

January 02, 2009

Morning Note
FOCUS OF THE DAY: IDEA CELLULAR (Idea)

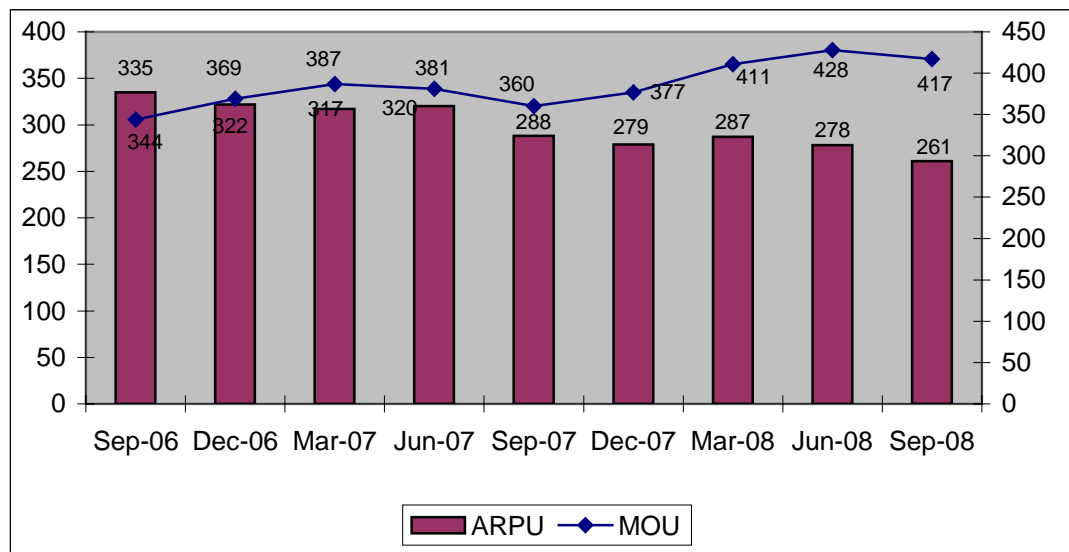
CMP (Rs): 52.65
Mkt Cap (Rs Bn): 139.5
Mkt Cap (\$ Mn): 2872

Disappointing set of Q2 FY09 numbers

Although Idea's sales increased by a whopping 47% yoy in Q2 FY09 and its subscriber base increased 62.7% yoy to reach ~23 mn, the company's profitability declined sharply. EBITDA declined 15.7% qoq to Rs 6,072 mn due to the increase in network operating expenditure, which grew by 19.38% qoq mainly due to addition of new cell sites and the company's entry into the Mumbai circle. Furthermore, profitability was also hampered by an increase in personnel expenditure, which grew by 29.4% qoq due to the annual increment paid to its employees, which Idea pays in the second quarter of every year. EBITDA margins declined by 670 bps to 26.4% on a qoq basis on account of a surge of 16.3% qoq and 61.3% yoy in total expenditure. Idea continued with its growth program of adding cell sites to improve its network performance. In the first half of the year, the company increased its cell sites by 8,600 or 35% to take the total number of cell sites to 33,000. The costs associated with cell sites, for eg fuel costs in rural areas where electricity is scarce also increased the network opex. Net profits declined 45.2% qoq to Rs 1,442 mn in line with the decline in profits at the operating levels and 10.5% qoq increase in depreciation.

Operating figures on a declining trend

In Q2 FY09, ARPU as well as MOU declined by 6% and 2.5% respectively on qoq basis to Rs 261 and 417 minutes. The decline in the ARPU can be explained by the company's concentration on rural markets, where the majority of its subscribers are prepaid ones and also due to the reduction in roaming charges and ISD rates by TRAI. MOU decline was due to seasonality.


Entry into new circles hurting margins and overall profitability

Idea is present in 13 out of 23 telecom circles in India. Idea's current strategy of expansion is taking a toll on its profitability. Idea is a late entrant in most circles. In Q2 FY09, Idea entered Mumbai and Bihar circles and has plans to enter Tamil Nadu and Orissa circles in the coming quarters and thereafter Jammu & Kashmir, West Bengal and North East circles. It takes at least 2 years for a circle to become profitable. The company entered Himachal Pradesh, UP (East) and Rajasthan circles two years ago. Only the UP East circle has become profitable in Q2 FY09. The company

expects HP and Rajasthan to become profitable in the next two quarters. Idea's entry into the heavily penetrated Mumbai circle (wireless penetration level ~75-80%) is believed to be a late move and it will take considerable time to break even as Idea will find it difficult to win subscribers in this highly competitive market where Vodafone and Bharti are ruling the roost. In the first five weeks of its launch, Idea added 100,000 subscribers and incurred losses of \$337 mn in the Mumbai circle. Going forward, we believe that with Idea's launch in so many circles on a continuous basis the company will witness increasing pressures on operating profits and margin performance.

