Indiabulls

Spice Communications
IPO NOTE

EQUITY RESEARCH | June 25, 2007

IPO Note

IPO Details	
Face Value	Rs. 10.0
Price Band	Rs. 41 - 46
Issue Opens	June 25, 2007
Issue Closes	June 27, 2007
Bloomberg	SPCM IN
BRLM	ENAM Financial Consultants
Registrar to issue	Karvy Computershare Ltd.
Shares on offer for sale	113.1 mn

Pre issue shareholding pattern

Shareholders	% Stake
Modi Wellvest Private Limited	48.8
TMI India Ltd (subsidiary of TMI Mauritius)	46.9
QIBs	3.2
Other Public Category	1.1

Post issue shareholding pattern

Shareholders	% Stake
Modi Wellvest Private Limited	40.8
TMI India Ltd (subsidiary of TMI Mauritius)	39.2
QIBs	12.3
Other Public Category	7.7

Issue Composition	
Net Issue to Public	**113,111,111.0**
QIBs	66,666,667.0
Non-Institutional	11,111,111.0
Retail	33,333,333.0
Employee Reservation Portion	2,000,000.0

Enterprise Value	Lower End	Upper End
Price Band	Rs. 41.0	Rs. 46.0
Equity Shares prior to issue (mn)	576.8	576.8
Fresh Issue of shares (mn)	113.1	113.1
Total Equity Shares (mn)	689.9	689.9
Share Capital at face value (mn)	Rs. 6,899.3	Rs. 6,899.3
Implied market cap (mn)	Rs. 28,286.9	Rs. 31,736.6
Debt (mn) (as on 31/12/2006)	Rs. 12,079.1	Rs. 12,079.1
Cash (mn) (as on 31/12/2006)	Rs. 1,272.9	Rs. 1,272.9
Implied EV (mn)	Rs. 39,093.2	Rs. 42,542.8

Spice Communications Limited — Subscribe

Spice Communications Limited is a GSM cellular services provider in Punjab and Karnataka circles. With a customer base of over 3 mn subscribers, the company is the second largest telecom provider in Punjab and the fifth largest in Karnataka. To complement its existing markets, the company has recently embarked on a pan-India expansion strategy by applying for licences for an additional 20 circles across India, in addition to the licences for providing National Long Distance (NLD) and International Long Distance (ILD) services.

Valuation and Recommendation

At the higher price band of Rs. 46.0, Spice's EV/Subscriber of Rs. 14,147.4 is at 64.5% discount to Bharti Airtel and 36.6% discount to Idea. Spice is at 28.7% and 19.0% discount on EV/Revenue when compared to Bharti and Idea respectively. The premium enjoyed by its peers adequately reflects their strong subscriber base, commanding market share across India, and superior financial metrics. The only set back lies with the issue is the weakness in company's EBITDA margin as compared to its peers, which is substantiated by the strong topline growth and lower per subscriber valuation.

We expect modest gains upon listing, post which the stock is likely to track relative valuations with respect to the larger integrated listed players. We recommend the investors to Subscribe to the issue.

Valuation Analysis

	EV / Subscribers	EV / Revenue	EV / EBITDA
Bharti Airtel	39,883.1	8.8x	21.9x
Idea	22,328.9	7.7x	22.6x
Spice			
Lower Price Band	13,000.2	5.7x	23.6x
Higher Price Band	14,147.4	6.3x	25.7x
Premium / (Discount) to Bharti			
Lower Price Band	(67.4%)	(34.5%)	8.1%
Higher Price Band	(64.5%)	(28.7%)	17.6%
Premium / (Discount) to Idea			
Lower Price Band	(41.8%)	(25.6%)	4.7%
Higher Price Band	(36.6%)	(19.0%)	14.0%

IPO

Issue details

Spice Communication plans to raise Rs. 5.2 bn, offloading 20% of equity, in an IPO for 113 mn shares of face value Rs. 10 each and at price band of Rs. 41-46. About 33.3 mn of the total shares is allocated to the public, 66.7 mn to Qualified Institutional Buyers, 11.1 mn to Non-Institutional buyers and 2 mn to employees. The company has already concluded a pre-IPO placement of 25 mn shares at Rs. 45 pre share, raising Rs. 1.1 bn

