

# IDEA CELLULAR

## Lower but profitable growth

India Equity Research | Telecom



Idea Cellular (IDEA) reported revenues of INR53.1bn, implying a sequential decline of 3.4% vs our estimate of a 0.8% decline while EBITDA margins were above estimates. Revenue decline was primarily due to a soft quarter further aggravated by a sharp decline in MOU (~5.3% on a QoQ basis). The silver lining has been the 20bps QoQ increase in RPM and a 70bps sequential increase in EBITDA margins to 26.8% in spite of the revenue decline. We believe Idea is moving away from its earlier strategy of chasing volume while the focus is now on more profitable growth. We are revising downwards our FY13/14 EBITDA by 1%/4% and earnings by 8%/10%. At 5.2x FY14 EV/EBITDA, we maintain 'BUY', but prefer Bharti as the regulatory impact has not been discounted fully yet in Idea.

### Volume, ARPU nosedive, RPM sees an uptick

Idea reported a volume and ARPU decline of 4.0% and 5.1% on a QoQ basis. Its revenue stood at INR53.1bn, down 3.4% QoQ. Volume decline of 4.0% in a seasonally weak quarter coupled with a sharp reduction in ARPU led to the decline in revenue. The subscriber acquisition cost came down by ~230bps due to the decline in discretionary spend, partially offset by an increase in network opex by 90bps QoQ.

### Aiming for a profitable growth

During Q2FY13 the company reduced the discount and trade payouts and had also cut down on discretionary spend. Further, the management has stated that it will continue its endeavor for an improvement in the EBITDA margin. We believe, Idea has realised that it is better to focus on customers with higher spends thus ensuring a profitable growth.

### Outlook and valuations: Low but profitable growth; maintain 'BUY'

Although Idea's revenue was lower than expectation, it expects data revenues to go up in the coming quarters with price rationalization and an increase in affordable smartphones. Going forward, we believe that Idea would focus on improving RPM, the only way to achieve meaningful margins. At 5.2x FY14 EV/EBITDA, the stock is yet to fully discount the risk of regulatory costs. We maintain 'BUY', as EBITDA growth will still be strong at 16% in FY14, but prefer Bharti as the regulatory impact is fully discounted.

#### Financials

(INR mn)

Year to March	Q2FY13	Q2FY12	% change	Q1FY13	% change	FY12	FY13E	FY14E
Revenues	53,140	46,199	15.0	55,037	(3.4)	195,412	222,821	257,818
EBITDA	14,225	11,866	19.9	14,355	(0.9)	52,424	60,663	70,438
Net profits	2,400	1,058	126.9	2,341	2.6	8,729	11,461	18,186
Dil. EPS (INR)	0.7	0.3	126.9	0.7	2.6	2.6	3.5	5.5
Diluted P/E (x)						30.9	23.5	14.8
EV/EBITDA (x)						7.7	6.4	5.2
ROAE (%)						6.9	8.4	12.0

#### EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Performer
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Equalweight

#### MARKET DATA (R: IDEA.BO, B: IDEA IN)

CMP	: INR 81
Target Price	: INR 102
52-week range (INR)	: 103 / 66
Share in issue (mn)	: 3,310.8
M cap (INR bn/USD mn)	: 270 / 5,005
Avg. Daily Vol.BSE/NSE('000)	: 4,359.0

#### SHARE HOLDING PATTERN (%)

	Current	Q1FY13	Q4FY12
Promoters*	45.9	45.9	46.0
MF's, FI's & BK's	6.3	6.9	6.2
FII's	15.8	14.8	15.3
others	32.0	32.3	32.6
* Promoters pledged shares (% of share in issue)	:		NIL

#### PRICE PERFORMANCE (%)

	Stock	Nifty	EW Telecom Index
1 month	(7.4)	0.0	2.2
3 months	1.5	11.2	(15.2)
12 months	(11.0)	12.7	(24.0)

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**Table 1: Key performance indicators**

