Company report

Telecoms, Media & Technology
Wireless Telecoms
Equity – India

HSBC Global Research

Idea Cellular (IDEA)

Overweight (V)

Target price (INR)	160.00
Share price (INR)	107.45
Potential total return (%)	48.9

Mar	2008a	2009e	2010e
HSBC EPS	3.96	4.34	6.00
HSBC PE	27.1	24.7	17.9

Performance	1M	3M	12M
Absolute (%)	-1.3	-0.5	-7.2
Relative^ (%)	-2.0	2.1	-20.6

Note: (V) = volatile (please see disclosure appendix)

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Reiterate OW(V): Raising capital through tower sale

- **20% stake sale in Aditya Telecom to private equity values Indus ahead of our estimates**
- **Monetizing towers is highly cash generative and allows Idea to repair its geared balance sheet**
- **Reiterate OW(V) rating but cutting target price by 9.6% to INR160 (INR177) to reflect price cuts and higher capex**

Selling a tower asset: Idea has sold a 20% stake in Aditya Telecom (wholly owned subsidiary), which holds a 16% stake in the Indus tower JV and a license in Bihar. The transaction values Aditya Telecom at USD3.2bn or c49% of Idea's current market cap, suggesting that Idea may be undervalued. In addition, Idea's management has highlighted the possibility of listing Aditya Telecom.

Our analysis suggests that Indus valuations are attractive compared to US based tower companies. Further US tower companies have outperformed the telecom space on a relative basis, implying that viable tower business models with visible tenancies will create shareholder value in the longer term.

Balance sheet constraints are overstated: We believe concerns pertaining to Idea's balance sheet are overstated as repeatedly monetizing tower assets should be cash generative and allow for substantial de-gearing in the balance sheet for the coming years.

Underlying telco business is strong: The company continues to gain market share from 11.3% currently to 12.3% in FY09e.

Target price INR160: We conservatively do not include the proceeds from the tower sale in the balance sheet until regulatory approval is obtained in August. We lower our earnings estimate by 7.6% in FY09e to reflect higher interest costs. Key downside risk is a lower than modelled pick-up in usage.

Year to Mar	FY08	FY09e	FY10e	FY11e	FY12e
Revenue (INR mn)	67,377	98,559	130,810	156,600	176,785
EPS (INR)	3.96	4.34	6.00	7.59	8.99
PE (x)	27.0	24.6	17.8	14.1	11.9

Source: Company data, HSBC estimates

Index^	BOMBAY SE IDX
Index level	16907.11
RIC	IDEA.BO
Bloomberg	IDEA IN

Source: HSBC

Free float (%)	100
Market cap (USDm)	6,592
Market cap (INRm)	283,169

Source: HSBC

Financials & valuation

Financial statements

Year to	03/2008a	03/2009e	03/2010e	03/2011e
Profit & loss summary (INRm)				
Revenue	67,377	98,559	130,810	156,600
EBITDA	22,687	26,279	33,446	42,001
Depreciation & amortisation	-8,789	-9,074	-9,325	-12,854
Operating profit/EBIT	13,898	17,204	24,120	29,147
Net interest	-2,771	-6,017	-11,321	-12,444
PBT	11,127	12,300	17,854	22,857
HSBC PBT	11,148	12,300	17,854	22,857
Taxation	-726	-688	-1,280	-1,837
Net profit	10,401	11,612	16,574	21,020
HSBC net profit	10,422	11,440	15,819	20,002
Cash flow summary (INRm)				
Cash flow from operations	19,190	20,378	23,394	31,182
Capex	-48,941	-67,058	-44,917	-37,172
Cash flow from investment	-48,941	-67,058	-44,917	-37,172
Dividends	0	0	0	0
Change in net debt	31,929	88,656	64,416	19,741
FCF equity	-29,751	-47,485	-24,072	-9,452
Balance sheet summary (INRm)				
Intangible fixed assets	17,892	29,189	40,018	49,038
Tangible fixed assets	89,271	70,877	95,638	110,937
Current assets	17,683	83,983	85,733	87,407
Cash & others	8,918	10,000	10,000	10,000
Total assets	124,984	184,186	221,528	247,520
Operating liabilities	23,723	23,723	23,723	33,724
Gross debt	65,154	154,892	219,308	239,050
Net debt	56,236	144,892	209,308	229,050
Shareholders funds	35,446	46,886	62,705	72,706
Invested capital	92,205	192,301	272,536	302,278

Ratio, growth and per share analysis

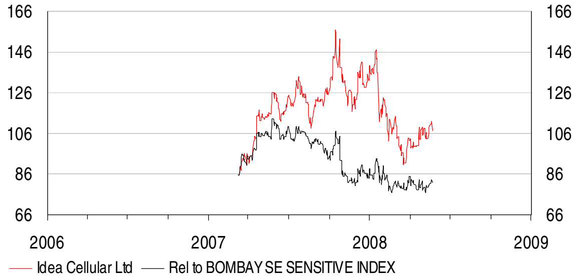
Year to	03/2008a	03/2009e	03/2010e	03/2011e
Y-o-y % change				
Revenue	53.6	46.3	32.7	19.7
EBITDA	52.7	15.8	27.3	25.6
Operating profit	70.7	23.8	40.2	20.8
PBT	118.6	10.5	45.2	28.0
HSBC EPS	94.8	9.5	38.3	26.4
Ratios (%)				
Revenue/IC (x)	1.0	0.7	0.6	0.5
ROIC	23.6	13.0	11.2	11.0
ROE	36.4	27.8	28.9	29.5
ROA	12.3	11.2	13.4	13.8
EBITDA margin	33.7	26.7	25.6	26.8
Operating profit margin	20.6	17.5	18.4	18.6
EBITDA/net interest (x)	8.2	4.4	3.0	3.4
Net debt/equity	158.7	309.0	333.8	315.0
Net debt/EBITDA (x)	2.5	5.5	6.3	5.5
CF from operations/net debt	34.1	14.1	11.2	13.6
Per share data (INR)				
EPS reported (fully diluted)	3.96	4.41	6.29	7.98
HSBC EPS (fully diluted)	3.96	4.34	6.00	7.59
DPS	0.00	0.00	0.00	0.00
NAV	13.48	17.79	23.80	27.59

