

3Q surprises; growth to slow



Reena Verma Bhasin, CFA >> +91 22 6632 8667
Research Analyst
DSP Merrill Lynch (India)
reena.verma@baml.com

3Q events refuel expectations of ownership change

Idea posted better-than-expected 3Q net profit of Rs2.4bn, up 35% QoQ. Key 3Q-related events that have likely re-fueled market expectations of a potential ownership change include: 1) the resignation of the CEO – Mr Sanjeev Aga, 2) potential valuation upside from recent strong subscriber additions; Idea's net adds are up from ~1.7mn per month in 1H FY11 to ~2.9mn per month in Nov/Dec 2010, and 3) prima facie, slower-than-peers timetable for 3G rollout.

Results beat expectations despite margin pressure

In 3Q, all revenue drivers posted QoQ improvement; net adds accelerated, minutes grew strongly and the fall in revenue per minute (rpm) was marginal. We flag 2 areas of concern: 1) slipping margins despite stable tariffs; 2) rising churn.

F'casts tweaked; revenue uplift offset by weak margins

Factoring in 3Q trends, we have lifted our FY11-12E revenue forecasts by 4-10%, but EBITDA stays largely unchanged due to lower margins vs. earlier. We expect margin slippage to continue, led by network expansion and inflationary pressures in 1H CY11 and potential impact of mobile number portability (MNP) in 2H CY11.

Mgt. emphasizes seasonal momentum; downplays MNP

On its post-results call, top management attributed the strong improvement in both net adds and traffic minutes to pronounced seasonality, led by relatively high exposure to rural India. The company does not expect MNP to dramatically hurt post-paid rpm.

Rich valuations; possible low M&A upside for minorities

Our Underperform rating on Idea reflects its already rich valuation, at ~8x FY12-EV/EBITDA. Returns for minorities from a potential open offer could also be low.

Estimates (Mar)

(Rs)	2009A	2010A	2011E	2012E	2013E
Net Income (Adjusted - mn)	9,006	9,222	8,951	10,439	7,321
EPS	3.14	2.88	2.71	3.16	2.22
EPS Change (YoY)	-21.2%	-8.2%	-5.9%	16.6%	-29.9%
Dividend / Share	0	0	0	0	0
Free Cash Flow / Share	(24.53)	(14.04)	2.01	1.40	(7.01)

Valuation (Mar)

	2009A	2010A	2011E	2012E	2013E
P/E	22.83x	24.86x	26.41x	22.65x	32.30x
Dividend Yield	0%	0%	0%	0%	0%
EV / EBITDA*	12.73x	10.77x	9.69x	8.04x	6.75x
Free Cash Flow Yield*	-29.77%	-19.01%	2.81%	1.96%	-9.79%

* For full definitions of *iQmethod*SM measures, see page 7.

Stock Data

Price	Rs71.65
Price Objective	Rs65.00
Date Established	26-Oct-2010
Investment Opinion	C-3-9
Volatility Risk	HIGH
52-Week Range	Rs48.50-Rs80.00
Mrkt Val / Shares Out (mn)	US\$5,174 / 3,299.8
Average Daily Volume	3,311,062
BofAML Ticker / Exchange	IDEAF / BSE
Bloomberg / Reuters	IDEA IN / IDEA.BO
ROE (2011E)	7.6%
Net Dbt to Eqty (Mar-2010A)	56.6%
Est. 5-Yr EPS / DPS Growth	12.0% / NA
Free Float	53.0%

Key Changes

(Rs)	Previous	Current
2011E Rev (m)	149,102.3	155,215.4
2012E Rev (m)	168,763.3	184,902.3
2013E Rev (m)	195,511.8	216,011.0
2011E EPS	2.63	2.71
2012E EPS	3.04	3.16
2013E EPS	3.30	2.22

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Refer to important disclosures on page 8 to 10. Analyst Certification on Page 6. Price Objective Basis/Risk on page 6. Link to Definitions on page 6. 11012784

26 January 2011

iQprofileSM Idea Cellular Ltd.

