

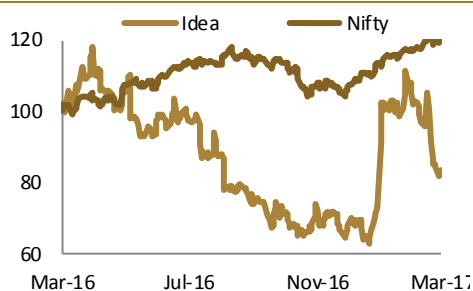
Market statistics

Current stock price (`)	89
Shares O/S (cr.)	360.3
Mcap (` cr)	31,981
52W H/L (`)	128/66
6m avg. volume	22,991,494
Bloomberg	IDEA IN

Shareholding pattern

Promoters	42.45
Domestic Institution	6.88
Foreign Institution	24.34
Non-institution	26.33
of which more than 1%	
P5 Asia Investments (Mauritius)	3.33
ICICI Prudential Life Insurance	3.17

Idea vs Nifty



Capital efficiency & valuations

Particulars	FY14	FY15	FY16
RoCE (%)	12.8	16.2	12.6
EPS (`)	5.9	9.0	8.5
P/E (x)	23.3	20.9	12.9
EV/EBITDA (x)	7.9	7.4	6.0
Income growth (%)	18.0	19.3	14.0
EBITDA growth (%)	38.3	30.0	20.8
PAT growth (%)	101.4	62.5	(3.4)

ANALYST

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We believe, the merger between Idea, Aditya Birla Telecom arm and Vodafone are in order in terms of delivering synergies. However, high leverage (<5.4x debt/EBITDA for Idea + Vodafone) needs to be watched. We understand that both, Aditya Birla Group and Vodafone, have given a go-ahead to infuse equity incase leverage rises above certain threshold. We believe Idea could rise by ~47% in the medium term, implying a 7xEV/EBITDA applied on FY19 EBITDA estimate for the merged company. However, 4Q for Idea could be a weak quarter.

The transaction structure will be as follows: Vodafone group will get ~3.6bn shares for 50% stake in the merged company (Idea + Vodafone), which will have Idea, along with its directly owned towers and 11.5% stake in Indus and Vodafone India, along with its directly owned towers but excluding 42% stake in Indus. Thereafter, for US\$579mn/Rs38.74bn, AB Group will buy ~4.9% stake in the merged entity from the Vodafone group. The merged entity will have 7.26bn shares and debt of Rs527bn from Idea and Rs552bn from Vodafone.

Merger synergies exist on both operating expenses and capital expenditure: 1) Spectrum liberalisation payment estimated at Rs28bn. 2) The savings on operating and capex is estimated at Rs.140bn by the fourth years from deal completion. The net debt to EBITDA of the consolidated entity is 4.4x, which on account of tower asset sale (Idea and Vodafone's captive towers and Idea's 11.15% stake in Indus) and synergies is expected to come down to 3.0x, per management expectations.

High spectrum synergies: Vodafone and Idea have followed similar spectrum strategies with bulk of the 3G rollout in 2100MHz band, with 900MHz spectrum in key circles, while their 4G rollout has been in 1800MHz band. In the 2016 spectrum auction, both operators obtained 2500MHz spectrum to expand their LTE capacity spectrum holding. This will enable them to significantly rationalise costs.

Regulations could dent Revenue Market Share (RMS) by ~240bps: As on Oct'16, Idea and Vodafone subscribers stood at 180.3mn and 201.9mn, respectively, totaling to a subscriber base of 382.2mn subscribers for the merged entity. Bharti Airtel has a subscriber base 262.3mn. Subscriber base of merged entity will represent ~35.4% market share vs ~24.3% for Bharti. The revenue market share of Idea and Vodafone, as on Sep'16, stood at 18.7% and 23.3%, respectively, leading to combined revenue share of 42.0% vs. Bharti's RMS of 32.8%. However, revenue of the combined entity will > 50% of RMS in the following 6 circles, i.e., Gujarat, Haryana, Kerala, Madhya Pradesh, Maharashtra and U. P. (West), where it will have to reduce its market share to < 50% within a period of 1 year. This will lead to reduction in RMS by ~240bps and effective RMS will stand at 39.6%.

Deal; well done: We believe the Aditya Birla group has done well from this deal, since it has structured the deal – that gives them time to reach parity in shareholding with Vodafone over three years. The AB group is also to buy 4.9% stake from Vodafone group at Rs109/share. Its option to buy a further 9.5% stake from the Vodafone group at Rs130/share within three years is also fairly attractive relative to the estimated value that can come from synergies. Lastly, despite the time given to the group to reach parity, it will have equal voting rights, board representation, and roughly equal management say relative to Vodafone.

