and value-added services. Greater expenditure on SG&A and higher capex investments to improve quality of service (QoS) are also expected. Thus, the end-impact of this scenario is likely to be a fall in margins of telcos including Idea.

Exhibit 3: MNP impact in Hong Kong



Source: Frost & Sullivan, Karvy Institutional Research

Exhibit 4: MNP impact in Taiwan



Source: Frost & Sullivan, Karvy Institutional Research

Maintain 'Under performer' on Idea

Owing to stretched valuations and lack of positive triggers going forward, **we maintain our 'Under performer' rating on Idea Cellular with a target price of Rs 66, implying an EV/EBITDA of 7x FY12E EBITDA.**

Stock Ratings	Absolute Returns
Buy	: > 25%
Out Performer	: 16 - 25%
Market Performer	: 0 - 15%
Under Performer	: < 0%
Sell	: <(25%)

Hemindra Hazari

(Head of Research)

hemindra.hazari@karvy.com

For further enquiries please contact:

research@karvy.com

Tel: +91-22-22895000

Disclosures Appendix

Analyst certification

The following analyst(s), who is (are) primarily responsible for this report, certify (ies) that the views expressed herein accurately reflect his (their) personal view(s) about the subject security (ies) and issuer(s) and that no part of his (their) compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report.

Disclaimer

The information and views presented in this report are prepared by Karvy Stock Broking Limited. The information contained herein is based on our analysis and upon sources that we consider reliable. We, however, do not vouch for the accuracy or the completeness thereof. This material is for personal information and we are not responsible for any loss incurred based upon it. The investments discussed or recommended in this report may not be suitable for all investors. Investors must make their own investment decisions based on their specific investment objectives and financial position and using such independent advice, as they believe necessary. While acting upon any information or analysis mentioned in this report, investors may please note that neither Karvy nor Karvy Stock Broking nor any person connected with any associate companies of Karvy accepts any liability arising from the use of this information and views mentioned in this document.

The author, directors and other employees of Karvy and its affiliates may hold long or short positions in the above mentioned companies from time to time. Every employee of Karvy and its associate companies are required to disclose their individual stock holdings and details of trades, if any, that they undertake. The team rendering corporate analysis and investment recommendations are restricted in purchasing/selling of shares or other securities till such a time this recommendation has either been displayed or has been forwarded to clients of Karvy. All employees are further restricted to place orders only through Karvy Stock Broking Ltd. This report is intended for a restricted audience and we are not soliciting any action based on it. Neither the information nor any opinion expressed herein constitutes an offer or an invitation to make an offer, to buy or sell any securities, or any options, futures nor other derivatives related to such securities.

Karvy Stock Broking Limited

Institutional Equities

2nd Floor, Regent Chambers, Nariman Point - Mumbai 400 021.

Regd Off : 46, Road No 4, Street No 1, Banjara Hills, Hyderabad – 500 034.