

Sector: Telecom

Sensex:	15,544
CMP (Rs):	80
Target price (Rs):	100
Upside (%):	24.8
52 Week h/l (Rs):	104/52
Market cap (Rscr) :	26,503
6m Avg vol ('000Nos):	8,702
No of o/s shares (mn):	3,307
FV (Rs):	10
Bloomberg code:	IDEA IN
Reuters code:	IDEA.BO
BSE code:	532822
NSE code:	IDEA

Closing price as on 29 Dec, 2011

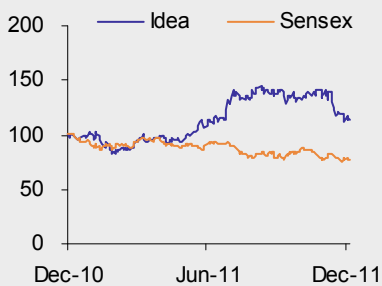
Shareholding pattern

September ' 11	(%)
Promoters	46.0
Institutions	20.5
Non promoter corp hold	0.8
Public & others	32.7

Performance rel. to sensex

(%)	1m	3m	1yr
Idea	(12.9)	(11.4)	36.9
Bharti	(5.8)	(2.6)	18.8
Rcom	(3.3)	(5.1)	(28.1)

Share price trend



Research Analyst

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We interacted with Idea Cellular to gauge its view on the current regulatory milieu and based on the feedback built in some of the possible regulatory risks into our estimates. Idea believes present regulatory scenario is fluid in nature and none of the extant issues have been effectively settled. That said, it also remains confident of the market ability to digest any potential tariff hikes required (duly spread out) to offset some of the increased regulatory burden. We estimate the cumulative impact of excess spectrum charge and 2G/3G roaming cancellations at Rs17/share while cut in IUC to 10p would be broadly EBIDTA neutral. On the operating front, Idea retains its robust execution edge as evident from healthy total MOU growth delta over its peers. Retain BUY with a revised 9-mth TP of Rs100.

Offers value even if adjusted for regulatory risks

Extant regulatory regime is in a state of flux which we believe might be tackled in a new telecom policy in 2012. For now, we attempt to calculate the potential impact of key risks such as excess spectrum charge, renewal fees, refarming, 2G/3G roaming cancellations and IUC cuts.

Based on our talks with Idea and earlier conversations with Bharti, we believe spectrum refarming would be practically difficult to implement given the staggered nature of license maturity profile across operators; accordingly, we do not built in any impact of the same. Although we use TRAI recommended 2G prices for excess spectrum charge calculation, our sense is that these may not be final as even TRAI favours market determined prices. Indeed 2G spectrum prices in any possible future auction might also be affected by the M&A/exit policy since enabling regulations may allow consolidation and/or exits which might entail return of excess spectrum to the government, thereby increasing its supply.

Pure wireless play with robust execution record

Even adjusted for regulatory risks, we believe Idea remains a quality wireless play especially given its robust execution record signified by improving rev market share, high quality sub base and +ve MOU growth delta wrt peers. We bake in the impact of above regulatory risks save for renewal fees, tweak FY12/13 EPS estimates but retain BUY with a revised 9-mth TP of Rs100 (earlier Rs110).

Financial highlights

Y/e 31 Mar (Rs m)	FY10	FY11	FY12E	FY13E
Revenues	123,979	154,384	191,770	230,446
yoy growth (%)	22.4	24.5	24.2	20.2
Operating profit	33,580	37,258	48,710	59,916
OPM (%)	27.1	24.1	25.4	26.0
Pre-exceptional PAT	7,071	7,878	6,938	14,198
Reported PAT	9,540	8,987	6,938	14,198
yoy growth (%)	8.2	(5.8)	(22.8)	104.6
EPS (Rs)	2.9	2.7	2.1	4.3
P/E (x)	27.5	29.2	37.9	18.5
P/BV (x)	2.2	2.1	2.0	1.8
EV/EBITDA (x)	10.1	10.2	7.2	5.5
Debt/Equity (x)	0.7	1.0	0.9	0.7
ROE (%)	5.5	6.5	5.5	10.4
ROCE (%)	6.3	6.0	8.2	11.8

Source: Company, India Infoline Research

We project the impact of regulatory risks except for renewal fees at Rs17/share

Spectrum refarming appears practically difficult to implement, in our view and we do not build it in to our target price calculation

Quantifying key regulatory risks

We spoke with Idea to get views on the current regulatory standpoint on several contentious aspects of telecom policy chiefly excess spectrum charge, renewal and spectrum refarming. On refarming, Idea believes it would be practically difficult to implement as it involves shifting subscribers to a different band.