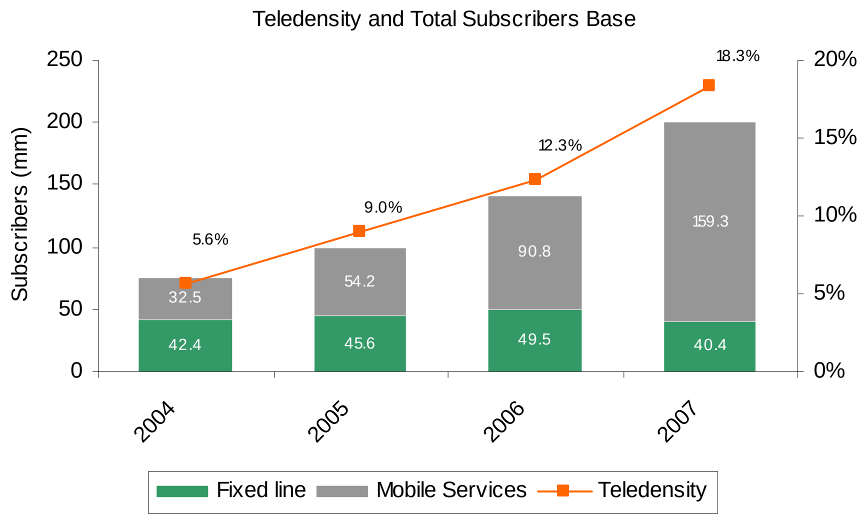
Issue objective

The objectives of the issues are to achieve the benefits of listing on the stock exchanges and to raise funds for

- Part-payment of the long term debt; intends to use upto 50% of the Issue proceeds towards the part-payment
- Payment of National Long Distance and International Long Distance license fees amounting to Rs. 636 mn
- Payment of Rs. 1,776.3 mn to vendors for network equipments and other capital expenditure related to set up of NLD/ILD network
- Other general corporate expenses
- Public issue expenses

Industry Overview

The Indian telecommunications industry has experienced significant growth in recent years, primarily in the mobile sector. Historically, this sector was primarily run by the Government under the Ministry of Telecommunications and Information Technology, Department of Telecommunications. The liberalisation of this sector began in the early 1990s and by 1998 all the different telecommunications service areas have been opened up to competition and private sector participation. Indian telecommunications market can be broadly classified into Wireless, Wireline, National Long Distance, International Long Distance and Data Services.



For the past few years mobile services has seen significant growth over fixed line services as shown above.

The Indian Cellular industry has seen a growing footprint of mobile companies over the last few years. Mobile service providers such as Bharti Airtel, Hutchison, Reliance Communications and BSNL have established networks that have pan-India coverage.

The operation of cellular networks by any provider is limited by the amount of spectrum allocated to them in the jurisdictions where they operate. Radio spectrum is the essential resource for all GSM mobile networks. Spectrum is a finite resource and its allocation is determined by the relevant governmental authorities. Owing to growing demand the DoT intends to release further spectrum in the 900 and 1800 MHz ranges to commercial mobile operators once the Indian defence forces cease using these ranges.

Anticipating the growth of a market for 3G services in India along the lines of more advanced markets, TRAI has recommended a comprehensive 3G policy under which it has released limited spectrum in 2.1GHz band for 3G trials to Bharti Airtel, BSNL, MTNL and Hutchison

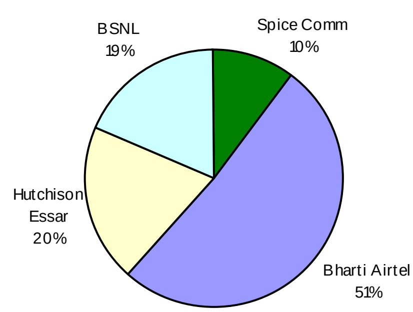
Also, Indian telecommunication markets will see an era of consolidation and network sharing. Increasing competition will pull prices further down and thus put pressure on the operating margins. As foreign direct investment limit in telecom companies has been raised to 74% from 49%, the industry will see more capital infusion by existing players or new foreign players entering the market through joint-ventures.

