

Idea Cellular

Rs54
UNDERPERFORMER

RESULT NOTE

Mkt Cap: Rs168bn; US\$3.6bn

Analyst: Chirag Shah (91-22-6638 3306; chirag@idfcsski.com)
Ashish Shah (91-22-6638 3371; ashishshah@idfcsski.com)

Result: Q2FY10

Comment: Erosion in minute base leads to sharply lower earnings

Last report: 8 October 2009 (Price Rs65; Recommendation: Underperformer)

Key valuation metrics (Consolidated: Spice @41.09%)

Year end 31 Mar (Rs m)	Net sales (Rs m)	% Change yoy	Net profit (Rs m)	EPS (Rs)	% Change yoy	PE (x)	EV/EBITDA (x)
2007	43,664	47.2	5,022	2.2	132.9	24.9	10.6
2008	67,375	54.3	10,423	4.0	81.6	13.7	8.9
2009	101,544	50.7	8,816	3.0	(24.0)	18.0	6.9
2010E	121,333	19.5	7,892	2.5	(15.5)	21.3	7.9
2011E	134,755	11.1	3,582	1.2	(54.6)	47.0	7.9

HIGHLIGHTS OF Q2FY10 RESULTS

- Idea's Q2FY10 consolidated revenues fell 0.1%qoq (up 29.1%yoy) to Rs29.7bn and were below our estimate of Rs31.5bn driven by a sharper than estimated drop in ARPU.
- Idea's consolidated ARPU dropped 9.3%qoq to Rs213 with the MOU dropping 5.9%qoq to 379min/month and rev/min dropping 3.6%qoq to Rs0.56/min. While the drop in Idea's rev/min is in line with our estimate the extent of fall in MOU has been a surprise.
- We believe the sharper than expected drop in MOUs besides being driven by lower usage from incremental subscribers has also been significantly driven by loss of minute market share. We estimate erosion of 2-3% in the company's total minute base to competition in Q2FY10 vis-à-vis Q1FY10 after factoring in the reported churn and assuming no drop in the blended usage of the company's Q1FY10 subscriber base. Overall, total usage on the network grew by 3.0%qoq to 56.1bn minutes vis-à-vis a 9.4%qoq growth in EOP subscriber base.
- Consolidated EBIDTA margin stood at 27.2% down 170bp qoq and up 90bp yoy and was lower our estimate of 28.0%. Consolidated EBIDTA/min dropped 10.6%qoq to Rs0.14/min vis-à-vis our estimate of Rs0.15/min. Profitability has been impacted mainly by lower ARPU with the cost/min actually declining by 1.1%qoq to Rs0.42/min from Rs0.43/min.
- Resultant consolidated EBIDTA stood at Rs8.1bn, down 5.9%qoq, up 33.5%yoy and was sharply below our estimate of Rs8.8bn.
- Other income was boosted by one-time gain of Rs317m resulting from pre-payment of bonds issued by one of the company's erstwhile subsidiary (now amalgamated) to Escorts Ltd. We have treated this income as an extra-ordinary income.
- Net finance cost increased 21.6%qoq to Rs1.1bn due to lower interest income and income from investments. Net debt increased from Rs43.4bn in Q1FY10 to Rs48.6bn in Q2FY10.
- Effective tax rate (adjusted for the estimated tax impact of the extra-ordinary income of Rs317m) was higher at 11.3% against 6.4% in Q1FY10.

- Adjusted net profit declined 33%qoq (up 38.1%yoy) to Rs2.0bn and was sharply below our estimate of Rs2.8bn. Reported net profit declined 25.9%qoq (up 52.8%yoy) to Rs2.2bn.

Key Performance indicators (consolidated)

Rs m	Q3FY09	Q4FY09	Q1FY10	Q2FY10
Subscribers (EOP)	38	43	47	51
MOU	445	410	403	379
Rev/min	0.65	0.64	0.58	0.56
ARPU	285	257	235	213
Total minutes (bn)	45.7	49.8	54.5	56.1
qoq growth (%)				
Subscribers (EOP)	nc	13.2	9.5	9.4
MOU	nc	(8.0)	(1.7)	(5.9)
Rev/min	nc	(0.9)	(9.0)	(3.6)
ARPU	nc	(9.9)	(8.6)	(9.3)
Total minutes	nc	9.0	9.3	3.0

Source: Company reports, nc - not comparable due to Spice consolidation from Q3FY09

