

Company In-Depth

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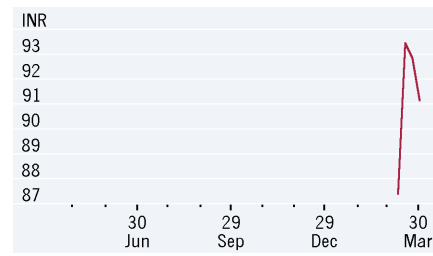
IDEA Cellular (IDEA.BO)

Initiate at Buy: Free from Shackles, Poised for Growth

- Initiate coverage at Buy/Low Risk** — Our DCF-based target price of Rs112 implies a target valuation of 11.6x FY09E EV/EBITDA – in line with that of Bharti. We believe Idea’s relatively undiluted exposure to India’s wireless growth, its higher growth rates (FY07-09E EPS CAGR of 47.7%) and long-term M&A possibilities make it a better proxy for Bharti than is RCOM.
- Leverage to wireless growth restored** — Post its restructuring and IPO, Idea is placed to expand and deepen its network in what is essentially a supply-driven market (FY10E penetration of 32.8%). Roll-outs in three new circles have done well; two more rollouts are due based on spectrum. Margins will soften with new rollouts, but recover gradually to generate FY07-09E EBITDA CAGR of 42.6%.
- Strong regional player** — Idea Cellular has a national market share of 8.7% (Feb-07). More importantly, its strong presence in the eight old circles with 18.2% share and top-three ranking in six of them indicate inherent strengths. Besides, respectable key performance indicators (KPIs), which imply rational competitive behaviour, provide a boost to our confidence in Idea’s ability to achieve NAV accretion from new rollouts.
- Key risks** — Delays in procuring spectrum impacting the rollout timetable and project cost overruns remain the key risks. From an industry perspective, we believe low revenue yields and moderate EBITDA margins leave little room for disruptive pricing.

Buy/Low Risk	1L
Price (10 Apr 07)	Rs94.90
Target price	Rs112.00
Expected share price return	18.0%
Expected dividend yield	0.0%
Expected total return	18.0%
Market Cap	Rs246,062M
	US\$5,765M

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



See Appendix A-1 for Analyst Certification and important disclosures.

Figure 1. Statistical abstract

Year to	EBITDA	Net Profit	FD EPS	EPS Growth	P/E	EV/EBITDA	Price/CEPS
31 Mar	(Rs m)	(Rs m)	(Rs)	(%)	(x)	(x)	(x)
2005P	8,210	760	0.1	NA	NA	NA	NA
2006P	10,674	2,118	0.7	637%	NA	NA	NA
2007E	14,635	4,229	1.6	119%	58.3	18.7	22.2
2008E	21,873	6,631	2.5	54%	37.8	13.3	14.3
2009E	29,762	9,379	3.6	41%	26.7	10.1	10.6

Source: Citigroup Investment Research estimates

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Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	nm	127.7	58.3	37.8	26.7
EV/EBITDA adjusted (x)	34.1	26.7	19.0	12.8	9.8
P/BV (x)	49.0	33.0	6.9	5.5	4.6
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Per Share Data (Rs)					
EPS adjusted	0.10	0.74	1.63	2.52	3.56
EPS reported	0.10	0.74	1.63	2.52	3.56
BVPS	1.94	2.88	13.78	17.29	20.84
DPS	0.00	0.00	0.00	0.00	0.00
Profit & Loss (RsM)					
Net sales	22,558	29,655	43,379	65,284	84,558
Operating expenses	-18,774	-24,476	-35,602	-54,257	-69,011
EBIT	3,784	5,179	7,778	11,026	15,547
Net interest expense	-3,189	-3,225	-3,979	-4,730	-5,165
Non-operating/exceptionals	171	244	495	540	180
Pre-tax profit	766	2,198	4,294	6,836	10,562
Tax	0	-80	-64	-205	-1,183
Extraord./Min.Int./Pref.div.	-538	-435	0	0	0
Reported net income	228	1,683	4,229	6,631	9,379
Adjusted earnings	228	1,683	4,229	6,631	9,379
Adjusted EBITDA	8,210	10,674	14,635	21,873	29,762
Growth Rates (%)					
Sales	74.0	31.5	46.3	50.5	29.5
EBIT adjusted	760.1	36.9	50.2	41.8	41.0
EBITDA adjusted	118.6	30.0	37.1	49.5	36.1
EPS adjusted	107.9	636.7	119.0	54.3	41.4
Cash Flow (RsM)					
Operating cash flow	19,912	22,418	30,463	41,520	48,223
Depreciation/amortization	4,427	5,495	6,857	10,847	14,215
Net working capital	784	4,505	6,705	3,498	-2,652
Investing cash flow	-9,195	-7,188	-32,966	-35,692	-29,378
Capital expenditure	-16,068	-7,188	-32,966	-35,692	-29,378
Acquisitions/disposals	7,322	0	0	0	0
Financing cash flow	13,223	-4,083	12,889	1,103	9,585
Borrowings	13,223	-4,083	9,555	678	9,585
Dividends paid	0	0	0	0	0
Change in cash	23,940	11,147	10,385	6,931	28,431
Balance Sheet (RsM)					
Total assets	53,310	56,547	98,604	113,860	131,096
Cash & cash equivalent	1,772	1,493	15,000	3,000	3,000
Accounts receivable	1,514	1,308	1,810	2,256	2,516
Net fixed assets	25,125	28,835	54,901	82,046	99,509
Total liabilities	44,092	45,211	62,868	68,305	76,163
Accounts payable	4,169	8,693	15,306	18,421	15,264
Total Debt	36,939	32,856	42,411	43,090	52,675
Shareholders' funds	9,218	11,336	35,735	45,554	54,933
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	36.4	36.0	33.7	33.5	35.2
ROE adjusted	5.7	30.9	20.0	16.3	18.7
ROIC adjusted	10.1	11.7	14.5	14.5	15.1
Net debt to equity	381.5	276.7	76.7	88.0	90.4
Total debt to capital	80.0	74.3	54.3	48.6	49.0

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Valuation Analysis

DCF-based target price of Rs112

We set our 12-month price target for Idea Cellular at Rs112 per share giving a total return of 18% based on Mar 08E DCF. We believe this is an appropriate method due to the back-ended nature of free cash flows, especially in the context of new circle roll outs. We use a WACC of 10.8% at a target debt to total capital of 50.0% along with long-term terminal growth rate of 4.0% (similar to Bharti). Our DCF is based on explicit forecasts of FY07-16E with a terminal year EBITDA margins at 37.1% (~200bps below Bharti) and capex/sales of ~10% (in line with Bharti).

Figure 2. DCF Valuation

Rs m	Mar-07E	Mar-08E	Mar-09E	Mar-10E	Mar-11E	Mar-12E	Mar-13E	Mar-14E	Mar-15E	Mar-16E
Oper. EBIT	7,778	11,026	15,547	19,507	23,395	26,607	29,444	31,796	33,695	35,230
(Less) Taxes	(64)	(205)	(1,183)	(1,615)	(2,129)	(2,627)	(3,132)	(8,718)	(10,894)	(12,077)
Net int. income/(exp)	(3,484)	(4,190)	(4,985)	(5,086)	(4,382)	(3,155)	(1,476)	494	2,619	5,025
Marginal Tax Rate	34%	34%	34%	34%	34%	34%	34%	34%	34%	34%
Tax shield adjustments	(1,171)	(1,408)	(1,675)	(1,709)	(1,472)	(1,060)	(496)	166	880	1,688
NOPAT	6,543	9,413	12,689	16,183	19,793	22,920	25,815	23,243	23,681	24,842
(Add) Depreciation	5,814	9,697	13,065	15,819	18,241	20,556	22,755	24,838	26,786	28,583
(Add) Amortisation	1,044	1,150	1,150	1,150	1,150	1,150	1,150	1,150	1,150	1,150
(Less) Capex	(30,611)	(36,842)	(30,528)	(24,558)	(23,875)	(22,431)	(21,541)	(20,111)	(18,853)	(17,098)
(Less) Investments	-	-	-	-	-	-	-	-	-	-
(Less) Working Capital	6,705	3,498	(2,652)	(2,485)	(277)	(822)	(110)	(438)	(400)	(793)
Other adjustments	-	-	-	-	-	-	-	-	-	-
Free Cash Flows	(10,506)	(13,084)	(6,275)	6,109	15,033	21,374	28,069	28,682	32,364	36,684
Terminal Growth Rate	4.0%									
WACC	10.8%									
NPV (explicit FCF)	88,768									
NPV of terminal value	246,655									
Firm value	335,423									
Net debt/cash	40,090									
Equity value	295,333									
No. of shares	2,635									
Equity value per share	112									