Moreover, according to the company, such an exercise has not been carried out in other markets. In our earlier conversation with Bharti Airtel, it too had talked about difficulty in implementation of the same. We concur with these views and await TRAI norms on the same. We also do not build any balance sheet impact from refarming for now given 1) low probability of implementation in its present form and 2) TRAI having already determined price of 900MHz as 1.5x1800MHz. We also exclude the impact of spectrum renewal fees (PV=Rs15/share based on TRAI recommended 2G prices) as licenses come up for renewal over a period of time so the burden would be spread out accordingly. On the potential IUC cuts to 10p, Idea indicated that it would be largely EBIDTA neutral for the company.

Idea: impact of key regulatory risks

Regulatory issues	Rs/share
Excess spectrum charge	4
2G roaming cancellation	9
3G roaming cancellation	4
IUC cut to 10p	-

Source: Company, India Infoline Research

Idea excess spectrum charge works to Rs4/share

Circles	Spectrum owned		Excess spectrum(>6.2MHz)		Date of license	DoE	Years left	Pro-rata excess spectrum charge (Rs mn)
	1800MHz	900MHz	1800MHz	900MHz				
Delhi	8.0	-	1.8	-	Oct-01	Oct-21	11.5	2,589
Mumbai	4.4	-	-	-	Dec-06	Dec-26	16.7	-
Kolkata	4.4	-	-	-	Jan-08	Jan-28	17.8	-
Maharashtra	2.0	7.8	2.0	1.6	Dec-95	Dec-15	5.7	4,697
Gujarat	-	6.2	-	-	Dec-95	Dec-15	5.7	-
AP	1.8	6.2	1.8	-	Dec-95	Dec-15	5.7	2,224
Karnataka	-	6.2	-	-	Apr-96	Apr-16	6.0	-
TN	4.4	-	-	-	Jan-08	Jan-28	17.8	-
Kerala	1.8	6.2	1.8	-	Dec-95	Dec-15	5.7	1,191
Punjab	-	7.8	-	1.6	Apr-96	Apr-16	6.0	1,306
Haryana	-	6.2	-	-	Dec-95	Dec-15	5.7	-
UP (W)	1.8	6.2	1.8	-	Dec-95	Dec-15	5.7	1,296
UP (E)	6.2	-	-	-	Oct-01	Oct-21	11.5	-
Rajasthan	-	6.2	-	-	Oct-01	Oct-21	11.5	-
MP	1.8	6.2	1.8	-	Dec-95	Dec-15	5.7	1,306
WB	4.4	-	-	-	Jan-08	Jan-28	17.8	-
HP	4.4	-	-	-	Oct-01	Oct-21	11.5	-
Bihar	4.4	-	-	-	Dec-06	Dec-26	16.7	-
Orissa	4.4	-	-	-	Jan-08	Jan-28	17.8	-
Assam	4.4	-	-	-	Jan-08	Jan-28	17.8	-
NE	4.4	-	-	-	Jan-08	Jan-28	17.8	-
J&K	4.4	-	-	-	Jan-08	Jan-28	17.8	-
Total	67.4	65.2	11.0	3.2				14,609

Source: Company, India Infoline Research

Renewal fee hit >10% but impact spread out

We calculate Idea's spectrum renewal fees based on TRAI recommended 2G prices up to 6.2MHz and incremental beyond 6.2MHz. Assuming base year as Mar' 13, the PV of the renewal fees works to Rs15/share. However, we do not incorporate it into our target price calculations given the staggered nature of maturity and uncertainty regarding actual prices of 2G spectrum.

