Idea Cellular Limited Earnings Conference Call

July 29, 2011

Moderator: Ladies and gentlemen, good day. This is Rochelle, and I will be the moderator for your conference call. Welcome to the Idea Cellular Conference. For the duration of this presentation, all participants' lines will be in the listen-only mode. After the presentation, a question and answer session will be conducted.

We have with us today, Mr. Himanshu Kapania, Managing Director of Idea Cellular and Mr. Akshaya Moondra, Chief Financial Officer of Idea Cellular, along with other key members of the senior management. I want to thank the management team on behalf of all the participants for taking valuable time to be with us.

Given that the senior management is on this conference call, participants are requested to focus on the key strategic and important questions to make sure that we make good use of senior management's time.

I must remind you that the discussions on today's conference call may include certain forward-looking statements and must be viewed therefore in conjunction with the risks that the company faces.

With this I hand the call over to Mr. Himanshu Kapania. Thank you and over to you, sir.

Himanshu Kapania: Thank you, Rochelle. On behalf of Idea, I welcome all participants to this earnings call. Today morning, our Board of Directors adopted our unaudited results for the first quarter of financial year FY12, ending June 30, 2011. The press release, the quarterly report and results have all been uploaded on our web site and I assume you had a chance to go through the same.

Due to delayed last financial year Q4 results, we are back on the call within a short span of only 45 days. Therefore, before providing my analysis on the company performance during this quarter, I would first like to update all of you on the litigation cases with the DoT.

Maintaining the high standard of corporate governance, we have provided in the press release and in the advertisement that will appear in tomorrow's leading newspapers, a brief update on Idea-Spice merger dispute under Point No. 7 in the press release and Point No. 4 as per Clause 41 of the Listing Agreement in the newspaper advertisement. After the last earning call, wherein we had shared that on the application made by the DoT for recall of the sanction order, the single judge bench of the Hon'ble High Court of Delhi announced its judgment on 4th July 2011, reaffirming the amalgamation of Spice into Idea but with certain conditions. As the conditions imposed were unacceptable, we had filed an appeal before the Appellate Division Bench of the Hon'ble High Court of Delhi, challenging the above judgment. The appeal is currently sub-judice.

Also, consequent to Idea-Spice merger dispute and related alleged violation of certain license conditions and guidelines, the company has challenged and filed appropriate multiple petitions before the Hon'ble TDSAT or responded to DoT showcause notices. The details of the same have been provided under Notes: Point No. 5 and 6 as per Clause 41 of the Listing Agreement. These litigation matters are in the courts and sub-judice. Thus, as a matter of abundant caution, Idea management team will not be able to take any further questions beyond the disclosures given at this stage.

Moving on to the business performance for the first quarter of financial year 2011-12, in our pursuit for profitable growth, Idea Cellular starts the new financial year with gross revenue in excess of US$1 billion for the quarter. In the last earning call I had mentioned Idea as a company, had upgraded its competitive ability by challenging the standard telecom market review parameters like subscriber count, ARPU and ARR. We instead, have focused on five critical internal parameters namely absolute gross revenue, cash profit and EBITDA, active subscribers, total minutes of use and mobile number portability. Let me cover all these five points performance with reference to this quarter's result.

Point No. 1 – Gross Revenue. On the back of 7% and 8.2% sequential revenue growth in the preceding quarter of Q4 and Q3 of last financial year respectively, Idea continued on its upward trajectory and is happy to announce a 6.7% revenue growth in this quarter over last quarter. With standalone revenue of Rs. 45,559 million, the company has grown by 23.5% against last year's first quarter revenue.

We are also happy to report reversal of two-year painful trend of decline in the average realized rate. After eight quarters of declining rate trend, Idea has had a marginal improvement of 1% in the ARR to 41 paisa for the quarter against 40.6 paisa in the previous quarter. As you are aware since 2009 with the overcapacity phase, the industry has gone through a savage price drop. We at Idea in this period, when outgoing call tariff fell to 1 paisa for per second calling and 50 paisa for per minute calling, were careful to offer discounted promotions to most of our subscribers for a limited validity of one year.

For the six established circles of Kerala, Andhra Pradesh, Maharashtra, Gujarat, Madhya Pradesh and UP West, we have closed or modified the promotional offer of 1 paisa per second and now the new subscribers joining us in these circles can sign on for a six-month or a one-year special tariff promotion of 1.2 paisa per second, for calls to other Idea subscribers or any other mobile subscribers, local and STD. As regards existing subscribers, they need to join the revised promotional offer only after their existing promotional offer validity expires. Hence, the impact of the revised per second promotion offer will be gradual on the ARR of the company. We will closely watch the impact of the change in the promotional offer on competitive action within the industry, especially from the new operators. Secondly, we will monitor the effect on minutes of usage and elasticity of demand from our existing customers before considering other service areas for revision in the promotional offer. The exuberance on the change in the promotional tariff offer should be restrained as the sector still suffers overcapacity and we need to carefully monitor the equation between revenue market share loss and depressed minutes of usage versus any realization gain.