Source: Citigroup Investment Research estimates

Figure 3. WACC Estimation

Risk-free rate (%) - (Rf)	8.0%
Equity risk premium (%) (Rp)	8.0%
Beta (B)	1.0
Cost of equity	16.0%
Cost of debt	8.5%
Marginal tax rate (%)	34.0%
Target Debt to total capital (%)	50.0%
Long Run Nominal Growth rate (g) (%)	4.0%
WACC	10.8%

Source: Citigroup Investment Research

Figure 4. Valuation Sensitivities

WACC/g	2.5%	3.0%	3.5%	4.0%	4.5%	5.0%	5.5%
9.3%	124	133	143	155	170	188	211
9.8%	113	120	128	138	150	164	182
10.3%	103	109	116	124	134	145	159
10.8%	94	99	105	112	120	129	140
11.3%	86	91	96	102	108	116	125
11.8%	80	83	88	93	98	105	112
12.3%	73	77	81	85	90	95	101

Source: Citigroup Investment Research

Idea's EV/EBITDA at par with Bharti, but multiple factors to support it

Idea trades at a 6.5% discount to Bharti on FY09E EV/EBITDA. Our DCF based target of Rs112 equates to an EV/EBITDA of 11.6x, a slight premium to Bharti's target multiples (for the ex-towerco portion of Rs800). Though Bharti's scale and well established management track record warrant a premium, we believe the following factors will support Idea's valuations:

1. Higher EBITDA growth rates for Idea for FY07-09E (800bps over Bharti) partly on account of the low base due to the under-investment in FY06 and 1HFY07.
2. Liquidity overflow from the best-in-class Bharti (due to constraints imposed by the foreign limit) should benefit Idea.
3. Meanwhile, restoration of Idea's leverage to India's wireless growth and constraints faced by peers (RCOM's impending GSM overlay), makes the stock a preferred alternative.
4. Though the Aditya Birla Group has ruled out any potential M&A transaction in the immediate future, we believe that M&A potential exists in the long run, especially as spectrum constraints hinder the new entrants in GSM (Maxis, RCOM, Telekom Malaysia). A significant block (~30%) of private equity investors with a lock-in of one year, will also keep potential suitors interested.
 - a. RCOM, post its unsuccessful bid for Hutch-Essar, could be interested in Idea as it provides near-perfect fit for RCOM's present GSM presence.
 - b. Vodafone's stated target of 20-25% market share (from ~16%) appears steep and may have to involve inorganic options.
 - c. Idea's footprint also provides good fit for Maxis.

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Figure 5. Peer Valuation Comparison (At current prices)

	EV/EBITDA (x)		PER (x)		P/CEPS (x)		EBITDA CAGR (FY07-09E)	EPS CAGR (FY07-09E)
	2008E	2009E	2008E	2009E	2008E	2009E		
Idea	13.3x	10.1x	37.8x	26.7x	14.3x	10.6x	42.6%	47.7%
Bharti	13.5x	10.8x	23.9x	19.7x	15.1x	12.3x	34.6%	32.8%
RCOM	10.4x	7.9x	18.9x	14.4x	10.9x	8.4x	37.4%	39.0%

Source: Citigroup Investment Research estimates

Figure 6. Peer Valuation Comparison (At target prices)

	EV/EBITDA (x)		PER (x)		P/CEPS (x)		EBITDA CAGR (FY07-09E)	EPS CAGR (FY07-09E)
	2008E	2009E	2008E	2009E	2008E	2009E		
Idea	15.3x	11.6x	44.5x	31.5x	16.9x	12.5x	42.6%	47.7%
Bharti ¹	14.2x	11.3x	25.1x	20.8x	15.9x	12.9x	34.6%	32.8%
RCOM	12.7x	9.7x	23.2x	17.7x	13.4x	10.4x	37.4%	39.0%

¹ TP of Rs.800 ex-Towerco

Source: Citigroup Investment Research estimates

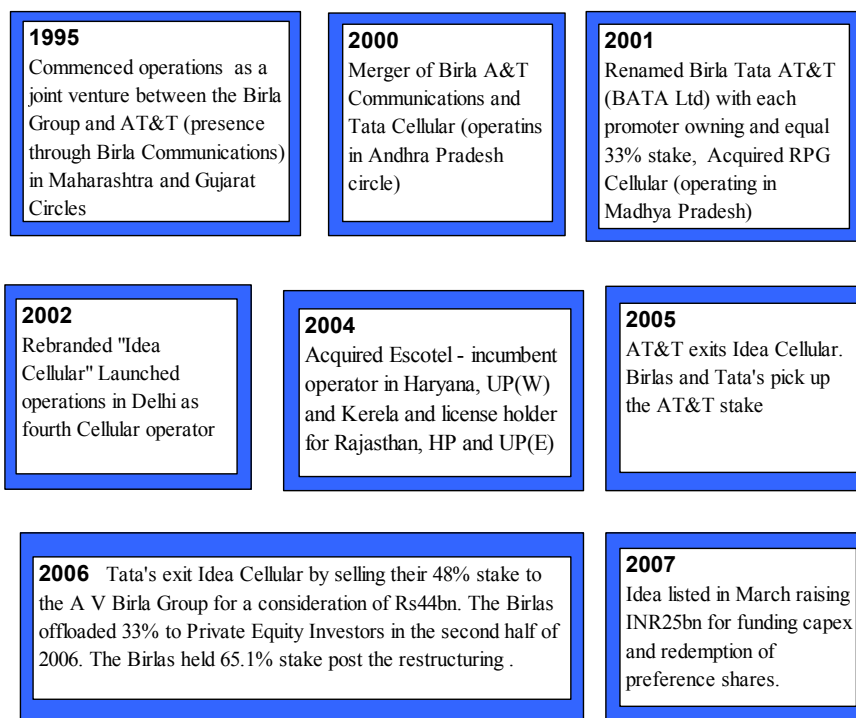
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Idea in FY08/09 - Regaining Lost Ground

Evolution of Idea

Originally a joint venture between the Aditya Birla group and A&T (presence through Birla Communications), the shareholding structure has undergone a significant change since it commenced operations in 1995

Figure 7. Flashback



Source: Citigroup Investment Research

What has changed now?

Strong and single local promoter in charge now

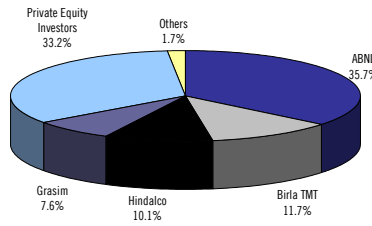
After years of restructuring and lack of clarity among the various promoter groups, Idea Cellular is finally under one single promoter – the A.V. Birla Group, from 2006 onwards post the sale of Tata's 48% stake in Idea Cellular to the A.V. Birla Group. The A.V. Birla Group held a 65.1% stake post this final round of restructuring. With this restructuring, Idea Cellular joined the other major India telcos such as Tata Tele, Bharti and Reliance, which are backed by a financially strong promoter.

Post the management control shifting to the Birlas and reduced uncertainty among the shareholders, the focus has increased on: 1) improving coverage in existing eight circles where peers had moved ahead, 2) implementing rollout in three new circles, i.e. H.P., UP(E) and Rajasthan in FY07, and 3) rollout in Mumbai and Bihar in 2HFY08 post spectrum allocation.

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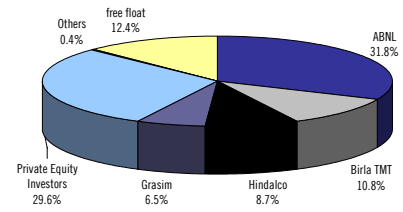
Besides, a single promoter now enables greater flexibility in decision making, especially with respect to rollout strategies, new circle acquisitions and more dynamic capex budgeting. We therefore believe that the benefits of the change in its corporate structure suit the requirement of the Indian wireless industry.

Figure 8. Shareholding Pattern (Post restructuring)



Source: Company Reports, Citigroup Investment Research

Figure 9. Shareholding Pattern (Post IPO)



Source: Company reports, Citigroup Investment Research

Idea's public listing

Post the last round of restructuring, which brought the emergence of one dominant promoter – A.V. Birla Group – Idea Cellular listed on the Indian bourses in March 2007 at an issue price of Rs75 per share with the promoters diluting 7.4% stake. It raised Rs25bn to fund its capex programme, with part of the proceeds already used for redemption of preference shares (Rs7.6bn including accumulated dividend).