Upside: We believe that Idea Cellular could give a ~47% upside based on 7x EV/EBITDA applied on the FY19E EBITDA for the merged the combined company.



We believe, the merger between Idea, Aditya Birla Telecom arm and Vodafone are in order in terms of delivering synergies. However, high leverage (<5.4x debt/EBITDA for Idea+Vodafone) needs to be watched. We understand that both, Aditya Birla Group and Vodafone, have given a go-ahead to infuse equity incase leverage rises above certain threshold. We believe Idea could rise by ~47% in the medium term, implying a 7xEV/EBITDA applied on FY19 EBITDA estimate for the merged company. However, 4Q for Idea could be a weak quarter.

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Exhibit 1: AB Group will buy Idea shares from Vodafone at ~Rs110

Amount to be received by Vodafone (Rs.mn)	38,740
Stake to be exchanged (%)	4.9%
Implied Equity value of Idea + Vodafone (Rs.mn)	790,612
Shares on merger (mn)	7,302
Idea implied price at which AB Group will buy (Rs.)	110

Source: Company, Trust

AB group will pay Vodafone Rs38.74bn to increase its stake by 4.9% stake in the merged entity, which implies a value of the merged entity of Rs790bn. This 4.9% will enable Idea's promoters to reach 26% and become eligible to be classified as a promoter of the merged entity.

Key approvals

- Filing of Scheme with Stock Exchanges and SEBI for approval
- Apply for regulatory approvals (CCI, DoT, RBI, FIPB (if applicable))
- Filing of Scheme with NCLT
- Shareholder and creditor meetings
- Scheme approved by NCLT
- Regulatory approval
- Listing approval

Merger synergies exist on both operating expenses and capital expenditure

- Spectrum liberalisation payment estimated at Rs28bn.
- The savings on operating and capex is estimated at Rs.140bn by the fourth years from deal completion.

The net debt to EBITDA of the consolidated entity is 4.4x, which on account of tower asset sale (Idea and Vodafone's captive towers and Idea's 11.15% stake in Indus) and synergies is expected to come down to 3.0x, per management expectations.

Exhibit 2: Details of the merger synergies

INR mn	
Opex synergies after 4 years	84,000
Capex Synergies	56,000
Total annualized synergies	140,000

Source: Company, Trust

We believe that the telecom sector will slowly come out of the stagnation/pain it has been stuck for several years. However, a leveraged balance sheet may limit the ability of the company to be aggressive and ay result in loss of market share.



However, Mr. Kumar Mangalam Birla, clarified today that both the parties have an agreement to capitalize the merged company if leverage crosses a threshold. He also confirmed that both groups are very conscious of the negative FCF and EBITDA decline period that the industry is currently witnessing.

High spectrum synergies

Vodafone and Idea have followed similar spectrum strategies with bulk of the 3G rollout in 2100MHz band, with 900MHz spectrum in key circles, while their 4G rollout has been in 1800MHz band. In the 2016 spectrum auction, both operators obtained 2500MHz spectrum to expand their LTE capacity spectrum holding. This will enable them to significantly rationalise costs.

Exhibit 3: Spectrum holding for Idea-Vodafone combined entity

	RJIO (incl. sharing with RCOM)			Bharti Airtel				Idea+Vodafone				
	800MHz	1800MHz	2300MHz	900MHz	1800MHz	2100MHz	2300MHz	900MHz	1800MHz	2100MHz	2300MHz	2500MHz
A.P.	5.0	5.8	30.0	9.0	10.0	5.0	30.0	5.0	6.6	5.0	-	10.0
Assam	10.0	5.4	30.0	8.0	9.5	5.0	30.0	-	20.5	5.0	-	20.0
Bihar	10.0	5.0	30.0	7.8	8.0	10.0	30.0	-	8.8	5.0	-	10.0
Delhi	8.8	5.4	30.0	6.0	7.0	10.0	30.0	10.0	10.6	5.0	-	20.0
Gujarat	15.0	6.0	30.0	-	11.2	5.0	10.0	11.0	20.8	10.0	-	30.0
Haryana	10.0	5.0	20.0	-	16.2	5.0	20.0	12.2	15.7	15.0	-	20.0
H.P.	10.0	10.4	30.0	7.4	10.2	5.0	10.0	-	6.7	5.0	-	10.0
J&K	10.0	10.0	20.0	6.2	5.0	10.0	20.0	-	12.5	5.0	-	10.0
Karnataka	8.8	5.0	30.0	8.8	8.8	5.0	30.0	5.0	11.0	5.0	-	-
Kerala	8.8	5.0	30.0	-	11.2	5.0	20.0	12.4	18.9	10.0	10.0	20.0
Kolkata	10.0	10.0	30.0	7.0	9.0	-	30.0	7.0	16.0	10.0	-	20.0
M.P.	10.0	6.4	30.0	-	17.0	5.0	20.0	7.4	14.1	5.0	10.0	20.0
Maharashtra	5.0	5.0	30.0	-	13.2	5.0	20.0	14.0	12.3	15.0	10.0	30.0
Mumbai	10.0	6.6	30.0	5.0	15.2	5.0	30.0	11.0	10.2	10.0	-	20.0
Orissa	10.0	5.0	30.0	7.4	13.0	5.0	30.0	5.0	12.5	5.0	-	20.0
Punjab	10.0	5.2	20.0	10.0	10.0	-	20.0	5.6	14.9	10.0	-	10.0
Rajasthan	8.8	10.0	20.0	6.0	10.0	10.0	-	6.4	10.0	15.0	-	20.0
Tamil Nadu	8.8	6.8	30.0	6.2	8.0	10.0	30.0	-	11.4	15.0	-	-
U.P. (East)	10.0	6.4	20.0	6.2	6.0	5.0	-	5.6	8.5	20.0	-	20.0
U.P. (West)	10.0	6.4	20.0	-	11.2	5.0	-	5.0	14.3	10.0	-	20.0
West Bengal	8.8	10.6	30.0	6.6	6.2	5.0	30.0	2.2	21.4	5.0	-	20.0
North East	10.0	6.4	30.0	8.8	10.0	5.0	30.0	-	21.3	5.0	-	20.0
Avg, Spectrum	9.4	6.7	13.6	5.3	10.3	5.7	10.7	5.7	13.6	8.9	0.7	8.4

