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INDIAN TELECOM INDUSTRY

Credit implications of Vodafone Idea Limited's financial stress on various stakeholders

SEPTEMBER 2021

Highlights

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Given the precarious position of the balance sheet of VIL, material external support (primarily Government) might be necessary. The support can be in the form of deferment of spectrum dues, reduction in levies or any other.

In case VIL exits, this will result in vacation of around 180,000 tenancies that it currently occupies. Of these, only 40-50% of the tenancies will be regained by the tower companies over a period of 18-24 months.

- Feeling the heat of the headwinds faced by the industry, Vodafone Idea Limited (VIL) also witnessed pressure in the form of shrinking subscriber base, stagnating 4G user base, pressure on cash flow generation, low ARPU levels, low capex levels and burgeoning debt levels and it has come to a point where it needs material external support to continue operations.
- In a scenario where VIL exits Indian markets, not only the employees and subscribers, but the lenders and associated industries like towers and equipment manufacturers would be impacted.
- ICRA's sample of tower companies has sizeable dependence on VIL (around 35% in terms of tenancies). While there will be immediate vacation of tenancies, around 40-50% of these will be regained in 18-24 months as the subscribers of VIL will have to be served by the existing players.
- Although revenue and profit generation for tower companies will come under pressure in the near term, and the profitability and debt protection metrics will witness deterioration, the liquidity of the ICRA sample of tower companies is expected to help them tide over this pressure.
- With a widespread impact of the bankruptcy of VIL, the Government of India could be under pressure to revive VIL. The support could come in the form of deferment of spectrum dues, reduction in levies, reduction in interest rates on DoT dues, and increase in tenure of spectrum allocation. Of these, deferment of spectrum dues is likely to be the most impactful.
- Of the 23 scheduled commercial banks rated by ICRA, five have material exposure to VIL in relation to their advances or operating profit or capital. However, ICRA's ratings on banks factor in the potential stress. Capital ratios for these banks are likely to remain above regulatory levels.

Vodafone Idea Limited – Under Pressure on All Fronts

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Stagnating 4G subs

While other telcos are reporting healthy growth in 4G subs base, for VIL, the same has largely stagnated

Low on capex

Owing to liquidity pressures, the capex has witnessed a decline, exerting pressure on the network

Subscriber loss

Since the merger of erstwhile Vodafone India and Idea Cellular, the merged entity has been witnessing sizeable subscriber churn rates

Low ARPU levels

VIL's ARPU levels have remained much lower than BAL and RJIL, primarily on account of low proportion of 4G subscribers

Elevated debt and losses

Amid weak cash flow generation and mounting losses, the financial liabilities have burgeoned significantly, resulting in precarious balance sheet position