I move to Point No. 2 – Cash profit and EBITDA margin. During this quarter Idea improved EBITDA margin by 1.2%, from 22.2% (Q4FY11) to 23.4% (Q1FY12), primarily by strong performance in the established service areas. These 13 established service areas, launched before FY09, contribute to over 89% of Ideas' revenue and this quarter we improved our margin by 1.8% to 29.6% from 27.9% in the last quarter, thereby helping to absorb the higher losses from the 9 new service areas.

Idea strategy of higher investment focus in established circles with calibrated launch in new service areas has helped the company to balance the need for long-term growth and short-term better asset utilization. With the launch of 3G services in nine service areas, additional expense of amortization of 3G spectrum fees of 656 million and benefit of related interest cost capitalization of 1,228 million in the last quarter will no more be available, impacting short-term profitability i.e. PAT of the company.

As the company is still in the investment mode with significant long-term opportunity in the wireless broadband arena, it will continue to monitor closely two important parameters. First, net debt to EBITDA ratio which remains at acceptable level of 2.43 and second, cash profit. While this quarter's cash profit has declined from 9,031 million to 8,609 million that is Rs. 422 million but the same is after absorption of additional net interest and financing cost of Rs. 1,575 million.

We are comforted that even though our leverage has gone up, Idea with improved generation of EBITDA from its operations; is able to absorb major portion of additional interest, depreciation and amortization as well as 3G network opex cost.

I move to Point No. 3 – Active Subscribers. As you are aware, TRAI started releasing active subscriber base of the telecom operator in terms of VLR subscribers. Idea has continued to lead the industry in terms of highest ratio of active subscribers to reported subscribers. As per the 31st May 2011 release of TRAI, Idea has 86.5 million subscribers on VLR out of reported end of period (EoP) of 93.75 million, thereby active subscriber percentage of 92.3% against industry average of 70.1%. While we command only 11.2% subscriber market share based on industry reported EoP customer count, we have improved our subscriber market share based on VLR to 14.8%, a clear lead of 3.6% over reported EoP numbers. We believe VLR market share is more accurate measure of the company's competitive standing as this share is also in line with the revenue market share which stands at 13.6% (Q4FY11), clearly establishes Idea as the third largest Indian mobile operator in terms of revenues and VLR.

Point No. 4 – Total Minutes of Usage. Robust growth trajectory in minutes of use continues in this quarter, registering a growth of 32% when compared to Q1 of last year. Company carried on an average 1.2 billion minutes per day and remained among the top 10 global operators in terms of voice minutes of usage. We consistently manage such huge voice traffic, which is a testimony of our ability to manage scale, complexity, business continuity processes and redundancy thereby preparing us for future challenges.

Point No. 5. - Mobile Number Portability. With a net gain of over 960,000 customers and lowest port out ratio of customers at 58 against every 100 customers ported in, Idea has extended its lead over all other operators in the MNP race. The success on MNP has been attributed to winning portability space in consumer mind. The consistent leadership in MNP exhibits strength of our network quality, customer service, growing power of our brand thereby giving huge confidence to our employees to act like leaders. While the company continues to win accolades from independent agency, we believe the latest recognition of our company as the No. 1 Telecom Employer by the “Great Place To Work” institute in partnership with The Economic Times, in a largest ever company survey of over 450 companies, is the acknowledgement of Idea strong consumer focus and people-oriented culture.

Now, I will move on to 3G business. We maintain the launch of 3G services will have two impacts on the market. It will keep the mobile growth story intact and secondly, it will widen the competitive edge of better managed and stronger companies. We have made major strides in 3G network coverage expansion over the last 45 days. While Idea launched its 3G services only on 28th March 2011, we have aggressively expanded our footprint and currently cover over 825 towns in 15 service areas including bilateral roaming arrangements, for service areas of Mumbai, Bihar, Karnataka, Delhi, Kolkata and Tamil Nadu(including Chennai), with leading quality operators. But we believe 3G network expansion is only one of the factors in the growth of wireless broadband penetration in the country. The company is gearing itself for a high 3G penetration of its existing user base. The company has decided to build future data factory which can handle many times the current daily data volume of 30 Terabytes. In the process of building the future data factory, the company is upgrading its backhaul transmission to high capacities, DWDM upgrading with microwave to IP radios and building requisite number of PoPs i.e. intra-city point of presence, especially in the top 100 cities. Similarly, we are transforming the existing charging, provisioning, customer care and IT capabilities to meet customer data demand and building packet core and related system capacity to manage the future surge in wireless broadband data traffic.