Valuation data

Year to	03/2008a	03/2009e	03/2010e	03/2011e
EV/sales	5.0	4.3	3.8	3.3
EV/EBITDA	15.0	16.3	14.7	12.2
EV/IC	3.7	2.2	1.8	1.7
PE*	27.1	24.7	17.9	14.2
P/NAV	8.0	6.0	4.5	3.9
FCF yield (%)	-10.5	-16.8	-8.5	-3.3
Dividend yield (%)	0.0	0.0	0.0	0.0

Note: * = Based on HSBC EPS (fully diluted)

Price relative



Source: HSBC

Note: price at close of 22 May 2008

Summary

- 20% stake sale in Aditya Telecom to private equity values Indus ahead of our estimates
- Monetizing towers is highly cash generative and allows Idea to repair its geared balance sheet
- We reiterate our OW(V) rating but cut our target price by 9.6% to INR160 reflect price cuts and higher capex

Investment thesis

We believe Idea Cellular offers the best exposure to pure Indian mobile growth, with a tower business catalyst and low reinvestment risk. In our view, Idea offers good growth potential with adequate spectrum and good management.

We believe balance sheet constraints are overstated as the combination of operating cash flow, access to debt and unlocking options in tower assets will provide financing to fund expansion.

Idea sold a 20% stake in Aditya Telecom (wholly owned subsidiary), which holds a 16% stake in the Indus tower JV and a license in Bihar. The transaction values Aditya Telecom at USD3.2bn or c49% of Idea's current market cap; this suggests that Idea may be undervalued. We value Idea's stake in the tower business at USD2.5bn and the aforesaid transaction values Indus ahead of our estimates.

In our view, this deal suggests that towers are not strategic assets for Idea and that it will continue to churn and monetise them; as such, balance sheet constraints may be overstated.

Idea's management has also highlighted the possibility of listing Aditya Telecom. We find that Indus valuations are cheap in comparison to US based American Tower and Crown Castle. US tower companies have outperformed the telecom space on a relative basis, implying that viable tower business models with visible tenancies will create shareholder value in the medium term. We believe investor demand for quality tower assets could provide additional cash for Idea to fund growth.

The underlying core business continues to be strong, and we expect Idea to gain market share from 11.3% currently to 12.3% in FY09e.

Valuation and earnings growth

At current levels, the core business (after stripping out the tower company valuations from the current market price) trades at 11x FY10e PE.

On the back of robust expected subscriber growth we estimate a FY08-10e EPS CAGR of 23%. We conservatively do not include proceeds from the tower sale on the balance sheet until regulatory approval is obtained. We lower our earnings number by 7.6% in FY09e to reflect higher interest costs.

HSBC

We are cutting our target price by 9.6% to INR160 to reflect recent price cuts, higher financial costs and higher capex. Upside risk to our valuation would be Idea's ability to lower its cost of capital in the coming years in the event that its balance sheet improves.

What could change our view?

We are bullish on the Indian telecom space and Idea is among our top picks in the sector. However, the following events could change our view:

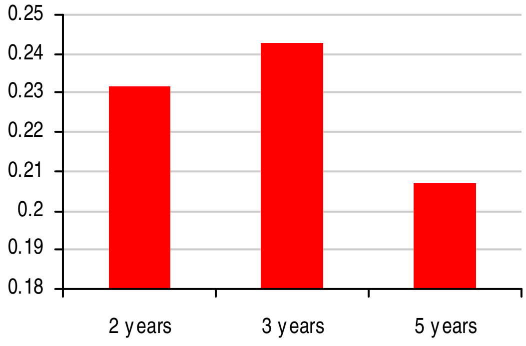
- Structural decline in margins on the back of higher than start up EBITDA losses in new markets
- Lower than expected increase in usage post the recent price cuts
- Slowdown in subscriber growth over the next 6-9 months
- Exit from Indus tower JV
- Inability to raise money via unlocking will see markets pricing in higher funding costs and potential de-rating

Idea Cellular key multiples

Key multiples	FY09e	FY10e
PE	25.2x	18.5x
EV/Sales	4.9x	3.9x
EV/EBITDA	13.2x	10.3x
EV/Subs in USD	365	231

Source: HSBC estimates

Idea Cellular EPS CAGR



Source: HSBC estimates

Tower and 3G catalysts

- Unlocking value in Indus and potential tower JV with Vodafone in non Indus areas likely to mitigate balance sheet constraints
- Idea recently sold 20% stake in Aditya Telecom, which holds 16% stake in Indus and license in Bihar
- Idea remains potential M&A target, in our view; 3G spectrum auctions will likely spur investor interest in existing telcos