Key Income Statement Data (Mar)	2009A	2010A	2011E	2012E	2013E
(Rs Millions)					
Sales	101,313	123,979	155,215	184,902	216,011
Gross Profit	28,137	33,580	36,988	44,592	53,094
Sell General & Admin Expense	NA	NA	NA	NA	NA
Operating Profit	14,098	13,430	13,387	17,085	18,432
Net Interest & Other Income	(4,731)	(2,994)	(3,766)	(4,355)	(9,504)
Associates	0	0	0	0	0
Pretax Income	9,367	10,436	9,621	12,731	8,928
Tax (expense) / Benefit	(361)	(1,214)	(669)	(2,292)	(1,607)
Net Income (Adjusted)	9,006	9,222	8,951	10,439	7,321
Average Fully Diluted Shares Outstanding	3,100	3,300	3,300	3,300	3,300

Key Cash Flow Statement Data

Net Income	9,006	9,222	8,951	10,439	7,321
Depreciation & Amortization	14,039	20,149	23,602	27,507	34,662
Change in Working Capital	2,040	(10,337)	8,200	27,227	7,264
Deferred Taxation Charge	0	0	0	0	0
Other Adjustments, Net	(40,888)	(31,325)	(2,198)	(2,812)	(3,919)
Cash Flow from Operations	(15,802)	(12,291)	38,555	62,361	45,328
Capital Expenditure	(54,595)	(32,645)	(31,916)	(57,737)	(68,463)
(Acquisition) / Disposal of Investments	(5,440)	17,170	0	0	0
Other Cash Inflow / (Outflow)	NA	NA	(61,981)	(4,360)	NA
Cash Flow from Investing	(60,035)	(15,475)	(93,897)	(62,097)	(68,463)
Shares Issue / (Repurchase)	93,831	0	0	0	0
Cost of Dividends Paid	0	0	0	0	0
Cash Flow from Financing	118,098	(9,347)	55,342	(265)	23,136
Free Cash Flow	(70,398)	(44,936)	6,639	4,625	(23,136)
Net Debt	37,849	64,389	119,731	119,466	142,602
Change in Net Debt	(18,249)	26,541	55,342	(265)	23,136

Key Balance Sheet Data

Property, Plant & Equipment	149,553	171,600	183,458	217,845	260,403
Other Non-Current Assets	44,785	15,604	76,239	79,253	74,416
Trade Receivables	4,507	5,515	6,905	8,225	9,609
Cash & Equivalents	51,316	14,204	14,204	14,204	14,204
Other Current Assets	3,072	3,072	3,072	3,072	3,072
Total Assets	253,233	209,995	283,877	322,600	361,704
Long-Term Debt	89,165	78,593	133,935	133,670	156,806
Other Non-Current Liabilities	917	2,142	2,142	2,142	2,142
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	24,865	15,536	25,125	53,673	62,321
Total Liabilities	114,947	96,271	161,202	189,485	221,269
Total Equity	138,286	113,724	122,675	133,115	140,435
Total Equity & Liabilities	253,233	209,995	283,877	322,600	361,704

iQmethodSM - Bus Performance*

Return On Capital Employed	9.2%	7.3%	5.3%	5.5%	5.5%
Return On Equity	10.4%	7.3%	7.6%	8.2%	5.4%
Operating Margin	13.9%	10.8%	8.6%	9.2%	8.5%
EBITDA Margin	27.8%	26.8%	23.8%	24.1%	24.6%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	-1.8x	-1.3x	4.3x	6.0x	6.2x
Asset Replacement Ratio	4.2x	1.9x	1.6x	2.5x	2.6x
Tax Rate (Reported)	3.9%	11.6%	7.0%	18.0%	18.0%
Net Debt-to-Equity Ratio	27.4%	56.6%	97.6%	89.7%	101.5%
Interest Cover	1.9x	1.9x	5.1x	4.2x	2.0x

Key Metrics

* For full definitions of iQmethodSM measures, see page 7.

Company Description

Idea Cellular is a pure wireless operator using GSM technology. Idea is now a pan-India operator having launched 5 new circles in 3Q FY10. It ranks among the top 3 operators within its material operating footprint and is now the fifth largest by subscriber market share on a pan-India basis. The AV Birla group is the controlling shareholder of Idea

Investment Thesis

We recognize Idea's improved business competitiveness, both in terms of subscriber and revenue market share. However, overall earnings growth will likely be modest and the ramp-up of 3G revenues will likely take more than 12 months. The stock's valuation is rich and we see no room for upside from the standpoint of minority shareholders.

