

## Company Flash

21 January 2008 | 6 pages

# IDEA Cellular (IDEA.BO)

## 3Q results In-Line: MOUs recover, EBITDA% gains muted

- EBITDA exactly in-line, ARPUs surprise** — Idea' 3QFY08 EBITDA at Rs5,672m was in line driven by robust revenue growth (9.3%qoq) though offset by sustained increase in network opex. Idea has started accounting pre-paid revenues net of distributor discount which explains the qoq decline in marketing costs/SAC. Adjusting for this, revenues grew 12.5%qoq. Net profit at Rs2,368m was below expectations due to higher deferred tax provision.
- MOUs bounce back, rev/min declined 5%qoq** — MOUs which had dipped in 2Q due to inactive subs/seasonality bounced back to 377, up 5% qoq though still lower than 1QFY08. Though reported ARPUs were down 3%, the decline was negligible adjusting for the impact of the accounting change on commissions. The adjusted rev/min qoq decline at ~5% though slightly more than larger peers is broadly in line with the industry trend.
- New circle launches, EBITDA breakeven in 18 months?** — Idea has recently been allotted spectrum for Mumbai & Bihar circles and licenses for the remaining 9. Idea's breakeven in the 3 new circles is likely to take about 18 months (launched in Oct-Nov 06). In this context, Idea's strategy for 2 (plus 9) new circles will be in terms of timing of launch and funding will be critical.
- Focus will be now on 4Q MOUs** — The incumbents have sharply reduced their pre-paid tariffs to Rs1/min in the beginning of Jan-08 to combat increased competition and take full advantage of price elasticity. Since price elasticity will kick in with some lag, the decline in rev/min will not be fully compensated by the MOUs which could result in weak qoq comparison in the next quarter.

<b>Hold/Low Risk</b>	<b>2L</b>
Price (18 Jan 08)	Rs136.05
Target price	Rs140.00
Expected share price return	2.9%
Expected dividend yield	0.0%
<b>Expected total return</b>	<b>2.9%</b>
Market Cap	Rs352,759M
	US\$8,997M

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


**Figure 1. Statistical Abstract**

Rs m	Dec-06 (est.)	Mar-07	Jun-07	Sep-07	Dec-07
Total Income	11,481.6	13,084.2	14,772.9	15,622.1	17,080.9
Network Operating Exp	(1,410.2)	(1,680.0)	(1,895.5)	(2,379.9)	(2,915.1)
License & WPC Charges	(1,172.1)	(1,410.9)	(1,598.6)	(1,551.1)	(1,736.3)
Access & Interconnect Charges	(1,949.6)	(2,202.5)	(2,396.1)	(2,550.2)	(2,930.1)
Advertisement & Business Promotion Exp	(1,986.5)	(2,179.2)	(2,283.4)	(2,513.6)	(2,185.4)
Administration & Other Exp	(486.5)	(564.0)	(763.7)	(643.0)	(687.7)
EBITDA	3,704.4	4,362.9	5,127.6	5,106.9	5,671.8
PAT	1,176.7	1,934.2	3,085.2	2,203.8	2,367.7

Source: Company, Citi Investment Research

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Figure 2. Financial Statements (Rs m)

	Dec-06 (est.)	Mar-07	Jun-07	Sep-07	Dec-07
Service Revenue	11,463.3	13,084.2	14,772.9	15,622.1	17,080.9
Sales of Trading Goods	18.4	-	0		
<b>Total Income</b>	<b>11,481.6</b>	<b>13,084.2</b>	<b>14,772.9</b>	<b>15,622.1</b>	<b>17,080.9</b>
Cost of Trading Goods	(13.4)				(0.1)
Personnel Expenditure	(759.0)	(684.7)	(708.0)	(877.4)	(954.4)
Network Operating Exp	(1,410.2)	(1,680.0)	(1,895.5)	(2,379.9)	(2,915.1)
License & WPC Charges	(1,172.1)	(1,410.9)	(1,598.6)	(1,551.1)	(1,736.3)
Access & Interconnect Charges	(1,949.6)	(2,202.5)	(2,396.1)	(2,550.2)	(2,930.1)
Subscriber Acquisition & Servicing Exp	(1,420.7)				
Advertisement & Business Promotion Exp	(565.9)	(2,179.2)	(2,283.4)	(2,513.6)	(2,185.4)
Administration & Other Exp	(486.5)	(564.0)	(763.7)	(643.0)	(687.7)
Total Opex	(7,777.2)	(8,721.3)	(9,645.3)	(10,515.2)	(11,409.1)
Impact of Restatement		0	0		
<b>Restated Total Opex</b>	<b>(7,777.2)</b>	<b>(8,721.3)</b>	<b>(9,645.3)</b>	<b>(10,515.2)</b>	<b>(11,409.1)</b>
<b>EBITDA</b>	<b>3,704.4</b>	<b>4,362.9</b>	<b>5,127.6</b>	<b>5,106.9</b>	<b>5,671.8</b>
<i>EBITDA Margin %</i>	<i>32.3%</i>	<i>33.3%</i>	<i>34.7%</i>	<i>32.7%</i>	<i>33.2%</i>
Depreciation	(1,523.9)	(1,761.3)	(1,886.8)	(2,007.0)	(2,277)
Amortisation of Intangible Assets	(276.6)				
EBIT	1,903.9	2,601.60	3,240.80	3,099.90	3,394.70
Interest & Financing Charges	(805.4)	(974.7)	(143.4)	(640.5)	(781.7)
Other Income	108.9	326.4	3.5	21.4	22.2
PBT	1,207.4	1,953.3	3,100.9	2,480.8	2,635.2
Tax	(30.7)	(19.1)	(15.7)	(277.0)	(267.5)
<b>PAT</b>	<b>1,176.7</b>	<b>1,934.2</b>	<b>3,085.2</b>	<b>2,203.8</b>	<b>2,367.7</b>
<i>PAT Margin (%)</i>	<i>10.2</i>	<i>14.8</i>	<i>20.9</i>	<i>14.1</i>	<i>13.9</i>