Current Operations Display Inherent Strengths

Idea Cellular is the fifth largest wireless operator in India. The Idea network runs on the GSM platform and operates in about 3,031 towns (census and non-census) in 11 circles in India. It has a subscriber base of about 13.6m subscribers as of Feb 2007 and an overall market share of 8.7% (18.2% in the 8 circles of active operation, i.e. excluding UP(E), Rajasthan and HP) behind Bharti, RCVL, BSNL and Hutch. Idea has a strong presence in its eight active circles in terms of operational coverage and market position. It has a total highway connectivity of about 24,000kms with 8,600 cell sites. It also has 142,440 retail outlets across the country, 36 Mobile Switching Centres (MSC's) and 128 Base Station Controllers (BSC's). Its network strategy in the existing circles follows a cluster approach, whereby it penetrates deeper in the existing circles and then expands coverage to render its network competitive.

Idea operates at 6.2Mhz spectrum capacity in Gujarat, Maharashtra and Haryana, at 8MHz in AP, Delhi and MP, 9.8MHz in UP(W) and 4.4MHz in Kerala. Further in the circles where it rolled out services in FY07, it has 6.2MHz in HP and Rajasthan and 8MHz in UP(E).

Figure 10. Spectrum Capacity

Established circles	900 MHz	1800 MHz	Total
AP	6.2	1.8	8.0
Delhi	-	8.0	8.0
Gujarat	6.2	-	6.2
Haryana	6.2	-	6.2
Kerala	-	4.4	4.4
MP	6.2	1.8	8.0
Maharashtra	6.2	-	6.2
UP(W)	7.8	2.0	9.8
New circles			
HP	-	6.2	6.2
Rajasthan	-	6.2	6.2
UP(E)	6.2	1.8	8.0

Source: Company Reports

Idea has applied for licenses in 11 circles, including Mumbai, Bihar, Orissa, Karnataka, Tamil Nadu, Punjab and Chennai. Out of this, the company has already paid the entry fee and activated the licence for Mumbai and Bihar. The selection of new circles is based on penetration levels, ease of roll-out, entry fee, and ability to acquire spectrum. Idea has already rolled out its network for the existing licenses in Rajasthan, UP(E) and HP (owned by Escotel earlier). While the next priority will be Mumbai and Bihar, which are expected to launch in the second half of FY08, timing will be contingent on the delayed spectrum allocation.

It has also applied for an NLD licence and has received the Letter of Intent (LoI). The company is toying with various options, however, which range between: 1) leasing capacity for carrying non-captive wholesale traffic, and 2) only carrying on-net traffic. The company is likely to take a decision on this only after evaluating the cost-benefit analysis vis-à-vis the wholesale carriage rates offered by the present NLD operators, which have come down substantially.

Strong player in existing circles

Idea is a market leader in the Maharashtra and UP (W) and ranks among the top-three operators in six of the 11 circles where it operates. This is helped in part on account of it being the incumbent operator in seven circles. The only circle, where, despite being an incumbent operator, Idea is not among the top-three players is AP, where its market share of 14.0% is lower than that of Bharti (27.7%), RCOM (22.7%) and BSNL (14.2%).

Figure 11. Circle Wise Market Share

	Idea	Bharti	BSNL ¹	Reliance	Hutch	Tata Tele	Others	Total
<i>Top player in the circle</i>								
Maharashtra	24.3%	21.0%	17.5%	19.9%	9.4%	7.9%		100%
U.P.(W)	20.8%	13.0%	17.0%	19.6%	20.8%	8.8%		100%
<i>Among top 2 players in the circle</i>								
M.P.	22.2%	19.2%	16.8%	36.8%	0.0%	5.1%		100%
Haryana	20.2%	17.6%	21.1%	12.5%	17.3%	11.2%		100%
<i>Among top 3 players in the circle</i>								
Gujarat	16.0%	14.8%	9.6%	17.6%	37.5%	4.4%		100%
Kerala	21.1%	13.4%	27.0%	21.6%	11.7%	5.3%		100%
<i>Rest of the circles in which Idea operates</i>								
A.P.	14.0%	27.7%	14.2%	22.7%	11.6%	9.7%		100%
Delhi	12.2%	25.8%	11.3%	17.6%	19.6%	13.5%		100%
H.P.	1.1%	39.0%	34.1%	19.6%	0.0%	5.9%	0.3%	100%
U.P.(E)	3.2%	15.2%	27.6%	21.1%	27.3%	5.6%		100%
Rajasthan	3.3%	24.6%	24.1%	18.2%	19.6%	9.7%	0.5%	100%
Total market share²	15.2%	20.2%	18.0%	20.7%	17.7%	8.1%	0.0%	100%

¹ Includes MTNL² Market share in the circles where Idea operates

Source: Citigroup Investment Research, COAI, AUSPI

Retaking the ground it lost since 2HFY07

Post the clarity on shareholding structure and with a single promoter at the helm, Idea has refocused its energies on the eight existing circles first. The market share/net adds in the eight circles lagged in the past, mainly due to the lack of adequate coverage capex, even as the peers surged ahead. This lower infrastructure spend prior to the restructuring resulted in Idea Cellular leaking its market share in some of the circles to its competitors (See figure 12).

Figure 12. Historical Capex Comparison

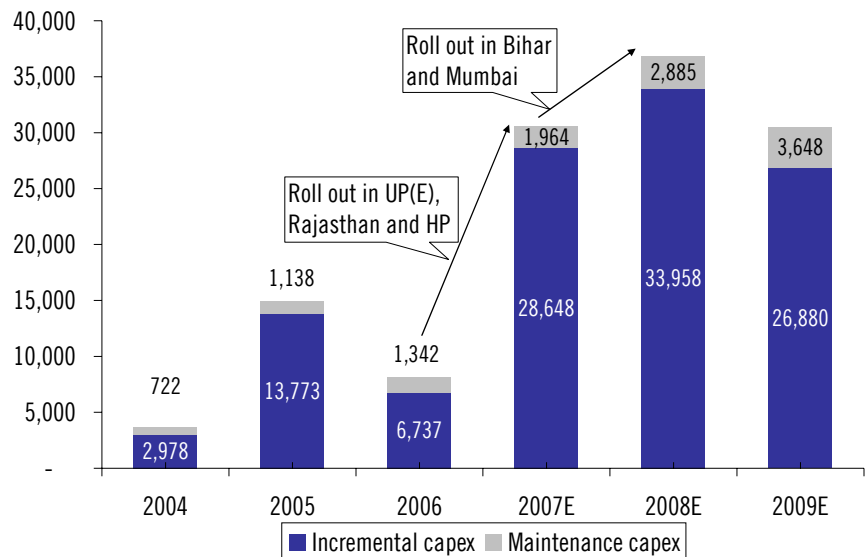
Year ended March 31,	Capex to sales (%)		
	2004	2005	2006
Idea Cellular	39.9%	67.2%	27.2%
Bharti Airtel ¹	51.6%	54.7%	53.3%

¹ Mobile capex only

Source: Citigroup Investment Research, Company Reports

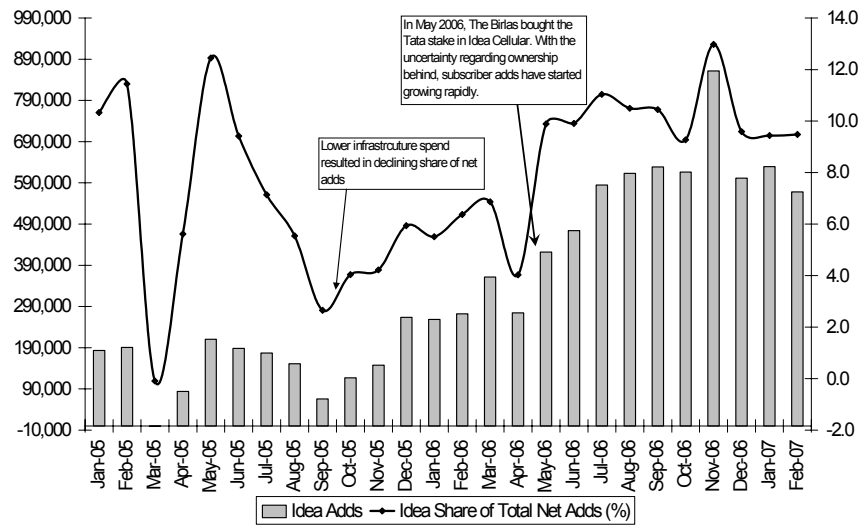
However, recent months brought a strong resurgence as Idea has stepped up capex in the existing circles to plug the coverage gap between itself and the other players viz. Bharti, Hutch and BSNL. This is quite evident in the sustained increase in Idea's net subscriber additions (Figure 14). Idea rolled out services in three new circles in FY07, i.e. UP(E), Rajasthan and H.P. It expects to roll out services in the Mumbai and Bihar circles by the second half of 2008 once spectrum becomes available. It expects to incur capex of Rs12bn over FY08 and FY09 for its roll out plans in these two new circles.

