

## Company Focus

21 November 2008 | 9 pages

# OnMobile Global (ONMO.BO)

Target price change ☒  
Estimate change ☒

## Buy: Growth Visibility in Mobile VAS, Despite Challenging Macro

- **New Rs337 target price** — We are reducing FY09-11E EPS by 5-16% with 1) delays in new product deployments particularly outside India; and 2) higher cost pressures as OnMobile continues to invest heavily on projects/new product development, whose revenue streams have yet to start flowing. Our target price is based on 16x Mar-10 P/E (25x earlier), and is in-line with multiples of comparable peers. Target P/E while appearing high in this environment, is justified given its strong growth prospects (37% EPS CAGR over FY08-11E).
- **Management becoming cautious on near term** — FY09 Guidance cut to 50-55% revenue growth and 20-21% PAT margins though longer term remains unchanged. The slow-down is primarily on deployment (operator driven) rather than order wins and is more pronounced in international markets (20% of revenues). Meanwhile capex has trimmed to ~20% of sales (20-25% earlier), which we believe is to better utilize network capacity.
- **Maintain Buy** – Maintain our positive stance on the domestic VAS market with a growing subscriber base and increasing contribution to wireless revenues. OnMobile, as the largest VAS player, is most leveraged to this growth. The IPO proceeds give it the flexibility to undertake strategic acquisitions for acquiring new products/technology or use it as an entry strategy.
- **Risks** — 1) Valuation remains high despite a steep correction in stock price; 2) any value destructive acquisitions; 3) success of international forays; 4) management's ability to handle rapid growth and sustain innovation; and 5) telcos shifting to a licensing model.

<b>Buy/High Risk</b>	<b>1H</b>
Price (19 Nov 08)	Rs223.50
Target price	Rs337.00
from Rs630.00	
Expected share price return	50.8%
Expected dividend yield	0.0%
<b>Expected total return</b>	<b>50.8%</b>
Market Cap	Rs12,912M
	US\$259M

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



### Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2007A	343	7.00	-97.2	31.9	0.4	27.7	0.7
2008A	603	11.62	66.1	19.2	2.1	14.8	0.0
2009E	776	13.46	15.8	16.6	1.9	11.9	0.0
2010E	1,216	21.08	56.7	10.6	1.6	16.2	0.0
2011E	1,741	30.17	43.1	7.4	1.3	19.4	0.0

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2007	2008	2009E	2010E	2011E
<b>Valuation Ratios</b>					
P/E adjusted (x)	31.9	19.2	16.6	10.6	7.4
EV/EBITDA adjusted (x)	20.6	10.1	7.8	4.6	3.1
P/BV (x)	0.4	2.1	1.9	1.6	1.3
Dividend yield (%)	0.7	0.0	0.0	0.0	0.0
<b>Per Share Data (Rs)</b>					
EPS adjusted	7.00	11.62	13.46	21.08	30.17
EPS reported	7.00	11.62	13.46	21.08	30.17
BVPS	614.17	106.46	119.37	140.45	170.62
DPS	1.61	0.00	0.00	0.00	0.00
<b>Profit &amp; Loss (RsM)</b>					
Net sales	1,330	2,618	4,005	6,029	8,185
Operating expenses	-863	-1,826	-3,286	-4,656	-6,072
<b>EBIT</b>	<b>467</b>	<b>792</b>	<b>720</b>	<b>1,373</b>	<b>2,113</b>
Net interest expense	43	58	330	294	305
Non-operating/exceptionals	0	0	0	0	0
<b>Pre-tax profit</b>	<b>510</b>	<b>850</b>	<b>1,049</b>	<b>1,666</b>	<b>2,418</b>
Tax	-167	-247	-273	-450	-677
Extraord./Min.Int./Pref.div.	0	0	0	0	0
<b>Reported net income</b>	<b>343</b>	<b>603</b>	<b>776</b>	<b>1,216</b>	<b>1,741</b>
Adjusted earnings	343	603	776	1,216	1,741
Adjusted EBITDA	610	1,048	1,179	2,050	3,026
<b>Growth Rates (%)</b>					
Sales	61.0	96.8	53.0	50.5	35.8
EBIT adjusted	20.9	69.5	-9.1	90.8	53.9
EBITDA adjusted	29.4	71.8	12.5	73.9	47.6
EPS adjusted	-97.2	66.1	15.8	56.7	43.1
<b>Cash Flow (RsM)</b>					
<b>Operating cash flow</b>	<b>392</b>	<b>506</b>	<b>75</b>	<b>988</b>	<b>1,466</b>
Depreciation/amortization	143	256	459	678	913
Net working capital	-52	-305	-831	-612	-883
<b>Investing cash flow</b>	<b>-1,415</b>	<b>-3,870</b>	<b>-403</b>	<b>-810</b>	<b>-1,204</b>
Capital expenditure	-264	-710	-733	-1,104	-1,509
Acquisitions/disposals	0	-1,064	0	0	0
<b>Financing cash flow</b>	<b>1,225</b>	<b>3,777</b>	<b>0</b>	<b>0</b>	<b>0</b>
Borrowings	0	0	0	0	0
Dividends paid	0	0	0	0	0
<b>Change in cash</b>	<b>202</b>	<b>413</b>	<b>-328</b>	<b>178</b>	<b>262</b>
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>2,793</b>	<b>8,889</b>	<b>9,748</b>	<b>11,466</b>	<b>13,422</b>
Cash & cash equivalent	1,230	4,653	4,138	4,256	4,446
Accounts receivable	539	990	1,680	2,673	3,693
Net fixed assets	335	909	1,368	1,855	2,522
<b>Total liabilities</b>	<b>753</b>	<b>2,778</b>	<b>2,861</b>	<b>3,362</b>	<b>3,578</b>
Accounts payable	244	648	688	1,154	1,347
Total Debt	0	0	0	0	0
<b>Shareholders' funds</b>	<b>2,041</b>	<b>6,111</b>	<b>6,887</b>	<b>8,104</b>	<b>9,845</b>
<b>Profitability/Solvency Ratios (%)</b>					
EBITDA margin adjusted	45.9	40.0	29.4	34.0	37.0
ROE adjusted	27.7	14.8	11.9	16.2	19.4
ROIC adjusted	31.8	24.6	11.7	18.3	22.5
Net debt to equity	-60.3	-76.1	-60.1	-52.5	-45.2
Total debt to capital	0.0	0.0	0.0	0.0	0.0