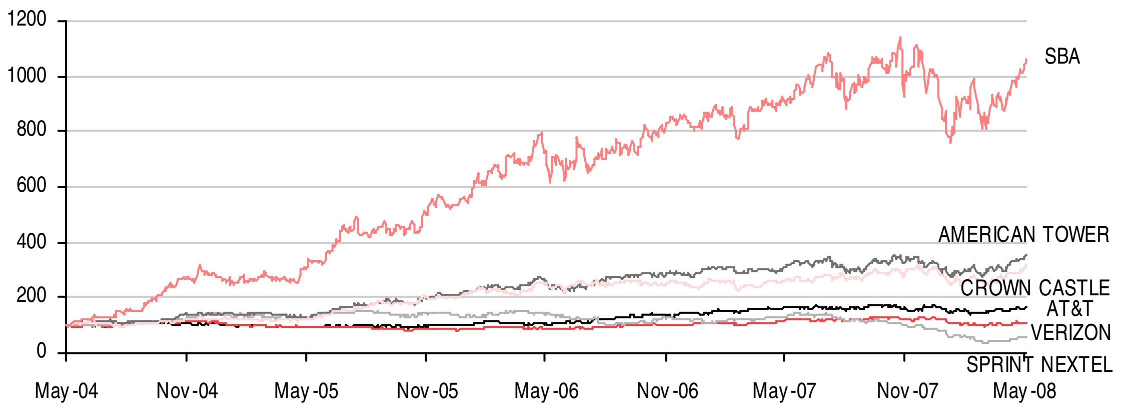
Towering ahead

Idea recently sold a 20% stake in Aditya Telecom, which holds a 16% stake in the Indus tower JV and has operations in Bihar. The transaction values Idea's stake in Indus at USD3.2bn, which is above our valuation of USD2.5bn. In addition, Idea's management has highlighted the possibility of listing Aditya Telecom. In our view, the market is not fully pricing Idea's investment in Indus; however, a combination of recent transactions and Idea's plans for listing Aditya Telecom bodes well for valuation.

Moreover we expect the tower space to gather momentum on the back of recent transactions and possible listing of a pure tower company.

By shifting its 16% stake in Indus to Aditya Telecom, Idea has adopted a holding company based structure to unlock value in Indus, which will ensure that access to tower assets is not affected despite monetizing a partial stake in Indus. In other words, Idea has created a holding company in Aditya Telecom which, in turn, has investments in Indus and other potential ventures.

US tower companies have outperformed the wireless space



Source: HSBC, Datastream

Both Bharti Airtel and Idea's managements have suggested the possibility of attracting more external investors in Indus and a possible listing in the medium term.

We believe markets have a cautious view of tower assets as they include tenancy only from 2G based entities. However, the wireless space globally is evolving from 2G to 3G/3.5G along with other technologies such as Wimax/LTE which is creating demand for tower slots. In addition, rapidly increasing minutes of use (MOU) demand more investment in capacity towers which, in turn, drives tenancies for tower assets.

We believe the Indus tower JV with three players (Bharti, Idea and Vodafone) is the best placed tower business model and is not dependent on new entrants.

Recent tower deals

Partners	Stake	No of towers	Deal size	Per tower value (INR mn)
Quipo -Tata	49%	13,500	1.9bn	12.1
Quip-Spice	100%	800	143m	7.5

Source: Press reports

Indus IPO possible

The Indian wireless space offers limited opportunities for investors seeking exposure to pure tower assets. However, the potential listing of Indus and Infratel could provide an avenue in the near term. During its 4Q earnings call, Idea's management stated that its longer-term intention was to attract external shareholders and an initial public offering (IPO) would be one way to do that. However, a listing would require at least one fiscal year of audited accounts such that an IPO would be 9-12 months away.

We believe an IPO would be beneficial for Idea as this would provide exit opportunities should it wish to dilute its stake in Indus.

US tower companies have outperformed

Our analysis finds that tower companies in the US have outperformed the wireless space over the past four years.

We have also compared Indus and Infratel with the US tower companies; we find that Indian tower companies are relatively cheap. We note that this is not an "apples to apples" comparison as FY09e/FY10e will be the initial years of operations of Indus and Infratel, but we still find the comparison useful.

Continuous churning of tower assets

Hutchison Telecommunications (HTIL) is a Hong Kong based telco that has been capex conscious in most of its markets, be it India, Hong Kong or Israel, and has extended this strategy to Indonesia as well. As a capex conscious investor, HTIL is monetizing tower assets on a continual basis. In its first year of operations it deployed about 3,600 towers and sold them to independent tower operator Protelindo for USD500m.

For market followers like Idea, towers are no longer strategic assets and churning them on a continuous basis would be a means to raise funds for growth. We believe a potential Idea Vodafone tower JV in non Indus areas would be a step in the right direction, and one which is not being priced by the market. Idea and Vodafone share towers in Bihar and we believe that the partnership may extend to other markets where they overlap.

Creation of a separate tower company

Non Indus area towers

Circles	FY09F	FY10F
MP/HP	3,000	4,000
Bihar	2,000	4,000
Orissa	1,000	3,000
Total non Indus tower assets	6,000	11,000
Avg value per tower (INR m)	10	10
Potential value (INR bn)	60	110
Potential value (USD bn)	1.5	2.7

Source: HSBC estimates

As per the *Economic Times*, Idea and Vodafone are in discussions to create a tower company for residual service areas. This company would operate in non Indus areas where both Idea and Vodafone have received spectrum in the recent past. Notably Vodafone has won spectrum in all seven circles (Bihar, Orissa, J&K, Assam, North East, Himachal Pradesh and Madhya Pradesh). Idea has operations in Himachal Pradesh and Madhya Pradesh and has start-up spectrum in Orissa and Bihar.

We view the extension of tower asset churn as positive, as capex in these markets would move from Idea to the tower company. This would enhance Idea's ability to monetise tower assets and raise funds to finance growth. We estimate c6,000 towers in FY09e in non Indus circles and c11,000 towers in FY10e.

Will Idea hit a funding wall?

The answer lies in Idea obtaining spectrum in the residual markets, namely Kolkata, West Bengal, and Karnataka.

As all these markets are part of the Indus JV the incremental capex requirements would be much lower versus greenfield rollout. Given that Indus is in its early days it is difficult to quantify the exact capex benefits, but our worst case is cUSD1bn and our best case is cUD250m.Our worst case scenario assumes that Idea would deploy c9500 incremental towers on its own. We believe the chance of the worst case is remote and markets are underestimating the benefits from Indus.

Also, we believe all towers deployed in Indus circles will continue to be transferred to Indus, suggesting that balance sheet constraints may be overstated.

