

Equities

8 November 2011 | 10 pages

OnMobile Global (ONMO.BO)

Value and Some Volume

- Company Update
- Target Price Change
- Estimate Change

| | |
|------------------------------|----------------------|
| Buy | 1 |
| Price (04 Nov 11) | Rs67.95 |
| Target price | Rs100.00 |
| | <i>from Rs170.00</i> |
| Expected share price return | 47.2% |
| Expected dividend yield | 0.0% |
| Expected total return | 47.2% |
| Market Cap | Rs7,944M |
| | US\$162M |

Price Performance (RIC: ONMO.BO, BB: ONMB IN)



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- **Why still a Buy** — The stock has had a bad run, with the domestic slowdown hitting EPS. However, we believe it is still a Buy and offers 50% upside from current levels on the back of ramp-up in the international segment. With the international execution on track, OnMobile should increasingly be de-risked and offer good growth. EBITDA is cut 20%-28% over FY12-14E on the domestic slowdown. The EPS cut is sharper due to a small base. The new TP is based on 13x FY13E P/E (prev. 20x Mar-12E) and is now broadly in line with the market multiple (premium earlier). Multiple is cut primarily to factor in deceleration in earnings growth & some uncertainty surrounding domestic business.
- **Overseas operations supporting growth** — After two slow quarters, revs in the Sep-11 quarter rebounded, growing 18%yoy to Rs1.6bn (Rs1.5bn exp) as tepid domestic segment was more than offset by ramp-up in the international segment. Margins stayed flat vs. expectation of an increase on salary hikes and product-mix changes led to a rise in content costs. Despite this, EBITDA grew a healthy Rs325m (20%qoq; 17%yoy). Reported PAT was significantly ahead, boosted by Rs466m gains on investment sales. Adjusting for this, PAT was below estimates on a higher amortization charge.
- **International business growing in leaps and bounds** — The international segment posted a strong growth rate of 51%yoy and accounted for 42% of the revenues. The execution of Telefonica LatAm deployment remains on track, and is now cash positive. The company's operations in Africa and developed markets too are doing well. The rising contribution of international revenues bodes well for earnings because of: (a) higher and stable contracted revenue share and (b) op leverage – software has been expensed, high incremental contribution margin.
- **Domestic market should remain challenging** — The Indian VAS market is likely to remain anemic due to: (a) TRAI regulations still in the works have increased uncertainty; (b) The “true addressable” mkt is already quite well penetrated. Incremental subs do not have the ability to pay for VAS; and (c) Operators are focused on 3G rollouts. As a result, we expect a meaningful slowdown in domestic revenues.

Statistical Abstract

| Year to | Net Profit | Diluted EPS | EPS growth | P/E | P/B | ROE | Yield |
|---------|------------|-------------|------------|------|-----|------|-------|
| 31 Mar | (RsM) | (Rs) | (%) | (x) | (x) | (%) | (%) |
| 2010A | 390 | 3.33 | -54.7 | 20.4 | 1.1 | 5.4 | 0.0 |
| 2011A | 867 | 14.37 | 331.3 | 4.7 | 0.5 | 11.0 | 0.0 |
| 2012E | 813 | 6.90 | -52.0 | 9.9 | 0.9 | 9.3 | 0.0 |
| 2013E | 900 | 7.64 | 10.7 | 8.9 | 0.8 | 9.4 | 0.0 |
| 2014E | 1,148 | 9.73 | 27.5 | 7.0 | 0.7 | 10.8 | 0.0 |