Stock Data

Price to Book Value 1.9x

3Q FY11 result highlights

Robust top line and one-off cost savings drive +ve surprise: Idea reported 3Q net profit of Rs2.4bn, up 35% QoQ. Operating performance (EBITDA) was 1-4% higher than consensus and our expectations. The positive surprise was driven by 2 key factors: 1) a lower-than-expected fall in tariffs and the consequent robust top line, 2) a write-back of network costs on settlement of bills with Indus.

All revenue drivers post QoQ improvement: Idea's wireless revenues grew 9% QoQ, 2% above our expectations, due to tad stronger subscriber momentum and lower tariff attrition than expected. Revenue per minute (rpm) fell 1% QoQ, to 42paise, versus our expectation of a 2% QoQ fall. Traffic grew 10% QoQ, owing to a seasonal recovery in usage (MoU/sub rose 2% QoQ to 401mins/mth) and 9% growth in average subscriber base.

Margin slippage continues, despite stable tariffs; churn up sharply: During 3Q, reported EBITDA margin in Idea's established circles fell 30bps QoQ. However, lower losses in new circles helped to moderate the overall margin decline. Overall, margin in the mobility business fell 10bps QoQ. In 3Q, Idea's subscriber churn rose sharply from 8% to 10%.

Network cost savings - not fully sustainable: In 3Q FY11, Idea's network costs fell from ~39% of revenues to ~36% of revenues, and rupee-costs stayed flat QoQ. Our conversation with Idea indicates that the settlement of dues with Indus resulted in lower network costs than previously provisioned. Also, the company witnessed a saving in power costs during 3Q.

Indus margins expand sharply, despite flattish top line: Based on Idea's disclosure, we estimate that Indus witnessed strong QoQ savings in operating costs during 3Q. Indus' EBITDA margin expanded ~400bps QoQ, although the top line was flattish QoQ.

Interest burden eases pending 3G launch: Idea's consolidated interest burden fell 8% QoQ pending launch of 3G operations. This reflects 1) lower net debt excluding 3G outgo, and 2) the absence of oa ne-time interest provision that had impacted 2Q results.

Capex guidance cut once again: Idea cut its FY11E capex guidance to Rs30bn vs. Rs40bn estimated earlier. The company said this reflects some spillover into the next year, as savings against earlier estimates.

3G rollout over few months: Idea expects to launch 3G services in the next few months.

Table 1: Idea consolidated - 3Q FY11 results summary

Yr to Mar	3QFY10*	2QFY11	3QFY11	YoY	QoQ
Rs mn					
Total Revenue	31,358	36,367	39,526	26%	9%
Access & interconnect charges	4,533	5,825	6,356	40%	9%
Net Revenue	26,825	30,542	33,170	24%	9%
Network operating expenses	7,937	10,091	9,936	25%	-2%
Employee costs	1,784	2,155	2,072	16%	-4%
Subscriber acquisition expenses	4,241	4,015	5,344	26%	33%
Other Opex	1,406	1540.5	1836.8	31%	19%
Total opex	15,368	17,801	19,189	25%	8%
Opex/net revenue	57%	58%	58%		
Licence fee	3,452	4,178	4,529	31%	8%
EBIDTA	8,005	8,563	9,452	18%	10%
EBIDTA margin	25.5%	23.5%	23.9%		
Depreciation and amortization	5,131	5,820	5,925	15%	2%
Recurring other income	137	225	30.2	-78%	-87%
EBIT	3,011	2,968	3,557	18%	20%
EBIT margin	10%	8%	9%		
Interest expense/(income)	938	1,028	941	0%	-8%
PBT	2,073	1,940	2,616	26%	35%
Tax	372	143	186	-50%	30%
Reported net profit	1,701	1,797	2,431	43%	35%

*Results are not strictly comparable due to partial impact of Spice merger in 2Q FY10 & full impact in 2Q FY11 & 3Q FY11

Source: Company data, BofA Merrill Lynch Global Research

Table 2: Trend in key performance indicators of Idea

Yr to 31 March	3QFY10*	4QFY10*	1QFY11	2QFY11	3QFY11	YoY chng	QoQ chng
Subscriber base (mn)	58	64	69	74	82	42%	10%
Share of industry net adds	11%	10%	10%	10%	12%		
Churn	9%	8%	8%	8%	10%		
RPM (Rs/min)	0.51	0.47	0.44	0.42	0.42	-18%	-1%
ARPU (Rs/month)	200	185	182	167	168	-16%	1%
MoU(mins/month)	389	398	415	394	401	3%	2%