Figure 13. Capex Build-up...



Source: Citigroup Investment Research, Company Reports

Figure 14. ... Resulting in Improvement in Idea's Share of Net Adds in the Past 10 Months



Source: COAI, AUSPI, Citigroup Investment Research

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KPIs compare well with peers

Idea's key performance indicators (MOU, ARPU and EBITDA margins) compare well with those of its peers. This indicates Idea's ability to execute well, despite the scale shortcomings vis-à-vis the nationwide players. Besides, it has achieved its strong market share position without compromising on tariffs (rev/min).

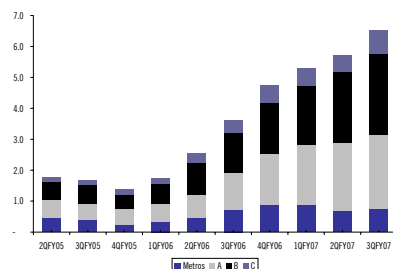
Please note, however, that Idea's pre-paid ARPUs are calculated without amortizing the lifetime rentals (which is amortized over 18 months for Bharti and 46-65 months for RCVL). This explains the increase in Idea's pre-paid ARPUs during 2HFY06, when lifetime rentals made a significant contribution. This also explains the jump in EBITDA margins.

Figure 15. Indian Wireless: KPI Comparison

Blended ARPU (Rs)	Jun-05	Sep-05	Dec-05	Mar-06	Jun-06	Sep-06
Bharti	491	476	470	442	441	438
Hutch Essar	554	518	511	454	433	420
Reliance	403	421	413	379	379	354
Idea	416	375	397	381	362	335
Blended MOU (min)						
Bharti	383	388	411	431	441	451
Hutch Essar	351	369	385	378	392	406
Reliance	501	568	547	532	491	461
Idea	280	282	290	302	342	344
ARPM (Rs/Min)						
Bharti	1.31	1.25	1.17	1.04	1.01	0.98
Hutch Essar	1.58	1.40	1.33	1.20	1.10	1.03
Reliance	0.80	0.74	0.76	0.71	0.77	0.77
Idea	1.49	1.33	1.37	1.26	1.06	0.97
EBITDA Margins %						
Bharti	34.8	36.5	36.5	36.2	36.4	36.9
Hutch Essar	33.6	NA	31.3	NA	32.7	NA
Reliance	22.7	28.2	32.1	35.7	36.0	36.1
Idea	NA	34.0	35.5	39.1	33.6	35.1

Source: Company Reports and Citigroup Investment Research

Industry Overview and Outlook

Figure 16. Subscriber Adds by Category (m)

Source: Citigroup Investment Research

India remains among our favorite markets. We recently raised our growth forecasts to reflect a record-setting pace that we believe is achievable. Our subscriber estimates stand at 239m for March-08 and 388m for March-10. We are firmly convinced that a combination of increased coverage helped in part by infrastructure sharing, lower cost handsets, innovative pricing and regulatory cost cuts will drive Indian wireless subscriber growth consistently higher – we expect ~50% wireless penetration by 2016.

Indian wireless – strong tailwinds

We expect 239m subscribers by March 2008 and 388m by March 2010. While higher peak in net adds in recent months confirms the trend, our forecasts are based on the continued strong tailwinds in the form of unprecedented coverage expansion, lower price handsets (esp. in GSM), rising affordability and affordable tariffs.

Figure 17. Subscriber Estimates

	FY07E	FY08E	FY09E	FY10E	FY16E
Subscriber Estimates ('000)	162,230	239,186	313,894	387,693	664,128
Population (Million)	1,130	1,147	1,164	1,182	1,292
Penetration (%)	14.4%	20.9%	27.0%	32.8%	51.4%

Source: Citigroup Investment Research estimates

Figure 18. Teledensity Forecasts

	FY06	FY07E	FY08E	FY09E
Total Fixed	56,409	61,472	64,194	67,114
Wireline	49,795	50,710	49,358	48,202
Fixed Wireless	6,614	10,763	14,837	18,912
Total Wireless	91,993	162,230	239,186	313,894
GSM	69,194	121,234	180,328	237,513
CDMA	22,800	40,997	58,858	76,381
Total Subs (000)	148,402	223,703	303,381	381,009
Population	1,113	1,130	1,147	1,164
Growth (%)	1.5%	1.5%	1.5%	1.5%
Mobile penetration (%)	8.3	14.4	20.9	27.0
Fixed penetration (%)	5.1	5.4	5.6	5.8
Total teledensity (%)	13.3	19.8	26.4	32.7

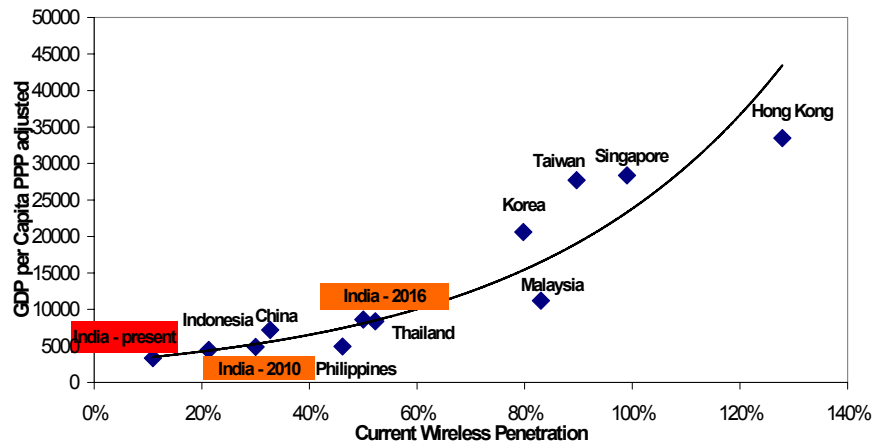
Source: COAI, AUSPI, Citigroup Investment Research estimates

Wireless Penetration Forecasts

India's wireless penetration is the lowest in the region, in line with the country's per capita income (see chart below). But that is changing dramatically with the rise in nominal income levels; India's penetration is likely to reach ~30% in 2010 and 50% in 2016 if one simplistically follows the best-fit curve that explains the correlation between teledensity and per capita income.

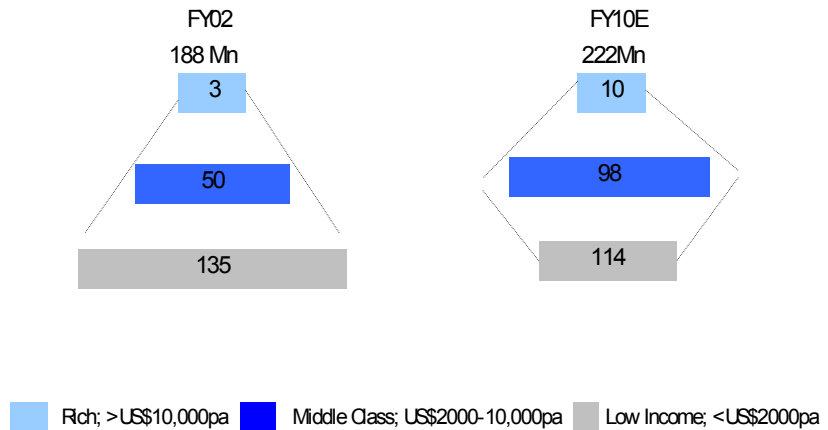
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Figure 19. Wireless Penetration in Sync with Per Capita GDP (US\$/annum)



Source: Citigroup Investment Research

Figure 20. India's Income Distribution (Number of Households in Millions)