Estimate 2-3% erosion in minute base for Idea due to multiple SIM ownership

Idea Cellular (ex-Spice)	Q2FY10
EOP subscriber base (m)	46.8
Net addition (m)	4.0
Blended Churn (%)	7.2
Churn in no of subscribers (m)*	9.2
Implied Gross addition (m)	13.3
MOU (min/month)	375
a) Minutes used by Q1FY10 EOP subscriber base (adjusted for churn)*	45,665
b) Estimated minutes from new subscribers @ MOU of 300	5,971
c) Estimated total minutes (a+b) (m min)	51,636
d) Reported total minutes (m min)	50,339
e) Loss of existing minute base (c-d)	1,297
f) Previous quarter minute base (Q1FY10)	48,729
g) % of Q1FY10 minute base	2.7

Source: IDFC-SSKI Research * - we assume that 1) the entire churn is out of the Q1FY10 subscriber base 2) Blended MOU of Q1FY10 subscriber base remained constant 3) MOU of outgoing subscribers=blended MOU of Q1FY10 subscriber base

❑ Lower ARPU in established circles, higher losses in new circles drag profitability

Revenues from Idea's 11 established circles declined by 1.3%qoq to Rs27.1bn driven by ARPU leading to a marginal dip in EBIDTA margin in 11 established circles to 30.0% from 30.4% in Q1FY10. With the full impact of three new circles launches – Tamil Nadu, Chennai & Orissa in Q2FY10, EBIDTA loss from new circles increased from Rs644m in Q1FY10 to Rs830m. Spice (41.09% holding) too witnessed a sharp erosion in its profitability.

Revenue and Profitability break-up for Idea

(Rsm)	Q3FY09	Q4FY09	FY09	Q1FY10	Q2FY10
Revenue Break-up					
11 service areas	25,726	27,642	96,664	27,456	27,087
New service areas	483	985	2,959	1,427	1,822
Idea standalone	26,209	28,627	99,623	28,883	28,909
Spice@41.09%	1,100	1,339	2,439	1,359	1,401
Indus@16%	172	1,870	2,070	1,990	1,925
Consolidated Eliminations	171	2,479	2,650	2,472	2,496
Idea consolidated	27,310	29,357	101,482	29,760	29,739
EBIDTA Break-up (Rsm)					
11 service areas	7,570	8,069	29,442	8,345	8,137
New service areas	(765)	(654)	(1,939)	(644)	(830)
Idea standalone	6,805	7,415	27,503	7,701	7,307
Spice@41.09%	224	336	560	294	182
Indus@16%	-	358	358	606	606
Idea consolidated	7,029	8,109	28,421	8,601	8,095
EBIDTA Margin (%)					
11 service areas	29.4	29.2	30.5	30.4	30.0
New service areas	(158.4)	(66.4)	(65.5)	(45.1)	(45.6)
Idea standalone	26.0	25.9	27.6	26.7	25.3
Spice@41.09%	20.3	25.1	22.9	21.6	13.0
Indus@16%	-	19.1	17.3	30.5	31.5
Idea consolidated	25.7	27.6	28.0	28.9	27.2

Source: Company reports

□ Idea's FY10 capex target (ex-Indus) lowered to Rs45bn (Rs55bn earlier)

Idea's Q2FY10 capex (Spice @100%) excluding Indus stood at Rs9.6bn and its reported consolidated capex stood at Rs11.1bn in Q2FY10. Idea has lowered its FY10 capex target (Idea+Spice@100%) from Rs55bn earlier to Rs45bn due to rationalization of capacity addition schedules with estimated MOU growth as well as with potential 3G capacity additions. The company has also attributed the capex reduction to favorable commercial terms and better inventory management.

□ New circle launches on schedule – target to become a pan India player by Dec-09

Idea launched its services in Orissa in April-09, in Tamil Nadu in May 2009 and in Chennai in July-09. Further it launched its services in J&K on 14th October 2009 and in NE and Assam on 27th October, 2009. As per its original schedule it plans to expand its presence in the two balance circles of NE and Assam (before end CY09) which would then make Idea a pan India player. The company has indicated that it would look at cash break-even in new circles within 18-27 months of launch and PAT break-even in 3-3.5 years from launch.

VALUATIONS & VIEW

We recently downgraded our recommendation on the telecommunication sector to Underperformer on concerns of rapid pricing/ARPU erosion percolating to erosion in profitability and earnings as also to pressure on valuations (refer our report dated October 8th 2009 – Fresh wave of tariff aggression – changing sector stance to Underperformer). While Idea's pricing erosion was in line with our estimate the fall in MOU was much steeper – resulting from loss of minute market share as also due to lower usage of incremental subscribers. We have lowered our ARPU estimate for Idea by 6.2% for FY10E and 10.7% for FY11E resulting in an EBIDTA downgrade of 8.2% and 13.8% for FY10E and FY11E, respectively. The resultant impact on earnings has been more pronounced due to a higher fixed cost structure (depreciation and interest charges remain largely unchanged) combined with Idea's lower scale of operations. Consequently, there has been an earnings downgrade of 27% in FY10E and 63% in FY11E to Rs2.6/share and Rs1.2/share respectively (estimates include 3G capex).