Based on TRAI's 2G prices, we estimate the PV of spectrum renewal fees at Rs15/share

We do not build in the impact of spectrum renewal in our target price

In our conversation with Idea, the company believed 2G prices should be market determined; in other words, price discovered in auctions should form the basis for valuing 2G spectrum as when it comes up for renewal. We believe even TRAI favours a market determined prices for 2G spectrum but in the absence of one, it has recommended expert determined prices. Pricing of 2G spectrum would also be affected by consolidation and exit policy since, in either case, spectrum might be returned to the government, which can then be used to conduct auctions.

Idea spectrum renewal charge pegged at Rs15/share

Circles	Spectrum owned		Excess spectrum(>6.2MHz)		Date of license	DoE	Years left*	Renewal fees (Rs mn)	PV of renewal fees (Rs mn)
	1800MHz	900MHz	1800MHz	900MHz					
Delhi	8.0	-	1.8	-	Oct-01	Oct-21	8.5	5,993	3,955
Mumbai	4.4	-	-	-	Dec-06	Dec-26	13.7	1,011	518
Kolkata	4.4	-	-	-	Jan-08	Jan-28	14.8	495	240
Maharashtra	2.0	7.8	2.0	1.6	Dec-95	Dec-15	2.7	9,247	8,105
Gujarat	-	6.2	-	-	Dec-95	Dec-15	2.7	2,248	1,970
AP	1.8	6.2	1.8	-	Dec-95	Dec-15	2.7	10,082	8,828
Karnataka	-	6.2	-	-	Apr-96	Apr-16	3.0	2,042	1,762
TN	4.4	-	-	-	Jan-08	Jan-28	14.8	1,874	909
Kerala	1.8	6.2	1.8	-	Dec-95	Dec-15	2.7	5,289	4,636
Punjab	-	7.8	-	1.6	Apr-96	Apr-16	3.0	5,426	4,681
Haryana	-	6.2	-	-	Dec-95	Dec-15	2.7	218	191
UP (W)	1.8	6.2	1.8	-	Dec-95	Dec-15	2.7	5,448	4,775
UP (E)	6.2	-	-	-	Oct-01	Oct-21	8.5	1,518	1,001
Rajasthan	-	6.2	-	-	Oct-01	Oct-21	8.5	1,590	1,049
MP	1.8	6.2	1.8	-	Dec-95	Dec-15	2.7	5,896	5,168
WB	4.4	-	-	-	Jan-08	Jan-28	14.8	448	217
HP	4.4	-	-	-	Oct-01	Oct-21	8.5	93	62
Bihar	4.4	-	-	-	Dec-06	Dec-26	13.7	510	262
Orissa	4.4	-	-	-	Jan-08	Jan-28	14.8	243	118
Assam	4.4	-	-	-	Jan-08	Jan-28	14.8	104	50
NE	4.4	-	-	-	Jan-08	Jan-28	14.8	106	51
J&K	4.4	-	-	-	Jan-08	Jan-28	14.8	76	37
Total	67.4	65.2	11.0	3.2				59,956	48,586

Source: Company, India Infoline Research

*assumed base year as Mar' 13

Key issues: current regulatory position

Key issues	DoT views	TRAI response	Our comments
Spectrum refarming	Would wait for TRAI recos which should be out well before licenses come up for renewal from 2014	To give refarming recos in due time; commercial use of 800/900MHz can fetch revenues in "tens of thousands of crores"; limit 700Mhz (for 4G/LTE auction) only to those without 900MHz spectrum	We are given to understand that refarming would be a complex process as license maturity profile is staggered across circles for most players plus practical difficulties in shifting to 1800MHz and already an implicit TRAI recognition of (higher) value of 900MHz (Px=1.5x1800MHz); lack of access to 700MHz auction to hurt 900MHz holders (Bharti, Idea)
Spectrum fund	Expenditure for spectrum vacation by Defence/Space to be funded by govt; no credit support for pvt players	Disagrees with DoT saying this would lead to procedural delays; wants a dedicated fund under DoT; no firm view for pvt player support till refarming recos in place	-
License fees	Accepts uniformity of license fees but pegs rate at 8.5% of AGR	Reiterates that a 6% uniform rate would not adversely impact govt revenues	To impact all telcos
Spectrum pricing		TRAI favours "current" price as discovered in an auction but would stick to expert determined px in its (auction) absence	Even telcos are reportedly in favour of auctions, if one goes by media reports; impact on Bharti even at TRAI prices would be a manageable Rs9/share
M&A norms	DoT in favour of a simple and easy to implement M&A policy with minimal conditions	1) Merged entity sub/AGR share ceiling raised to 35%; beyond 35% and up to 60% to be decided by govt after TRAI recos; merger with >60% share not allowed 2) total merged entity spectrum not >25% of spectrum assigned to circle 3) Merged entity to be entitled to only 6.2MHz and would pay excess spectrum charge at current px minus entry fee for circle 4) Levy of spectrum transfer charge @5% of diff b/w transaction px and total current px	Merger norms would probably be part of new telecom policy and could be synchronized with exit policy which would open up options from a potential M&A target perspective; if exits become feasible and spectrum is returned, it could help lower auction prices, in our view