Source: NCAER, Citigroup Investment Research

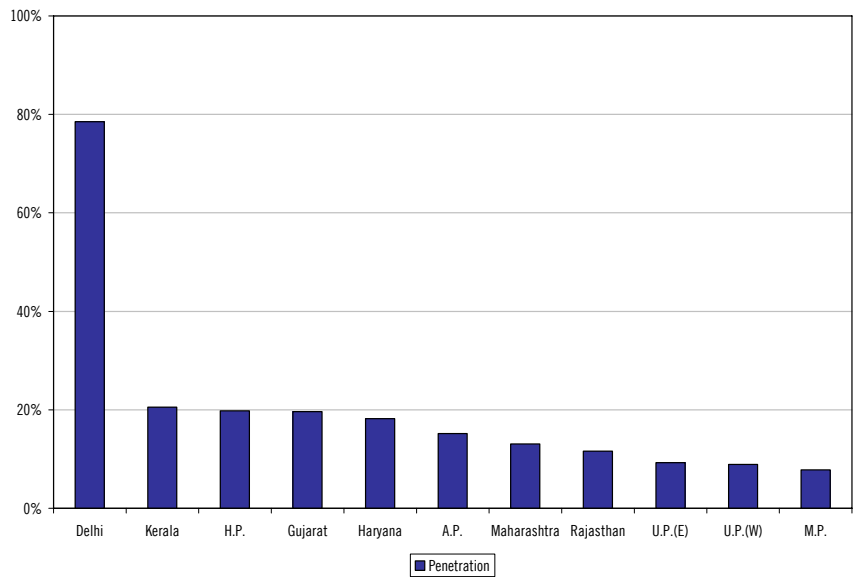
Besides the empirical evidence, our renewed confidence in India's growth potential stems from two factors:

1. Affordability — Lowest tariffs in the world (revenue yields at 2cents/min) and innovative offerings (which match up to the best in the industry) offset some of the disadvantages of low per capita incomes. In fact, MOUs have remained high and ARPUs have not fallen that sharply either, indicating that the Indian subscriber's affordability may have been underestimated earlier.

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2. Coverage — With only 50% of the population covered and all operators pursuing a scorching rate of geographical expansion, we believe that coverage itself could continue to drive net adds over the next 18-24 months. This is evident in the wide difference between penetrations in various circles in which Idea is present.

Figure 21. Penetration in Idea's 11 licenses Reflects Significant Potential



Source: Citigroup Investment Research, COAI, AUSPI

ARPU curve to reflect affordability, price elasticity to be restrained

Increasing penetration is, however, likely to come at lower ARPUs. Though ARPUs have remained relatively resilient on account of the spurt in usage levels in the recent past, we believe that price elasticity of usage will wear off eventually. Average MOUs and hence ARPUs will, therefore, decline (especially in the pre-paid segment) as wireless penetration deepens to accommodate customers with less disposable income.

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Financial Overview

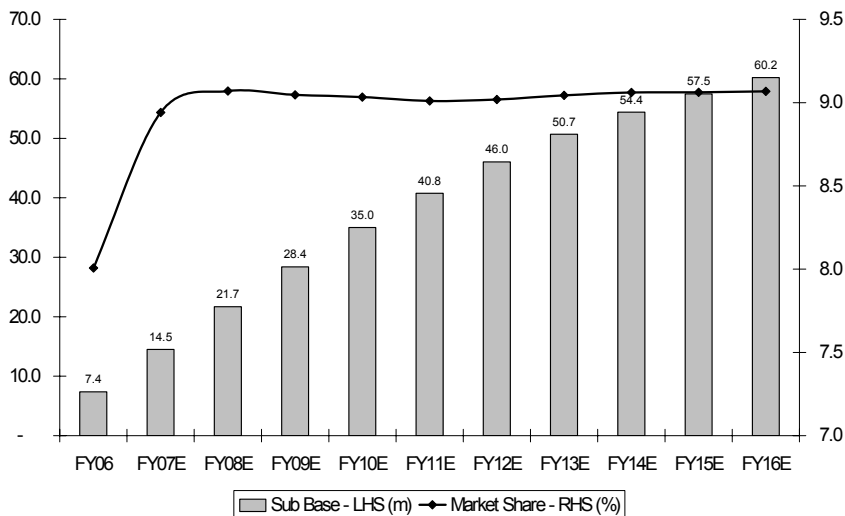
Our financial forecasts for FY07-09E incorporate the rollouts on three licenses (UP-East, Rajasthan and HP) in the current fiscal year and proposed rollouts in Mumbai and Bihar in 2HFY08. While the company also proposes an NLD rollout, its commitment in terms of entry fee (Rs25m) and rollout capex will likely remain manageable as the company is likely to follow a mix of “make” and “buy” strategies.

Key assumptions

Market Share

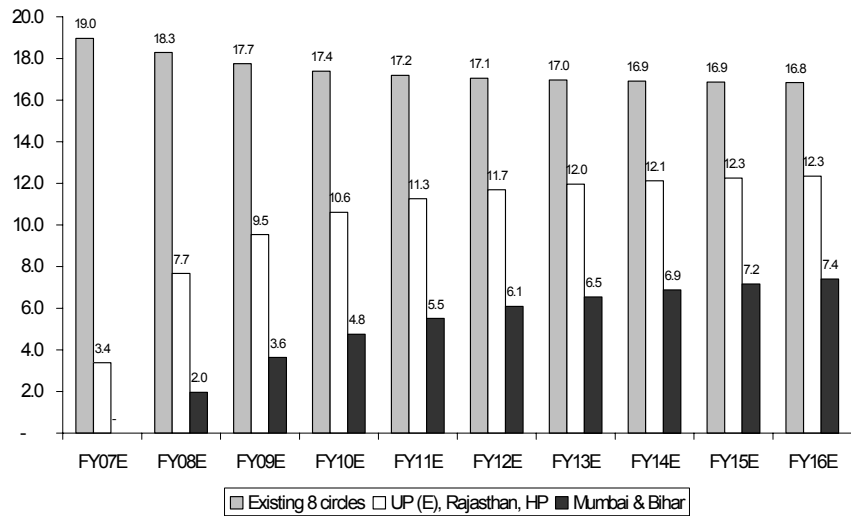
We believe that Idea’s overall market share will stabilize at around 9% (including incremental market share in five new circles). However, we conservatively assume a lower market share for the three new circles, which were launched in FY07 (UP-East, Rajasthan and HP) and the proposed two new circles (Mumbai & Bihar). The market share assumption for the new circles is in line with Idea’s performance in Delhi, where it was a relatively late entrant as a fourth operator. The strong presence of incumbents (esp. in Mumbai) and potential entry of new players (Maxis, RCOM GSM) will also play a role in determining the extent of Idea’s gains.

Figure 22. Idea’s Subscriber Forecasts



Source: COAI, AUSPI, Citigroup Investment Research estimates

Figure 23. Idea's Market Share – Existing, New and Proposed Circles (%)

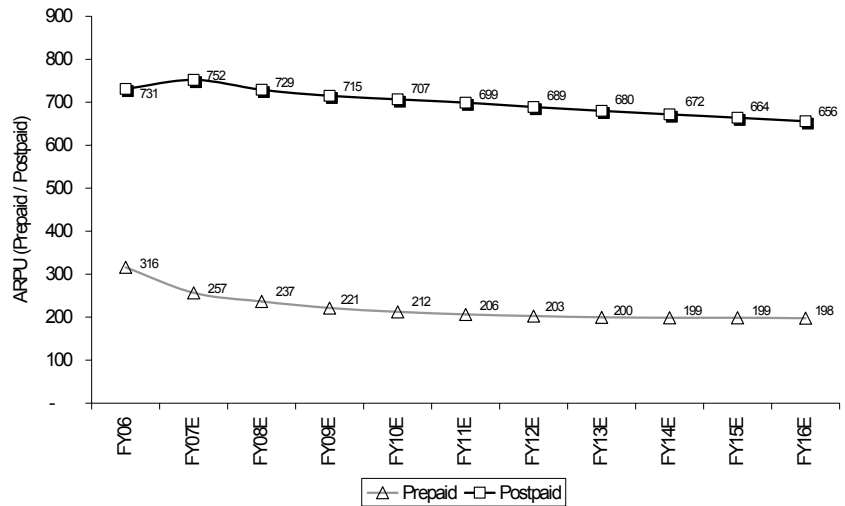


Source: Citigroup Investment Research

ARPU and revenue per min

We forecast Idea's ARPU to decline from about Rs390 (US\$9) in FY06 to about Rs300 (US\$6.5) in FY08E and Rs250 (US\$5.5) in 2016E. Increasing penetration would obviously come at lower ARPUs. Though ARPUs have remained remarkably resilient on account of a spurt in usage levels, we believe that price elasticity of usage will wear off eventually as tariff declines moderate from hereon. MOUs and hence ARPUs will, therefore, decline (esp. in pre-paid segment) as wireless penetration deepens.