Other catalysts

Existing operators look more promising for foreign telcos

The issue of fresh licenses to new players has provided foreign telcos with an opportunity to enter the Indian market. A lower penetration rate, strong domestic consumption story, attractive EBITDA margins of existing operators, and higher FDI (Foreign Direct Investment) are encouraging. We believe foreign telcos would do well to invest in existing operators than in new Indian entrants.

Of late, Dubai-based telcos such as Etisalat and Zain Group have expressed interest in entering the Indian telecom space through new entrants or regional players like Spice Telecom. We believe that as operational and financial challenges of partnering with new (read late) market entrants become clearer, they may act as deterrents. We continue to believe that consolidation in India is inevitable and the recent issue of fresh licenses should delay, but not halt, the consolidation process.

For a detailed discussion on potential entrants from the Middle East in the Indian wireless telecom space, please refer to our report published on 15 April – *Indian Telecoms- Identifying potential Gulf based entrants.*

Auction of 3G spectrum

Will foreign telcos be allowed to participate?

Whether foreign telcos will be allowed to participate in 3G spectrum auctions is unclear. A decision either way should be a positive for players like Idea.

If they are not allowed to bid in 3G spectrum auctions directly, Idea could provide interested foreign telcos with a point of entry.

If, on the other hand, foreign telcos do get direct entry, there will be challenges in rolling out networks (both 2G and 3G). They would do well, then, to venture with players having reasonable network coverage and depth.

A pressure point for management

Even so, the decision to partner with a foreign telco will ultimately depend on the management's keenness and approach to 3G.

Until now, Idea's management has denied the possibility of partnering with a foreign player but 3G auctions in the near term may be a pressure point.

Can Idea survive in its current form?

We think so

There is scepticism about Idea being able to survive for long in its current form (i.e., as an Indian regional operator).

CDMA players, BSNL and new entrants more vulnerable than Idea

However, there are other players, among the 6-7 active telcos in India today, which we believe are more vulnerable than Idea:

Bharat Sanchar Nigam Ltd. (BSNL – a state-owned telco) and Tata Teleservices, for instance. BSNL continues to lose market share, and a high employee cost structure is likely to hinder its execution and profitability. Tata Teleservices has a fragmented corporate structure.

Our outlook on operators facing GSM/CDMA transition is cautious, as well; we believe markets are underestimating the cost and complexity of running a dual network.

We do not believe new entrants will be a long-term threat to existing, established companies like Idea. Rolling out infrastructure should keep them too busy to pose a serious threat for now.

There are other vulnerable players like BPL Mumbai and Spice Telecom, which have a fragmented regional presence and have an unclear approach for expansion.

Idea offers expansion and execution

Idea, on the other hand, is growing from a regional player to a national one. It has a strong tower-sharing model in place – the Indus tower JV – which will allow it to minimise capex.

At present, Idea has operations in 11 markets in India, of which 8 circles are established markets; in 3 of the markets, the rollout has been recent.

Of the 8 established markets, Idea is the market leader in 3, and is the No. 2 operator in the other 3. This demonstrates that Idea's execution has been strong. Further, in none of these markets does Idea have a competitive advantage, in terms of being the sole player; all are 5-6-player markets.

Is circle by circle position relevant?

We view telcos as factories, generating MOU. Unlike other businesses, one cannot import/export minutes; the generation of minutes has to be local. Hence telecoms is an aggregation of local markets, and local characteristics hold significance. This is a characteristic unique to telecoms, highlighting that holding strong circle (i.e., local market) positions is a significant advantage.

Moreover India's layout is very much state by state and division of the Indian telecom markets is an overlay on the state based framework.

With 3G, things may change

Given the above factors, we believe Idea is suitably placed to compete as a No. 2/3 player and should continue in its current format long term.

However, the Indian telecom market may not stay in 2G mode for long, while our base case is 2G-based. The possibility of 3G hitting the Indian wireless space over the next 6-12 months could be a pressure point, and is a risk to our assumptions.

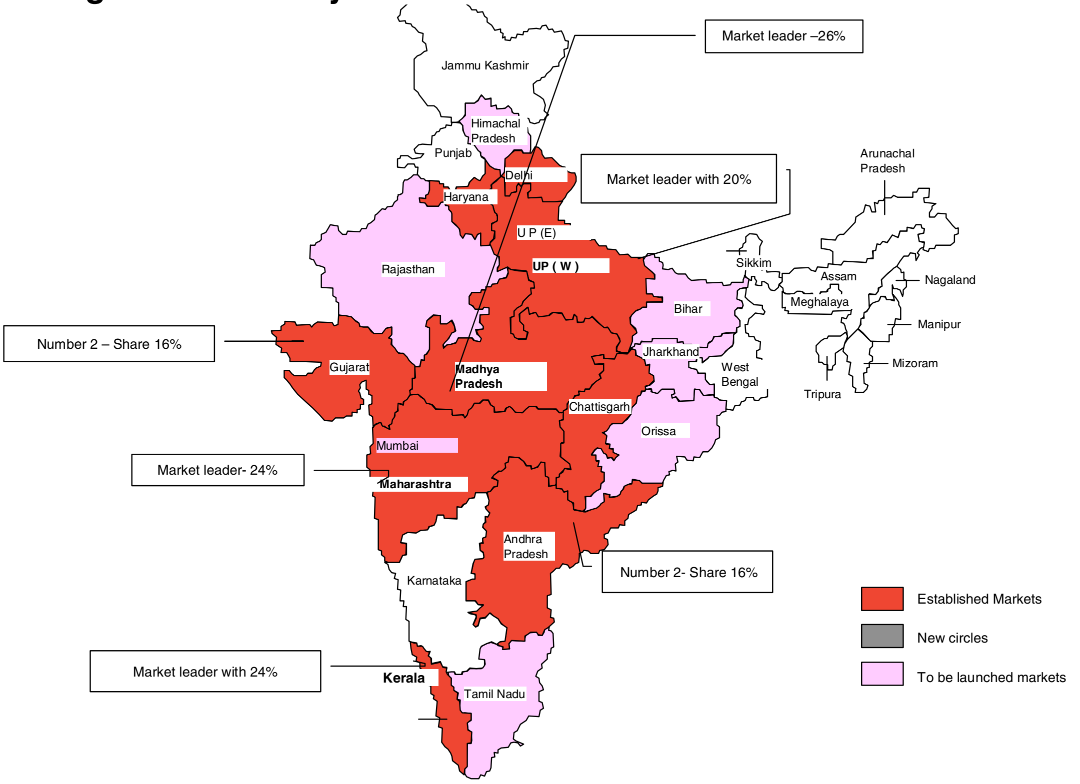
Even so, as we said earlier, embedded value in tower assets and various other unlocking options should allow Idea to mitigate funding constraints..