VIL Metrics Compared with Other Industry Participants

EXHIBIT: Movement of subscriber base of telcos

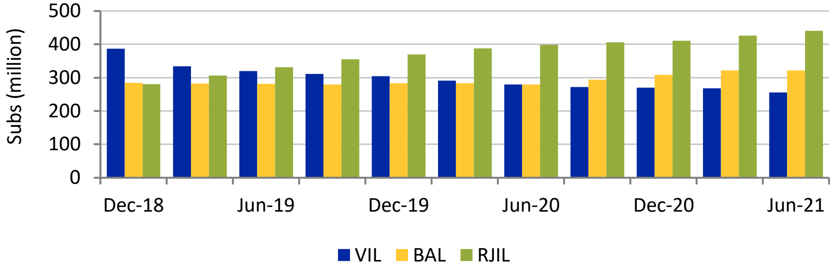


EXHIBIT: Movement of 4G subscriber base of telcos

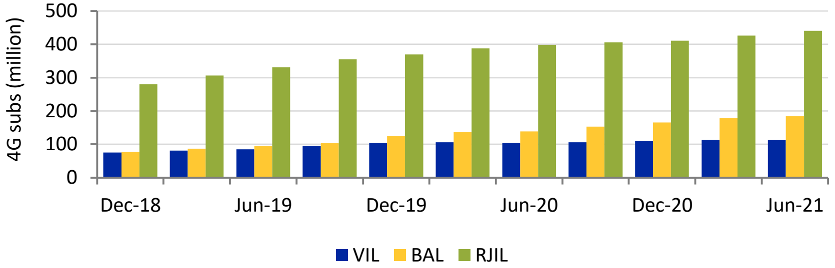


EXHIBIT: Movement of ARPU (Rs.) for telcos

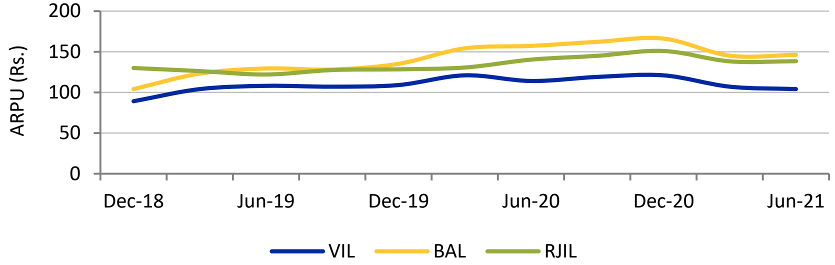
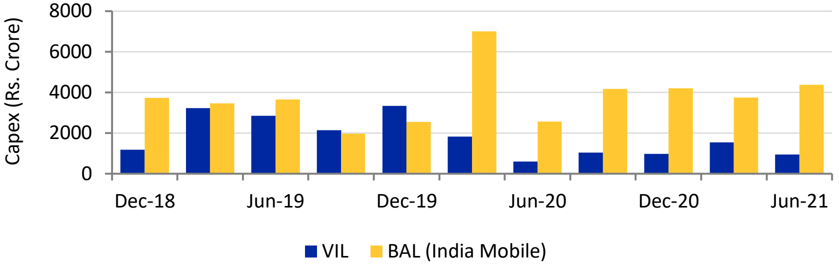


EXHIBIT: Comparison of capex with BAL



Source: ICRA Research, Quarterly reports of Bharti Airtel Limited (BAL), VIL and RJIL

Elevated Debt Remains the Achilles' Heel

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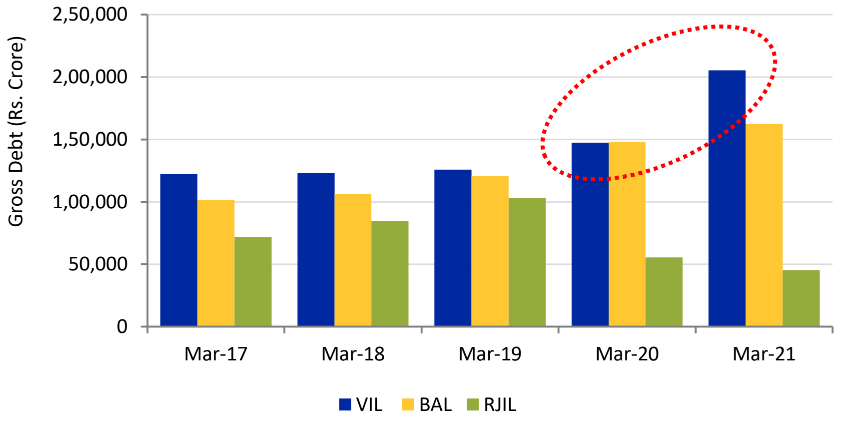
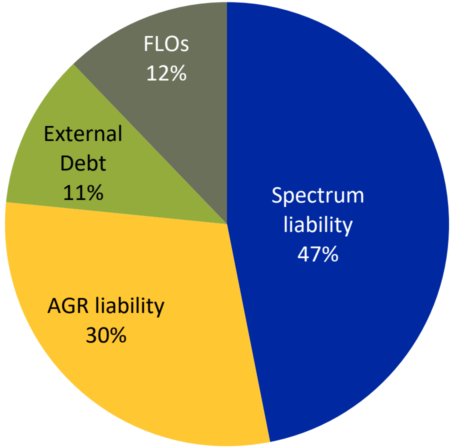
EXHIBIT: Movement of gross debt for telcos



Source: Annual Reports and Quarterly Reports of Telcos; ICRA Research

EXHIBIT: VIL Breakup of Debt (March 31, 2021)



Source: VIL Quarterly reports and ICRA Research; FLO – Finance Lease Obligation

- While external debt was ~Rs. 23,000 crore as on March 31, 2021, VIL also has Bank Guarantees of ~ Rs. 23,500 crore.
- VIL has to pay around Rs. 9,000 crore towards AGR liability by March 31, 2022
- As the moratorium on deferred spectrum payments ends in FY2022, VIL has to pay ~Rs. 16,000 crore in FY2023 towards the spectrum liabilities
- These, in addition to the repayments of the external debt, balloons to a staggering amount, especially in the light of the losses posted by the company in recent quarters

Impact of VIL's Exit on Various Stakeholders

Lenders and Government

- As on June 30, 2021, VIL had liabilities payable to the government to the tune of Rs. 168,190 crore and other debt of Rs. 23,400 crore