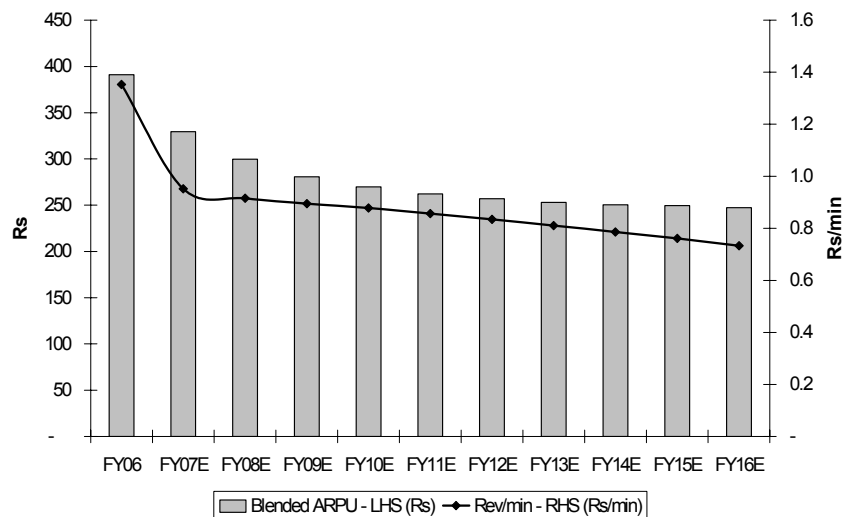
Figure 24. ARPU Trends (Rs.)



Source: Company Reports, Citigroup Investment Research estimates

We expect the revenue per min (ARPU divided by MOU) to decline from about Rs1.0 to Rs0.73 by 2016. Competitive equilibrium and likely rational pricing strategies from new entrants will ensure that declines in revenue yields will moderate compared with previous levels. Also, the improving outgoing/incoming mix and growing contribution from mobile value added services (VAS) should cushion the decline in revenue per min. This trend is evident in the recent KPIs of Bharti and will also likely kick in for Idea going forward.

Figure 25. Revenue Yields and Blended ARPU



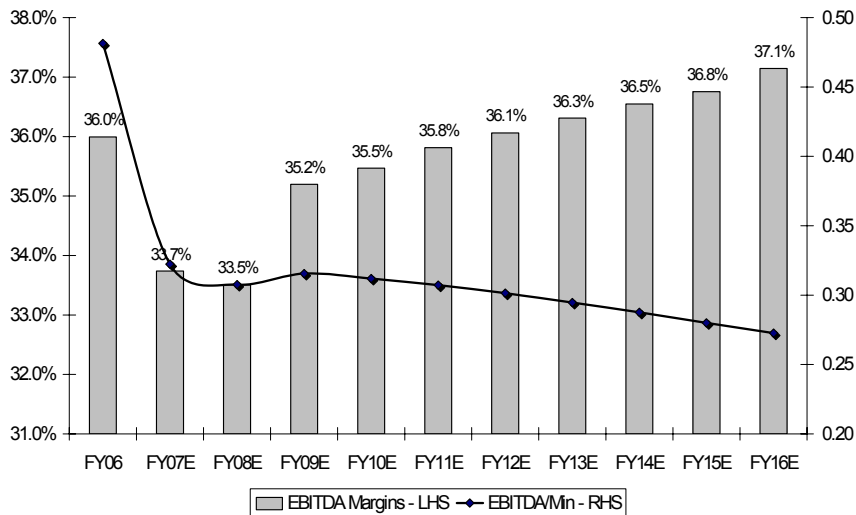
Source: Company Reports, Citigroup Investment Research estimates

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EBITDA margins

We expect pressure on Idea’s EBITDA margins during FY07-08E on account of the new rollout of the five new circles. Upfronting of fixed costs and inevitable gradual ramp-up in revenues will mean EBITDA breakeven could take 12-15 months in the new circles. We expect Idea to achieve a stable state EBITDA of 36-37%, about 200bps lower than its larger peer, Bharti.

Figure 26. EBITDA - % of Revenue and Rs/min

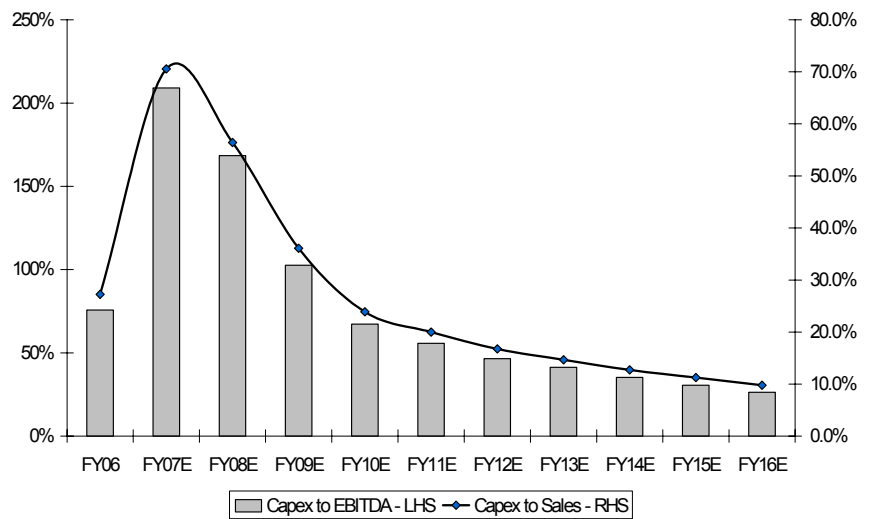


Source: Company Reports, Citigroup Investment Research estimates

Capital expenditure – catch up + new rollouts

Capital expenditure for FY07-08E will be on the higher side (compared to EBITDA and sales) due to the new rollouts – including ~Rs12bn for Mumbai and Bihar to be incurred during FY08-09E. Idea is likely to get spectrum in the 1800MHz frequency from the Wireless Planning & Coordination (WPC) wing of the DoT, which would entail higher capex spending as compared to if it were to roll out services using the 900 MHz frequency. Terminal Capex/sales of 10% (FY16E) and Capex/EBITDA of 26%, are, however, in line with the rest of the industry.

Figure 27. Capital Expenditure Assumptions

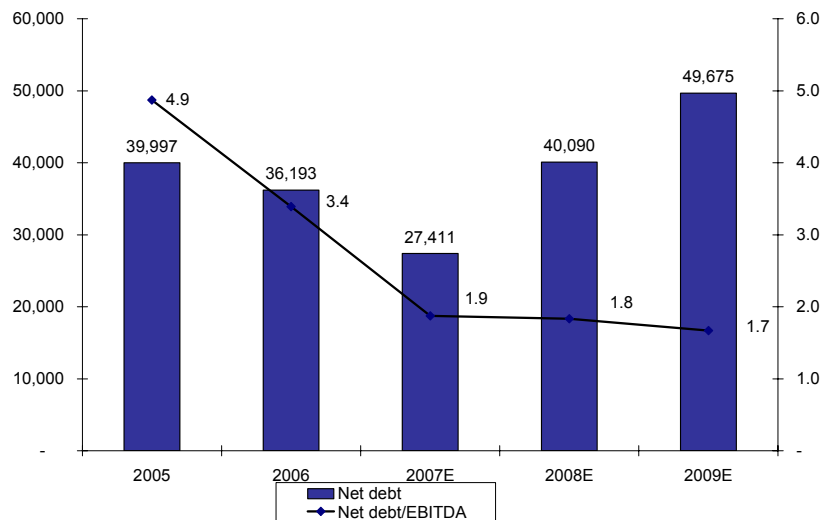


Source: Citigroup Investment Research, Company Reports estimates

Leverage under control

Despite the IPO funding, Idea will require additional debt to fund its capex in FY08-09. However, its net debt/EBITDA will come down to manageable levels of ~1.8x in FY08E. We factor in a greenshoe option (42.5m shares) which was recently exercised by the company, leading to an increase in equity capital to Rs26,354m and the consequent increase in share premium.

Figure 28. Leverage Under Control Post IPO (Rs m)



Source: Company Reports, Citigroup Investment Research estimates

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Key assumptions – Comparison with peers

To summarise our key assumptions for FY07-09E, we compare our forecasts for Idea with its peers that we have under coverage – Bharti, RCOM, Hutch-Essar. Our assumptions for Idea reflect its stage of rollout, and its strengths & weaknesses vis-à-vis the integrated and larger players. The key difference is Idea's EBITDA margin, which will be constrained in FY07E-08E due to new circle rollouts.