Until recently the category 'A' and 'B' circles have been instrumental in driving subscriber growth. As operators continue to roll out, we expect significant growth to emerge from rural areas within existing circles and growth in 'C' circles. Despite stronger growth from the non-urban areas of all circles, tele-density in rural areas continues to lag the tele-density of urban India. Rural households have the potential for significant growth if services could be extended to cover these areas. However, the capital cost of setting up connectivity in these areas can be seen as the main hurdle, limiting growth potential.

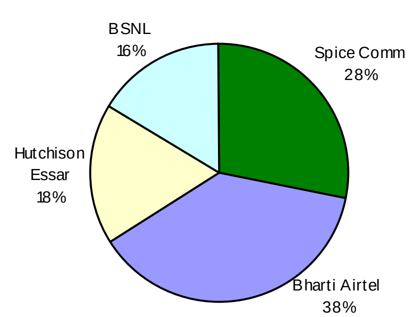
Investment Rationale

One of the leading players in Indian telecom industry with strong hold in Punjab and Karnataka circle

Spice is the second largest operator in Punjab, with approximately 2.05 mn subscribers and the fifth largest operator in Karnataka, with approximately 0.95 mn subscribers. The company enjoys strong brand recognition in these markets targeting youths with a range of pre-paid and post-paid schemes.



Karnataka Circle



Punjab Circle

** excluding WLL players*

Spice is an incumbent cellular operator in the states of Punjab and Karnataka with an allocation in the 900 MHz spectrum in both these states. As of December 31, 2006, the company had installed 1,358 sites throughout Punjab and 1,019 sites throughout Karnataka.

Strategic investment from Telecom Malaysia provides the company with expertise

Telecom Malaysia is a leading telecommunications company based in Malaysia with strong presence in the Asia-Pacific region, including strategic investment in Sri Lanka, Bangladesh, Indonesia, Cambodia, Singapore and Pakistan. TM forayed into Indian telecom sector in March 2006 with the acquisition of 49% stake in the company. It provided Spice with operational and strategic expertise to implement its pan-India expansion strategy with access to technical & marketing expertise and economies of scale.

Pan-India expansion strategy

Spice's pan-India expansion strategy involves a gradual build-out of a nation wide cellular network and related brand positioning. The Company's experience in developing its business in local markets in Punjab and Karnataka will be valuable in expanding business throughout the diverse markets of India. Spice has applied to obtain licences for providing cellular services in an additional 20 circles throughout India. The company has also applied to obtain NLD and ILD licences, because providing these services could provide additional revenue streams at a relatively low marginal cost.

Well spread distribution network in Punjab and Karnataka

Spice enjoys well spread distribution network in both circles of Punjab and Karnataka through which it sells pre-paid and post-paid services. As of March 31, 2006, the company distributed its services through 300 exclusive distributors, which tapped into a network of 90 corporate dealers and over 28,000 independent retailers. Such exclusive distributors provide the company with ongoing support in customer acquisition and retention. Spice also intend to expand its network of dealers and distributors in order to increase its brand awareness, provide better logistical support to its customer base and create a strong channel of communication between the company and its subscribers.

Risks and Concerns

Weak financial indicators

Spice has been incurring significant accumulated costs for past few years. As of December 31, 2006 the company continue to have negative net worth because of accumulated losses of Rs. 6,843.6 mn. In future accumulated losses are expected to rise as the company has to incur significant expenditures on account of capital cost, operational cost and debt repayments. For the same reason Spice was unable to meet the eligibility criteria for listing on the NSE, which may adversely affect the liquidity and tradability of its equity shares.

The company is also experiencing drop in EBITDA margins due to increased selling, marketing and administration costs. A continuous fluctuation in EBIT margins shows inconsistence performance. This inconsistency coupled with continuous net losses indicates requirement for better financials management and focus on maximizing gains to the investors.