Employees

- Company has around 11,500 employees on its rolls

Subscribers

- While there has been a high subscriber churn, VIL had around 255 million subscribers as on June 30, 2021

Tower Companies

- Exit of VIL would result in immediate vacation of sizeable tenancies for the tower companies, which can be only partly recouped, and that too gradually over time

Equipment Manufacturers

- VIL's exit will also contract the revenue generation potential for the equipment manufacturers

Tower Companies – Impact Assessment

VIL's share for independent tower companies*

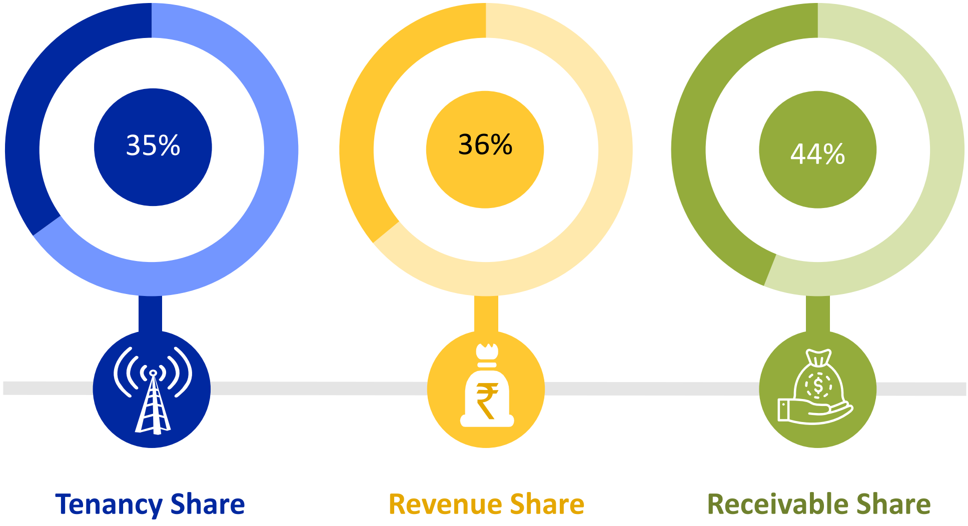
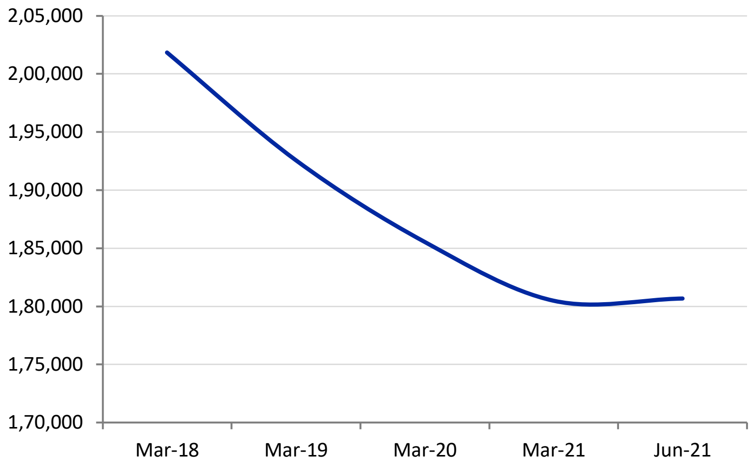


EXHIBIT: Movement of VIL's tenancies (number)