Particulars	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12	Q3FY12	Q4FY12	Q1FY13	Q2FY13
Subscriber base (mn)	74	82	90	95	100	106	113	117	116
Prepaid subscriber propn. (%)	96.1	96.3	96.4	96.5	96.5	96.6	96.5	96.5	96.2
Post-paid churn (%)	2.9	2.8	2.7	3.0	3.0	2.9	2.8	3.1	3.0
Prepaid churn (%)	8.2	10.3	11.0	9.8	10.1	10.7	10.1	10.1	10.4
Blended churn (%)	8.0	10.0	10.7	9.6	9.9	10.4	9.9	9.9	10.1
<b>Operating parameters</b>									
Average revenue per user (INR)	167	168	161	160	155	159	160	156	148
% change in above	(8.2)	0.6	(4.2)	(0.6)	(3.1)	2.6	0.6	(2.5)	(5.1)
Average minutes of use per user	394	401	397	391	364	369	379	379	359
% change in above	(5.1)	1.8	(1.0)	(1.5)	(6.9)	1.4	2.7	0.0	(5.3)
Average realised rate (INR)	0.42	0.42	0.41	0.41	0.43	0.43	0.42	0.41	0.41
% change in above	(3.4)	(1.4)	(3.0)	0.9	4.3	1.4	(2.5)	(2.4)	0.2
Non-voice revenue (% of ARPU)	12.9	13.0	12.1	12.1	13.2	13.7	14.3	14.5	15.6
Minutes of usage (mn)	84,828	93,503	101,960	108,630	106,224	113,964	124,305	130,926	125,646
Cell-sites (rented- Others)	22,524	23,445	25,004	26,213	27,369	28,424	29,737	30,114	31,048
Cell-sites (rented- Indus)	36,618	37,819	39,587	40,953	41,865	43,021	44,214	44,479	45,429
Owned towers	8,838	8,944	9,077	9,125	9,133	9,192	9,239	9,267	9,302
Tenancy ratio (owned towers)	1.53	1.53	1.54	1.54	1.54	1.54	1.55	1.56	1.57
Owned towers (IRU)	11,094	11,094	11,094	11,094	11,094	11,094	11,094	11,094	11,094
3G cell sites				6,989	9,744	10,902	12,825	13,363	14,467

Source: Company

**Table 2: Change in assumptions**

Assumptions	FY13			FY14		
	New	Old	Change (%)	New	Old	Change (%)
End of period mobile subscribers	121,973,519	131,864,342	(7.5)	136,373,519	146,264,342	(6.8)
Monthly Subscriber additions	770,902	1,595,138	(51.7)	1,200,000	1,200,000	-
ARPU (INR)	158	157	0.8	162	160	1.5
MOU	371	371	0.1	377	374	1.0
Total minutes	523,039	544,304	(3.9)	584,972	623,407	(6.2)
Blended RPM (INR)	0.425	0.423	0.7	0.430	0.428	0.5

Source: Edelweiss research

**Financial snapshot**

(INR mn)

Year to March	Q2FY13	Q2FY12	% Change	Q1FY13	% Change	FY12	FY13E	FY14E
Net revenues	53,140	46,199	15.0	55,037	(3.4)	195,412	222,821	257,818
Direct costs	29,221	24,674	18.4	29,642	(1.4)	102,636	120,615	139,637
Employee expenses	2,779	2,417	15.0	2,740	1.4	9,499	10,736	12,423
Other expenses	6,915	7,242	(4.5)	8,300	(16.7)	30,853	30,806	35,321
Total expenditure	38,915	34,333	13.3	40,682	(4.3)	142,988	162,158	187,380
EBITDA	14,225	11,866	19.9	14,355	(0.9)	52,424	60,663	70,438
Depreciation	8,526	7,369	15.7	8,325	2.4	29,813	34,501	35,831
EBIT	5,700	4,498	26.7	6,031	(5.5)	22,611	26,162	34,607
Other income	-	-	-	-	-	(150)	183	-
Interest	2,164	2,939	(26.4)	2,671	(19.0)	10,409	9,709	8,249
Profit before tax	3,536	1,559	126.8	3,360	5.2	12,052	16,636	26,357
Tax	1,136	501	126.6	1,019	11.4	3,323	5,175	8,171
Core profit	2,400	1,058	126.9	2,341	2.6	8,729	11,461	18,186
Net profit	2,400	1,058	126.9	2,341	2.6	8,729	11,461	18,186
Diluted EPS (INR)	0.7	0.3	126.9	0.7	2.6	2.6	3.5	5.5
Basic EPS (INR)	0.7	0.3	126.9	0.7	2.6	2.6	3.5	5.5