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## Earnings revision

We are cutting FY08-11E EPS by 5-16% due to:

1. Delays in new product deployments particularly outside India. No slowdown in order wins however. Major order wins during 2Q included RBT deployment for Aircel's new circles and RBT replacement from two major operators outside India.
2. Impact of rising cost pressures especially as OnMobile continues to invest heavily in new product development/projects whose revenue streams have yet to begin.

Figure 1. OnMobile – Earnings revision

	2009E			2010E			2011E		
	Old	New	Change	Old	New	Change	Old	New	Change
EPS	15.88	13.46	-15.3%	25.09	21.08	-16.0%	31.69	30.17	-4.8%

Source: Citi Investment Research estimates

## New target price based on 16x Mar-10 P/E

We apply a 16x multiple to Mar-10E EPS which is in line with the current average for comparable peers, yielding a target price of Rs337. Our valuation is based on FY10E (and not FY09E) as it better captures OnMobile's evolving business model. We believe our target P/E, though high in the current market environment, is justified by the company's high earnings growth prospects, with FY08-11E CAGR at 37%.

## Peer set drawn from high-growth media/internet companies

We have drawn OnMobile's peers from companies in the Internet/media sector, which also are in a high-growth phase. The list of global peers, some of them much larger than OnMobile (Figure 2).

Figure 2. OnMobile – Valuation comparisons

	RIC code	Rating	Price Crcy	Price 14 Nov 08	Mkt cap US\$m		P/E(x)				PEG	EPS CAGR	P/B (x)	ROE
							CY07	CY08E	CY09E	CY10E	CY09E	CY07-10E	CY09E	CY09E
<b>China Internet</b>														
51job	JOBS.CN	2M	USD	6.8	191		10.0	13.5	9.4	7.1	0.8	11.9%	1.0	8.5%
Alibaba	1688.HK	2H	HKD	5.4	3,488		20.4	16.3	19.8	13.8	1.4	14.1%	3.8	17.7%
Baidu	BIDU.CN	1M	USD	178.9	6,117		67.8	34.1	21.6	13.2	0.3	72.3%	7.9	45.0%
Ctrip	CTRP.CN	1L	USD	23.0	1,526		23.6	18.0	13.2	10.1	0.4	32.8%	4.4	32.3%
Sina	SINA.CN	1M	USD	26.3	1,457		23.4	15.7	13.1	8.1	0.3	42.2%	2.1	16.0%
Tencent	0700.HK	1L	HKD	50.2	11,638		48.6	29.3	21.3	15.1	0.4	47.6%	7.1	38.5%
<b>Average</b>							<b>32.3</b>	<b>21.1</b>	<b>16.4</b>	<b>11.2</b>	<b>0.6</b>	<b>36.8%</b>	<b>4.4</b>	<b>26.3%</b>
<b>India Internet*</b>														
Info Edge	INED.IN	2H	INR	420.3	235		20.0	21.2	17.7	11.7	0.9	19.7%	3.0	18.2%
<b>Average</b>							<b>20.0</b>	<b>21.2</b>	<b>17.7</b>	<b>11.7</b>	<b>0.9</b>	<b>19.7%</b>	<b>3.0</b>	<b>18.2%</b>
<b>US Internet</b>														
Amazon	AMZN.US	2H	USD	41.8	17,904		37.2	30.3	27.8	21.9	1.4	19.3%	5.5	21.9%
eBay	EBAY.US	2H	USD	12.4	15,783		8.1	7.2	7.0	6.3	0.8	8.4%	1.3	15.3%
Expedia	EXPE.US	2H	USD	7.8	2,238		6.4	6.1	6.0	4.8	0.6	9.8%	0.4	6.1%
Google	GOOG.US	1H	USD	310.0	97,580		19.9	16.0	14.6	12.5	0.9	16.8%	2.9	18.2%
Priceline	PCLN.US	1H	USD	53.8	2,184		13.0	9.3	9.4	8.5	0.6	15.4%	2.7	19.9%
Yahoo	YHOO.US	2H	USD	10.8	15,015		22.9	26.8	23.6	20.3	5.7	4.2%	1.2	5.3%
<b>Average</b>							<b>17.9</b>	<b>16.0</b>	<b>14.8</b>	<b>12.4</b>	<b>1.7</b>	<b>28.7%</b>	<b>2.3</b>	<b>14.5%</b>
<b>Overall Average</b>							<b>17.8</b>	<b>14.6</b>	<b>16.3</b>	<b>9.6</b>	<b>0.8</b>	<b>24.4%</b>	<b>2.5</b>	<b>17.9%</b>
OnMobile at current price*	ONMO.BO	1H	INR	210.0	248		16.8	15.7	10.0	7.0	0.3	37.4%	1.5	16.2%
<b>OnMobile at target price</b>	<b>ONMO.BO</b>	<b>1H</b>	<b>INR</b>	<b>337.0</b>	<b>397</b>		<b>26.8</b>	<b>25.0</b>	<b>16.0</b>	<b>11.2</b>	<b>0.4</b>	<b>37.4%</b>	<b>2.4</b>	<b>16.2%</b>