We have uptill now signed on over 2 million 3G subscribers but on an average only 22-25% of these customers are on daily VLR. Our assessment is there is an urgent requirement to engage these customers and upgrade their need hierarchy for high speed data services. We believe significant marketing expenditure industry is incurring to educate the market will slowly yield results. Idea has embarked on these efforts for popularizing the theme services with our latest thematic campaign targeted at the market by showcasing various Idea 3G applications like mobile

TVs, superfast internet, gaming and video calling in an interesting way that will keep India busy on Idea 3G services.

Most of the recent telecom analyst reports have positioned India 3G services to be expensive. I disagree. While it is true Indian operators are offering tired data pricing and not unlimited plans but just like voice, these plans are among the lowest in the world in terms of realized rate per MB. One of the reasons for the gap in the price perception is the significant difference in the data rates offered on 2G versus 3G platform. We believe that 2G data rates currently offered in the market are unsustainable and far below cost. As the 2G and 3G rate converge, there will be a transition of customers from low speed platform to quality high speed 3G services.

To summarize, improving capacity utilization of our 2G voice services, capturing future opportunities in wireless broadband, increasing preference of customers for Idea brand, generation of healthy cash profits with strong balance sheet underscores Idea's ability to benefit from long-term secter opportunities once the hyper-competition phase draws to its inevitable close and pricing power returns back to the operators.

I now request Akshaya to give you a little more detail on the financials.

Akshaya Moondra: Thanks very much, Himanshu. A very good afternoon to participants from India and a good morning or evening as applicable to overseas participants. Firstly, let me begin by confirming that our reporting on standalone and consolidated basis remains unchanged and all the comments may be seen in that context.

As mentioned by Himanshu with sequential revenue growth of 6.7%, Idea crossed the mark of US$1 billion of quarterly revenue. The revenue growth for the quarter was driven by a growth of 6.5% in total minutes of use and by improved ARR compared to the last quarter.

Moving onto the cost side, compared to last quarter the network opex showed an increase of around 1.2% as a percentage of revenue. As you may recollect in Q4 there were one-time credits amounting to Rs. 380 million and after normalizing for the same network opex is up by around 0.3% as a percentage of revenue on a Q-o-Q basis. This increase in network opex is primarily on account of expansion of existing 2G network and incremental costs associated with the launch of 3G services. Lower gross additions during the quarter led to lower subscriber acquisition costs and the advertising and business promotion expenses were also low during this quarter, resulting in reduction in these costs by 2.4% as a percentage of revenue.

Consequently, the standalone EBITDA margin increased by 1.2% compared to last quarter and stands at 23.4%. EBITDA margin for established service areas improved by 1.8% whereas EBITDA losses for the new service areas increased by Rs. 224 million on a Q-o-Q basis.

As mentioned in our press release and quarterly report, additional expenses of Rs. 656 million on account of 3G spectrum fees amortization and related interest cost of Rs. 1228 million, resulted in PBT for the quarter at Rs. 2217 million being lower than Rs. 3068 million in the previous quarter.

With regard to tax, the charge continues to consist mainly of deferred tax. With the tax holiday period for the pre-99 launched circles now ending, the deferred tax charge is now progressing towards full tax rate and we expect the charge to remain at similar rates in the ensuing quarters. The deferred tax in this quarter is therefore higher compared to last quarter by Rs. 175 million.

Contribution from Indus to net profit increased to 232 million compared to Rs. 169 million in last quarter, resulting in a consolidated net profit of Rs. 1773 million.

Capex during the quarter has been just over Rs. 10 billion and the capex guidance for FY12 remains at Rs. 40 billion.

The net debt stands at Rs. 103.8 billion as of the end of the quarter and the net debt to annualized EBITDA for the quarter is 2.43. This combined with the cash profit level of Rs. 8.6 billion, post deduction of complete 3G interest during this quarter puts the company in a strong financial position despite the significant 3G investments and the hyper competitive scenario which the industry has witnessed in the last two years.

With this I will hand over to call back to Rochelle and open the floor to questions. Thank you.

Moderator: Thank you very much Mr. Moondra. Ladies and gentlemen we will now begin the question and answer session. Our first question is from the line of Sachin Salgaonkar of Goldman Sachs, please go ahead.

Sachin Salgaonkar: Hi, thank you for the call and congratulations for a good set of results. I have three questions. Firstly, wanted to understand the impact of per second promotion tariff hike on a) MoU per subscriber and churn. Do you see some kind of a decline in MoU per subscriber and increase in churn because of this? And b) Now there is a price arbitrage between your tariffs, so should you see subscribers migrating from one of your package to another? Secondly, VAS as a percentage of total revenues has not picked up despite 3G launch; it is still stand at around 12% of revenues, so any color on what is actually happening out here? And thirdly, wanted to know your thoughts on the outlook of subscriber acquisition costs. Obviously, in this quarter it declined close to around 11% QoQ, is this trend maintainable going forward? Thank you.