**As % of net revenues**

Employee cost	13.0	15.7		15.1		15.8	13.8	13.7
EBITDA	26.8	25.7		26.1		26.8	27.2	27.3
Reported net profit	4.5	2.3		4.3		4.5	5.1	7.1
Tax rate	32.1	32.1		30.3		27.6	31.1	31.0

**Change in estimates**

	FY13E			FY14E			Comments
	New	Old	% change	New	Old	% change	
Net revenue	222,821	228,905	(2.7)	257,818	268,048	(3.8)	Reducing the subscriber addition by 7.5% in FY13 leads to reduction in revenues for FY13 and FY14
EBDITA	60,663	61,073	(0.7)	70,438	73,675	(4.4)	
EBDITA margin (%)	27.2	26.7		27.3	27.5		
PAT	11,461	12,488	(8.2)	18,186	20,243	(10.2)	Lower revenues lead to cut in PAT
PAT margin (%)	5.1	5.5		7.1	7.6		
Capex	35,000	35,000	-	35,000	35,000	-	

## Company Description

Idea is India's fourth largest telecom operator with a subscriber base of 116mn and is the third largest with revenue market share of ~15%. The company is a pure play GSM operator with pan-India operations including two circles of Punjab and Karnataka which it obtained via acquisition of Spice Communication. Idea is the incumbent licensee in seven circles of operation and is the market leader in three circles of Maharashtra, Haryana, and Uttar Pradesh (West).

## Investment Theme

The telecom sector is going through uncertain times as there are pressures on all counts regulatory, operationally and financially. The TRAI recommendations on spectrum pricing would lead to severe stress on the balance sheets of operators. On the operational front, due to high competitive intensity, the yields are under pressure and distributor commissions are rising. Given the loans related to 3G spectrum funding and further requirements to pay for 2G spectrum, the sector is going through financial challenges. We believe, operators are beginning to realize that focus on subscriber market share is leading to dilution in profitability, hence expect RPMs to firm up. Idea faces a risk of higher regulatory costs, which we believe, is not discounted fully in the stock. But it is expected to still deliver superior EBITDA growth compared to peers, hence it would be viewed favourably by the street.

## Key Risks

If the DoT accepts TRAI's recommendations on spectrum pricing and refarming it would lead to significant cash outflow for Idea. If Idea chooses to return some excess spectrum to minimize the impact of cash outflows, then its growth would slow down, thereby disappointing the street.

## Financial Statements

### Key Assumptions

Year to March		FY10	FY11	FY12	FY13E	FY14E
Macro -	GDP(Y-o-Y %)	8.4	8.4	6.5	5.8	6.5
	Inflation (Avg)	3.6	9.9	8.8	7.8	6.0
	Repo rate (exit rate)	5.0	6.8	8.5	7.5	6.8
	USD/INR (Avg)	47.4	45.6	47.9	53.5	52.0
Sector -	Total subscribers (mn)	579	812	919	1,019	1,102
	Growth	-	40	11	11	8
Company -	Total subscribers (mn)	50.6	77.5	96.8	100.6	99.4
	growth	-	53.2	24.9	4.0	(1.2)
	MOU	407.3	422.8	376.0	372.6	378.4
	RPM	0.8	0.4	0.4	0.4	0.4
	growth	-	(45.6)	4.9	(2.2)	1.2
	Total subscribers	7.3	12.0	16.0	17.7	22.8
	growth	-	63.9	32.9	11.2	28.4
	MOU	300.3	370.7	357.7	364.6	371.9
	RPM	0.4	0.3	0.4	0.4	0.4
	growth	-	(19.0)	2.9	3.3	1.7

### Income statement

(INR mn)