Lowest comparative performance among peers

On a comparative basis Spice falls behind all of the major performance indicators in its peer group. As mentioned in the table below the company has lowest ARPU, subscriber base and market share when compared to its peers. It lags behind tremendously on the subscriber base and market share due to its presence in only 2 circles out total 23 circles.

Company Name	Subscriber base	Market share	ARPU (Rs.)
Bharti Airtel	40,743,725	31.2%	343.2
Hutch	28,200,396	21.6%	340.2
Idea	15,266,618	11.7%	277.5
Spice	3,007,118	2.3%	241.8
BSNL	27,994,410	21.4%	NA
Others	15,395,688	11.8%	NA

Significant competition from larger, national cellular service providers

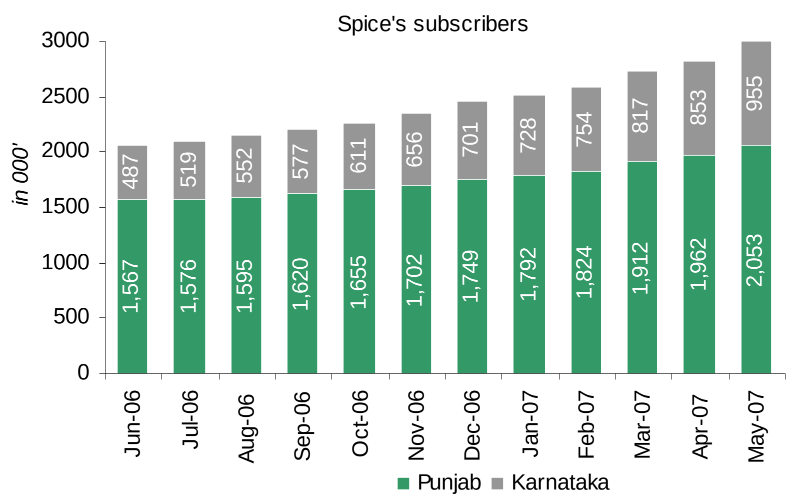
Spice currently operates exclusively in the Punjab and Karnataka circles. Being a regional and small player in the cellular services industry, it has to face significant competition from larger, national cellular service providers, which may have a material adverse effect on its profitability. Most of its competitors are larger in size with pan-India presence and possess greater financial, technical and marketing resources. In the past, the company lost key corporate clients, particularly in the Karnataka market, primarily due to lack of coverage in certain geographic areas.

Competition from new entrants

Spice's business also faces significant competition from potential new entrants, including government controlled companies. With the increase in foreign direct investment limit from 49% to 74%, competition is more likely to intensify as new players will enter the market. Stiff competition will further trim down the prices affecting Spice's revenues, margins and market share.

Rely significantly on a small number of customers

Spice generates its revenues from small number of customers concentrated in two circles only, Punjab and Karnataka. With other players increasing penetration with significant rate markets for these circles will become very competitive. Unless Spice is able to increase its customer base with significant amount, it may have to face tough competition ahead and threat of extinction.



Spice has been growing, though not as fast as most others. In the past 12 months, its subscriber base has increased from 2.1 mn to 3 mn, or an increase of 46%.

Spectrum allocated to Spice is not sufficient for the expansion plans

Spice's cellular network operates in the 900 MHz band spectrum with allocation of 7.8 MHz and 6.2 MHz in Punjab and Karnataka respectively. The company has applied for additional spectrum of 2 MHz in Punjab based on its subscriber base and has also applied for 3G spectrum allocation. Till date application is pending with the DoT. The expansion and development of the company's networks may be impacted by the limited availability of frequency spectrum.

Spice do not own "SPICE" trademark

The Company conduct most of its business under the trademark of "SPICE", which it acquired for use only in respect of services relating to telecommunication activities, from its associate company MCorp Global Private Limited. Termination of the agreement with MCorp may adversely affect the business as the company has to incur costs in reacquiring the same trademark or has to rebuild reputation and goodwill with new trademark.