Source: Powered by dataCentral

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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| Fiscal year end 31-Mar | 2010 | 2011 | 2012E | 2013E | 2014E |
|--|---------------|---------------|---------------|---------------|---------------|
| Valuation Ratios | | | | | |
| P/E adjusted (x) | 20.4 | 4.7 | 9.9 | 8.9 | 7.0 |
| EV/EBITDA adjusted (x) | 7.6 | 5.7 | 4.9 | 3.0 | 1.9 |
| P/BV (x) | 1.1 | 0.5 | 0.9 | 0.8 | 0.7 |
| Dividend yield (%) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Per Share Data (Rs) | | | | | |
| EPS adjusted | 3.33 | 14.37 | 6.90 | 7.64 | 9.73 |
| EPS reported | 3.33 | 14.37 | 6.90 | 7.64 | 9.73 |
| BVPS | 63.19 | 137.97 | 77.48 | 85.11 | 94.85 |
| DPS | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Profit & Loss (RsM) | | | | | |
| Net sales | 4,544 | 5,372 | 6,387 | 7,358 | 8,311 |
| Operating expenses | -4,154 | -4,733 | -5,910 | -6,473 | -7,100 |
| EBIT | 390 | 639 | 477 | 884 | 1,211 |
| Net interest expense | 201 | 110 | 593 | 301 | 428 |
| Non-operating/exceptionals | 0 | 0 | 0 | 0 | 0 |
| Pre-tax profit | 591 | 749 | 1,070 | 1,185 | 1,640 |
| Tax | -201 | -212 | -257 | -284 | -492 |
| Extraord./Min.Int./Pref.div. | 0 | 330 | 0 | 0 | 0 |
| Reported net income | 390 | 867 | 813 | 900 | 1,148 |
| Adjusted earnings | 390 | 867 | 813 | 900 | 1,148 |
| Adjusted EBITDA | 831 | 1,206 | 1,293 | 1,771 | 2,141 |
| Growth Rates (%) | | | | | |
| Sales | 11.8 | 18.2 | 18.9 | 15.2 | 13.0 |
| EBIT adjusted | -53.6 | 63.7 | -25.3 | 85.2 | 37.0 |
| EBITDA adjusted | -35.1 | 45.1 | 7.2 | 37.0 | 20.9 |
| EPS adjusted | -54.7 | 331.3 | -52.0 | 10.7 | 27.5 |
| Cash Flow (RsM) | | | | | |
| Operating cash flow | 461 | 938 | 1,523 | 826 | 2,157 |
| Depreciation/amortization | 441 | 567 | 815 | 886 | 930 |
| Net working capital | -168 | -421 | 487 | -660 | 507 |
| Investing cash flow | -3,037 | -194 | 123 | -250 | -100 |
| Capital expenditure | -2,712 | -775 | -488 | -551 | -528 |
| Acquisitions/disposals | 62 | 0 | 0 | 0 | 0 |
| Financing cash flow | 72 | 285 | -337 | 0 | 0 |
| Borrowings | 40 | 273 | -318 | 0 | 0 |
| Dividends paid | 0 | 0 | 0 | 0 | 0 |
| Change in cash | -2,504 | 1,030 | 1,310 | 576 | 2,057 |
| Balance Sheet (RsM) | | | | | |
| Total assets | 11,827 | 11,210 | 12,366 | 13,224 | 15,030 |
| Cash & cash equivalent | 2,560 | 1,454 | 2,735 | 3,277 | 5,292 |
| Accounts receivable | 1,690 | 2,245 | 2,368 | 2,946 | 3,056 |
| Net fixed assets | 3,386 | 3,921 | 3,623 | 3,321 | 2,961 |
| Total liabilities | 4,431 | 2,888 | 3,231 | 3,188 | 3,847 |
| Accounts payable | 1,032 | 1,463 | 2,086 | 2,002 | 2,615 |
| Total Debt | 87 | 318 | 0 | 0 | 0 |
| Shareholders' funds | 7,396 | 8,322 | 9,135 | 10,036 | 11,183 |
| Profitability/Solvency Ratios (%) | | | | | |
| EBITDA margin adjusted | 18.3 | 22.4 | 20.2 | 24.1 | 25.8 |
| ROE adjusted | 5.4 | 11.0 | 9.3 | 9.4 | 10.8 |
| ROIC adjusted | 3.3 | 6.2 | 3.1 | 8.6 | 10.6 |
| Net debt to equity | -33.4 | -13.7 | -29.9 | -32.7 | -47.3 |
| Total debt to capital | 1.2 | 3.7 | 0.0 | 0.0 | 0.0 |