Incremental capex requirements in 3G should not be high for Idea, as a partner in the Indus tower JV. We believe in its early days, 3G will find a presence in select cities only – where Indus already operates.

Admittedly, if 3G spectrum auctions are delayed, Idea will get a breather; it may be in a better position to finance 3G at a later date (i.e., in 6-12 months).

Detailed view of market position pan India

Coverage of markets by Indus Tower JV



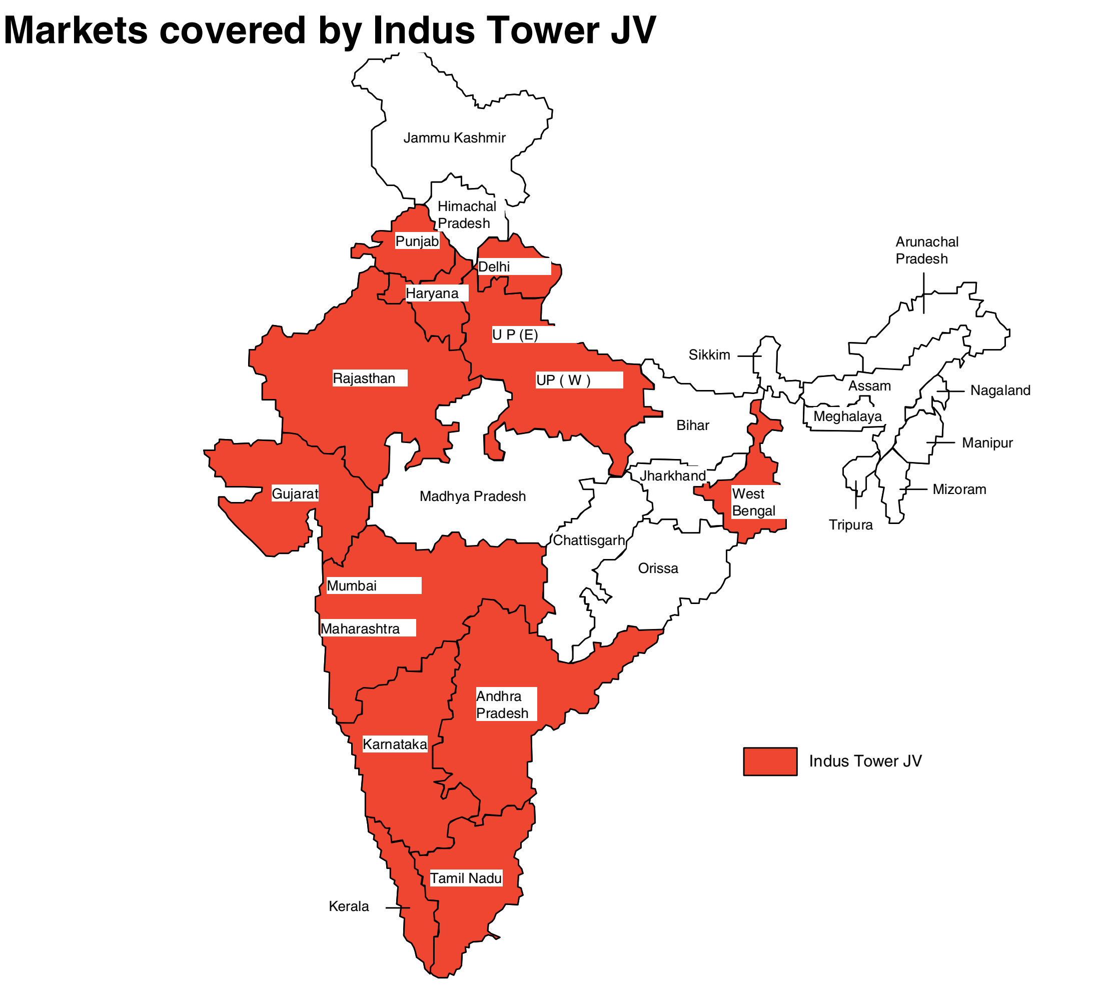
Source: HSBC

Comparative metrics

	American Tower		Crown Castle		SBA Communication		Indus Tower JV		Bharti Infratel	
	FY09e	FY10e	FY09e	FY10e	FY09e	FY10e	FY09e	FY10e	FY09e	FY10e
Towers	22,800	22,800	23,400	23,400	6,026	6,026	76,634	80,703	36,903	45,441
Revenue in USD m	1,577	1,706	1,506	1,613	467	517	1,254	1,737	560	817
EBITDA in USD m	1,187	1,309	856	948	258	295	625	1,026	182	437
Revenue/Tower in USD	69,167	74,825	64,359	68,932	77,498	85,795	16,358	21,521	15,184	17,973
EBITDA/Tower in USD	52,061	57,412	36,581	40,513	42,814	48,955	8,161	12,707	4,919	9,628
EV/Sales	13.7x	12.7x	11.9x	11.1x	12.2x	11.0x	12.9x	9.3x	9.9x	6.8x
EV/EBITDA	18.2x	16.5x	20.9x	18.9x	22.0x	19.3x	25.9x	15.8x	30.6x	12.7x
EBITDA Margins	75%	77%	57%	59%	55%	57%	50%	59%	32%	54%
EV/Tower in USD	949,605	949,605	766,154	766,154	943,578	943,578	211,643	200,971	150,391	122,134