Year to March	FY10	FY11	FY12	FY13E	FY14E
Net revenue	124,470	155,032	195,412	222,821	257,818
Direct costs	63,044	83,025	102,636	120,615	139,637
Employee costs	6,451	8,056	9,499	10,736	12,423
Other Expenses	20,904	26,045	30,853	30,806	35,321
Total operating expenses	90,398	117,125	142,988	162,158	187,380
EBITDA	34,072	37,907	52,424	60,663	70,438
Depreciation & Amortization	20,149	23,973	29,813	34,501	35,831
EBIT	13,923	13,934	22,611	26,162	34,607
Other income	3,655	757	(150)	183	-
Interest expenses	6,825	4,722	10,409	9,709	8,249
Profit before tax	10,753	9,969	12,052	16,636	26,357
Provision for tax	1,214	982	3,323	5,175	8,171
Net profit	9,539	8,987	8,729	11,461	18,186
Profit after minority interest	9,539	8,987	8,729	11,461	18,186
Diluted EPS (INR)	2.9	2.7	2.6	3.5	5.5

### Common size metrics - as % of net revenues

Year to March	FY10	FY11	FY12	FY13E	FY14E
Operating expenses	72.6	75.5	73.2	72.8	72.7
EBITDA margins	27.4	24.5	26.8	27.2	27.3
Net profit margins	7.7	5.8	4.5	5.1	7.1

### Growth ratios (%)

Year to March	FY10	FY11	FY12	FY13E	FY14E
Rev. growth (%)	22.6	24.6	26.0	14.0	15.7
EBITDA	20.1	11.3	38.3	15.7	16.1
Net profit	8.2	(5.8)	(2.9)	31.3	58.7
EPS growth (%)	1.7	(5.9)	(3.0)	31.3	58.7

Balance sheet					(INR mn)
As on 31st March	FY10	FY11	FY12	FY13E	FY14E
Equity capital	32,998	33,033	33,088	33,088	33,088
Reserves & surplus	80,261	89,469	97,045	108,506	126,693
Shareholders funds	113,724	122,999	130,502	141,963	160,150
Secured loans	73,166	92,815	107,916	105,979	88,547
Unsecured loans	5,427	27,890	25,456	15,951	6,447
Borrowings	78,593	120,705	133,372	121,930	94,993
Others	-	4,056	6,233	6,209	6,216
<b>Sources of funds</b>	<b>192,317</b>	<b>247,760</b>	<b>270,107</b>	<b>270,103</b>	<b>261,359</b>
Gross block	234,095	265,320	314,083	349,083	384,083
Accumulated depreciation	68,615	89,322	112,778	141,874	172,301
Net block	165,480	175,997	201,305	207,208	211,782
Capital work in progress	5,465	36,006	6,799	6,799	6,799
Total fixed assets	170,945	212,003	208,103	214,007	218,580
Goodwill	16,260	48,912	68,633	63,229	57,824
Intangible assets	-	9,219	22,563	18,050	14,440
Investments	11,304	10,200	976	-	-
Inventories	536	659	926	1,055	1,221
Sundry debtors	4,656	5,557	8,227	9,381	10,854
Cash and equivalents	2,900	4,577	1,521	4,639	1,541
Loans and advances	25,559	10,982	15,386	18,494	21,657
Other current assets	2,979	8	18	19	21
Total current assets	36,630	21,784	26,077	33,589	35,295
Total current liabilities & provisions	40,680	51,257	49,972	52,498	58,507
Net current assets	(4,050)	(29,474)	(23,895)	(18,909)	(23,213)
Net Deferred tax	(2,142)	(3,099)	(6,273)	(6,273)	(6,273)
Miscellaneous expenditure	-	-	-	-	-
<b>Uses of funds</b>	<b>192,317</b>	<b>247,760</b>	<b>270,107</b>	<b>270,103</b>	<b>261,359</b>
Book value per share (INR)	34.5	37.2	39.4	42.9	48.4

Free cash flow					(INR mn)
Year to March	FY10	FY11	FY12	FY13E	FY14E
Net profit	9,539	8,987	8,729	11,461	18,186
Depreciation	20,149	23,973	29,813	34,501	35,831
Deferred tax	-	(2,346)	(818)	-	-
Others	3,237	(4,668)	(2,275)	(24)	6
Gross cash flow	32,925	25,948	35,449	45,939	54,024
Less: Changes in WC	7,504	(15,756)	8,468	1,868	(1,205)
Operating cash flow	25,421	41,704	26,981	44,071	55,229
Less: Capex	41,474	85,473	47,327	35,000	35,000
<b>Free cash flow</b>	<b>(16,053)</b>	<b>(43,769)</b>	<b>(20,346)</b>	<b>9,071</b>	<b>20,229</b>