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Quarterly Summary

Figure 1. Quarterly Summary

| Rs m | Sep-09 | Dec-09 | Mar-10 | Jun-10 | Sep-10 | Dec-10 | Mar-11 | Jun-11 | Sep-11 | QoQ % | YoY% |
|------------------------------|--------|--------|---------|--------|---------|---------|---------|---------|---------|--------|--------|
| Total revenues | 1,086 | 1,155 | 1,229 | 1,238 | 1,315 | 1,486 | 1,333 | 1,364 | 1,552 | 13.8% | 18.0% |
| Telecom value added services | 1,034 | 1,028 | 1,204 | 1,190 | 1,294 | 1,424 | 1,227 | 1,304 | 1,488 | 14.1% | 14.9% |
| Other services | 52 | 127 | 25 | 47 | 21 | 62 | 107 | 60 | 65 | 7.3% | 206.2% |
| Total expenditure | (951) | (924) | (1,010) | (956) | (1,037) | (1,150) | (1,026) | (1,094) | (1,227) | 12.2% | 18.4% |
| Cost of sales | (307) | (334) | (386) | (338) | (345) | (390) | (232) | (271) | (346) | 27.8% | 0.3% |
| Employee cost | (366) | (377) | (387) | (410) | (426) | (454) | (484) | (500) | (574) | 15.0% | 34.8% |
| Other expenditure | (279) | (213) | (236) | (208) | (265) | (306) | (311) | (324) | (307) | -5.2% | 15.7% |
| EBITDA | 135 | 231 | 219 | 282 | 279 | 336 | 307 | 270 | 325 | 20.4% | 16.5% |
| EBITDA margins (%) | 12.4% | 20.0% | 17.8% | 22.8% | 21.2% | 22.6% | 23.0% | 19.8% | 20.9% | 5.8% | -1.2% |
| PAT | 107 | 132 | 111 | 184 | 228 | 209 | 269 | 128 | 477 | 273.2% | 108.9% |
| PAT margin (%) | 9.9% | 10.9% | 8.3% | 14.3% | 16.7% | 13.4% | 20.1% | 9.4% | 30.7% | 228.1% | 83.6% |

Source: Company Data, Citi Investment Research and Analysis

Figure 2. Segmental Revenue Breakup

| Rs m | Sep-09 | Dec-09 | Mar-10 | Jun-10 | Sep-10 | Dec-10 | Mar-11 | Jun-11 | Sep-11 |
|-------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| India revenues | 793 | 820 | 942 | 952 | 1,017 | 1,028 | 908 | 927 | 893 |
| Sequential growth | -5.4% | 3.4% | 14.8% | 1.1% | 6.8% | 1.1% | -11.7% | 2.1% | -3.7% |
| O/S India | 293 | 334 | 287 | 286 | 299 | 458 | 425 | 437 | 658 |
| % growth | 25.3% | 14.1% | -14.2% | -0.3% | 4.5% | 53.2% | -7.2% | 2.8% | 50.6% |
| Proportion | 27.0% | 29.0% | 23.4% | 23.1% | 22.7% | 30.8% | 31.9% | 32.0% | 42.4% |

Source: Company Data, Citi Investment Research and Analysis

Earnings Revision

FY12-14E EBITDA is cut by 20%-28% to factor in the slowdown in the domestic business even though the top line is down only by 5%-16% given the relative maturity of this segment (capex is behind, stable state businesses). The cut in EPS is accentuated given a small base and a higher effective tax rate.