Source: Company, India Infoline Research

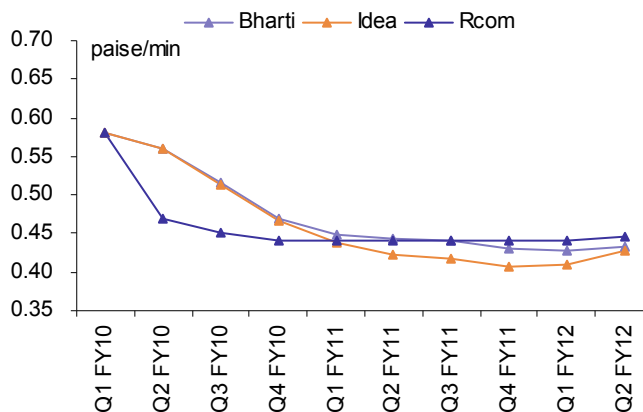
We remain positive on RPM trajectory from Q3FY12 as mid Q2 hike takes effect; market may be able to digest further tariff hikes spread over a period of time

RPM trend healthy; further hikes may be palatable

Over the past two quarters, the incumbent telcos have either arrested their rev/min decline or even posted a rise. Telcos' Q2 earnings commentary as well as our interactions with Bharti and Idea suggests there are grounds for cautious optimism on tariffs even as the 20% tariff hike by major telcos in mid Q2 is yet to make its impact.

More importantly, the market may be able to digest further hikes in case, as is likely, operators may increase rates in response to regulatory risks outlined above. Idea too believes that market can withstand another 8-10% tariff hike but duly spread out over a period of time.

RPMs appear to have bottomed out for now



Source: Company, India Infoline Research

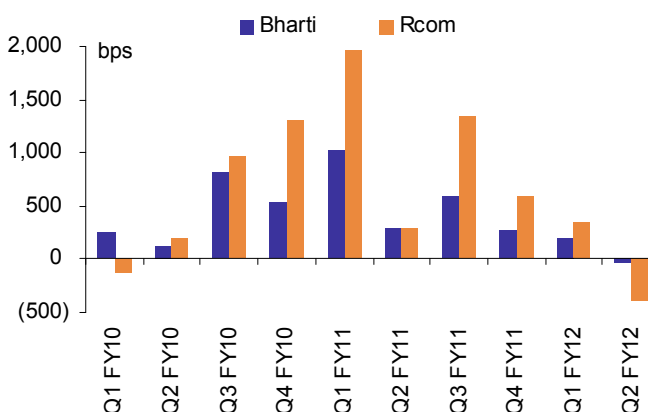
Idea has largely outpaced both Bharti and Rcom in volume growth

Over the past 9 quarters, Idea has outpaced peers like Bharti and Rcom in terms of growth in total minutes of use (MOUs). Even allowing for an aberration in Q2 FY12, Idea total MOUs have on an average outgrown Bharti/Rcom MOUs by 406bps/647bps on sequential basis.

Since Q2 FY10, Idea has outpaced both Bharti and Rcom in total MOU growth over the 9 quarters but one

Along with high quality subscriber base and improved rev market share (+330bps over 2 years), we believe healthy MOU growth is yet another indicator of its robust execution record.