Himanshu Kapania: Thank you, Sachin. Let me answer the questions one by one. On first question, when in 2009 before we started the promotional tariffs, at that point of time all customers who were joining in; joined us for a lifetime plan and the default tariff was Re. 1 per minute per on-net calling and Rs. 1.50 for off-net calling. For these customers we had a value voucher, which could give a tariff rate of, if they wanted a per second billing, one paisa per second in some circles or one paisa on on-net call and 1.2 paisa on off-net calls in other. Now for the six circles as I mentioned, we have raised the value voucher price and currently available tariff for new customer is only, one price which is at 1.2 paisa per second for calls to our Idea network or to other mobile local and STD. There is no question of any price arbitrage because this is the only promotion that is available in the market for our new customers. For the existing customers, the customers had earlier signed on a one-year validity and the validity will expire given at different points of time. Once their validity expires they would be entitled to buy the new promotions. So we don't see any price arbitrage opportunity.

Come to the second point is on value-added services, as I said in the last call also, we are extremely focused on value-added services. You are absolutely right that as a percentage of revenue it has remained flat but remember that we have had a 6.7% revenue growth, so in absolute terms value-added services has gone up. But as I mentioned, even in the last call we are in the process of being able to readjust our portfolio for value-added services. While there has been some growth for data services, there has been some adjustment of value-added services on the non-data side, primarily on the voice VAS front. Impact of 3G services as far as we are concerned, it is just 45 to 50 days old and we are rolling our services, so it is very premature to be able to draw any conclusion on VAS services or the data revenue.

As I mentioned in my speech there is a very large future opportunity (on data front) but it is going to take time for the customers to be able to accept 3G services and we are in the process of marketing the benefits of 3G to the customers and raising need hierarchy. I am going to pass on to Akshaya to be able to answer on the cost of acquisition.

Akshaya Moondra: Thanks. Sachin, on the subscriber acquisition cost front, as we said the additions during this quarter have been lower, so the subscriber acquisition cost have been lower. I think sustainability of these costs is largely dependent also on what direction the industry goes because if you look compared to a year back, the level of gross adds in absolute terms for the whole industry has gone up significantly. I think we are seeing more stability in the market. This stability in the market, from a competitive perspective, should result in better performance on this front. But this is still early time and we just have to see how this pans out.

Sachin Salgaonkar: Okay, thanks Akshaya for that. I have just one follow-up question to Himanshu. Himanshu, let me rephrase my first question as in what are your initial thoughts on the tariff hikes, i.e., do you see any impact on subscriber additions, usage patterns and churn rates, going forward?

Himanshu Kapania: I was very specific in the opening remarks that we are testing the water at this point of time, and it is premature to be able to give a clear guidance. Obviously the six circles that we have mentioned are leadership circles of ours and we have taken the lead to test new promotional prices. We will carefully observe what happens as far as the industry is concerned. If the industry were to follow then I don't think there is an issue. If the industry doesn't follow then we will evaluate and readjust what is necessary.

Sachin Salgaonkar: Okay, alright, great, thank you.

Moderator: Thank you. Our next question is from the line of Suresh Mahadevan of UBS, please go ahead.

Suresh Mahadevan: Good afternoon sir, congratulations on yet another good set of numbers. I think every quarter you have set a new benchmark, it is great to see that. A couple of quick questions from me, more at a strategic level. One is I think this year a lot of news is expected on the regulations, NTP-11 or whatever you may call it, I would like to know what your wish list is or whatever you think is realistic and NTP-11 should address? I think it will give us a good sense of how the industry is looking at it.

Second question is on pricing, I mean it just seems to me that everybody knew at some point the pricing is likely to go up but I would like to hear from you what is the catalyst that caused this, at least from Idea's position. I mean like you hinted that 2G data everybody is pricing below cost, so what is it in terms of voice pricing? And I think you partly answered my question by saying you are still testing the waters, but I would still like to know that what you think, based on your experience, is a sustainable level of pricing today as you see in the market, without really compromising too much on the growth? Thank you.

Himanshu Kapania: Okay, let me first answer your question on pricing, Suresh. I think what is being forgotten by most of our colleagues and friends from the investor community that last year the telecom industry has gone through very significant event and that event is 3G and BWA auction. Over US $22 billion of funds for 3G plus BWA spectrum fees has been transferred from the telecom operators to the government. If you notice across the industry, for the listed operators as well as for unlisted operators, the overall leverage has gone up, so the cost per se has gone up directly in form of interest. We are also seeing the inflation level in the country has being going up. While there is no doubt the telecom operators have made every effort to bring down cost per minute but there is a belief and we believe that we are bottoming out as far as reduction in the cost per minute is concerned. For sustaining of our operations it is inevitable that we need to be able to increase price. I think the catalyst is very, very clear that cost structure of the telecom operators are going up and we are also reaching a stage in the urban markets where some degree of maturity coming in. So it is important that leaders in each of the service areas should try and see if there is a possibility for the rates to go up. That is why we have taken the lead in the circles, where we felt that the customers there have a higher degree of loyalty for our services.