Though telecom stocks have corrected 15-20% since our recent rating downgrade vis-à-vis a 3% drop in Sensex over the same period, we maintain our view that valuations would experience overhang of weak earnings expectations over the

next few quarters and the adverse news flow pertaining to sharp tariff cuts and aggressive new launches. At CMP Idea trades at EV/EBIDTA of 7.9x FY11E. Maintain Underperformer on Idea with a revised DCF-based price target of Rs61 (Rs73) which includes a valuation of Rs19/share for Idea's 16% stake in Indus.

Idea Cellular: Change in estimates

Idea Cellular (Rsm)*	New estimates			Old estimates			Change in estimates (%)	
	FY09	FY10E	FY11E	FY09	FY10E	FY11E	FY10E	FY11E
Revenue	101,544	121,333	134,755	101,484	128,474	149,998	(5.6)	(10.2)
EBIDTA	28,364	32,643	36,234	28,345	35,558	42,050	(8.2)	(13.8)
Adjusted PAT	8,816	7,892	3,582	9,009	10,861	9,573	(27.3)	(62.6)
Adjusted EPS (Rs)	3.0	2.5	1.2	3.1	3.5	3.1	(27.3)	(62.6)
Wireless MOU (min)	423	378	357	423	401	400	(5.8)	(10.9)
Wireless Rev/min (Rs)	0.63	0.55	0.47	0.63	0.55	0.47	0.1	(0.2)
Wireless ARPU (Rs)	265	204	170	265	217	190	(6.2)	(10.7)
Wireless EBIDTA/min (Rs)	0.17	0.13	0.12	0.17	0.14	0.13	(3.5)	(3.3)

Source: IDFC-SSKI Research * - FY09 financials are as restated

Quarterly results (consolidated)

Rs m	Q2FY09	Q3FY09	Q4FY09	FY09	Q1FY10	Q2FY10	FY10E
Net Sales	23,034	27,305	29,425	101,544	29,759	29,739	121,333
Personnel expenses	1,323	1,457	1,443	5,245	1,446	1,663	6,695
Network operating expenses	2,988	3,951	3,507	13,041	3,664	3,516	14,814
License fees and WPC charges	2,571	2,983	3,239	11,239	3,369	3,320	13,651
Interconnect cost	4,271	5,083	5,132	18,442	4,221	4,184	17,394
SG&A & others	5,816	6,862	7,976	25,212	8,461	8,962	36,136
Total Expenses	16,968	20,336	21,297	73,179	21,160	21,644	88,690
EBITDA	6,065	6,969	8,127	28,364	8,599	8,095	32,643
Other income	3	6	(9)	-	-	-	6
Depreciation and amortization	3,032	3,937	4,310	14,028	4,555	4,797	19,764
EBIT	3,036	3,037	3,809	14,337	4,044	3,299	12,885
Net finance cost	1,497	874	1,049	4,945	869	1,057	4,137
PBT	1,540	2,164	2,760	9,391	3,175	2,242	8,748
Tax	99	(31)	211	576	204	253	856
Adjusted PAT	1,441	2,195	2,550	8,816	2,971	1,989	7,892
Extra-ordinary expenses (income)	-	-	-	-	-	(212)	(212)
Reported PAT	1,441	2,195	2,550	8,816	2,971	2,202	8,104
Outstanding shares (m)	3,100	3,100	3,100	3,100	3,100	3,100	3,100
Adjusted EPS	0.5	0.7	0.8	3.0	1.0	0.6	2.5
Operating ratios (%)							
EBITDA margin	26.3	25.5	27.6	27.9	28.9	27.2	26.9
EBIT margin	13.2	11.1	12.9	14.1	13.6	11.1	10.6
Cost/min (Rs/min)	0.45	0.48	0.47	0.46	0.43	0.42	0.41
EBIDTA/min (Rs/min)	0.17	0.16	0.17	0.17	0.15	0.14	0.13
PAT margin	6.3	8.0	8.7	8.7	10.0	6.7	6.5
yoy growth (%)							
Income	47.2	59.7	48.2	50.7	36.6	29.1	19.5
EBITDA	18.3	22.4	20.7	25.0	19.4	33.5	15.1
Depreciation	51.1	72.9	65.9	60.0	65.7	58.2	40.9
Interest	133.7	11.7	(13.0)	78.1	(43.1)	(29.4)	(16.3)
Adjusted PAT	(34.6)	(7.3)	(7.8)	(15.4)	12.9	38.1	(10.5)
Reported PAT	(34.6)	(7.3)	(7.8)	(15.4)	12.9	52.8	(8.1)

