

RESULT UPDATE

Idea Cellular

Maintain Underperformer

Price: Rs 42

BSE Index: 8,814

23 January 2009

Share Data

Reuters code	IDEA.BO
Bloomberg code	IDEA IN
Market cap. (US\$ mn)	2,660
6M avg. daily turnover (US\$ mn)	8.6
Issued shares (mn)	3,100
Target price (Rs)	42

Performance (%)	1M	3M	12M
Absolute	(18)	(11)	(63)
Relative	(8)	2	(30)

Valuation Ratios

Yr to 31 Mar	FY09E	FY10E
EPS (Rs)	3.4	3.5
+/- (%)	(14.9)	5.2
PER (x)	12.5	11.9
PBV (x)	1.1	1.1
EV/Sales (x)	1.9	1.6
EV/EBITDA (x)	6.8	5.6

Major shareholders (%)

Promoters	49
FII's	9
MF's	2
BFSI's	4
Public & Others	36

Financial highlights*

(Rs mn)	2QFY09	3QFY09	QoQ (%)	3QFY08	YoY (%)	FY08	FY09E	YoY (%)	FY10E	YoY (%)
Net Sales	22,992	26,059	13.3	17,081.0	52.6	67,200	99,321	47.8	122,787	23.6
EBITDA	6,024	7,149	18.7	5,673.0	26.0	22,518	28,091	24.7	34,352	22.3
EBITDA Margin (%)	26.2	27.4	-	33.2	-	33.5	28.3	-	28.0	-
Other Income	45	6	(87.6)	22.0	(75.0)	175	102	(41.8)	22	(78.3)
Interest	1,497	687	(54.1)	782.0	(12.1)	2,776	4,709	69.6	4,911	4.3
Depreciation	3,032	3,450	13.8	2,277.0	51.5	8,768	12,821	46.2	17,105	33.4
PBT	1,540	3,017	96.0	2,636	14.5	11,148	10,662	(4.4)	12,358	15.9
Tax	99	177	79.0	268.0	(34.0)	725	684	(5.7)	689	0.7
Reported PAT	1,441	2,840	97.1	2,368	19.9	10,423	9,978	(4.3)	11,669	16.9
Adj. PAT (After extraordinary)	1,441	2,840	97.1	2,368	19.9	10,423	9,978	(4.3)	11,669	16.9
Adj. PAT margin (%)	6.3	10.9	-	13.9	-	15.5	10.0	-	9.5	-
EPS (Rs)	0.5	1.5	200.0	0.9	66.9	4.0	3.4	(14.9)	3.5	5.2

*Standalone numbers; that is, without including ABTL and Spice contribution.

3QFY09 Result – Spice merger, new launches to put margin pressure

For 3QFY09, Idea gave consolidated results, which include contribution from Spice Communications (as per joint venture accounting) and from Aditya Birla Telecom Ltd. (ABTL). ABTL holds licence for Bihar circle and it also holds 16% in Indus Towers. Hence, on a QoQ basis, results are not comparable. On a standalone basis, EBITDA margin and bottom line improved. However, after including proportionate contribution from Spice, EBITDA margin shows decline on a sequential basis.

We feel that impending merger with Spice and further rollouts will continue to keep overall margins under pressure. Idea has single revenue stream in wireless, which increases the risk factor in case of sharp tariff fall. Spice's operations in two circles, though operationally good, have low EBITDA margin and they make losses at the net level. Furthermore, as Idea's newly added subscribers are marginal ones; we expect a high pressure on the ARPU. The company's RoCE is already low and its participation in 3G auctions will further reduce the return ratios. We maintain the Underperformer rating on the stock, with a target price of Rs 42. We have downward revised our target price from Rs 55 earlier, as we reduce our ARPU and EBITDA margin estimates. The stock trades at 13x FY09E standalone earnings and 12x FY10E standalone earnings.

Key highlights

- **Standalone results** (Idea's operation in existing 11 circles + Mumbai operation):
 - o Revenue increased by 13.3% QoQ, to Rs 26 bn, as the company registered impressive subscriber additions and ARPU increased during the quarter.
 - o With control over marketing expenses, EBITDA margin increased by 120 bps, to 27.4%.
 - o Bottom line increased by 97% QoQ, to Rs 2.8 bn. Forex loss for the quarter is Rs 131 mn, against Rs 187 mn in 2QFY09.