*Results are not strictly comparable due to partial impact of Spice merger in 4Q FY10 & full impact in 1Q & 2Q FY11

Source: Company data, BofA Merrill Lynch Global Research

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Table 3: Valuation comparison of GEM wireless majors

Company Name	Market Cap US\$ bn	Sh Price (Local Curr)	BofAML Rating	P/E		EPS CAGR CY10-12E	EBITDA CAGR CY10E-12E	ROE CY11E	EV/EBITDA		Net Debt/ EBITDA CY10E
				CY10E	CY11E				CY10E	CY11E	
Bharti	28.0	338	C-3-7	16.6	13.5	20%	21%	19.5	9.2	7.6	2.7
Idea	5.2	72	C-3-9	26.4	22.7	-10%	20%	8.2	9.6	8.0	3.2
RCom	7.7	133	C-3-7	18.6	23.1	-28%	6%	3.1	8.3	7.9	4.1
Zain	20.4	1	C-3-7	5.7	16.3	16%	10%	15.1	14.1	12.7	-0.8
MTN Group	35.4	127	B-1-7	12.9	10.6	27%	7%	24.5	6.3	5.7	0.0
SingTel	41.2	3	B-1-7	12.5	11.5	9%	4%	16.8	7.8	7.2	1.2
China Mobile*	200.6	79	NA	11.1	10.7	4%	4%	20.3	4.5	4.1	-0.9
Axiata Group	12.4	5	B-1-9	16.1	13.6	10%	10%	13.4	6.6	5.9	0.7
America Movil	115.2	59	B-1-7	17.2	13.6	19%	15%	35.9	8.2	6.4	0.9
ECMS Mobinil	3.2	158	C-2-7	10.8	12.1	2%	7%	30.3	4.6	4.3	1.5
China Unicom*	35.3	11	NA	48.8	30.6	53%	12%	3.4	4.9	4.5	1.3
Total Access	3.1	1	C-1-7	9.9	10.0	-4%	1%	13.8	4.0	3.9	0.2
Turkcell	15.5	11	C-2-7	12.3	10.1	10%	11%	20.0	5.9	5.1	-0.8
Advanced Info	9.3	81	C-1-8	11.6	10.9	10%	3%	62.7	5.0	4.8	0.5
MobileOne*	1.7	2	NA	13.2	12.3	6%	3%	53.5	7.5	7.0	0.7
Partner	3.2	74	A-3-8	9.0	9.8	-9%	-7%	190.0	5.6	6.0	1.4
MTS	20.0	20	C-1-8	10.2	8.9	17%	9%	39.8	4.9	4.4	1.0
LG Uplus	3.6	6810	C-2-7	4.8	5.6	-10%	-4%	13.0	2.3	2.5	0.6
SK Telecom	12.1	168000	B-2-7	9.3	8.4	-6%	1%	12.9	3.9	3.6	0.8
India Average (Mcap weighted)				17.3	14.2	7%	18%	15.0	9.1	7.7	3.0
Asia Average (Mcap weighted)				15.6	13.7	10%	7%	19.6	6.0	5.4	0.2
GEM Average (Mcap weighted)				14.0	11.9	13%	8%	23.9	6.4	5.6	0.3

*Bloomberg consensus; Source: BofA Merrill Lynch Global Research

Price objective basis & risk

Idea Cellular (IDEAF)

Our PO of Rs65/sh for Idea is based on DCF. Our PO implies a valuation of 7.5x FY12E-EV/EBITDA, i.e., a 35% premium vs. GEM wireless majors to allow for stronger long-term growth potential if 3G ramps up. Sooner-than-expected industry consolidation and stronger-than-anticipated Indus profitability could present upside to our PO. Significantly higher competitive intensity in the industry and dramatic regulatory changes pose downside risks.

Link to Definitions

Media & Telecom

Click [here](#) for definitions of commonly used terms.