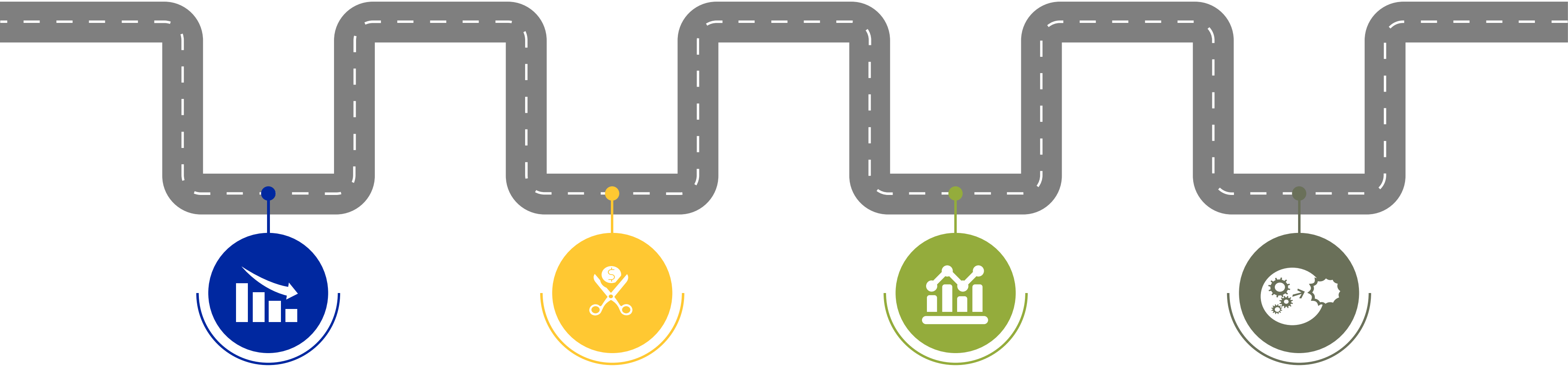


Source: ICRA Research, VIL quarterly reports

There has been a consistent decline in the tenancies of VIL. However, VIL still has sizeable presence in the tower industry in terms of tenancies, revenues and receivables, and thus exit of VIL will impact the tower companies in near term

** - ICRA sample – Indus Towers Limited, ATC Telecom Infrastructure Private Limited, Tower Vision India Private Limited and Ascend Telecom Infrastructure Private Limited*

VIL Exit – Expected Roadmap for Tower Industry



Immediate tenancy losses leading to revenue and EBITDA loss; although there would be some savings on capex. There can be dismantling of some towers

VIL receivables will have to be written off, and there would be no receipt of exit penalties

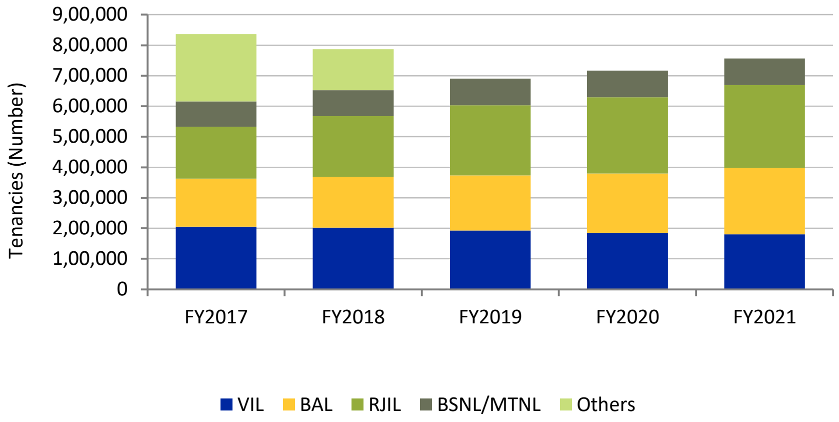
Steady regaining of tenancies as BAL and RJIL will have to cater to the subscribers of VIL.

Tower companies will witness higher loadings and demand for high power small cells

ICRA expects that only 40-50% of the VIL's tenancies will be regained by the tower companies and that too over a period of 18-24 months and the balance will be lost owing to redundancies and network alignment

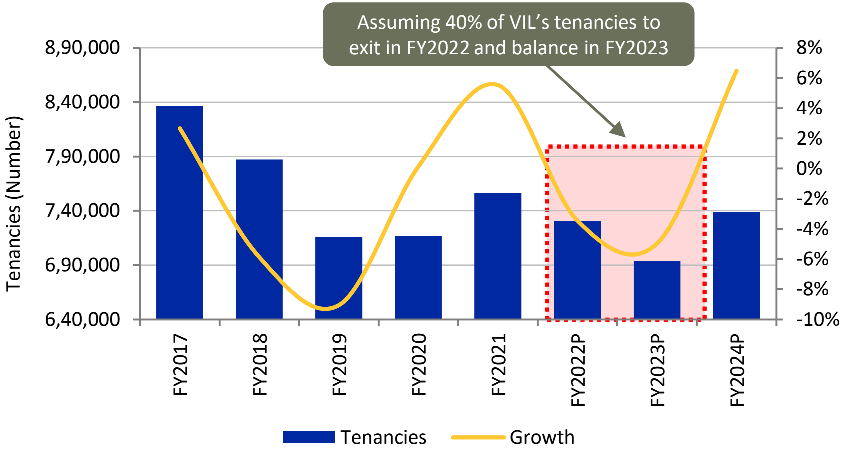
Tower Industry – Expected Tenancy Movement

