Driven by various policy initiatives, the Indian telecom sector witnessed a complete transformation over the first decade of the 21st century. The Indian telecom industry has proved to be the fastest growing in the world and is currently the second largest globally in terms of subscriber base. The success of the sector can be attributed largely to the growth in the wireless segment and also to the regulatory support provided by the Government over the years in the form of various policies and initiatives which resulted in increased competition in the sector due to the entry of a number of private players and lowering of tariffs.

CARE assesses the credit worthiness of the Mobile Service Providers on the basis of an analysis of various quantitative financial and operational parameters as well as qualitative factor assessments. The qualitative factors include an analysis of the operating environment/industry and company-specific parameters which include an analysis of its operating efficiency as well as its competitiveness as compared to other players in the industry.
While rating Mobile Service Providers, CARE makes a critical assessment of the following parameters:

**Operating Environment/Industry**

CARE analyses the features of the industry to understand the risk factors affecting all the service providers within the industry and then focuses on the explicit factors affecting the operator which helps in ascertaining the relative position of the operator in the given industry. The key factors that CARE looks at while evaluating the industry are as follows:

**Structure of the industry**

An evaluation of the industry structure includes an analysis of the number of players present within the industry, its stability, entry barriers and level of competition. The characteristics of the Indian telecom sector include high growth rates, large subscriber base, declining Average Revenue Per User (ARPU) and Average Revenue Per Minute (ARPM), high level of competition with the presence of a large number of established players as well as new entrants and high churn rates. The Indian telecom sector is still in the expansion phase with operators looking to expand their operations into the rural and semi-urban areas through existing and new service offerings. This requires large investments in network deployment and rollout of services and the projects typically have a long gestation period. CARE analyses the ability of the operators to complete their rollout obligations in a timely manner, their capacity to absorb the significant customer acquisition cost as well as the financial flexibility to fund initial losses and unanticipated delays.

**Regulatory Framework**

Regulatory actions determine the area of service, type and nature of service, number of competitors, tariff plans and also the levies on the operators. Although regulatory uncertainties have been brought down substantially through an interactive mechanism, regulatory risk continues to be of paramount importance. Any new regulation can bring about a major change in the competitive environment resulting in major uncertainty with respect to the operations of a company. The presence of an independent regulator in the form of Telecom Regulatory Authority of India (TRAI) and the introduction of a number of positive regulatory measures have helped propel the Indian telecom industry into the growth phase. However, a number of issues still need to be
resolved so as to bring about stability within the industry and to maintain the momentum of growth.

**Company-specific/Business Parameters**

**Market Position**

CARE considers market position to be an important operating factor in the analysis of telecom service providers. The relative position and strength of a service provider in the segment within which it operates is considered integral to the sustainability of its operations along with its ability to counter competitive pressures exerted by other service providers. The market position of a company is measured in terms of revenue, performance track record and incremental subscriber additions per month. Given the huge outlay required owing to the capital-intensive nature of the industry and the extensive marketing costs involved, having a widespread presence and large scale of operations is important as the scale and size determines an operator’s ability to distribute fixed costs over a larger base. A larger market share also ensures greater network efficiency and scale advantages in marketing and distribution.

CARE analyses the relative position of an operator within the circles where it operates using trend analyses and peer group analyses of subscriber penetration levels and churn. Incumbent operators generally have a stronger position in a larger number of service areas due to their extensive network which is the key to their market dominance. However, in case of both the incumbents as well as the new entrants, a strong market position within its areas of operation and growing subscriber penetration levels are considered to be significant parameters. CARE also analyses the potential for growth offered by the service areas within which the service provider operates and the strategic initiatives undertaken by the service provider to enhance its customer value proposition.

**Technology Risk**

With the rapid technological developments in the telecom sector, the operators face the risk of competition from other players who have access to superior technology by means of global tie-ups and hence can offer high-quality services at fairly reasonable prices. Thus even though, evolving technology offers new opportunities in terms of revenue diversification, it is important for operators to have the requisite financial flexibility to upgrade their network to match the technological advances. With the intense competition prevalent within the telecom sector, the
The key differentiator would be the ability of an operator to offer a diversified portfolio of innovative products and services which require superior technological platforms. As technological up-gradations require considerable financial investment, CARE analyses an operator’s financial ability to be able make periodic investments for technological upgrade and also analyses the risks associated with and the prospective returns from the technological platforms chosen by the operator.

The rapidly changing technology exposes the operators to obsolescence risk, and hence huge investment outlays by operators on telecom infrastructure may be infeasible and hence the industry has now seen a paradigm shift towards passive infrastructure sharing. Sharing of passive infrastructure significantly reduces the capex required to be incurred by the operators and enables them to reduce the huge bottlenecks arising out of the time consumed in setting up of infrastructure.

**Geographical Diversification/Consumer Mix**

An operator with a diversified reach and strong presence in a large number of service areas would be at an advantage as compared to operators with presence in a limited number of service areas. Diversification not only ensures that the operator is not over dependent on a limited number of service areas for its revenues but also allows operators considerable bargaining power with equipment and handset vendors.

