

Company Flash

25 October 2007 | 7 pages

IDEA Cellular (IDEA.BO)

2Q Below Par: Discontinuity in Costs, Lower ARPU Do the Damage

- Operating profit disappoints** — Idea Cellular's 2QFY08 EBITDA at Rs5,106m was below expectations and in fact declined sequentially due to 1) faster than expected decline in ARPU (Rs299) and 2) high network rollout cost with ~3,900 cell sites added during the quarter (3,000 sites in previous quarter).
- Faster decline in ARPU may have been due to lifetime rentals** — Sharper decline in ARPU (6% sequentially) may have been the result of lower proportion of lifetime subs added during the quarter (33% in 1Q). Idea had launched lifetime validity scheme during 1QFY08 for which it books revenues (Rs499/sub) upfront rather than amortizing them over the life of the subscriber like Bharti/RCOM do. We, however, await further details on the earnings call tomorrow before revisiting estimates.
- Discontinuity in costs** — Function of lower scale: Idea's cell site count has gone up 70% in 1HFY08, which was reflected in the sharp 25%qoq jump in network opex. This we believe is typical of Idea and unlikely to be repeated for its larger peers (Bharti, RCOM), which report next week, since they have a smoother rollout profile.
- Net interest higher + higher tax** — Net interest charges increased during the quarter to Rs640m (Rs143m in 1Q) as IPO proceeds were utilized and lower forex gains sequentially. Idea also took deferred tax provision of Rs261m during the quarter on which we await further details.

Buy/Low Risk	1L
Price (25 Oct 07)	Rs152.00
Target price	Rs155.00
Expected share price return	2.0%
Expected dividend yield	0.0%
Expected total return	2.0%
Market Cap	Rs394,115M US\$9,974M

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



Figure 1. Statistical Abstract

	EBITDA	Net Profit	FD EPS	EPS Growth	P/E	EV/EBITDA	Price/CEPS
	(Rs m)	(Rs m)	(Rs)	(%)	(x)	(x)	(x)
2005P	8,210	760	0.1		1,503.3	46.1	66.8
2006P	10,674	2,118	0.7	637%	204.1	35.1	46.1
2007E	14,637	5,033	1.9	161%	78.3	28.3	33.5
2008E	24,875	13,520	5.1	164%	29.6	17.6	17.3
2009E	34,470	15,736	6.0	16%	25.5	13.1	13.4

Source: Citi Investment Research

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Figure 2. Financial Statements (Rs m)

	Sep-06	Dec-06 (est.)	Mar-07	Jun-07	Sep-07
Service Revenue	10,013.0	11,463.3	13,084.2	14,772.9	15,622.1
Sales of Trading Goods	83.0	18.4	-	0	
Total Income	10,096.0	11,481.6	13,084.2	14,772.9	15,622.1
Cost of Trading Goods	(28.0)	(13.4)			
Personnel Expenditure	(600.0)	(759.0)	(684.7)	(708.0)	(877.4)
Network Operating Exp	(1,144.0)	(1,410.2)	(1,680.0)	(1,895.5)	(2,379.9)
License & WPC Charges	(995.0)	(1,172.1)	(1,410.9)	(1,598.6)	(1,551.1)
Access & Interconnect Charges	(1,622.0)	(1,949.6)	(2,202.5)	(2,396.1)	(2,550.2)
Subscriber Acquisition & Servicing Exp	(1,341.0)	(1,420.7)			
Advertisement & Business Promotion Exp	(395.0)	(565.9)	(2,179.2)	(2,283.4)	(2,513.6)
Administration & Other Exp	(432.0)	(486.5)	(564.0)	(763.7)	(643.0)
Total Opex	(6,557.0)	(7,777.2)	(8,721.3)	(9,645.3)	(10,515.2)
Impact of Restatement	(3.0)		0	0	
Restated Total Opex	(6,554.0)	(7,777.2)	(8,721.3)	(9,645.3)	(10,515.2)
EBITDA	3,542.0	3,704.4	4,362.9	5,127.6	5,106.9
<i>Margin %</i>	<i>35.1%</i>	<i>32.3%</i>	<i>33.3%</i>	<i>34.7%</i>	<i>32.7%</i>
Depreciation	(1,432.0)	(1,523.9)	(1,761.3)	(1,886.8)	(2,007.0)
Amortisation of Intangible Assets	(268.0)	(276.6)			
EBIT	1,842.0	1,903.9	2,601.60	3,240.80	3,099.90
Interest & Financing Charges	(774.0)	(805.4)	(974.7)	(143.4)	(640.5)
Other Income	11	108.9	326.4	3.5	21.4
PBT	1,079.0	1,207.4	1,953.3	3,100.9	2,480.8
Tax	(6.0)	(30.7)	(19.1)	(15.7)	(277.0)
PAT	1,073.0	1,176.7	1,934.2	3,085.2	2,203.8
<i>PAT Margin</i>	<i>10.6</i>	<i>10.2</i>	<i>14.8</i>	<i>20.9</i>	<i>14.1</i>

Source: Company reports

Figure 3. Operating results below expectations

	Estimates	Actual	Difference	Comments
Sales	16,579.2	15,622.1	-5.8%	Sharper decline in ARPUs
EBITDA	6,001.7	5,106.9	-14.9%	High network deployment cost
PAT	3,569.1	2,203.8	-38.3%	Lower forex income and higher taxation

Source: Citi Investment Research

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 strategy

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 an earnings CAGR of 50% 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 Rs155 based on Sep-08E DCF of Rs140 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 41.5% (~500bps below Bharti) and capex/sales of ~8% (in line with Bharti). The DCF value implies an EV/EBITDA of 12.2x, broadly in line with Bharti's target multiples (for the ex-towerco portion of Rs1,010), which is supported by Idea's higher growth rates notwithstanding Idea's smaller size and relatively less established track record.

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

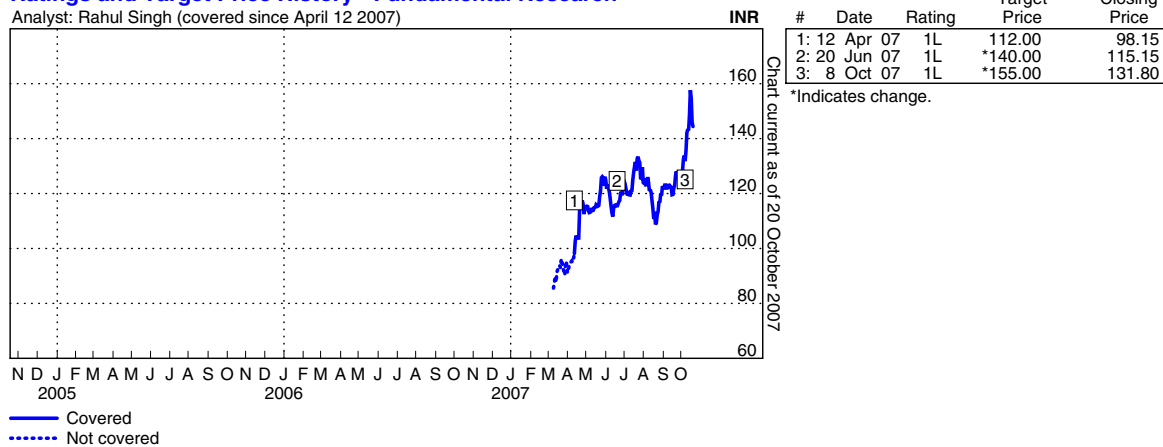
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Analyst: Rahul Singh (covered since April 12 2007)



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