Source: Trust, TRAI, DoT

Regulations could dent Revenue Market Share (RMS) by ~240bps As on Oct'16, Idea and Vodafone subscribers stood at 180.3mn and 201.9mn, respectively, totaling to a subscriber base of 382.2mn subscribers for the merged entity. Bharti Airtel has a subscriber base 262.3mn. Subscriber base of merged entity will represent ~35.4% market share vs ~24.3% for Bharti. The revenue market share of Idea and Vodafone, as on Sep'16, stood at 18.7% and 23.3%, respectively, leading to combined revenue share of 42.0% vs. Bharti's RMS of 32.8%. However, revenue of the combined entity will > 50% of RMS in the following 6 circles, i.e., Gujarat, Haryana, Kerala, Madhya Pradesh, Maharashtra and U. P. (West), where it will have to reduce its market share to < 50% within a period of 1 year. This will lead to reduction in RMS by ~240bps and effective RMS will stand at 39.6%.

**Exhibit 4: Spectrum holding for Idea-Vodafone combined entity**

	Subscriber Market share (%)				Revenue Market share (Sept End) (%)			
	Idea	Vodafone	Idea+Vodafone	Bharti	Idea	Vodafone	Idea+Vodafone	Bharti
A.P.	21.3	9.0	30.4	32.0	24.3	10.5	34.7	43.2
Assam	5.9	19.3	25.2	30.9	5.0	22.6	27.6	36.8
Bihar	14.1	12.0	26.1	37.7	13.3	13.8	27.1	46.5
Delhi	13.1	21.8	34.9	23.8	12.5	29.0	41.5	38.3
Gujarat	18.9	30.1	48.9	13.4	22.1	37.9	60.0	17.4
Haryana	21.1	24.6	45.6	14.6	27.8	28.9	56.7	20.3
H.P.	8.5	7.7	16.2	30.8	12.6	10.0	22.5	48.7
J&K	5.2	8.7	13.9	31.9	7.0	10.3	17.3	36.8
Karnataka	13.8	12.1	25.9	33.8	11.1	14.5	25.6	48.5
Kerala	29.7	21.1	50.8	12.4	41.6	23.4	65.0	15.0
Kolkota	8.4	21.0	29.5	18.2	7.2	34.4	41.7	28.6
M.P.	34.6	10.8	45.4	21.0	42.4	9.8	52.2	25.5
Maharashtra	27.7	21.4	49.1	15.8	32.7	25.1	57.9	19.3
Mumbai	12.9	27.1	40.0	18.4	10.3	36.6	46.9	27.0
Orissa	5.8	13.3	19.1	34.3	5.6	15.7	21.3	40.9
Punjab	18.8	15.1	33.8	24.0	25.5	17.6	43.1	36.7
Rajasthan	12.2	19.0	31.2	32.2	13.1	21.6	34.6	44.4
Tamil Nadu	7.4	19.1	26.5	21.6	6.7	24.2	30.9	34.3
U.P. (East)	11.3	20.1	31.5	22.8	13.7	28.8	42.5	29.7
U.P. (West)	24.6	19.2	43.8	14.2	31.9	22.2	54.1	21.5
West Bengal	10.6	35.3	45.9	29.1	8.8	37.0	45.9	32.4
North East	4.4	13.7	18.1	34.1	4.3	17.7	22.0	48.2
Tot. Mkt.Share	16.7	18.7	35.4	24.3	18.7	23.3	42.0	32.8

Source: Trust, TRAI

Pro forma financials

Based on the pro forma financials of the merged entity for the last twelve months implies margins of slightly less than 30% and Net debt/EBITDA of 4.4x. Management believes that this should improve with synergies due to overlapping fixed costs between the two entities.