Cash flow metrics					
Year to March	FY10	FY11	FY12	FY13E	FY14E
Operating cash flow	25,421	41,704	26,981	44,071	55,229
Investing cash flow	(29,532)	(82,488)	(37,627)	(29,511)	(31,390)
Financing cash flow	(23,853)	42,462	7,589	(11,441)	(26,937)
Net cash flow	(27,964)	1,678	(3,057)	3,118	(3,098)
Capex	(41,474)	(85,473)	(47,327)	(35,000)	(35,000)
Share issuance/(buyback)	23	138	237	-	-

**Profitability & efficiency ratios**

Year to March	FY10	FY11	FY12	FY13E	FY14E
ROAE (%)	7.7	7.6	6.9	8.4	12.0
ROACE (%)	7.3	6.7	8.9	9.7	13.0
Debtors days	12	12	13	14	14
Current ratio	0.9	0.4	0.5	0.6	0.6
Debt/EBITDA	2.3	3.2	2.5	2.0	1.3
Average working capital turnover	26.8	(9.2)	(7.3)	(10.4)	(12.2)
Debt/Equity	0.7	1.0	1.0	0.9	0.6
Adjusted debt/equity	0.7	1.0	1.0	0.9	0.6

**Operating ratios**

Year to March	FY10	FY11	FY12	FY13E	FY14E
Total asset turnover	0.6	0.7	0.8	0.8	1.0
Fixed asset turnover	0.8	0.9	1.0	1.1	1.2
Equity turnover	1.0	1.3	1.5	1.6	1.7

**Valuation parameters**

Year to March	FY10	FY11	FY12	FY13E	FY14E
Diluted EPS (INR)	2.9	2.7	2.6	3.5	5.5
Y-o-Y growth (%)	1.7	(5.9)	(3.0)	31.3	58.7
CEPS (INR)	9.0	9.3	11.4	13.9	16.3
Diluted PE (x)	28.2	29.9	30.9	23.5	14.8
Price/BV (x)	2.4	2.2	2.1	1.9	1.7
EV/Sales (x)	2.8	2.5	2.1	1.7	1.4
EV/EBITDA (x)	9.8	9.9	7.6	6.4	5.2

**Peer comparison valuation**

Company	Absolute Reco	CMP (INR)	Mcap (INR bn)	P/E (x)		EV/EBITDA (x)		ROACE(%)	
				FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
Bharti	BUY	271	1,030	14.8	12.6	5.9	5.0	10.9	12.4
Idea	BUY	81	270	23.5	14.8	6.4	5.2	9.7	13.0
RCom	HOLD	59	123	11.2	8.6	7.1	6.0	4.8	5.5

Source: Edelweiss research



Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Bharti Airtel	BUY	SO	L	Idea Cellular	BUY	SP	M
Reliance Communication	HOLD	SU	H				

### ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

### RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

### RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

### SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return





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**Coverage group(s) of stocks by primary analyst(s): Telecom**

Bharti Airtel, Idea Cellular, Reliance Communication

**Recent Research**

Date	Company	Title	Price (INR)	Recos
22-Aug-12	<b>Tulip Telecom</b>	Balance sheet woes continue; <i>Result Update</i>	105	Hold
13-Aug-12	<b>RCOM</b>	Muted quarter; <i>Result Update</i>	56	Hold
08-Aug-12	<b>Bharti Airtel</b>	Is this the turning point?; <i>Result Update</i>	274	Buy

**Distribution of Ratings / Market Cap**

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	113	53	19	186
* 1 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	114	58	14	

**Rating Interpretation**

Rating	Expected to
<b>Buy</b>	appreciate more than 15% over a 12-month period
<b>Hold</b>	appreciate up to 15% over a 12-month period
<b>Reduce</b>	depreciate more than 5% over a 12-month period

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