Source: HSBC estimates, Company data

Detailed view of Indus tower JV coverage – Idea holds 16%



Source: HSBC

Market share gains

- Market share set to improve from 11.3% to 12.3% in FY09e on back of new rollouts
- Expansion of footprint will maximise network utilization and reduce interconnection charges
- Rollout in new markets, recent price cuts to drag near-term EBITDA margin; better-than-expected subscriber/usage growth may offer respite

Expanding footprint

Idea's market share in 11 operational service areas has improved from 14.9% to 16.2% over the past 12 months. Share of net additions in 11 operational markets rose from 17.1% to 18.8%. On a pan India basis, market share has improved from 8.6% to 9.4% over the past 12 months.

Idea plans to launch in Mumbai and Bihar by Q3FY09; both markets account for c8% of total wireless net additions. Recently, it obtained spectrum in Orissa and Tamil Nadu (including Chennai). It also obtained additional spectrum in Rajasthan and Uttar Pradesh (East) which we believe will allow increasing coverage in these markets.

Potential in new launches

The Mumbai circle, with 14m subscribers, has been growing by c2.5% (0.35m subscribers) on a monthly basis. Bihar, with c10m subscribers, adds c0.5m subscribers every month. Tamil Nadu and Chennai have average subscriber additions of c0.6m and c0.2m respectively per month.

In effect, Idea will have access to incremental 1.7m subscriber additions over the next six months.

We are modelling Mumbai and Bihar rollout from Q2FY09e and rollout in Chennai and Orissa by end FY09e.

The launches in Orissa and Bihar are positive; these markets are under-penetrated and offer an opportunity to raise market share and assume scale.

Launches in Mumbai and Bihar

- A launch in Mumbai in the medium to long term provides Idea with an opportunity to enhance ARPU relative to its other operations
- Idea is the market leader in Maharashtra with c23% market share and it is the No. 2 operator in Gujarat, with c15% market share. The proximity of these two states should make for low termination and interconnect charges
- No wireless telecom operator has launched services in Mumbai since 2004

- GSM operator BPL Mumbai with operations in Mumbai only (10% market share) with standalone operations may be an easy competitor to gain quick market share
- Bihar, with 8% mobile penetration, offers opportunity

Expansion should allow benefits of scale

The most important hurdles a regional operator faces are profitability and sustainability. Telecoms is a capital-intensive business and has high fixed costs, and a low-cost model structure is only possible with scale. Scale benefits come from a variety of sources, including greater intra-network calling and a more efficient network.

We are of the view that expanding footprint and organic growth in existing circles will allow Idea to maximise network utilization and savings on interconnection.

However, in the near term (12 months), expansion in new markets will continue to have a drag on overall profitability.

Usage growth in focus

GSM - Composition of outgoing MOU

Circle	Local (Intra circle)	NLD (Inter circle)
A	88.4%	11.1%
B	88.5%	10.9%
C	86.6%	13.1%
Metro	76.2%	22.8%
All India	86.2%	13.2%

Source: TRAI

Idea's MOU were up 9% sequentially in Q4FY08, and a similar trend was visible for Bharti with its MOUs improving 7% sequentially. In our view, the GSM based players are now focussing on ARPU stabilization by driving usage over and above subscriber growth. Idea's management stated that elasticity was 0.7x.

Elasticity in play

After cutting tariffs on local calls, Bharti slashed long distance and roaming rates by c40%. Recent price cuts by Bharti support our argument that telecoms are a capital-intensive business and price is a function of scale.

Generating MOU

Net realisation for Idea Cellular (regional player)

Realisation in long distance O/G call off-net	
STD rates	1.30
Carriage charges	0.26
Termination charges	0.30
Net realisation	0.74
Realisation in local O/G call off-net	
Local calls	1.0
Termination charges	0.3
Net realisation	0.7
Higher net realisation	6%

Source: HSBC (O/G refers to outgoing calls)

The recent price cuts were on long distance and roaming calls, which should boost usage.

As per the Telecom Regulatory Authority of India (TRAI), long distance accounts for c13% for outgoing MOU.We have previously written that the best way to view a telco is to see it as a factory generating MOU, and telcos attempt to maximise yield.

The most likely outcome of the recent tariff cuts will be an increase in the proportion of long distance calls, which should allow the telcos to maximise yield as per minute realisations on long distance calls are higher than on local calls.

Net realisations for integrated operators	
Call description	**(INR)**
Realisation in long distance O/G call off-net	
STD rates	1.3
Carriage charges	
Termination charges	0.3
Net realisation	1.00
Realisation in local O/G call off-net	
Local Calls	1.0
Termination charges	0.3
Net realisation	0.7
Higher net realisation	30%

Source: HSBC (O/G refers to outgoing calls)

Although positive for Idea, one needs to recall that its cost of production of minutes is higher than other pan India operators, due to the absence of pan India NLD fibre and regional operations.

To conclude, incremental gains for Idea are likely to be lower than for other integrated operators. The key disadvantage is lack of NLD fibre; we expect Idea to expand its NLD fibre network in a few quarters.

Higher usage is likely to provide revenue growth support as evidence of strong elasticity has been visible in the last quarter.

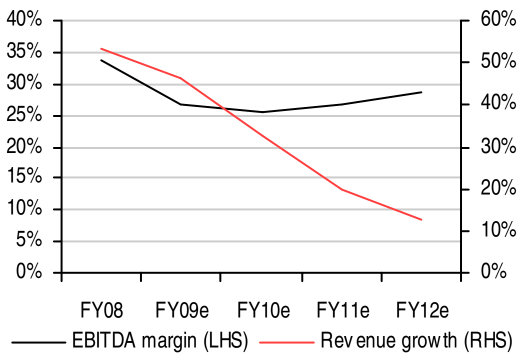
Causing existing subscribers' usage to increase by cutting prices should work well for Idea as it provides an opportunity to increase its network utilization in established markets. Admittedly, though, higher usage will imply more capacity capex. We reflect this in our revised capex estimates.