Exhibit 5: Pro forma financials for Idea + Vodafone (LTM Dec-16)

INR bn	Idea	Vodafone	Idea + Vodafone
Revenue	369	447	816
EBITDA	114	130	244
Net debt	527	552	1,079
Net Debt/EBITDA	4.6	4.2	4.4
Capex	75	79	154
Total Spectrum Investment	617	788	1,405

Source: Trust, Company



Asset Monetization

The tower assets of the Idea + Vodafone will be 33,500, with 62,800 slots and an estimated EV of Rs134bn, and generating an EBITDA of Rs15.2bn (based on 8.7x EV/EBITDA). The quarter annualized EBITDA for the merged entity was RS180bn and LTM was Rs244bn. The estimated EBITDA of the Idea + Vodafone for FY18 will be ~Rs185bn with debt of ~Rs1.08trn, making for debt/EBITDA of 5.9x. In addition, pro forma debt as of the end of Dec-16 was Rs1.08trn. Sale of all the tower assets will bring debt/EBITDA down to 5.5x. Further, assuming ~10% reduction in the combined company's operating expense, this can come down to 4.6x.

Exhibit 6: Tower sale can fetch Rs136bn, EBITDA reduction of ~Rs15bn

Tower stake value	Towers	Slots	Tenancy
Indus towers (11.5%)	13,714	31,544	2.3
Vodafone direct owned towers	10,926	15,846	1.5
Idea direct owned towers	8,886	15,418	1.7
Total	33,526	62,808	1.9
Indus Total slots		284,149	
Indus estimated EV (Rs mn)		596,754	
Indus EV/slot (Rs mn)		2.1	
Merged Entity tower EV based on EV/Slot (Rs m)		135,476	
Merged Entity tower EBITDA based on 8.7x EV/EBITDA (Rs m)		15,213	

Source: Trust

Management also said that an agreement between the three major shareholders of Indus would govern the eventual 11.5% stake sale of Indus by the merged company.

However, synergies will come over the medium-to-long term. We assume that synergies will happen over FY19-21, which means debt/EBITDA may further worsen for a while in FY19. This matches Idea management's guidance today.

Integration costs would include cost of surrender of spectrum, tenancies, and associated exit penalties, market share where applicable, and costs for relocation of sites. Apart from opex and capex savings, the synergies would include churn reduction and savings in brand spending and advertising costs.

Exhibit 7: Both companies are highly leveraged

	Towers	Slots	Tenancy
Debt contribution (Dec 31st 2016) (Rs m)	527,000	552,000	1,079,000
FY18E EBITDA (Rs.mn)	89,578	95,883	185,461
Debt/EBITDA (FY18)	5.9	5.8	5.8

Source: Trust, Company

Exhibit 8: Even after tower sale, leverage to remain high

	After Merger
Post tower sale debt	925,784
Post tower sale EBITDA	166,954
Post Tower sale EV/FY18 EBITDA	5.9
Post Tower sale EV/FY18 EBITDA with FY18 normalized for synergies	4.6

Source: Company, Trust

Management was confident that the merger stood a high chance of being approved. The approval request has to be sent to Competition Commission of India (CCI) within 30 days from today, and from there on, management expects the process to take more than a year.



We believe the Aditya Birla group has done well from this deal, since it has structured the deal – that gives them time to reach parity in shareholding with Vodafone over three years. The AB group is also to buy 4.9% stake from Vodafone group at Rs109/share. Its option to buy a further 9.5% stake from the Vodafone group at Rs130/share within three years is also fairly attractive relative to the estimated value that can come from synergies. Lastly, despite the time given to the group to reach parity, it will have equal voting rights, board representation, and roughly equal management say relative to Vodafone.

The transaction is described by the companies as being at comparable valuations, which is derived by taking Idea's volume weighted price for 30 days in January, deriving market cap.

Exhibit 9: We believe there is ~47% upside to Idea Cellular in the medium term

Total current Idea share count	3,602
New share count	7,203
Merged EBITDA post tower sale in FY19 (Rs.mn)	255,345
Target EV/EBITDA	7.0
Estimated EV	1,786,715
Estimated Debt (Rs.mn)	842,768
Equity value (Rs.mn)	943,947
Value per share (Rs.)	131

Source: Company, Trust

Based on this, we believe that Idea Cellular could give a ~47% upside based on 7x EV/EBITDA applied on the FY19E EBITDA for the merged the combined company.



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