- **Consolidated results** (Idea standalone + ABTL + 41% contribution from Spice):
 - o Consolidated EBITDA margin reduced to 25.5% because of low EBITDA margin for Spice (16-19%) and a negative EBITDA for Bihar operation.
 - o As Spice is making losses at net level, consolidated PAT for the quarter stands at Rs 2.2 bn. The consolidated forex loss for the quarter is Rs 102 mn.

Revenue and EBITDA – Standalone versus consolidated performance

(Rs mn)	3QFY09	2QFY09	QoQ (%)	3QFY08	YoY (%)
Revenue-11 service areas	25,726	22,954	12.1	17,103	50.4
Revenue-2 service areas (Mumbai + Bihar)	483	52	828.8	–	–
Revenue-13 service areas	26,209	23,006	13.9	17,103	53.2
Proportionate revenue from joint ventures	1,273	65	–	–	–
Intersegment eliminations	(171)	(34)	–	–	–
Total revenue	27,311	23,037	18.6	17,103	59.7
EBITDA-11 service areas	7,570	6,446	17.4	5,694	32.9
EBITDA-2 service areas (Mumbai + Bihar)	(765)	(366)	–	–	–
EBITDA-13 service areas	6,805	6,080	11.9	5,694	19.5
Proportionate EBITDA from joint ventures	169	(13)	–	–	–
Total EBITDA	6,974	6,067	14.9	5,694	22.5
EBITDA margin-11 service areas (%)	29.4	28.1	–	33.3	–
EBITDA margin-13 service areas (%)	26.0	26.4	–	33.3	–
Proportionate EBITDA margin from joint ventures (%)	13.3	(20.0)	–	–	–
EBITDA margin (%)	25.5	26.3	–	33.3	–

- **Operational:**

- o Idea Standalone + Bihar operation

ARPU increased by 1.9% QoQ, to Rs 266, and MoU declined by 1.7% QoQ, to 410 minutes. Idea added 3.83 mn subscribers in 3QFY09 (compared to 3.19 mn in 2QFY09), taking the total base to 34.21 mn.

- o Spice Communications

Spice shows better operational numbers, compared to Idea's standalone operations. ARPU, at Rs 279, increased 7.7% QoQ and MoU, at 494 minutes, showed a sequential growth of 13.8%. Spice has a high churn rate of 6.2%.

- **Balance sheet:**

Net debt to equity reduces to 0.14, from 0.26 last quarter, as Providence Partners invested funds worth Rs 21 bn in ABTL.

Outlook

Spice's inferior financials will keep pressure on the consolidated P&L. Tariff war is another big concern for the company, especially since it has single revenue stream. Since Idea lacks owned fibre cables, movement in carriage charges will greatly influence its EBITDA margin. As new subscribers added are marginal; the ARPU will come under pressure. We consider an increase in ARPU this quarter as an exception.

After RCom's GSM launch, we have seen a reduction in entry point rates for subscribers. We are reducing our tariff estimates for the company, which results in reduced estimates for revenue and EBITDA margin.

Valuation

For DCF calculation (refer Appendix 3 for detailed calculations):

- We are consolidating Spice's operation with that of Idea's.
- We are factoring in monthly tower rentals that Idea will pay on its rented towers.
- We also include Indus' contribution to Idea (as per joint venture accounting).
- We take outstanding shares as 3,300 mn (after Idea-Spice merger).

We maintain Underperformer rating on the stock, with a target price of Rs 42. At the current market price, the stock trades at 13x FY09E standalone earnings and 12x FY10E standalone earnings.

Appendix 1: Operating Metrics- Idea standalone + Bihar operation

	2QFY09	3QFY09	QoQ (%)	3QFY08	YoY (%)
Total subscribers ('000)	30,380	34,211	12.6	21,054	62.5
Overall market share- cop (%)	9.8	10.0	–	9.2	–
Prepaid subscribers (%)	94.0	94.3	–	92.6	–
Subscribers added ('000)	3,186	3,831	20.2	2,382	60.8
ARPU (Rs)	261	266	1.9	279	(4.7)
EBITDA per user per month (Rs)	66	70	5.4	90	(22.5)
MoU (min/subscriber)	417	410	(1.7)	377	8.8
ARPM (Rs per min)	0.63	0.65	3.7	0.74	(12.3)
Churn (%)	3.9	4.3	–	4.7	–
VAS revenue (as % of ARPU)	9.8	9.5	–	8.0	–
Towns and villages covered	110,850	137,585	24.1	70,556	95.0