Analyst Certification

I, Reena Verma Bhasin, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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Address – Mafatlal Centre, 8th Floor, Nariman Point, Mumbai, India. 400021

Tel : +91 22 6632 8000

APR - Telecommunications Coverage Cluster

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
BUY	Advanced Info Axiata Group	XVDIF XLMTF	ADVANC TB AXIATA MK	Thititthep Nophaket Reena Verma Bhasin, CFA

APR - Telecommunications Coverage Cluster

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
	Funtalk China Holdings Ltd	FTLK	FTLK US	Chen Luo, CFA
	KT	KT	KT US	Sean Oh
	KT	KTCNF	030200 KS	Sean Oh
	Philippine Long Distance Telephone	ZHPLF	TEL PM	Edser Trinidad
	PLDT -A	PHI	PHI US	Edser Trinidad
	SingTel	SNGNF	ST SP	Reena Verma Bhasin, CFA
	Total Access	TACJF	DTAC SP	Thititthep Nophaket
	Total Access Communication	TACPF	DTAC TB	Thititthep Nophaket
NEUTRAL				
	LG Uplus	LTCLF	032640 KS	Sean Oh
	SK Telecom	SKM	SKM US	Sean Oh
	SK Telecom	SKMTF	017670 KS	Sean Oh
UNDERPERFORM				
	Bharti	BHTIF	BHARTI IN	Reena Verma Bhasin, CFA
	Globe Telecom	GTMEF	GLO PM	Jidgette Velasco
	Idea Cellular	IDEAF	IDEA IN	Reena Verma Bhasin, CFA
	MTNL	XMTNF	MTNL IN	Reena Verma Bhasin, CFA
	MTNL	MTE	MTE US	Reena Verma Bhasin, CFA
	RCVL	RLCMF	RCOM IN	Reena Verma Bhasin, CFA
	SK Broadband	HANTF	033630 KS	Sean Oh
	Tata Communications Limited	VLSLF	TCOM IN	Reena Verma Bhasin, CFA
	Tata Communications Limited	TCL	TCL US	Reena Verma Bhasin, CFA
	TRUE Corp	TCPJF	TRUE TB	Thititthep Nophaket

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill Amortization}$
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	$\text{Net Debt} = \text{Total Debt, Less Cash \& Equivalents}$	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Other LT Liabilities}$	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

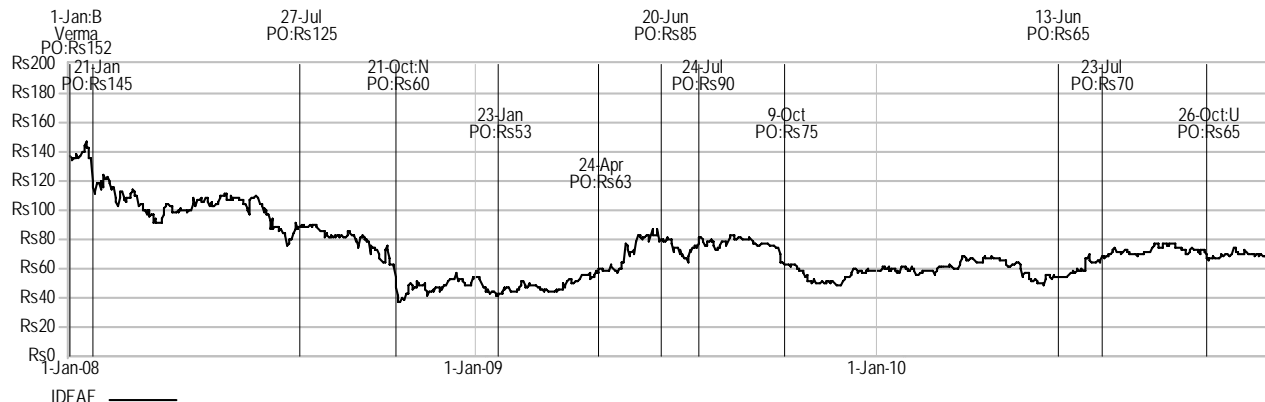
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Important Disclosures

IDEAF Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid, NR: No Rating

Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of December 31, 2010 or such later date as indicated.

Investment Rating Distribution: Telecommunications Group (as of 01 Jan 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	84	49.41%	Buy	37	52.86%
Neutral	50	29.41%	Neutral	26	60.47%
Sell	36	21.18%	Sell	14	46.67%

Investment Rating Distribution: Global Group (as of 01 Jan 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	2011	53.86%	Buy	874	48.31%
Neutral	925	24.77%	Neutral	444	52.30%
Sell	798	21.37%	Sell	276	36.75%

* Companies in respect of which BofA Merrill Lynch or one of its affiliates has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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