With regards to regulations, there are multiple areas that the industry is waiting for to be included. We are seeing that the industry cannot continue to operate in the current environment, where there are 15 operators and there is overcapacity. We are also reaching a stage in number of our markets where our spectrum is completely stretched and for us that is a very serious area. We are hoping that at some point of time incremental spectrum is available to us in the main markets and also in some of the markets where we have 4.4 MHz of spectrum. So spectrum trading policy, transfer policy, merger and acquisition policy are obviously some issues for which we are eagerly waiting. It will be unfair to say on this call when it will happen. The overall environment is completely known to everybody so we will have to wait and watch for the time when the government feels that they would be in a position to help the industry grow, consolidate and improve the health of the telecom operators.

Suresh Mahadevan: Sir, one quick follow up from me. You mentioned a few things on the cost side which is one of the catalysts (for tariff increase) but cost per minute has been continuously coming down in this sector primarily because of the huge scale you are able to drive, which is 1.2 billion minutes a day now. Do you envisage at any point, because as you also said the cost per minute is kind of bottoming out, you have used all your efforts to try and optimize the cost, the cost per minute to go up?

Himanshu Kapania: We are being very careful on it. If we were reckless and we were to go all out in our expenses on the 3G or in the new circles, where our market share is extremely low, the possibility of cost per minute going up always exists. Also the external factors in terms of diesel prices, in terms of network operating costs and other related administrative costs are going up. So, these are obviously the factors which are not currently in the favor of telecom operators. Having said that, our model remains on better asset utilization and we have to follow, what we call a balanced short-term asset utilization as well as long-term growth because there is obviously an opportunity available for us to grow in the wireless broadband space. We have to make significant investments on our transmission, on our IT system, on our billing system as well as on roll-out of 3G network across India. We have to balance both of these. The cost per minute has to be always under focus but if you become reckless in investment, it will go up.

Suresh Mahadevan: Thank you sir, thanks so much, and congratulations once again.

Moderator: Thank you. Our next question is from the line of Rajeev Sharma of HSBC, please go ahead.

Rajeev Sharma: Thanks for the opportunity; I just have a couple of questions. First is, if you can just help us with understanding why the EBITDA loss in new circle is going up? And second question is on 3G VLR subs. There was a comment from Himanshu that 3G VLR subs are about 25%. It has been just one or two months of 3G launch and the scenario in the first two months we are reaching is, that the subscriber is buying a 3G handset or is already having a 3G headset and then not recharging frequently or is there any other reason that he is not in VLR or any specific reasons you see of that. Why this is happening, some commentary, some color would be helpful?

Himanshu Kapania: I would handle the 3G VLR question and then pass it onto Akshaya for EBITDA loss in our new service areas. First and foremost, the way we have gone about migrating customers on 3G in the service areas where we have launched 3G, services are offered to our existing customers. Most of the customers that we have; had 3G handsets and most of them are on the smart-phone or on the feature phone of 3G.

Having said that most of these customers were primarily on voice and they are slowly engaging themselves on the data side. The power of 3G is on high speed data and as I said in my speech that the need for high speed data is just about taking off. As we have seen in the developed countries in first world and second world, there is normally a time gap. In some countries the time gap was one to two years and in some countries even more, for adoption of services by the customers and their movement from current usage pattern, which is voice and text oriented, to voice, text, and data. So the industry, I believe, and especially Idea, will continue to be able to improve the needs/requirements of the customer on the high speed data. Because the 3G services are getting settled, the coverage is in the process of improving and there may be some gaps on the indoor side, the customers are toggling between 2G and 3G that is the reason the VLR percentage, we believe, is low.

Akshaya Moondra: Rajeev, the EBITDA loss for new circles has increased by roughly Rs. 22 crores. If you remember in the last quarter there were some one-offs and we had mentioned that those pertaining to new circles were roughly of the order of Rs. 12 crores. So essentially, the EBITDA loss for new circles has gone up by Rs. 10 crores, compared to the last quarter. Now as we have been maintaining earlier, that for these circles where we have a calibrated approach and we do not want losses to go beyond a certain point, but as long as the losses can be contained within that limit, we are growing in those circles. I think the EBITDA losses will continue to be in that vicinity and we will continue to grow the business within that broad framework.