Appendix 2: Operating Metrics- Spice Communications

	2QFY09	3QFY09	QoQ (%)
Operating service areas	2	2	–
Total subscribers ('000)	3,600	3,802	5.6
Market share (%)	1.2	1.1	–
Prepaid subscribers (%)	84.5	85.7	–
ARPU (Rs)	259	279	7.7
MoU (min/subscriber)	434	494	13.8
ARPM (Rs per min)	0.60	0.56	(5.4)
Churn (%)	13.9	6.2	–
VAS revenue (% of ARPU)	8.7	10.9	–

Appendix 3: DCF calculation for Idea Cellular

(Rs mn)	FY09E	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E	FY16E	FY17E	FY18E
Idea standalone										
Revenue	99,321	122,787	128,754	139,394	153,334	167,134	180,505	193,140	204,728	214,965
YoY growth (%)	47.8	23.6	4.9	8.3	10.0	9.0	8.0	7.0	6.0	5.0
EBITDA	28,091	34,352	39,785	43,212	45,233	50,307	55,234	59,873	65,104	68,789
EBITDA margin (%)	28.3	28.0	30.9	31.0	29.5	30.1	30.6	31.0	31.8	32.0
Capex	(93,569)	(49,585)	(41,541)	(36,230)	(18,400)	(13,371)	(12,635)	(11,588)	(10,236)	(12,038)
Capex (as % of revenue)	94.2	40.4	32.3	26.0	12.0	8.0	7.0	6.0	5.0	5.6
Idea + Spice (merger) + Lease rentals (on rented cellsites) + Indus contribution (as per joint venture accounting)										
Revenue	120,549	147,945	157,180	169,692	187,034	205,846	226,134	246,000	266,700	286,797
YoY growth (%)		22.7	6.2	8.0	10.2	10.1	9.9	8.8	8.4	7.5
EBITDA	27,969	34,477	38,276	41,124	45,913	51,457	58,237	64,593	70,946	78,007
EBITDA margin (%)	23.2	23.3	24.4	24.2	24.5	25.0	25.8	26.3	26.6	27.2
Capex	(75,278)	(40,575)	(25,903)	(25,058)	(7,853)	(5,954)	(6,674)	(7,133)	(6,943)	(9,397)
Capex (as % of revenue)	62.4	27.4	16.5	14.8	4.2	2.9	3.0	2.9	2.6	3.3
FCF calculation										
Change in NWC	(39,708)	27,817	15,435	3,878	3,490	3,153	2,856	2,599	2,371	2,169
Tax	(759)	(580)	(219)	(427)	(4,041)	(6,709)	(9,834)	(12,518)	(15,615)	(18,784)
Tax rate (%)	6.4	5.6	6.0	8.0	15.0	20.0	24.0	26.0	28.0	30.0
FCF	(87,777)	21,140	27,589	19,516	37,509	41,948	44,585	47,541	50,759	51,996
YoY growth (%)		NA	30.5	(29.3)	92.2	11.8	6.3	6.6	6.8	2.4
Terminal Value										224,867
DCF assumptions										
CoE (%)	14.8									
CoD (%)	10.5									
Rf (%)	9.8									
Rp (%)	5.0									
D/E ratio (x)	0.67									
Beta (x)	1.0									
WACC (%)	13.1									
Terminal growth (%)	5.0									
Fair Value Calculation										
Discounted FCF	(87,777)	18,700	21,587	13,508	22,964	22,717	21,358	20,145	19,026	17,240
Discounted Terminal value										74,557
Value	164,026									
Net Debt	26,167									
Value of Equity	137,859									
O/s Shares (mn shares)	3,300									
Fair Value (Rs)	42									