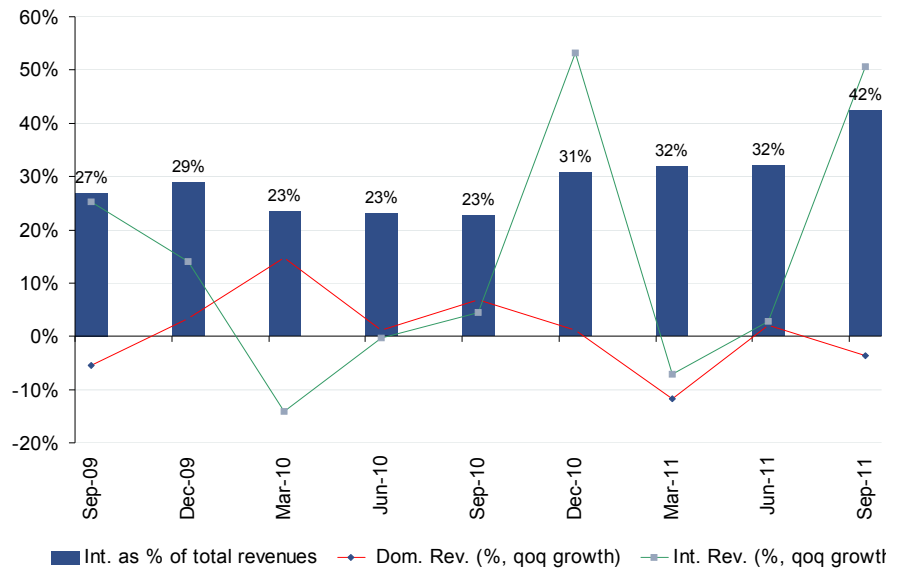
Figure 3. Earnings Revisions

| | FY12E | FY13E | FY14E |
|----------------------|-------|-------|-------|
| EBITDA (Rs m) | | | |
| Old | 1,799 | 2,308 | 2,684 |
| New | 1,293 | 1,771 | 2,141 |
| Change | -28% | -23% | -20% |
| EPS (Rs) | | | |
| Old | 8.5 | 11.4 | 13.5 |
| New | 6.9 | 7.6 | 9.7 |
| Change | -19% | -33% | -28% |

Source: Citi Investment Research and Analysis Estimates

Ramp-up of international revenues is critical for our earnings estimates. Our estimates include overseas revs growing at a CAGR of 31% over the next two years, contributing 57% to the overall revenues (42% in 2Q'12) by FY14E.

Figure 4. Increasing proportion from international segment should help de-risk



Source: Company Data, Citi Investment Research and Analysis

New Target Price of Rs100

The new target price of Rs100 (prev. Rs170) is arrived at using FY13E 13x P/E; broadly in line with the broader market (20x Mar-12E earlier; 30% premium earlier). We believe that the company can provide above-average returns with the ongoing ramp-up in the international business.

Figure 5. Premium/Discount to the Market



Source: Citi Investment Research and Analysis

OnMobile Global

Company description

Co-promoted in 2000 by Infosys Technologies, Argo Capital and individuals including Arvind Rao and Mouli Rman, OnMobile is India's leading application service provider (ASP) with market share estimated at 35% as of Mar 09. It develops white label applications and services for telecom operators (carrier customers) who market them to subscribers. It is headquartered in Bangalore, India. Though its genesis lay in developing applications for the US market, OnMobile shifted focus to the domestic market as the worldwide telecom industry went into turmoil in CY00-01. Its early start, success of Caller ringback tones (CRBT) and popularity of voice platform helped it achieve impressive growth with FY05-08 revenue CAGR of 86% and profit CAGR of 62.6%. OnMobile listed on the stock exchange in Feb 08 through a combination of primary and secondary issuance, constituting 18.99% of post-issuance equity.

Investment strategy

We rate OnMobile Buy with a target price of Rs100. The stock has had a bad run, with the domestic slowdown hitting earnings. However, we believe it is still a Buy and offers decent upside on the back of a ramp-up in the international segment. With the international execution on track, OnMobile should increasingly be de-risked and also offer good growth. We estimate total revenue, EBITDA and earnings CAGR of 14%, 23% and 22% respectively over the next three years.