EXHIBIT: Operator wise tenancy movement



Source: ICRA Research

EXHIBIT: Expected tenancy movement and growth rates

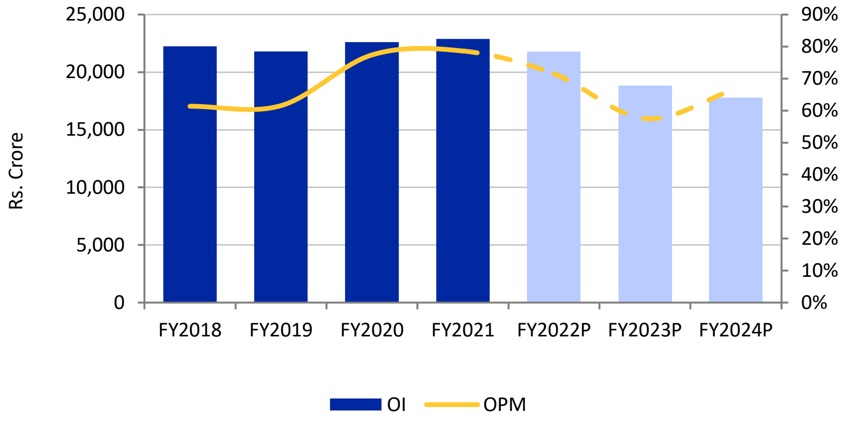


Source: ICRA Research

- After witnessing a decline over FY2018 and FY2019 following consolidation in the telecom services industries, the tenancies have improved steadily thereafter, thereby steadily regaining the tenancies lost in FY2018 and FY2019.
- In the analysis above and afterwards, it is assumed that 40% of VIL's tenancies will witness exit in FY2022 and the balance in FY2023. However, the other operators will occupy some of the vacancies, thereby resulting in improvement in tenancy levels thereafter, however, the levels will continue to remain lower than those in FY2021.

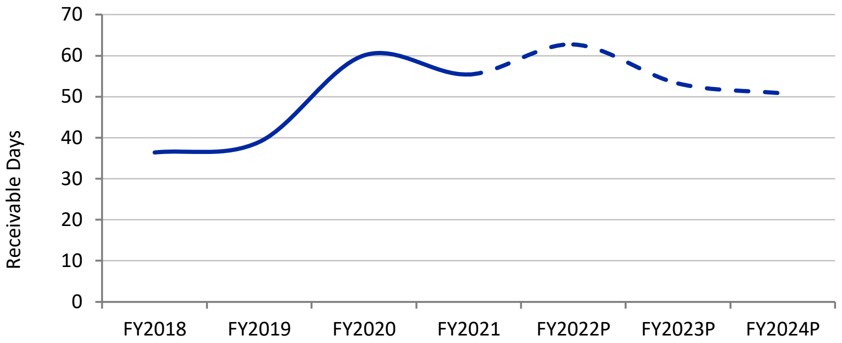
Financial Impact on Tower Companies – 1

EXHIBIT – Movement of OI and OPM for tower industry



Source: ICRA Research

EXHIBIT – Receivable days movement for tower industry

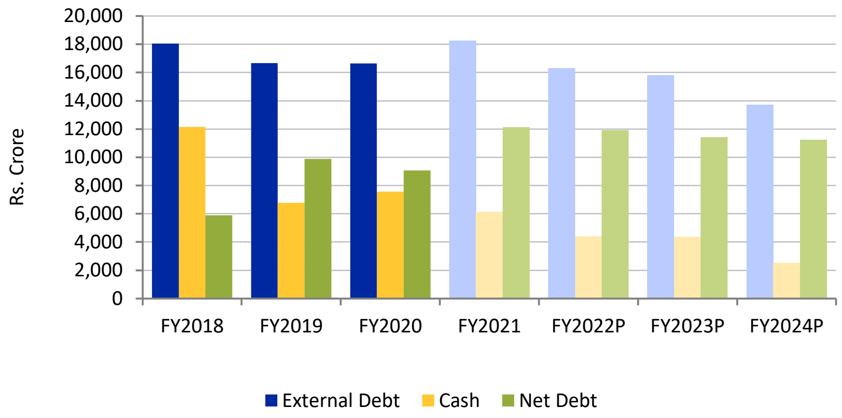


Source: ICRA Research

- While there would be a decline in revenue and profit generation in case of VIL exit, a part of the tenancies will be regained by existing telcos and the revenues are expected to increase again after a period 2-3 years. Margins will also be impacted, given the receivable write-offs and the decline in tenancies
- The receivable position is likely to remain elongated, however, with the write-off of receivables of VIL, some improvement is expected going forward given timely payments from BAL and RJIL