Source: Citi Investment Research, Company

Figure 3. Operating results exactly in line

Rs m	Estimates	Actual	Difference (%)	Comments
Sales	16,433	17,081	3.9%	ARPU surprises positively
EBITDA	5,670	5,672	0.0%	High network deployment cost
PAT	2,529	2,368	-6.4%	Higher deferred tax provision

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 Hold/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. With a relatively smaller base compared to larger peers, we estimate earnings CAGR of 47% over FY07-10E, ahead of peers and more than double that of the broader market. However, post the disappointing quality of earnings in 2Q, the Idea stock will likely decouple from Bharti, with a renewed upsurge in investor sentiment probably hinging on a turnaround in operational datapoints.

## Valuation

We have set our 12-month target price at Rs140 based on Sep-08E DCF of Rs127 and an M&A premium of 10%. Though new spectrum norms dilute the M&A appeal, we believe that the substantial private-equity holding (30%) and spectrum/coverage will still appeal to new entrants as they may not get spectrum post the Government's approval for dual technology. 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 41.1% (~500bps below Bharti) and capex/sales of ~8% (in line with Bharti). The DCF value implies an EV/EBITDA of 12.3x, 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. Upside risks to our estimates and valuation would include higher-than-expected industry trends in subscriber additions and MOUs. An acquisition bid for Idea from potential new entrants at a significant premium to existing valuations would also present upside risk to our valuations.

# Appendix A-1

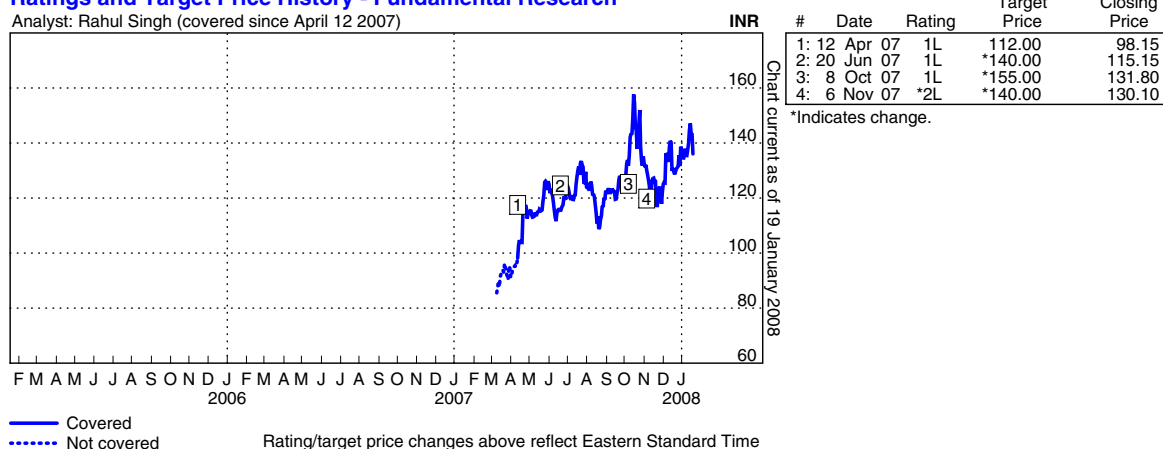
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Analyst: Rahul Singh (covered since April 12 2007)



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