Himanshu Kapania: I will only just incrementally add, unless we reach a particular scale or a particular revenue market share, I think this is a reflection of a performance of any operator in new service areas. If the overall standing in that market is as low as the fourth, fifth, sixth or seventh operator in those markets, it is a reflection of performance which is naturally expected, Even if we are the most cost focus operator. There is no possibility of anybody to make money in case if your ranking is as low as where we are in these service areas.

Rajeev Sharma: Yeah, thank you very much and wish you the very best for the coming quarters.

Moderator: Thank you. Our next question is from the line of Reena Verma of Merrill Lynch. Please go ahead.

Reena Verma: Thank you very much for the call. I just have a few questions. One is on your gross revenue growth outlook. Can you please share with us what do you think will be the key driver of gross revenue growth, which is one of the key indicators you look at, over the next two quarters and whether you think gross adds will accelerate or do you think that minutes of use per gross add will accelerate, so please can you throw some light on that? I also wanted to understand that the slowdown in your traffic growth compared to earlier quarters is that clearly driven by circles where you have hiked revenue per minute or can you throw some light on what trends you are seeing with regard to elasticity? While you have in broad generic terms explained the rise in your RPM, can you please be specific about whether some of these promotions expired through April to June quarter or it is only now that the impact will start to show? I will stop there.

Himanshu Kapania: Let me answer third part first. The RPM rates for the quarter has no implications of the promotion offered, which we have just modified, so that is not the driving factor.

Reena Verma: Sorry, sir may I ask you why the 1Q RPM improved in that case?

Himanshu Kapania: I think we have said in the previous earnings call that RPM is combination of multiple factors which includes incoming/outgoing ratio, on-net/off-net call ratio, value voucher pricing and so on and so forth. We have been little cautious on the degree of promotions that have been offered in our key markets and that is one of the improvements that has happened. The second area is invariably when you acquire a larger number of customers, which has a lot of free minutes built into it, the RPM falls. So there is a certain degree of linkage to lower gross adds to improvement in RPM. I think there are so many factors that we cannot give a very clean one single line answer.

Coming on to the most important question of yours, which is the gross revenue outlook. Will it be driven by gross adds or minutes of usage, while it is very difficult to be able to give you a very specific answer but we are completely convinced that the driving of gross revenue for telecom operator is going to be through the improving VLR route. If you have to look at TRAI release of May 2011, the total industry has only close to 600 million subscribers and even if we were to take the dual SIM customers, the actual penetration of India is not more than 55% to 60% of the covered population.

We believe that there is still a significant juice available in the rural markets and in a number of B and C circles, where there is large number of customers who are still not entered the category. Our revenue growth will always come through improved VLR growth. We will continue to concentrate to invest in rural markets and continue to improve our distribution so that we can improve our VLR. On minutes of usage per subscriber, we don't believe that it will improve as the lower end of the subscriber join in, in fact it may decline.

Reena Verma: No, sorry, I just wanted to then be more clear. The gross addition level of Q1 is that a happy level for you or do you think that it could fall because reported net add numbers have been falling. I just want to understand once again what specifically is your outlook on gross adds going forward? While you said that MoU per sub will decline, I want to know whether, what you have already done, has started impacting traffic in your circles?

Himanshu Kapania: Okay, I am not sure what you are referring to, has MOU per sub declined? The answer is no. Now the second question is will gross add decline that we see in Q1, be the trend going forward? I think the answer of that is more in the trend. If you look at the four quarters of the telecom operations, two quarters which is October to March are high gross adds quarters and two quarters which is from April to September, the gross adds tend to decline because somewhere around June is when the seasonal impact can be seen in the rural markets. So there is nothing different that has happened in this quarter, which has not happened in the past. We do not see any change in trends. The trends on voice business continue to be similar and we expect when we come back to Q3 and Q4, it will be similar to what we saw in previous years. But that is what we are expecting, I think we will have to wait and watch.

Reena Verma: Thank you, and I just have one small follow-up question for Akshaya. If we look at your results compared to 3rd quarter, and not to the 4th quarter, your gross adds were similar. Your revenue per minute in Q3 was higher and yet your margins are way higher (in Q1) than where they were in the Q3. Would it be fair to assume that the entire improvement in margins reflects the shrinkage in the advertising budget possibly due to the World Cup advertising going out?

Akshaya Moondra: Reena, you are totally missing out the volume increase that has happened over last two quarters. If the price remains flat and the volume grows in two quarters successively then definitely the margins will go up.

Reena Verma: No, sorry, Akshaya but your RPM has actually fallen compared to 3rd quarter and I am factoring in the volumes when I am looking at your SG&A on a per minute basis, as that seems to be the only thing that has fallen?