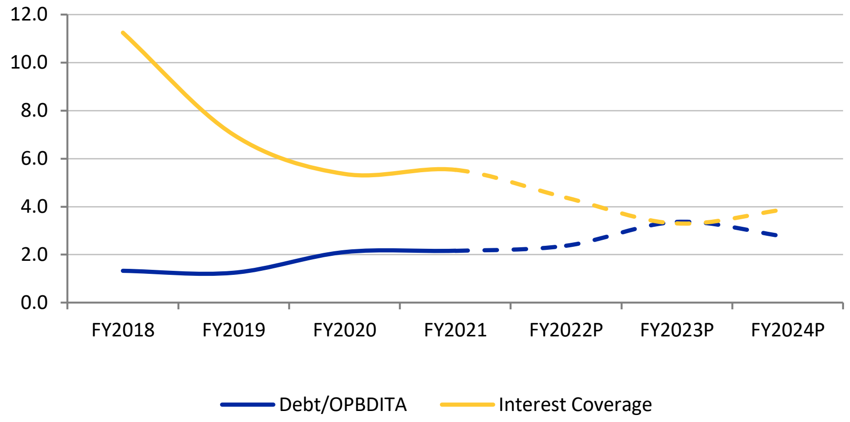
Financial Impact on Tower Companies – 2

EXHIBIT – Movement of debt and cash position for tower industry



Source: ICRA Research

EXHIBIT – Movement of debt protection metrics



Source: ICRA Research

- Despite these pressures, the liquidity, as indicated by the available cash position of the industry, continues to remain healthy and debt levels remain relatively low
- The pressure on profit generation is expected to weigh down on the credit metrics like debt/OPBDITA and interest coverage and these are expected to moderate to some extent going forward.

Anticipated Government Support Mechanism

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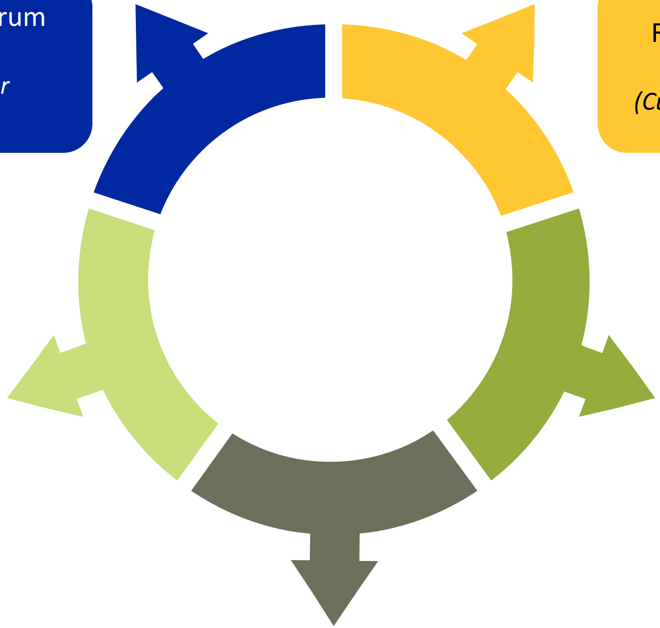


Extension of moratorium on spectrum dues
(Currently spectrum dues are under moratorium till FY2022)

Reduction in levies – License Fee and Spectrum Usage charges
(Currently 8% and 3-6% of AGR respectively)

Introduction of floor prices for tariffs

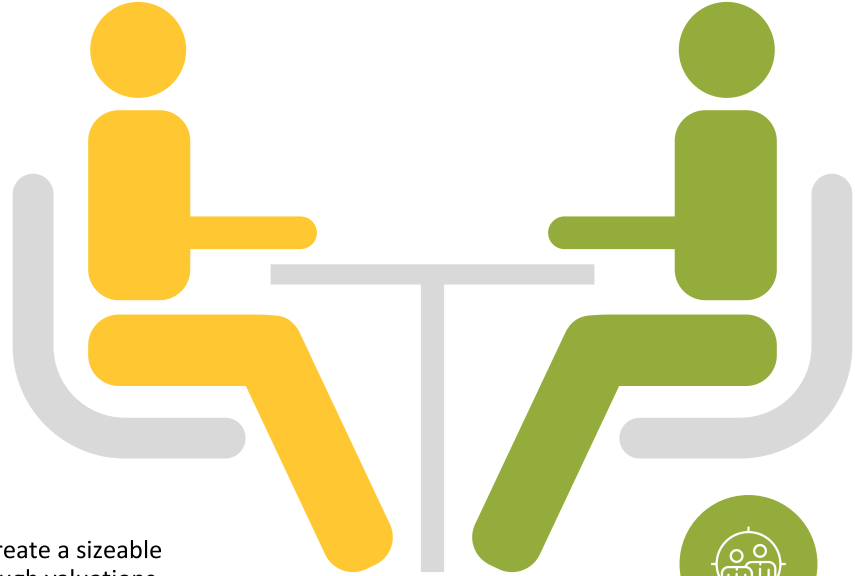
Reduction in interest rates on deferred payment obligations to the GoI
(Currently between 7.3%-10%)