Outlook

The Indian telecommunications industry has experienced significant growth in recent years, primarily in the mobile sector. The industry is expected to grow at a rapid rate with the launch of new services such as 3G, Wi-fi and Wi-max. Given its low tele-density, economic liberalization and the increasing affordability of mobile telephones and services, the Indian mobile telecommunications industry is expected to enjoy growth in terms of both subscribers and usage.

With strong foothold in Punjab and Karnataka circles, Spice is implementing the Pan-India expansion strategy, under which it has applied to obtain licences for providing cellular services in an additional 20 circles throughout India.

Currently, Spice's fundamental financial position does not look very promising which is reflected by a negative net worth of Rs. 1.6 bn. However, the potential growth in subscriber base and an existence of huge market opportunity in 'B' and 'C' circles will provide sufficient momentum to the topline growth, leading to margins expansion. Hence, we believe fundamentally it may not be a prudent investment but, it is definitely a take-over target, sooner or later.

We expect modest gains upon listing, post which the stock is likely to track relative valuations with respect to the larger integrated listed.

Company Background

Spice commenced operations in 1997 as a cellular services provider in the states of Punjab and Karnataka in India. As of May 31, 2007, the company was the second largest cellular services provider in Punjab with 2.05 mn subscribers and fifth largest cellular services provider in Karnataka with 0.95 mn subscribers.

The company is focusing on horizontal and vertical branding to make “SPICE” brand more prominent in Punjab and Karnataka as well as creating a greater national presence. Spice positions its brand as youthful, innovative, high performing, savvy and technologically advanced, targeting the growing below- 35 years old demographic in India.

Spice cellular networks operate on spectrum in the 900 MHz band with allocation of 7.8 MHz and 6.2 MHz in Punjab and Karnataka respectively. The company distributes its services through 300 exclusive distributors, which tapped into a network of 90 corporate dealers and over 28,000 independent retailers. Spice has also tied-ups with over 448 international operators across 208 countries.

Spice is 49% owned by Malaysia’s incumbent service provider Telekom Malaysia, while Modi Group owns the remaining 51% stake.

Disclaimer

This report is not for public distribution and is only for private circulation and use. The Report should not be reproduced or redistributed to any other person or person(s) in any form. No action is solicited on the basis of the contents of this report.

This material is for the general information of the authorized recipient, and we are not soliciting any action based upon it. This report is not to be considered as an offer to sell or the solicitation of an offer to buy any stock or derivative in any jurisdiction where such an offer or solicitation would be illegal. It is for the general information of clients of Indiabulls Securities Limited. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. You are advised to independently evaluate the investments and strategies discussed herein and also seek the advice of your financial adviser.

Past performance is not a guide for future performance. The value of, and income from investments may vary because of changes in the macro and micro economic conditions. Past performance is not necessarily a guide to future performance.

This report is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon as such. Any opinions expressed here in reflect judgments at this date and are subject to change without notice. Indiabulls Securities Limited (ISL) and any/all of its group companies or directors or employees reserves its right to suspend the publication of this Report and are not under any obligation to tell you when opinions or information in this report change. In addition, ISL has no obligation to continue to publish reports on all the stocks currently under its coverage or to notify you in the event it terminates its coverage. Neither Indiabulls Securities Limited nor any of its affiliates, associates, directors or employees shall in any way be responsible for any loss or damage that may arise to any person from any error in the information contained in this report.

The analyst for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject stock and no part of his or her compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report. No part of this material may be duplicated in any form and/or redistributed without Indiabulls Securities Limited prior written consent.

The information given herein should be treated as only factor, while making investment decision. The report does not provide individually tailor-made investment advice. Indiabulls Securities Limited recommends that investors independently evaluate particular investments and strategies, and encourages investors to seek the advice of a financial adviser. Indiabulls Securities Limited shall not be responsible for any transaction conducted based on the information given in this report, which is in violation of rules and regulations of National Stock Exchange or Bombay Stock Exchange.