With infrastructure-sharing models in place, we believe the flexibility to increase capacity capex is greater which, in turn, will enhance margins as network utilization increases.

However, we identify several offsetting factors:

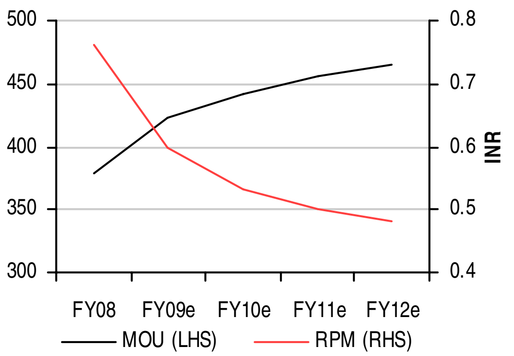
- We expect MOU to improve on the back of steep tariff cuts; we believe Idea is well placed with its spectrum allocation to accommodate increased network traffic
- Investments in captive NLD fibre will allow Idea to save on carriage charges
- The Indus tower JV will allow Idea to rapidly scale up capacity towers in centres with high network congestion
- Rapid rollout in new markets and receipt of additional spectrum will allow Idea to save on interconnection charges

EBITDA margins vs. revenue growth



Source: Company data, HSBC estimates

ARPU and MOU



Source: Company data, HSBC estimates

Valuation

- Retain our valuation for Indus tower JV; US tower companies have outperformed the US wireless space
- Reiterate OW(V) rating, but cut target by 9.6% to INR160 on higher capex and impact of recent price cuts
- Unlocking should boost net income growth as we factor in increased interest costs

Valuation

We cut our target price by c10% to INR160. We value Idea using a discounted cash flow (DCF) based sum-of-the-parts approach using a WACC of c11% (previously 9.5%), which assumes 12% cost of equity and 9% cost of debt. We try to price in a higher risk-reward ratio for investors by raising our WACC.

Fair value breakdown (INR)

	New	Previous
Idea's 16% stake in Indus (via Aditya Telecom)	38	38
Idea's core business and residual tower assets	122	139
Target price	160	177

Source: HSBC estimates

Base case

Our base case captures the impact of recent price cuts, expansion, and funding constraints. We have adopted a cautious stance in factoring interest costs (no respite from various unlocking options, no impact of the tower sale due to pending regulatory approval). We therefore raise interest costs from INR2.7bn to INR6.1bn on the back of funding requirements for FY09. However, proceeds from the transaction should reduce interest costs and boost earnings growth.

We raise our long-term market share estimate for Idea in Bihar from 5% to 10%. We remain cautious on Idea's market share in Mumbai, at c5%. After allocation of spectrum in Tamil Nadu, Chennai and Orissa, we are modelling roll-out in these markets from end FY09.

Given the recent cuts in call charges, we expect Idea's revenue per minute to decline 12% y-o-y in FY09e and usage to improve 12% y-o-y from 378 minutes to 423 minutes, the combination of which sees ARPU decline 12% y-o-y from INR288 to INR253.

We are modelling roaming and access charges at 17% of sales in FY09e, on the back of increased interconnection charges. We assume tower rentals make up 6.6% of sales for FY09e. Post adjustment for tower rentals, we are modelling 27% EBITDA margins in FY09e.

We expect FY09e earnings growth to be muted at 10% y-o-y, because of recent price cuts and adjustment of tower rentals. However, given the robust subscriber growth and healthy usage trends, we forecast a 23% FY08-10e EPS CAGR.

Put in another way, our base case prices in financial risk. By raising our WACC estimate we attempt to price in a higher risk-reward ratio.

Under our research model, for stocks with a volatility indicator, the Neutral band is 10 percentage points above and below the hurdle rate for Indian stocks of 11%. For Idea, this translates into a Neutral band of 1-21% around the current share price. Our target price of INR160 implies a total return of 49%, which is above the Neutral band; thus, we have an Overweight (V) rating on Idea stock.

Indus tower valuation

We retain our valuation for Indus as there has been no additional disclosure since our last report. However, we believe markets are cautious in considering the embedded value of towers, as they are not factoring in the incremental upside from foreseeable deployment of 3G/Wimax/LTE.

We value Idea's stake in the tower business at USD2.5bn and the recent transaction is c20% above our current valuation (assuming value of Bihar license is USD250m).We, however, prefer to be conservative and keep our tower valuation unchanged.

Risks

We are bullish on the Indian telecom space and Idea is among our top picks in the sector. However, the following events may change our view:

- Structural decline in margins on the back of higher than start up EBITDA losses in new markets
- Lower than expected increase in usage post the recent price cuts
- Slowdown in subscriber growth over the next 6-9 months
- Exit from Indus tower JV
- Inability to raise money via unlocking will see markets pricing in higher funding costs and a de-rating
- Decline in market share on the back of higher than estimated competitive intensity

HSBC vs. Consensus

INR mn	2009F	2010F	2011F
Sales			
HSBC	98,559	130,810	156,600
Mean	93,847	118,074	142,888
High	104,794	130,400	158,721
Low	84,606	94,553	127,602
Variance	5.0%	10.8%	9.6%
EBITDA			
HSBC	26,279	33,446	42,001
Mean	31,204	40,204	49,054
High	33,801	45,004	56,346
Low	23,576	29,677	41,452
Variance	-15.8%	-16.8%	-14.4%
Net Income			
HSBC	11,440	15,819	20,002
Mean	12,941	15,972	18,552
High	17,385	20,172	24,773
Low	10,906	11,440	12,583
Variance	-11.6%	-1.0%	7.8%