Figure 29. Comparison of Assumptions for FY06-09E with RCOM, Bharti and Hutch

	FY05/CY04	FY06/CY05	FY07/CY06E	FY08/CY07E	FY09/CY08E
Subs (M)					
Bharti	11.0	19.6	37.1	55.0	70.8
Hutch-Essar	-	11.4	23.4	37.0	49.7
RCOM	10.4	16.7	29.1	44.0	58.7
Idea	5.1	7.4	14.5	21.7	28.4
Blended ARPU (Rs)					
Bharti	498	441	425	375	342
Hutch-Essar	-	522	425	364	329
RCOM	NA	435	391	354	316
Idea	419	395	329	300	281
EBITDA % - wireless					
Bharti	34.2%	36.1%	36.5%	38.3%	38.9%
Hutch-Essar	0.0%	32.4%	33.0%	35.0%	36.5%
RCOM	NA	30.3%	36.9%	37.1%	38.4%
Idea	36.4%	36.0%	33.7%	33.5%	35.2%
Wireless Capex (INR M)					
Bharti	28,952	43,048	75,504	81,273	70,485
Hutch-Essar	14,410	15,545	49,237	53,368	47,343
RCOM	-	NA	62,683	76,629	79,171
Idea	14,911	8,079	30,611	36,842	30,528
Capex to sales (%) - wireless					
Bharti	55%	53%	52%	39%	27%
Hutch-Essar	0%	27%	55%	40%	28%
RCOM	0%	NA	58%	49%	41%
Idea	67%	27%	71%	56%	36%
Revenues – wireless (Rs m)					
Bharti	52,976	80,822	144,420	207,156	257,777
Hutch-Essar	-	56,630	89,522	133,421	169,083
RCOM	-	74,070	107,440	155,019	194,902
Idea	22,464	29,489	43,210	65,111	84,382
EBITDA – wireless (Rs m)					
Bharti	18,507	29,565	52,717	79,414	100,369
Hutch-Essar	-	18,339	29,542	46,697	61,715
RCOM	-	22,411	39,617	57,455	74,830
Idea	8,210	10,674	14,635	21,873	29,762

Source: Company Reports, Citigroup Investment Research estimates

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Financial Summary Tables

Figure 30. Income Statement (Rs m)

Year ending March 31	2005	2006	2007E	2008E	2009E
Service Revenue	22,464	29,489	43,210	65,111	84,382
Equipment Sales	93	166	169	172	176
Total Income	22,557	29,655	43,379	65,284	84,558
Cost of Trading Goods	(84)	(76)	(164)	(167)	(171)
License Fees	(1,472)	(2,152)	(3,258)	(5,695)	(8,110)
Interconnect & Roaming Charges	(5,151)	(6,485)	(9,080)	(13,511)	(16,974)
Network Operating Cost	(1,692)	(2,189)	(4,482)	(6,669)	(8,225)
Staff Costs	(1,419)	(1,734)	(1,875)	(2,676)	(3,470)
Selling Costs	(2,923)	(4,553)	(7,608)	(10,970)	(13,279)
Admin and Other Exp	(1,606)	(1,793)	(2,277)	(3,721)	(4,566)
Total Opex	(14,347)	(18,981)	(28,744)	(43,410)	(54,796)
EBITDA	8,210	10,674	14,635	21,873	29,762
<i>EBITDA margin</i>	<i>36.4%</i>	<i>36.0%</i>	<i>33.7%</i>	<i>33.5%</i>	<i>35.2%</i>
Net interest	(3,189)	(3,225)	(3,979)	(4,730)	(5,165)
Depreciation & Amortization	(4,427)	(5,495)	(6,857)	(10,847)	(14,215)
PBT	760	2,198	4,294	6,836	10,562
PAT	760	2,118	4,229	6,631	9,379
No of shares	2,260	2,260	2,593	2,635	2,635
EPS	0.1	0.7	1.6	2.5	3.6

Source: Company, Citigroup Investment Research estimates

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Figure 31. Balance sheet

Year ending March 31	2005	2006	2007E	2008E	2009E
Shareholders Funds	9,218	11,336	35,735	45,554	54,933
Equity Share Capital	22,595	22,595	25,929	26,354	26,354
Reserves & Surplus	998	998	22,665	25,428	25,428
General Reserves	(19,205)	(17,088)	(12,858)	(6,227)	3,152
Preference Share Capital	4,830	4,830	0	0	0
Loan Funds	36,939	32,856	42,411	43,090	52,675
Current Liabilities & Provisions	7,153	12,355	20,457	25,216	23,488
Eq Supply Payables	4,169	8,693	15,306	18,421	15,264
Advances from Customers	1,379	1,743	2,579	4,022	5,252
Deposits from Customers	760	699	1,000	1,000	1,000
Other Current Liab	739	1,047	1,400	1,600	1,800
Provisions	106	172	172	172	172
Total Liabilities	53,310	56,547	98,604	113,860	131,096
Fixed Assets	35,950	38,769	65,921	91,917	108,229
Goodwill on Consolidation	11,791	11,791	11,791	11,791	11,791
Current Assets, Loans & Advances	5,569	5,987	20,891	10,152	11,076
Inventories	176	114	200	250	300
Sundry Debtors	1,514	1,308	1,810	2,256	2,516
Cash & Bank	1,772	1,493	15,000	3,000	3,000
Other Current Assets	514	678	881	1,146	1,260
Loans & Advances	1,594	2,394	3,000	3,500	4,000
Total Assets	53,310	56,547	98,604	113,860	131,096

Source: Citigroup Investment Research estimates

Figure 32. Cash Flow Statement

Year ended March 31	2005	2006	2007E	2008E	2009E
Net Profit	760	2,118	4,229	6,631	9,379
Depreciation	8,983	4,370	5,814	9,697	13,065
Change in Working Capital	784	4,505	6,705	3,498	(2,652)
Operating Cash Flow	10,527	10,992	16,748	19,826	19,793
Capex	(16,068)	(7,188)	(32,966)	(35,692)	(29,378)
Acquisitions/Disposals	7,322	-	-	-	-
Investments	(450)	-	-	-	-
Other Investing Cash Flow					
Investing Cash Flow	(9,195)	(7,188)	(32,966)	(35,692)	(29,378)
Borrowings	13,223	(4,083)	9,555	678	9,585
Preference capital	-	-	(4,830)	-	-
Equity Changes	-	-	25,000	3,188	-
Financing Cash Flow	13,223	(4,083)	29,725	3,866	9,585
Opening Cash	962	1,772	1,493	15,000	3,000
Change in Cash	14,555	(279)	13,507	(12,000)	-
Closing Cash	15,517	1,493	15,000	3,000	3,000

Source: Company, Citigroup Investment Research estimates

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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 has an active presence in 11 of them. The company listed on the Indian bourses in March 2007 and is part of the Aditya Birla Group.

Investment Thesis

We rate Idea as Buy/Low Risk. Continued robust wireless market expansion and Idea's ability to regain its growth potential post its restructuring and full control by Aditya Birla Group are the key factors to 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. Given the spectrum issues facing potential new entrants, Idea should remain relatively unconstrained for the next 12-18 months. As a result, we estimate an earnings CAGR of 47.7% over FY07-09E, well ahead of its peers and more than double that of the broader market. From an industry perspective, we believe that low revenue yields and moderate EBITDA margins leave little room for disruptive pricing. Additionally, most regulatory concerns are now addressed and potentially costly 3G auctions cannot derail it from its growth path, in our view.

Valuation

We have set our 12-month target price at Rs112 based on Mar-08E DCF, which we think is an appropriate method 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 37.1% (~200bps below Bharti) and capex/sales of ~10% (in line with Bharti). The target price implies an EV/EBITDA of 11.6x, a slight premium to Bharti's target multiples (for the ex-towerco portion of Rs800), which we believe is supported by (1) higher EBITDA growth rates for Idea; (2) liquidity overflow from Bharti's foreign limit constraints; and (3) M&A possibilities in the long run given Idea's good fit for the potential suitors.

Risks

Our quantitative risk rating system assigns a default Speculative Risk rating to Idea due its trading history of less than 12 months. We believe, however, that a Low Risk rating is more appropriate due to the higher visibility of Indian wireless growth, Idea's reasonably competitive position, strong parentage and the reduction of financial leverage post-IPO. Operationally, the risks facing Idea are slightly higher than its more established peers on account of 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 the new circles. Idea will also face competition from the established players in the new circles and market share gains may be lower than expected.

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Idea will incur higher capex requirements in the new circles due to the coverage compulsions, which may depress return parameters in the initial years. Any rollout plans beyond 13 circles may also require a fresh equity infusion. These risk factors could impede the stock from reaching our target price.