IDFC - SSKI INDIA

Analyst	Sector/Industry/Coverage	E-mail	Tel. +91-22-6638 3300
Pathik Gandotra	Head of Research; Financials, Strategy	pathik@idfcsski.com	91-22-6638 3304
Shirish Rane	Construction, Power, Cement	shirish@idfcsski.com	91-22-6638 3313
Nikhil Vora	FMCG, Media, Mid Caps, Education, Exchanges	nikhilvora@idfcsski.com	91-22-6638 3308
Ramnath S	Automobiles, Auto ancillaries, Real Estate, Oil & Gas	ramnaths@idfcsski.com	91-22-6638 3380
Nitin Agarwal	Pharmaceuticals	nitinagarwal@idfcsski.com	91-22-6638 3395
Chirag Shah	Metals & Mining, Telecom, Pipes, Textiles	chirag@idfcsski.com	91-22-6638 3306
Bhoomika Nair	Logistics, Engineering	bhoomika@idfcsski.com	91-22-6638 3337
Hitesh Shah	IT Services	hitesh.shah@idfcsski.com	91-22-6638 3358
Bhushan Gajaria	Retailing, FMCG, Media, Mid Caps	bhushangajaria@idfcsski.com	91-22-6638 3367
Ashish Shah	Construction, Power, Cement, Telecom	ashishshah@idfcsski.com	91-22-6638 3371
Salil Desai	Construction, Power, Cement	salil@idfcsski.com	91-22-6638 3373
Ritesh Shah	Pharmaceuticals, IT Services	riteshshah@idfcsski.com	91-22-6638 3376
Neha Agrawal	Financials	neha@idfcsski.com	91-22-6638 3237
Swati Nangalia	Mid Caps, Media, Exchanges	swati@idfcsski.com	91-22-6638 3260
Sameer Bhise	Strategy, Financials	sameer@idfcsski.com	91-22-6638 3390
Shweta Dewan	Mid Caps, Education, FMCG	shweta.dewan@idfcsski.com	91-22-6638 3290
Nikhil Salvi	Construction, Power, Cement	nikhil.salvi@idfcsski.com	91-22-6638 3239
Rajeev Desai	Real Estate	rajeev@idfcsski.com	91-22-6638 3231
Chinmaya Garg	Financials	chinmaya@idfcsski.com	91-22-6638 3325
Aniket Mhatre	Automobiles, Auto ancillaries	aniket@idfcsski.com	91-22-6638 3311
Probal Sen	Oil & Gas	probal@idfcsski.com	91-22-6638 3238
Saumil Mehta	Metals, Pipes	saumil.mehta@idfcsski.com	91-22-6638 3344
Rupesh Sonawale	Database Analyst	rupesh@idfcsski.com	91-22-6638 3382
Dharmesh Bhatt	Technical Analyst	dharmesh@idfcsski.com	91-22-6638 3392
Equity Sales/Dealing	Designation	E-mail	Tel. +91-22-6638 3300
Naishadh Paleja	MD, CEO	naishadh@idfcsski.com	91-22-6638 3211
Paresh Shah	MD, Dealing	paresh@idfcsski.com	91-22-6638 3341
Vishal Purohit	MD, Sales	vishal@idfcsski.com	91-22-6638 3212
Nikhil Gholani	MD, Sales	nikhil@idfcsski.com	91-22-6638 3363
Sanjay Panicker	Director, Sales	sanjay@idfcsski.com	91-22-6638 3368
V Navin Roy	Director, Sales	navin@idfcsski.com	91-22-6638 3370
Suchit Sehgal	AVP, Sales	suchit@idfcsski.com	91-22-6638 3247
Pawan Sharma	MD, Derivatives	pawan.sharma@idfcsski.com	91-22-6638 3213
Dipesh Shah	Director, Derivatives	dipeshshah@idfcsski.com	91-22-6638 3245
Jignesh Shah	AVP, Derivatives	jignesh@idfcsski.com	91-22-6638 3321
Sunil Pandit	Director, Sales trading	sunil@idfcsski.com	91-22-6638 3299
Mukesh Chaturvedi	SVP, Sales trading	mukesh@idfcsski.com	91-22-6638 3298
Viren Sompura	VP, Sales trading	viren@idfcsski.com	91-22-6638 3277
Rajasheshkar Hiremath	VP, Sales trading	rajasheshkar@idfcsski.com	91-22-6638 3243

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