Source: Citi Investment Research estimates, \* CY09 refers to FY10

## 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 a 35% market share as of Mar 08. 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 shares Buy/High Risk. Continued robust growth in the domestic VAS market with rapidly rising subscriber base and deepening VAS penetration combined with OnMobile's strong position in the market (35%

market share as of FY08) are key factors in our investment argument. Its focus on developing applications rather than content aggregation, voice platform rather than text and international expansion should help it sustain growth momentum and profitability. We forecast earnings CAGR of 37% over FY08-11E. Zero leverage and proceeds from the recent IPO gives it flexibility to pursue growth-related acquisitions - an integral part of strategy.

## Valuation

Our target price of Rs337 is based on 16x Mar-10E EPS, in line with the average multiple for comparable peers in the global internet and media sector. Our valuation is based on FY10E (and not FY09E) as we believe it better captures the evolving business model of OnMobile. We believe our target P/E, though relatively high in this market environment, is justified by its high earnings growth prospects, with FY08-11E CAGR at 37%, implying a PEG of 0.4x. 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 correctly 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

Our quantitative risk-rating system assigns a default Speculative Risk rating to OnMobile shares due to its trading history of less than 12 months. We, however, see a High Risk rating as more appropriate on account of its strong positioning in a fragmented VAS market (largest VAS player with ~35% market share in FY08) and strong R&D focus, notwithstanding the high valuations in context of the current weak market environment. Key risks are: 1) Indian operators (like their western peers) shifting from revenue share to licensing model as VAS contribution to overall wireless revenues rises. This can result in a cap on OnMobile's revenues stream from any individual customer; and 2) sharp tariff cuts by operators to deepen penetration. Company-specific risks are: 1) high customer concentration; 2) management's ability to make necessary changes in the organisation structure to handle high growth; 3) success outside India; and 4) any value destructive acquisition. These risk factors could impede the stock from reaching our target price.

# Appendix A-1

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#### Ratings and Target Price History

#### Fundamental Research

Analyst: Gaurav Malhotra, CFA

Covered since September 1 2008

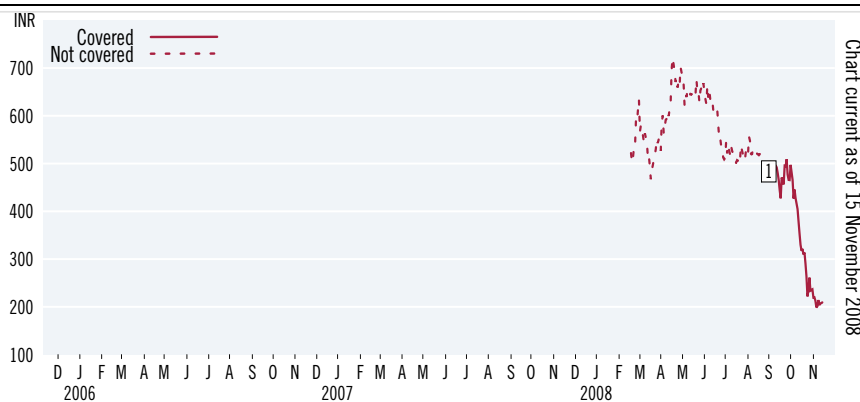


Chart current as of 15 November 2008

Date	Rating	Target Price	Closing Price
1 31-Aug-08	*1H	*630.00	483.60

\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Neil Doshi, associate, holds a long position in the shares of Google Inc

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