

Spectrum Auctions 2015: *Windfall for Government, must win for operators and tariff hike for subscribers*

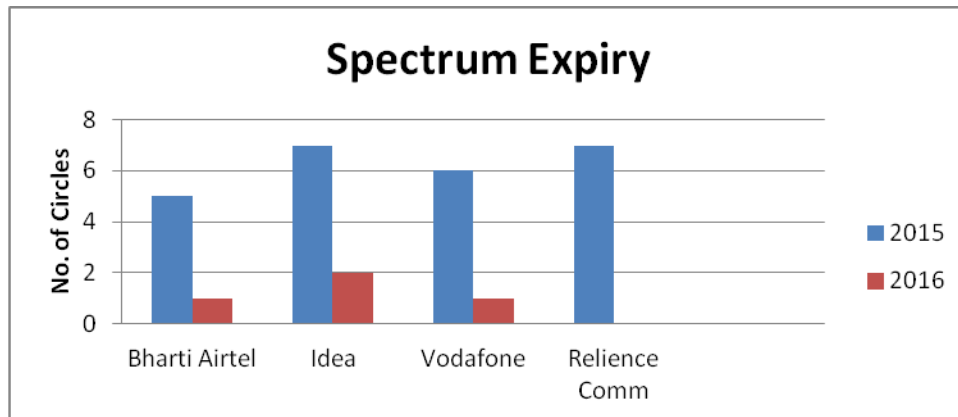
With the 2015 auctions of spectrum reaching their final phase with aggressive bidding being seen across the frequency bands, the government is set for a windfall gain which will be even higher than what the government realised during its most successful spectrum auctions of 2010. CARE Ratings expects that the operators will further leverage themselves, while the consumers will have to bear the brunt of tariff hikes which will become inevitable for the operators to realise returns on these huge investments.

India began its fresh round of auctions for spectrum on March 4, 2015, and has completed 80 rounds of bidding till March 18, 2015, with the bidding amount reaching a staggering Rs.108,000 crore surpassing the basic minimum amount of around Rs.82,000 crore based on the reserve prices. The spectrum offered for bidding includes frequencies in the 800 MHz, 900 MHz, 1,800 MHz and 2,100 MHz bands. In the earlier auctions, the spectrum on offer was either freshly released by the government or became vacant as a result of the order of Supreme Court, while these auctions, especially for spectrum in 900 MHz and 1,800 MHz bands, are for spectrum which is currently in use by the operators whose 20-year licenses are slated to expire in the next few months. The high bids are therefore not surprising as these operators face the unenviable task of protecting their large investments and revenue streams from these circles for which the auctions are happening.

Intense bidding; fate of leading operators hang in balance

The leading telecom service operators, viz, Airtel, Vodafone, Idea Cellular and Reliance Communications (RCom) have no choice but to buy back spectrum they are holding in 900 MHz band to ensure the continuity of their business in these circles, especially if they do not have other spectrum to fall back on. As a result, there is an intense bidding happening for these airwaves, which is expected to remain aggressive, especially for 900 MHz and 2,100 MHz bands. The government is selling only 5 MHz in each circle in the 2,100 MHz band, which is enough for just one player, while 900 MHz band is known for being more efficient and ideal for wide range of telecom services. As can be seen in the chart below, mobile licenses for Idea Cellular's 9 circles, Airtel's 6 circles and 7 circles each of Vodafone and Reliance communication are coming up for renewal. Overall, 29 licenses in 18 service areas will expire in 2015 and early 2016. While Idea derives

around 74% of its revenues from these circles, Airtel, Vodafone and Reliance Communications derive around 35%, 48% and 15% of their revenues, respectively, from these circles.



The government on its part has also kept the reserve price on a higher side as compared with the reserve prices suggested by the sector regulator, TRAI. The base price and the quantum of spectrum put for the latest auctions along with the prices suggested by TRAI are presented in the table below-

Band	Quantum	Base price (Final)	Base Price (TRAI)
800 MHz Band	103.75 MHz	Rs.3,646 crore/MHz	Rs.3,104 crore/MHz
900 MHz Band	177.8 MHz	Rs.3,980 crore/MHz	Rs.3,004 crore/MHz
1,800 MHz Band	99.2 MHz	Rs.2,191 crore/MHz	Rs.2,138 crore/MHz
2,100 MHz Band	85 MHz	Rs.3,705 crore/MHz	Rs.2,720 crore/MHz

With the survival of their operations in several circles at stake, a total of eight telecom operators have deposited Rs.20,435 crore as earnest money deposit for participating in the auction. Reliance Jio has paid the highest deposit of Rs.4,500 crore, followed by Rs.4,336 crore from Bharti Airtel.

Aggressive bidding; will the operators again get into a debt trap?

Telecom service providers are already under huge debt and an aggressive bidding may put more pressure on their balance sheets, as they may have to resort to raise further debt to fund the acquisition of these airwaves. Successful bidders have to make an upfront payment of 25-33% of the final sale price. This may help the government to garner nearly Rs.25,000 crore immediately in the current financial year through the current round

of spectrum auction. The winners in the 900 Mhz and the 800 Mhz bands will need to pay 25% of the winning amounts within 10 days of the auction close, while 33% of the winning bid price will be the upfront payment for spectrum in the 1,800 Mhz band. The balance amount would need to be paid in 10 equal annual installments after a 2-year moratorium.