Akshaya Moondra: No, Reena please understand. If you look at what has been happening in the past few quarters we have had volume growth and we have had rate decline. When a rate decline is coupled with volume growth, we have been seeing kind of flattish EBITDA margin when the rate decline has been very steep, you may see somewhat of a kind of decline in EBITDA margin. Now if you compare Q3 of last year with Q1 of this year, the difference is not very large, it is 41.8p versus 41p. If you consider that ARR is more or less at the same level and you have had two quarters of 9% and 6.5% MoU growth, definitely it will result in better margins. A&P (Advertising & Business Promotion) is a very, very small component of what you are talking about, the major margin improvement will come from the traffic growth. This is a business of scale and asset utilization.

Reena Verma: Okay, thank you.

Moderator: Thank you our next question is from the line of Vinay Jay Singh of Morgan Stanley. Please go ahead.

Vinay Jaising: Thank you so much sir. I am going to ask you couple of small questions because most of them have already been addressed by you or asked by my peers. The first is on net-working capital cycle. We see the networking capital cycle having increased, which has been one of the reasons why your net debt has gone up a bit, some Rs. 10- 11 billion. So if you can throw some light on that?

The second, Akshaya did mention on the losses in new circles and the ad-hoc last quarter's numbers so you have kind of matched it. Is it fair to assume that from here to the next 12 months your ambition should be to reduce it to half the losses per quarter? Any number there would be great?

The third question, the 3G number which you all mentioned of 2 million and then 25% VLR number you did on a question also try to address that. My question to you is the other way around. What is not permitting us to get a much higher number in 3G, is it the handsets or is it just coverage of your network sites, which has been a healthy 7000 this quarter? What will prevent you to let us say add 20 to 25% of your net adds or whatever number you are comfortable with in terms of 3G? What is the kind of ARPUs are you getting incrementally on 3G?

Finally back to Reena's last question but modified a bit. What are you looking at the selling, general, and admin expenses for the next 12 or 24 months. Is the current percentage right number to look at for the future? Thank you so much sir.

Himanshu Kapania: I will just take the 3G question and then ask Akshaya to take all the other questions. As regards 3G I think it is a very simple answer. We have only about 8% of our subscribers who have 3G handsets and the ecosystem for 3G has to go up. So the effort of the industry and handset manufacturers is to make sure that the existing customers when they need to buy the new handset, they buy the 3G handset. If you know currently the cycle in India, there are over 30 to 35 million (per quarter) handset sale and if the lifecycle of the handset is 3 years, there is a very large percentage of the 30- 35 million customers with a replacement cycle. Now with the 3G handset prices coming down and 3G handsets now available at a price point of US$115 to Us$120, it is our expectation that the throughput and the volume of 3G customers will go up. And with larger advertising money we have supported, this is what the trend that we are expecting to see.

Just to give you a sense there are now a number of developed countries, which have over 50% or so numbers which are primarily on the 3G. So, over a longer period of time so would be a trend in India. I hand over to Akshaya.

Akshaya Moondra: Vinay, your first comment on the increased net debt and the working capital cycle you mentioned, it is right the net debt has gone up. There are two main reasons; one is that the capex during the quarter is higher than the cash generation during the quarter so that is one contributor. Secondly, as you would have seen in March our working capital had changed significantly from December to March also and we had explained last quarter also that the capex creditors and creditors in general, had gone up significantly, because of concentration of imports. I think that has rectified itself significantly, so that is why this change in working capital. Going forward it should be somewhere within this range. I guess the level which you see right now is a more realistic level than what you saw in March.

On the new circle losses I think we are not saying that we are looking at reducing these losses to half. What we are saying is that these losses would probably remain in this range of Rs. 140 crores a quarter. There may be some improvement but it will not exceed Rs. 140 crores a quarter and if there is an improvement, we would like to invest a little more to improve our presence in those circles. So as we have been saying all along it is the strategy. We have financial goals which dominate our investment decisions in those circles besides anything else.

Your last question was relating to sales and SG&A. I think as far as advertising and promotion part of that is there, the economies of scale would keep on coming. Now these are not evenly spread throughout the year, so I would not say that this quarter is representative. However, as a general guideline one could say that compared to what you have seen in the last year you may see roughly a 10% increase going forward but definitely the volume of business grows much more than that level. So as a percentage of revenue, the A&P part should come down.

As far as customer acquisition and servicing costs are concerned you would see that if we compare Q1 of last year with Q1 of this year, the gross adds have been almost 50% higher, but the net adds have been about the same level, so this is a trend where one will just have to see where the industry is heading. If we see that the gross adds in this quarter have been lower than last quarter and if this is a continuing trend, then one may see a better performance, but it is very difficult to comment on this part of the cost.

Vinay Jaising:: Thank you very much sir.

Moderator: Thank you. Our next question is from the line of Srinivas Rao of Deutsche Bank. Please go ahead.