Another factor considered by CARE while analyzing an operators’ risk profile is the consumer mix in terms of the number of prepaid and postpaid consumers as this gives an indication of the operators’ usage levels and helps in the estimation of ARPU which is a critical parameter considered in the assessment of an operators’ performance. Since prepaid ARPUs are lower as compared to postpaid due to lower levels of usage along with higher churn rates for prepaid, a higher proportion of postpaid subscribers in the total subscriber base of operator is considered to be an advantage. Thus, CARE assesses an operator’s overall footprint in terms of the service areas covered combined with its ability to attract new subscribers and maintain its ARPU levels as these factors are an integral part of the overall credit quality analysis.
Brand Image/Network Coverage & Quality

The Indian telecom sector is overcrowded with a large number of players vying for a share of the market. In such a scenario, any reduction in tariffs by one operator is matched by its competitors. Since tariffs are market driven, it is important for an operator to carve out a niche for itself through better network coverage and quality and through provision of innovative services which will provide an operator a differentiating edge over others and will enhance the operator’s brand image. The ability of an operator to build its brand image amongst consumers is a critical parameter in determining the potential success or failure of the operator as this determines its subscriber base and ultimately its ability to generate revenues in an overcrowded market. The customer acquisition cost i.e the cost incurred by an operator on sales and brand building is normally high for all operators and is an expense that is difficult to minimize due to the intense competitive pressure. CARE analyses the ability of an operator to absorb the high customer acquisition costs and also the consumer awareness the operator has managed to generate within its area of operation.

One of the important factors that contribute to an operator’s brand image is its network coverage and quality. An operator that offers seamless coverage, lower call drops and better voice quality is preferred by consumers and has a better market image and thus has a competitive edge. CARE assesses an operator’s network quality based on certain Quality of Service (QoS) parameters such as average call completion rate and number of call drops. CARE also relies on the Quality of Service and Customer Satisfaction Survey reports released by TRAI which gives an indication of where the various players stand in terms of QoS and consumer satisfaction.

Financial Profile

CARE’s analysis of the financial profile of an operator considers both historical and projected financial performance. Trends over a 3 to 5 year period are analysed and compared to the industry average. CARE’s financial analysis is focused on the stability and sustainability of earnings and cash flow, which underpins the ability of the operators to repay their debt obligations. The greater the operator’s cash flow generation relative to the total amount of debt and other claims, the more able it will be to meet maturing debt obligations in the face of potentially adverse conditions.
The telecom sector is capital intensive as networks constantly require upgrading to meet technological advancements. A proportion of the capital expenditure in telecom is considered non-discretionary and this level can rise or fall depending upon the technological shifts which occur from time to time which necessitate an increase in the capex to be incurred by the operator. The ability of telecom operators to generate sufficient internal cash flow to meet these capital requirements is considered to be a key factor that influences the credit quality of the operator.

CARE also assesses the financial performance of an operator in terms of its profitability at the EBITDA level. The EBITDA margins of the operators have been under pressure owing to a number of factors and the pressure on the margins is likely to become more evident over time as a result of rising customer retention and acquisition costs, slower pace of returns on 3G services and competition from other operators.

**Leverage/Debt Profile**

Leverage is also a key factor in analyzing an operator’s long-term creditworthiness and solvency given the high capital intensity of the sector. CARE analyses various leverage ratios such as the debt to equity, overall gearing and debt to EBITDA as part of its overall methodology. CARE also pays special attention to the terms and conditions of the debt raised and the covenants associated with the various credit facilities. Companies in the telecom sector are required to make huge initial outlays during rollout and telecom projects have a long gestation period. As a result, the ability of a telecom operator to arrange for long-term debt with suitable maturity assumes paramount importance in determining viability of its operations.

**Promoter/Management Evaluation**

The Indian telecom sector continues to grow with a significant number of new subscribers being added every month. With the expansion into the semi-urban and rural markets, the growing number of subscribers and the introduction of new technologies, operators constantly need to scale up their operations and are hence almost perpetually in the project phase. Thus financial flexibility in terms of being able to infuse additional equity when required is a critical parameter when analyzing the risk profile of an operator. CARE pays significant attention to the promoter’s financial strength and their ability to infuse funds whenever required. Thus the financial flexibility of the promoters along with the way
in which they propose to fund initial losses and the contingencies arising out of unanticipated delays or longer-than-anticipated gestation period is critically examined by CARE. The management of the company is assessed for its role in developing and implementing long-term strategies that provide the foundation for a sustainable long-term competitive advantage. CARE believes that the strength of the management team will determine an operator’s medium to long-term competitiveness.

**Conclusion**

The rating outcome is ultimately an assessment of the fundamentals and the probabilities of change in the fundamentals. CARE assesses the credit quality of a telecom operator based on a number of qualitative and quantitative parameters which include the operator’s positioning on technology, strategies to maintain and expand market reach, capability and plans to offer higher-margin services and ability and willingness to explore new revenue sources.
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<th>Regional Offices</th>
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