Spice acquisition - a long-term positive

Spice acquisition will enable Idea to gain a strong presence in the circles of Punjab and Karnataka. Post Spice acquisition Idea will be see pressure on its earnings as Spice is a loss making company. However, in the long term, with a good chunk of Spice's subscribers in Karnataka and Punjab, Idea will be able to post a growth in top line as well as bottom line.

Recent cash infusion, a positive for the company

The recent cash infusion through stake purchase by TMI (Telecom Malaysia International) worth Rs 73 bn and Providence Equity Fund's cash infusion worth Rs 25 bn have reduced the debt burden of Idea to a great extent. However, going forward, with upcoming 3G launch, we believe the debt burden will increase again with the increase in Capex.

Outlook

Idea reported a disappointing set of numbers in Q2 FY2009. We believe the company's move of entering the highly penetrated and competitive circle of Mumbai is proving to be very expensive. The aggressive investment in cell sites will improve Idea's coverage and network, but higher dependence on rental cell sites has caused a surge in the operating expenditure. Brand building and advertising in the new circles of Mumbai, Bihar & Jharkhand and re-branding in the Punjab and Karnataka circles are also putting pressure on EBITDA margins. The company is in the process of launching its services in a few more circles in the next few quarters, which will again take considerable time to break even and put pressure on EBITDA margins. UP East circle broke even in this quarter at the operating levels, while Rajasthan and HP circles are still incurring losses. Mumbai circle will take more time than the other circles to break even as it is a difficult market. Idea's performance was further marred at the top line itself as ARPU as well as MOU took a hit. Considering these factors, we continue to have a negative outlook on Idea stock in line with our view expressed in the telecom sector de-rating report of September 23, 2008.

	Q2 FY09	Q2 FY08	yoy % change	Q1 FY09	qoq % change
Revenues	23037	21781	5.77%	15643	47.27%
EBITDA	6068	7203	-15.76%	5128	18.33%
EBITDA margins	26.34%	33.07%	(673 bps)	32.78%	(644 bps)
EBIT	3036	4454	-31.84%	3121	-2.72%
EBIT margins	13.18%	20.45%	(727 bps)	19.95%	(677 bps)
Net income	1441	2631	-45.23%	2203	-34.59%
Net income margins	6.26%	12.08%	(582 bps)	14.08%	(783 bps)
Subscriber base	30380	18672	62.70%	27194	11.72%
ARPU	261	288	-9.38%	278	-6.12%
MOU	417	360	15.83%	428	-2.57%

	BSE	NIFTY
Close	9903	3033
Change	256.15	74.30
52 Week High / Low	21207/7697	6357/2253

Other Markets	Close	Change
Dow Jones	8776	108.00
FTSE 100	4434	41.49
Nasdaq	1577	26.33

Trade Data 01/01	BSE	NSE
Turnover (Rs. bn)	30.89	70.16
Change	-6.57	-19.31
Adv/ Dec/ unchanged	31/8/1	0.6/0.05/1
	Buying	Selling
FII's (Rs. bn) 31/12	5.14	5.25
MF's (Rs. bn) 30/12	4.34	1.77

Interbank Closing	Close	Change
Rs/US \$	48.77	0.03
Rs/UK £	70.64	0.42
Rs/EURO	68.18	-0.13

10 year G-Sec yield : 5.4%

Sectoral Indices	Days' close	Previous close	P/E
Automobiles	2327	2239	8.23
Capital Goods	8710	8315	17.55
Cement	4711	4608	5.33
FMCG	3214	3207	18.57
Infotech	1915	1845	9.66
Construction	9383	8902	17.25

ADR / GDR	Latest	Previous	Change
Infosys	24.57	24.45	0.12
ICICI Bank	19.25	19.18	0.07
Wipro	8.13	8.18	-0.05
Tata Motors	4.45	4.56	-0.11
Satyam	9.04	8.75	0.29
Dr. Reddy's	9.80	9.81	-0.01
HDFC Bank	71.38	72.35	-0.97

Commodity Prices	Close	Change
Crude (\$/Bbl)	43.08	-1.52
Copper (\$/tn)	2901	90
Gold Std (Rs/10GM)	13625	205
Silver (Rs/Kg)	18300	400
Aluminium (\$/tn)	1453	8
Zinc (\$/tn)	1120	31

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