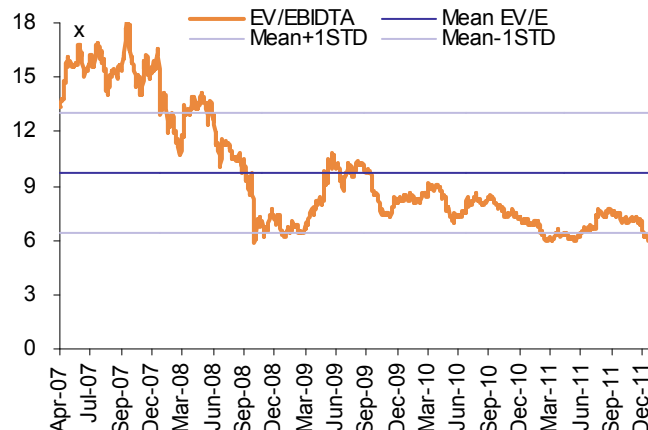
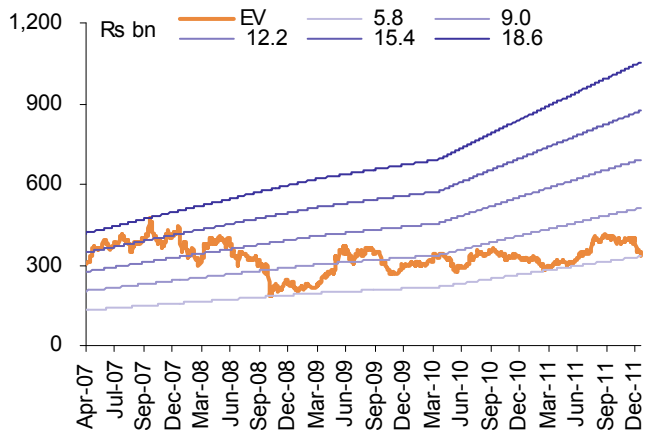
Idea total MOU growth delta vs peers



Source: Company, India Infoline Research

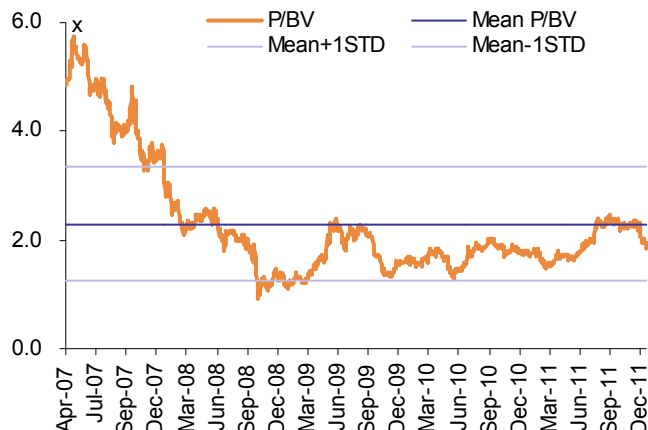
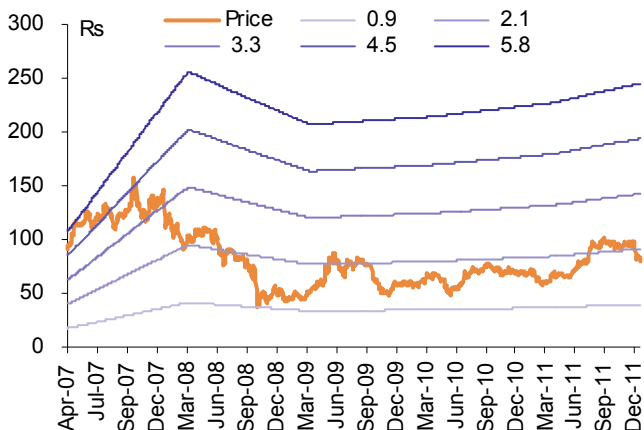
Note: +ve bps delta indicates higher total MOU growth for Idea