Increasing tenure of spectrum allocation to 40 years from 20 years, and reduction in BG requirements

Impact Assessment of Expected Government Relief

	Relief	Likelihood of implementation	Impact meter
Extension of Moratorium	Extension of moratorium on spectrum dues is likely to result in cashflow easing of Rs. 32,000 crore per annum for the industry as a whole and Rs. 16,000 crore per annum for VIL in particular	High	High
Introduction of Floor price/ Tariff hikes	Introduction of floor prices will uplift the ARPUs automatically, leading to significant EBITDA accretion. Re. 1 increase in ARPUs leads to around Rs. 450-500 crore EBITDA uplift for the industry	Low	Medium
Reduction in levies	Telcos pay LF and SUC as proportion of AGR. Of the 8% LF paid, 5% goes towards USOF, which has Rs. 58,000 crore funds unutilised. 1% reduction in levies result in saving of ~Rs. 1600 crore for the industry	High	Medium to low
Reduction in interest rates on deferred liabilities	1% reduction in interest rates on the deferred payment liabilities leads to a cash flow easing of Rs. 4500 crore per annum for the industry as a whole	Low	Medium to low
Increase in spectrum allotment tenure	Next set of expiries of spectrum is starting Feb 2024 which is still 2.5 years and thus the elongation of spectrum tenure might not provide any immediate relief to the sector.	Low	Low

Other Possibilities



Merger with BSNL

Merger with BSNL can create a sizeable telecom company, although valuations, synergies, employee issues and other integration challenges will have to be overcome

Loan restructuring with regulatory forbearance

While the exposure would be classified as Non-performing upon restructuring, however in case of regulatory forbearance for such classifications, banks may consider extension of loan repayment tenure

These are mere possibilities and the probability of these fructifying remain uncertain at this juncture

Banks – ICRA's Ratings on Banks factors in the Potential Stress of VIL

EXHIBIT: Banks having material exposure to VIL

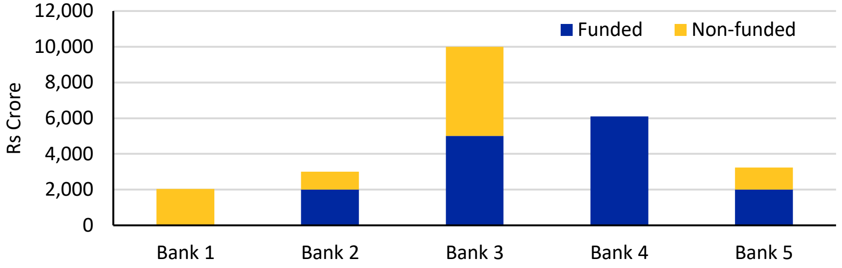


EXHIBIT: Share of VIL exposure to total advances

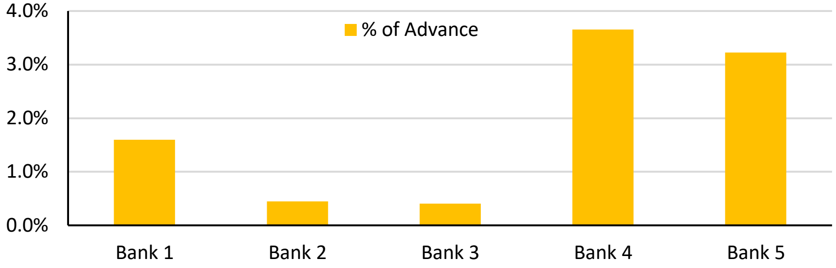


EXHIBIT: VIL exposure as % of core operating profit (FY2021)