Srinivas Rao: Thank you very much sir. Just two questions. One on your legacy circles where there has been a fairly dramatic improvement in EBITDA margin. Is it possible that is driven by some particular circles which have low EBITDA margin have performed better, would that be a fair assessment?

Himanshu Kapania: If you have been seeing we are consistently improving our revenue market share across most of our established circles. So it is not a one-off event, it is consistent over the established circles and the performance has been uniform across. So there is no one-off circle which is having an impact. It is primarily driven by improved revenue market share and our overall VLR market share in our established circles.

Srinivas Rao: Thank you, sir and I have one more question now. I appreciate that the legal issues are sub-judice and you are constrained to speak on that and I will just stick to that. If you can just clarify that the current case in the appellate court, is that the court which can decide on all the issues where the judgment had come from the Single Bench High Court? And secondly, the penalties which the Department of Telecom has asked to be paid, if one were to pay that will that would mean the end of those issues?

Himanshu Kapania: On the first question, I think all the people who are sitting on the call are not legal luminaries who can give you a very correct answer but as a general corporate person we understand that from a High Court there are courts where the next level of appeals can happen. So to say this is the final court, my general answer would be no. But the caveat is we are not legal experts.

The second question, I would not know what you mean that if we were to pay it is going to get sorted out. I do not know as far as we are concerned there is a degree of dispute and we are under appeal with the relevant courts and we will respect the judgment of the courts.

Akshaya Moondra: Just to add on to the first question it is like this, there are some matters at TDSAT and some matters are at Delhi High Court. Basically your question was that if the first judgment at Delhi High Court was delivered by a single judge, then the same matter has been appealed at in appellate bench and I would assume that the appellate bench is authorized to decide on matters which were decided by the single judge. So as far as that question is concerned if it is within the same court and going to higher level they should have the authority to decide. I am just telling you from a common sense point of view rather than a legal point of view.

Srinivas Rao: No, sure I agree that is just a clarification. One more question I have sir. This sometime back when we had in couple of circles, especially in Kerala, started to outsource call center services to third-party. I think that was one of the most significant efforts made by the company. How has been the experience and is now the entire call center operations or the customer care operations are outsourced to a third-party companies or that is not the case?

Akshaya Moondra: Call centers has been totally outsourced for the last three years almost and this was an initiative taken three years back and our experience has been very good. And I think almost the whole industry now works on an outsourcing model. Nobody has got in-house call centers.

Srinivas Rao: Fair enough, thank you so much.

Moderator: Thank you Mr. Rao. Our next question is from the line of Rahul Singh of Standard Chartered Securities. Please go ahead.

Rahul Singh: Good evening and a good set of numbers, so congratulations are due. Two questions; one is on the tariffs, what will bother you more, I mean what will make you reverse the recent intentions to increase the tariffs, whether it's the drop in traffic which will worry you more or whether it will be any kind of lack of follow-up from the new entrants in terms of increasing tariff, which of the two are you bothered with most? And the number two question is basically on the tax rate, I think I missed what Akshaya was saying. Is it likely to remain around the same for the next one or two years?

Himanshu Kapania: Okay, Akshaya will tell you about the tax rate. As far as tariff is concerned, I will repeat exactly what I had mentioned. We will carefully monitor the equation between the loss in revenue market share or depressed minutes of usage versus any realized gains. To me, If we see any loss of revenue market share or we see that there is a depressed minutes of usage we will be concerned and we will carefully monitor it, and take appropriate decisions based on this, rather than worry about what the other world will be doing. We will be focused completely on this equation.

Akshaya Moondra: Yes, Rahul on the tax rate, I did say that we are currently at 30% and it appears that in the coming future we will be staying at the full tax rate of 30 to 32%. That is the general sense right now.

Rahul Singh: Okay and that has happened briefly because of?

Akshaya Moondra: I mean the tax holidays of the pre-99 launched circles have expired and I think that creates a situation where we come to almost a full tax rate.

Rahul Singh: So we have exhausted the entire ten-year block of that 15 year?

Akshaya Moondra: Yes.

Rahul Singh: Okay, thank you.

Moderator: Thank you Mr. Singh. Ladies and gentlemen due to time constraints that was the last question. I now hand the conference over to Mr. Himanshu Kapania to add closing comments.

Himanshu Kapania: Thank you, Rochelle. This earning call, for me this has been my second earning call and this is always a great experience. So thank you so much gentlemen. All the questions always makes us think more and always we incorporate some of the strategies based on the kind of areas which the analysts are currently observing. Thank you so much and have a great day.

Moderator: Thank you Mr. Kapania and Mr. Moondra. Ladies and gentlemen with that we conclude this conference call. Thank you for joining us on the Chorus Call Conferencing Service. You may now disconnect your lines.