1-yr fwd EV/E bands



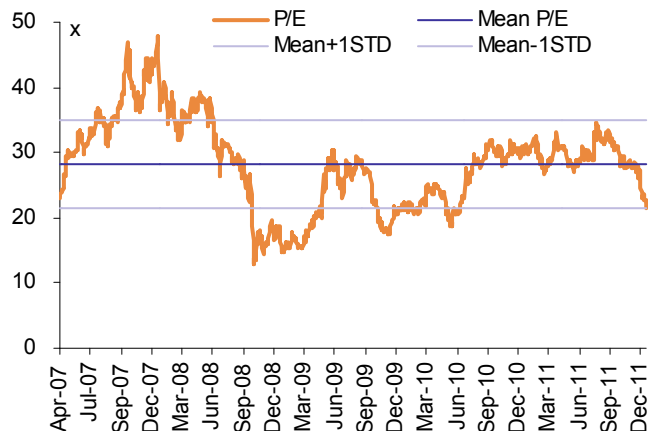
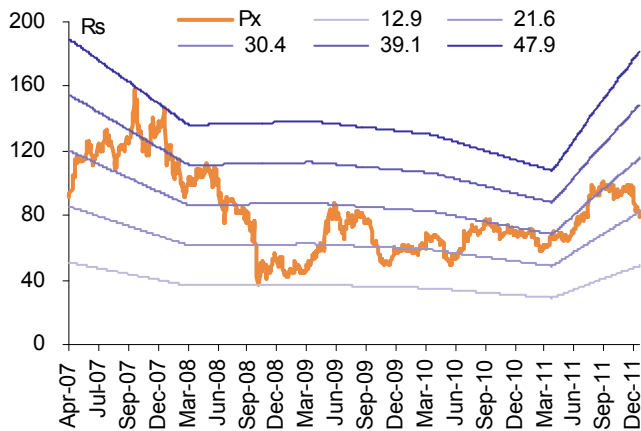
Source: Company, India Infoline Research

1-yr fwd P/B bands



Source: Company, India Infoline Research

1-yr fwd PE bands



Source: Company, India Infoline Research

Even after accounting for near term regulatory risks, we believe Idea offers value and remains the best bet to ride the growth in pure wireless space

Remains best bet in pure wireless space; retain BUY

Idea has outperformed the Sensex by ~37% over the past 1 year, better than Bharti's 19% outperformance as operational concerns like tariff decline recede. Even so, the stock has recently come off a bit on the back of perceived adverse regulatory risks. We have attempted to quantify the potential impact of adverse regulatory headwinds and accordingly now build them in to our target price.

We have only estimated the cost aspect of regulations and it may be so, as we expect, that operators may choose to offset some of the increased burden through higher tariffs. This would potentially dilute the effect of regulatory risks that have been built into our valuation. We tweak our FY12/13 EPS estimates but continue to value Idea at 7.6x FY13 EV/EBIDTA and retain BUY with a revised 9-mth TP of Rs100 (earlier Rs110).

Financials

Income statement

Y/e 31 Mar (Rs m)	FY10	FY11	FY12E	FY13E
Revenue	123,979	154,384	191,770	230,446
Op.profit	33,580	37,258	48,710	59,916
Dep & Amort	(20,149)	(23,973)	(28,298)	(30,488)
Interest exp	(5,215)	(4,515)	(10,593)	(9,243)
Other income	70	89	94	99
PBT	8,286	8,860	9,912	20,283
Taxes	(1,214)	(982)	(2,974)	(6,085)
Adj. profit	7,071	7,878	6,938	14,198
Extra items	2,468	1,109	-	-
Net profit	9,540	8,987	6,938	14,198

Balance sheet

Y/e 31 Mar (Rs m)	FY10	FY11	FY12E	FY13E
Equity capital	32,998	33,033	33,033	33,033
Reserves	85,299	89,469	96,407	110,605
Net worth	118,761	122,999	129,937	144,135
Debt	78,593	120,705	117,705	102,705
Def.tax lia	2,142	3,099	3,254	3,417
Total lia	199,496	246,803	250,896	250,257
Fixed assets	170,937	212,465	197,452	201,209
Intangibles	16,267	48,912	45,267	41,621
Investments	11,304	10,200	10,200	10,200
Net working cap	(4,050)	(24,774)	(2,022)	(2,773)
Inventories	536	659	1,051	1,263
Sundry debtors	4,656	4,789	6,830	8,208
Cash	2,900	4,577	28,215	33,562
Other curr assets	28,538	20,532	28,766	34,567
Sundry creditors	(24,134)	(37,682)	(43,608)	(52,403)
Other current lia	(16,545)	(17,650)	(23,275)	(27,969)
Misc.exp	5,038	-	-	-
Total assets	199,496	246,803	250,896	250,257