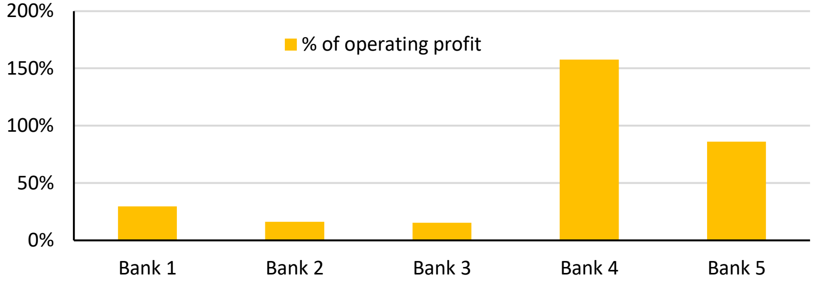
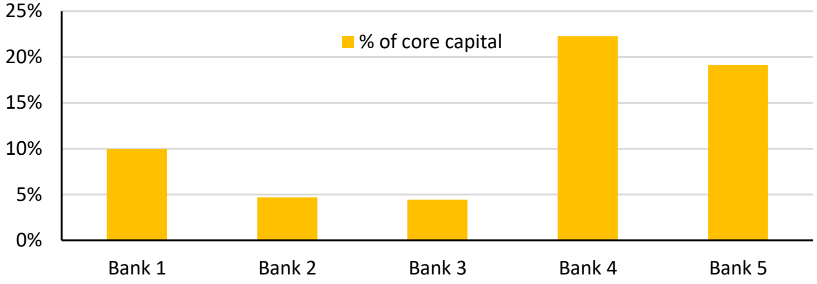


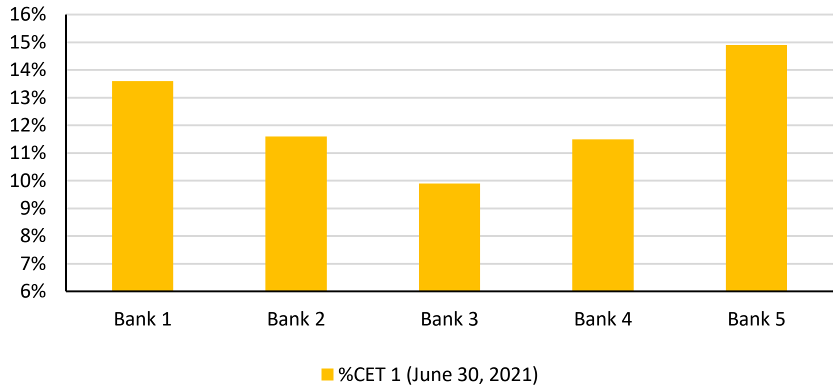
EXHIBIT: VIL exposure as % of Core Capital



Source: ICRA Research, Bank data, media reports

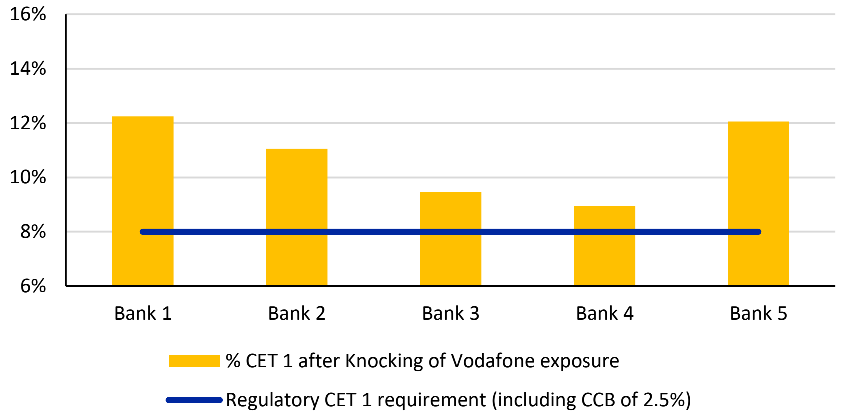
Capital Ratios Likely to Remain Above Regulatory Levels After Factoring in Stress

EXHIBIT – Reported Core Equity Capital Ratio (CET-I)



Source: ICRA Research, Bank data

EXHIBIT – Impact on CET after knocking off



Source: ICRA Research , Bank data

- ICRA has credit ratings on 23 large scheduled commercial banks, of which five are estimated to have material exposure to VIL
- The exposure of Bank 1, 2, and 3 is comfortable in relation to their operating profits, thereby providing headroom to absorb stress without impacting capital
- Exposure of Bank 4 and Bank 5 is relatively higher in relation to their operating profits, however, even after assuming a full-knock of VIL’s exposure, the core capital ratio is likely to remain above regulatory requirements (subject to stress from other exposures)
- Some banks are also carrying provision on their exposures; banks may not require 100% provision in year 1 and hence core capital will be better than the above estimates.

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Thank You!