Reliance Communications (RLCM.BO - Rs412.65; 1M)

Valuation

We value Indian wireless plays on DCF given the back-ended nature of profits and cash flow. For RCOM, however, we use EV/EBITDA in the absence of a detailed balance sheet. Our 12-month target price of Rs510 is based on 9.7x FY09E EV/EBITDA, a 15% discount to Bharti's target multiple (ex- towerco). We are now assuming a 15% discount to Bharti as against par valuations earlier (i.e. EV/EBITDA of 11.2x FY09E) to reflect the uncertainty on the timing of the GSM rollout and the associated challenges. We expect RCOM's valuation multiples to be determined by Bharti's due to the liquidity overflow from the latter, notwithstanding the risk of technology transition. Meanwhile, higher than average earnings growth (CAGR of 39.0% over FY07-09E) and low sensitivity of wireless demand to interest rates should continue to support premium valuations for the sector.

Risks

Our risk-rating system, which tracks 260-day share price volatility, assigns a High Risk rating to RCOM, but we believe Medium Risk is more appropriate. RCOM has been de-merged from Reliance Industries, and its shareholding at the time of listing mirrored the holding of RIL. The stock is therefore unlikely to have risks that are typical of newly listed companies. Besides, growth in the telecoms sector gives visibility to RCOM's prospects. But we believe its evolving financial history and risks pertaining to GSM overlay warrant a risk rating higher than the Low Risk assigned to Bharti. Downside risks to our target price include smaller-than-expected market share, lower-than-anticipated operating leverage (especially in FY07), cost-overruns in GSM overlay, regulatory and competition risks, un-remunerative capex, delays in the ongoing re-organization and more telecom-related paper.

Bharti Airtel (BRTI.BO - Rs773.50; 1L)

Valuation

Our 12-month forward target price of Rs960 is based on core DCF of Rs800 and a towerco option value of Rs158. The core DCF (as on March-08) is based on a WACC of 10.8%, a terminal growth rate of 4% and beta of 0.9 (implying a terminal EV/EBITDA multiple of 8.5x). We prefer DCF as our primary valuation methodology because the wireless market will likely continue to see robust growth requiring upfront capex but should generate significant free cash beyond 2009-10. Our target price (net of towerco value) represents a FY09E P/E of 20.8x, P/CEPS of 12.9x and EV/EBITDA of 11.3x. The imputed target P/E (net of towerco) of 25.0x FY08E is at 25% premium to the broad market P/E (20.0x FY08E at the higher end of our Sensex target of 16,000). This, we believe, is justified by above-average earnings growth, improved earnings visibility and relative insulation from macro risks.

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Risks

Our quantitative risk-rating system, which tracks 260-day share price volatility, rates Bharti as Low Risk. We are comfortable attributing a Low Risk rating for the following reasons: (1) Bharti has a track record of profitability and execution; (2) the company's capex plans are fully funded; and (3) the strategic shareholding of SingTel leaves us comfortable with execution issues and initiatives. The risks that could prevent the stock from reaching our target price include competition-led tariff pressures, un-remunerative capex, overall market downside, and slower-than-expected execution of the tower sharing initiative.

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Appendix A-1

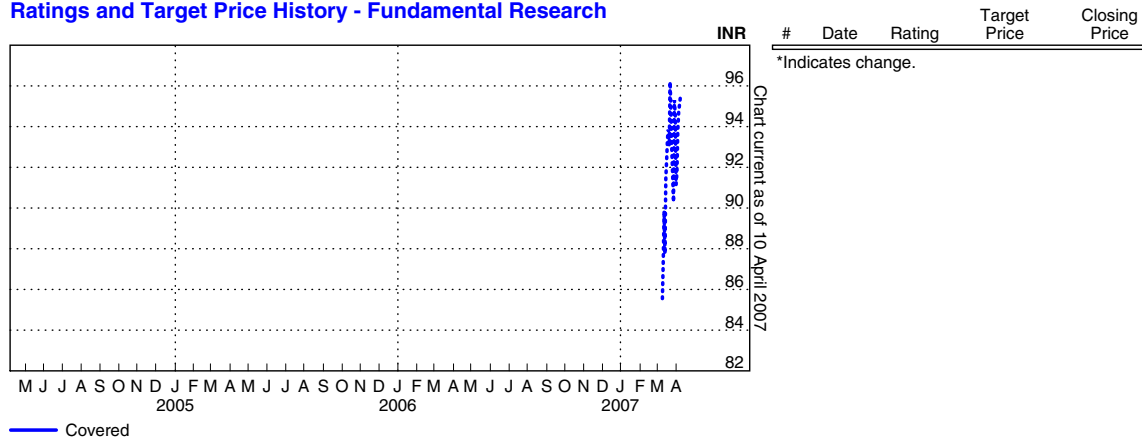
Analyst Certification

We, Rahul Singh and Anand Ramachandran, CFA, research analysts and the authors of this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

IMPORTANT DISCLOSURES

IDEA Cellular (IDEA.BO)

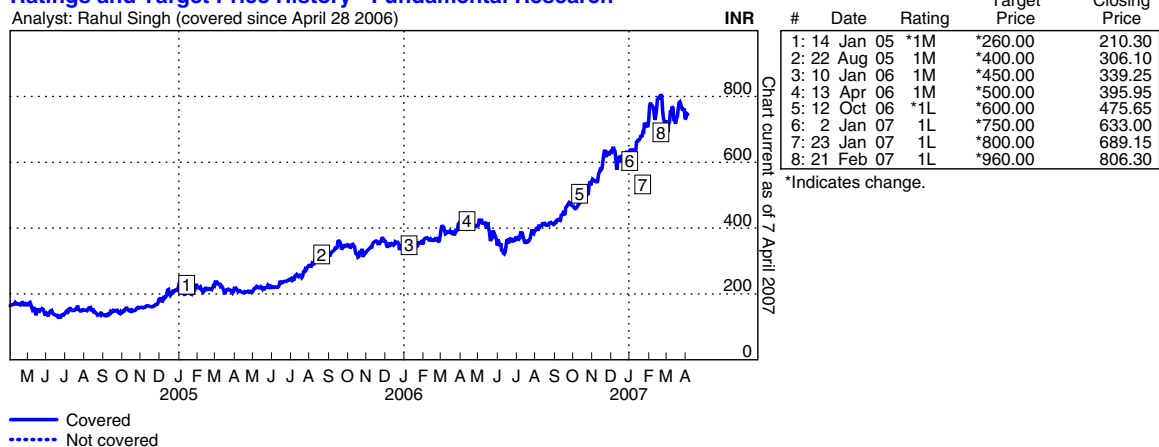
Ratings and Target Price History - Fundamental Research



Bharti Airtel (BRTI.BO)

Ratings and Target Price History - Fundamental Research

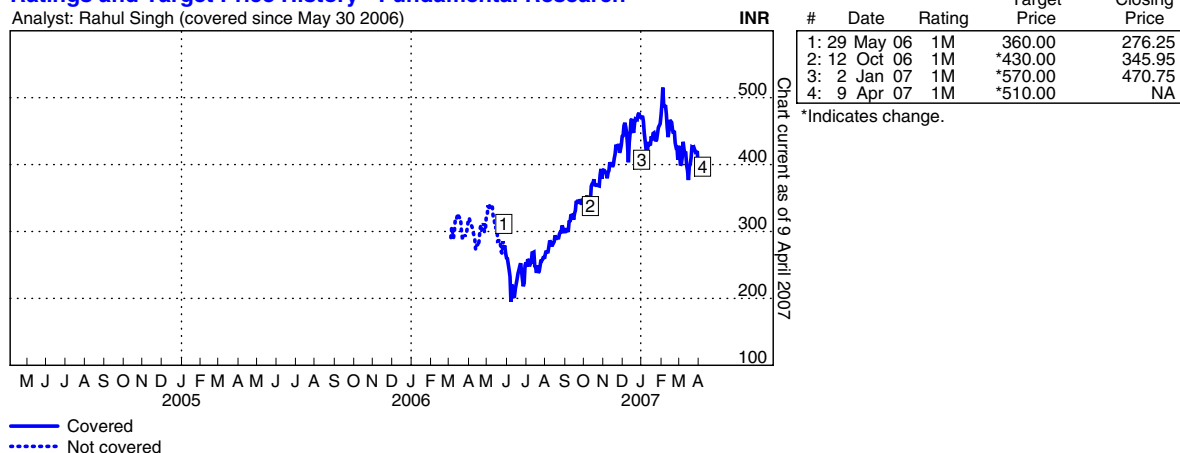
Analyst: Rahul Singh (covered since April 28 2006)



Reliance Communications (RLCM.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Rahul Singh (covered since May 30 2006)



IDEA Cellular (IDEA.BO)

12 April 2007

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Rahul Singh holds a long position in the shares of Bharti Airtel.

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