Cash flow statement

Y/e 31 Mar (Rs m)	FY10	FY11	FY12E	FY13E
Profit before tax	8,286	8,860	9,912	20,283
Dep & Amort	20,149	23,973	28,298	30,488
Misc.exp w/o	226	5,038	-	-
Def.tax lia	1,012	957	155	163
Tax paid	(1,214)	(982)	(2,974)	(6,085)
Working capital Δ	(10,590)	22,401	886	6,098
Other op.items	2,468	1,109	-	-
Operating CF	20,336	61,356	36,277	50,947
Capital exp	(18,224)	(98,146)	(9,639)	(30,600)
Free CF	2,112	(36,790)	26,638	20,347
Equity raised	(28,695)	(4,749)	-	-
Investments	9,148	1,104	-	-
Debt fin/disp	(10,529)	42,112	(3,000)	(15,000)
Net Δ in cash	(27,964)	1,677	23,638	5,347

Key ratios

Y/e 31 Mar	FY10	FY11	FY12E	FY13E
Growth matrix (%)				
Revenue growth	22.4	24.5	24.2	20.2
Op profit growth	19.4	11.0	30.7	23.0
EBIT growth	(5.8)	(0.9)	53.3	44.0
Net profit growth	8.2	(5.8)	(22.8)	104.6

Profitability ratios (%)

OPM	27.1	24.1	25.4	26.0
EBIT margin	10.9	8.7	10.7	12.8
Net profit margin	5.7	5.1	3.6	6.2
RoCE	6.3	6.0	8.2	11.8
RoNW	5.5	6.5	5.5	10.4
RoA	2.8	2.9	2.2	4.4

Per share ratios

EPS	2.1	2.4	2.1	4.3
Cash EPS	7.6	8.9	9.6	12.4
BV per share	36.0	37.2	39.3	43.6

Valuation ratios (x)

P/E	27.5	29.2	37.9	18.5
P/BV	2.2	2.1	2.0	1.8
M Cap/Sales	2.1	1.7	1.4	1.1
EV/EBIDTA	10.1	10.2	7.2	5.5

Payout (%)

Tax payout	14.7	11.1	30.0	30.0
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Liquidity ratios

Debtor days	14	11	13	13
Inventory days	2	2	2	2
Creditor days	71	89	83	83

Leverage ratios

Interest coverage	2.6	3.0	1.9	3.2
Net debt / equity	0.6	0.9	0.7	0.5
Net debt / op. profit	2.3	3.1	1.8	1.2

Du-Pont Analysis

Y/e 31 Mar (Rs m)	FY10	FY11	FY12E	FY13E
Tax burden (x)	0.85	0.89	0.70	0.70
Interest burden (x)	0.61	0.66	0.48	0.69
EBIT margin (x)	0.11	0.09	0.11	0.13
Asset turnover (x)	0.50	0.57	0.62	0.71
Financial leverage (x)	1.95	2.23	2.46	2.37

RoE (%)	5.5	6.5	5.5	10.4
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In the year 2011 itself, we have received two reputed awards for being the Best Broker in India.

'Best Equity Broker of the Year' – Bloomberg UTV, 2011

IIFL was awarded the 'Best Equity Broker of the Year' at the recently held Bloomberg UTV Financial Leadership Award, 2011. The award presented by the Hon'ble Finance Minister of India, Shri Pranab Mukherjee. The Bloomberg UTV Financial Leadership Awards acknowledge the extraordinary contribution of India's financial leaders and visionaries from January 2010 to January 2011.

'Best Broker in India' – Finance Asia, 2011

IIFL has been awarded the 'Best Broker in India' by Finance Asia. The award is the result of Finance Asia's annual quest for the best financial services firms across Asia, which culminated in the Country Awards 2011

Other awards



Recommendation parameters for fundamental reports:

Buy – Absolute return of over +10%

Market Performer – Absolute return between -10% to +10%

Sell – Absolute return below -10%

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