Source: HSBC estimates, Datastream

New vs. Old

Particulars	New		Old		Change	
	FY09e	FY10e	FY09e	FY10e	FY09e	FY10e
ARPU	253	235	251	237	0.8%	-1.0%
Market share	10.4%	11.0%	10.1%	10.4%	0.2%	0.5%
Subscribers in 'ooo	38,622	51,053	32,800	41,825	17.8%	22.1%
Revenue	98,559	130,810	87,797	109,189	12.3%	19.8%
EPS	4.34	6.00	4.70	6.66	-7.6%	-9.9%

Source: HSBC estimates

Sensitivities to cost of capital and terminal growth rates on fair value (INR)

Terminal growth rate vs. Cost of capital	9.0%	10.0%	11.0%	12.0%
3.0%	174	160	146	134
4.0%	191	175	**160**	147
5.0%	214	195	179	163
6.0%	246	224	204	187

Source: HSBC estimates

Subscriber performance overview

Y/e 31/3	2008A	2009e	2010e	2011e	2012e
Market Penetration	21.2%	31.7%	39.1%	44.0%	47.8%
Market Share	9.7%	10.4%	11.0%	11.3%	11.5%
ARPU (INR)	288	253	235	227	224
ARPU (USD) @ INR40/USD	7.2	6.3	5.9	5.7	5.6
ARPU YoY Chg.	-11.6%	-12.1%	-7.1%	-3.3%	-1.5%
MoU (Minutes)	378	423	442	455	465

Source: Company data, HSBC estimates

Profit and Loss Account

INR mn, y/e 31/3	2008A	2009e	2010e	2011e
Profit & Loss				
Revenue	67,377	98,559	130,810	156,600
Change	53.6%	46.3%	32.7%	19.7%
EBITDA clean	22,687	26,279	33,446	42,001
Change	52.7%	15.8%	27.3%	25.6%
Margin	33.7%	26.7%	25.6%	26.8%
Exceptional	0	0	0	0
EBITDA	22,687	26,279	33,446	42,001
Depreciation	-8,768	-9,074	-9,325	-12,854
Operating profit clean	13,919	17,204	24,120	29,147
Change	71.0%	23.6%	40.2%	20.8%
Margin	20.7%	17.5%	18.4%	18.6%
Operating profit	13,919	17,204	24,120	29,147
Non-op exceptional	0	0	0	0
PBIT clean	13,919	18,317	29,175	35,301
PBIT	13,919	18,317	29,175	35,301
Net Interest	-2,771	-6,017	-11,321	-12,444
PBT clean	11,148	12,300	17,854	22,857
PBT	11,148	12,300	17,854	22,857
Tax clean	-726	-688	-1,280	-1,837
Tax rate clean	6.51%	5.59%	10.00%	11.00%
Minorities	0	0	0	0
Net profit clean	10,422	11,440	15,819	20,002
Net profit	10,422	11,440	15,819	20,002
Number of shares (mn)	2,635	2,635	2,635	2,635
EPS	3.96	4.34	6.00	7.59
Change	107.6%	9.8%	38.3%	26.4%

Source: Company data, HSBC estimates

HSBC

Cash Flow Statement

INR mn, y/e 31/3	2008A	2009e	2010e	2011e
C/f from ops	21,961	25,591	32,166	40,164
Interest + minrty divs	2,771	6,017	11,321	12,444
Tax	-726	-688	-1,280	-1,837
Capex + investment	-48,941	-67,058	-44,917	-37,172
Dividends paid	0	0	0	0
Net c/f pre financing	-29,751	-46,680	-21,523	-5,990
Change in cash	-6,731	1,082	0	0

Source: Company data, HSBC estimates

Balance Sheet

INR mn, y/e 31/3	2008A	2009e	2010e	2011e
Intangible assets	17,892	29,189	40,018	49,038
Tangible assets	89,271	70,877	95,638	110,937
Investments	138	138	138	138
Fixed assets	107,301	100,204	135,795	160,113
Stocks	179	179	179	179
Debtors	1,525	1,525	1,525	1,525
Investments + cash	8,918	10,000	10,000	10,000
Current assets	17,683	83,983	85,733	87,407
Loans & borrowings	65,154	112,916	134,439	140,429
Current Liabilities	23,723	23,723	23,723	33,724
Provisions	661	661	661	661
Equity shrhldr funds	26,391	26,391	26,391	26,391

Source: Company data, HSBC estimates

Disclosure appendix

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Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in price target). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.

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Prior to this, from 7 June 2005 HSBC applied a ratings structure which ranked the stocks according to their notional target price vs current market price and then categorised (approximately) the top 40% as Overweight, the next 40% as Neutral and the last 20% as Underweight. The performance horizon is 2 years. The notional target price was defined as the mid-point of the analysts' valuation for a stock.

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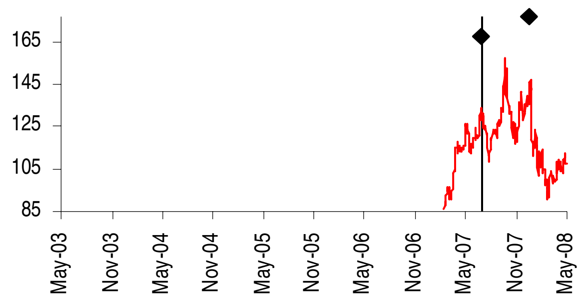
Overweight (Buy)	52%	(20% of these provided with Investment Banking Services)
Neutral (Hold)	34%	(21% of these provided with Investment Banking Services)
Underweight (Sell)	14%	(14% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities

Idea Cellular Ltd (IDEA.BO) Share Price performance INR Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
N/A	Overweight (V)	20 July 2007
Target Price	**Value**	**Date**
Price 1	168.00	20 July 2007
Price 2	177.00	11 January 2008

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
IDEA CELLULAR LTD	IDEA.BO	107.10	23-May-2008	4

Source: HSBC

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