Valuation

Our target price of Rs100 is based on 13x Mar-13E EPS. The target multiple is broadly in line with the broader market despite the company's above average growth, given deceleration in earnings (vs our previous est) and some uncertainty surrounding the domestic business. We prefer P/E over DCF as: 1) the nature of the business with high R&D focus makes it difficult for us to incorporate any innovations/new product developments in the revenue stream over a longer time period; 2) OnMobile is in the midst of raising its international presence and it is difficult to accurately estimate the market opportunity and OnMobile's market share in these markets over a longer time period; and 3) OnMobile benefits from incremental market share gains with every new contract from an operator, which can be quite significant and can materially alter EPS estimates due to the low base effect.

Risks

They key risks to our investment thesis and target price on OnMobile include 1) Indian operators (like their western peers) shifting from revenue share to licensing models as VAS contribution to overall wireless revenues rises. This could result in a cap on OnMobile's revenues stream from any individual customer; 2) any unfavorable regulations; 3) slower than expected international ramp-up and 4) further shrinkage of rev share in domestic market. On the positive side, deals with Vodafone and Telefonica will help OnMobile build credibility on its execution abilities and ability to manage scale apart from revenue upside. These deals should also help reduce sale cycle from 1-2 years now.

Appendix A-1

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IMPORTANT DISCLOSURES

OnMobile Global (ONMO.BO)

Ratings and Target Price History Fundamental Research

Analyst: Gaurav Malhotra, CFA



Chart current as of 5 November 2011

| | Date | Rating | Target Price | Closing Price |
|---|-----------|--------|--------------|---------------|
| 1 | 21-Nov-08 | 1H | *168.50 | 102.55 |
| 2 | 4-May-09 | 1H | *210.00 | 160.28 |
| 3 | 9-Jun-09 | *1M | *257.50 | 217.45 |

| | Date | Rating | Target Price | Closing Price |
|---|-----------|--------|--------------|---------------|
| 4 | 17-Jul-09 | 1M | *322.50 | 279.73 |
| 5 | 27-Oct-09 | *3M | *185.00 | 202.30 |
| 6 | 6-Aug-10 | *1M | *197.50 | 142.65 |

| | Date | Rating | Target Price | Closing Price |
|---|----------|-----------------------------|--------------|---------------|
| 7 | 2-May-11 | 1M | *170.00 | 128.40 |
| 8 | 7-Oct-11 | Stock rating system changed | | |
| 9 | 7-Oct-11 | *1 | 170.00 | 60.60 |

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

OnMobile Global (ONMO.BO)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Gaurav Malhotra, CFA

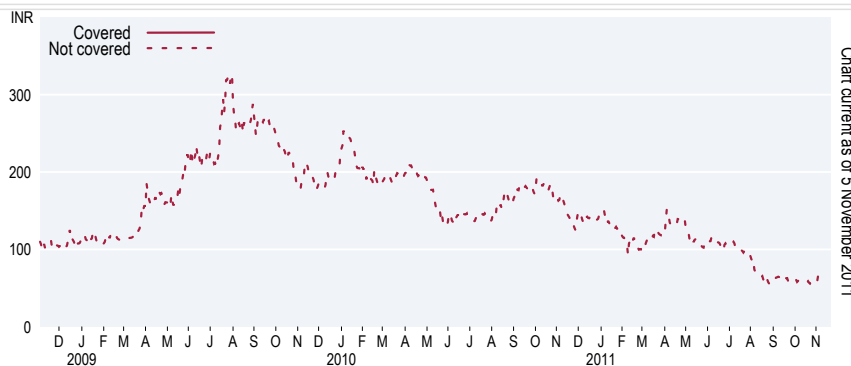


Chart current as of 5 November 2011

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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| <i>Data current as of 10 Oct 2011</i> | 12 Month Rating | | | Relative Rating | | |
|---|------------------------|-------------|-------------|------------------------|-------------|-------------|
| | Buy | Hold | Sell | Buy | Hold | Sell |
| Citi Investment Research & Analysis Global Fundamental Coverage | 59% | 34% | 7% | 10% | 79% | 10% |
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| Citigroup Global Markets India Private Limited | Gaurav Malhotra, CFA; Jitender Tokas |
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