Income Statement

Yr end 31 Mar (Rs mn)	FY07	FY08	FY09E	FY10E
Net sales	43,664	67,200	99,321	122,787
<i>Growth (%)</i>	<i>47.2</i>	<i>53.9</i>	<i>47.8</i>	<i>23.6</i>
Operating expenses	(29,011)	(44,682)	(71,230)	(88,434)
Operating profit	14,653	22,518	28,091	34,352
EBITDA	14,653	22,518	28,091	34,352
<i>Growth (%)</i>	<i>37.5</i>	<i>53.7</i>	<i>24.7</i>	<i>22.3</i>
Depreciation	(6,718)	(8,768)	(12,821)	(17,105)
Other income	209	175	102	22
EBIT	8,144	13,925	15,371	17,269
Interest paid	(3,051)	(2,776)	(4,709)	(4,911)
Pre-tax profit	5,093	11,148	10,662	12,358
(before non-recurring items)				
Pre-tax profit	5,093	11,148	10,662	12,358
(after non-recurring items)				
Tax (current + deferred)	(70)	(725)	(684)	(689)
Net profit	5,022	10,423	9,978	11,669
Adjusted net profit	5,022	10,423	9,978	11,669
<i>Growth (%)</i>	<i>137.2</i>	<i>107.5</i>	<i>(4.3)</i>	<i>16.9</i>
Net income	5,022	10,423	9,978	11,669

Balance Sheet

Yr end 31 Mar (Rs mn)	FY07	FY08	FY09E	FY10E
Current assets	24,660	15,500	72,142	53,129
Investments	12	5,560	5,560	4,520
Net fixed assets	61,100	107,163	173,194	208,944
Other non-current assets	61	61	61	61
Total assets	85,834	128,283	250,957	266,654
Current liabilities	21,520	27,022	40,251	48,650
Total debt	42,505	65,154	91,553	88,181
Other non-current liabilities	11	661	1,000	0
Total liabilities	64,036	92,837	132,804	136,831
Share capital	25,929	26,354	31,001	31,001
Reserves & surplus	(4,131)	9,055	87,152	98,822
Less: Misc. expenditure	0	38	0	0
Shareholders' funds	21,798	35,446	118,153	129,823
Total equity & liabilities	85,834	128,283	250,957	266,654

Note: All numbers are on standalone basis.

Cash Flow Statement

Yr end 31 Mar (Rs mn)	FY07	FY08	FY09E	FY10E
Pre-tax profit	5,093	11,148	10,662	12,358
Depreciation	14,730	4,936	12,821	17,105
Chg in working capital	22,344	1,438	15,958	10,134
Total tax paid	(60)	(75)	(345)	(1,689)
Cash flow from oper. (a)	42,107	17,448	39,096	37,908
Capital expenditure	(46,696)	(50,999)	(75,677)	(49,585)
Chg in investments	3,058	(5,548)	0	1,040
Cash flow from inv. (b)	(43,638)	(56,547)	(75,677)	(48,545)
Free cash flow (a+b)	(1,531)	(39,099)	(36,581)	(10,637)
Equity raised/(repaid)	(1,497)	463	4,610	0
Debt raised/(repaid)	13,349	22,649	26,399	(3,372)
Other financing activities	19,372	22,135	90,254	90,254
Cash flow from fin. (c)	31,225	45,247	121,263	86,882
Net chg in cash (a+b+c)	29,694	6,148	84,682	76,245

Key Ratios

Yr end 31 Mar (%)	FY07	FY08	FY09E	FY10E
EPS (Rs)	1.9	4.0	3.4	3.5
EPS growth	150.8	104.2	(14.9)	5.2
EBITDA margin	33.6	33.5	28.3	28.0
EBIT margin	18.7	20.7	15.5	14.1
RoCE	15.5	16.8	9.9	8.1
Net debt/Equity	111.5	169.8	23.0	31.7

Valuations

Yr end 31 Mar (x)	FY07	FY08	FY09E	FY10E
PER	21.8	10.7	12.5	11.9
PCE	9.3	5.8	5.5	4.8
Price/Book	5.0	3.1	1.1	1.1
EV/Net sales	4.4	2.8	1.9	1.6
EV/EBITDA	13.0	8.5	6.8	5.6

Du Pont Analysis – ROE

Yr end 31 Mar (x)	FY07	FY08	FY09E	FY10E
Net margin (%)	11.5	15.5	10.0	9.5
Asset turnover	0.6	0.6	0.5	0.5
Leverage factor	4.0	3.7	2.4	2.0
Return on equity (%)	30.0	36.4	13.0	9.4

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