Most of the telecom operators in the past few quarters have rejigged their business strategies and focused on select circles to maximise both their top lines as well as bottom lines. However, if these operators have to resort to excessive debt funding then some of the gains which these players have made in the last one year could again get wiped out.

Tariff hikes seems inevitable; competitive pressures to continue

The Telecom operators during the past couple of years have resorted to tariff hikes on several occasions to improve their profitability. The hikes were done based on their competitive strengths in specific circles and were for both, data and voice services. Now, faced with the prospect of bidding aggressively to regain the spectrum which they held, the telecom operators are unlikely to absorb the impact of higher cost of spectrum, especially in the circles where they are in a strong position and are likely to ultimately decide to go for tariff hikes.

However, tariff hikes may not be very easy to actually execute, as there would be competitive pressures, especially from the players who are not participating in these auctions. Furthermore, spectrum price has never been the single most driving factor that decides tariffs. There are also apprehensions regarding the strategy which may be employed by Reliance Jio Infocomm, the wireless arm of Reliance Industries Ltd to establish itself in this hypercompetitive market.

The situation may also compel these telecom operators to aggressively explore other revenue generating options and focus more on value added services. Furthermore, with the plans of some of the popular *chat applications* to offer the feature of voice calling in addition to traditional messaging, the operators will be under tremendous pressure to devise some way of charging for these services. Although the telecom operators were already demanding for some share in the revenue generated by these app providers but with voice revenue still being the main contributor to their top-line and data usage increasing as a result of use of these services, the operators were not very aggressive with their demand.

However, with the threat on their voice revenue becoming real, the operators are likely to aggressively pursue their demand. TRAI is already working on a consultation paper which will address problems of both parties, the operators and the over the top (OTT) players with revenue sharing looking likely as the most suitable option to sort the issue.

The X factor; Reliance Jio Infocomm:

The interesting element in the bidding process is Reliance Jio, which has put in a large amount of earnest money (Rs.4,500 crore, the highest) to indicate it may be bidding for large amount of spectrum. The company already has pan India spectrum in 2,300 MHz band and it also won spectrum in 1,800 MHz in 14 telecom circles during the last auctions. The company may bid aggressively for 900 MHz which has got better propagation characteristics as compared with spectrum in higher bands. In non-metro circles where lesser number of towers are available, the company may be interested in 900 MHz, while it may bid aggressively to acquire spectrum in 2,100 MHz in metro circles. This will help the company in offering a complete bouquet of services when it finally decides to launch its services, however, its aggressive bidding is expected to put the existing operators under pressure.

Legal tangle; No finality to the auction

Despite the spectacular bids, the government and the service providers would be nervous about the decision of the Supreme Court which is considering several challenges to the tender conditions set by the government for these auctions and has stayed the publication of auction results and the award of spectrum to winners till March 26, 2015, when it will take up the matter. The government which has budgeted around Rs.43,161 crore of non tax receipts under “other communications” during the current financial year to rein in the fiscal deficit will depend upon the Supreme court’s decision for realising the same. The court has directed that the auctions may continue, however nothing will be finalized and the successful bidders will also not be able to claim any rights over the spectrum they won without the court’s approval.

Telecom sector; Exciting times ahead

The telecom industry in India has experienced exponential growth over the past decade and has been an important contributor to overall economic growth; however, the cut-throat competition and intense tariff wars had a negative impact on the financial profile of these players. With a significant untapped potential still left in the rural space and with government’s renewed focus on developing rural telecom infrastructure to use telecom services to effectively reach out to the real beneficiaries of its various welfare schemes, the sector is expected to benefit.

CARE Ratings believes that in the long run, the transparent bidding process for spectrum is best suited for the growth of the sector, however, with the kind of aggressive bidding being seen in the current auctions, the operators will not be left with any choice but to go for tariff hikes to generate returns on the huge investments they are expected to make in the medium term.

Annexure: Outstanding Ratings on Telecom Service Providers

<u>Service Provider</u>	<u>Outstanding Ratings</u>
Aircel (includes Aircel Limited, Aircel Cellular Limited and Dishnet Wireless Limited)	CARE BBB+(SO)/CARE A2+(SO)
Idea Cellular Limited	CARE AA/ CARE A1+
Mahanagar Telephone Nigam Limited	CARE AAA (SO)
Reliance Communication Limited	CARE A-/ CARE A2+
Sistema Shyam Teleservices Limited	CARE A2 (SO)
Tata Teleservices Limited	CARE A/ CARE A1+
Tata Teleservices (Maharashtra) Limited	CARE A/ CARE A1

Contact:

Gaurav Dixit
Assistant General Manager
 gaurav.dixit@careratings.com
 +91-11-4533 3235

Vishesh Mehta
Analyst
 Vishesh.mehta@careratings.com
 +91-11-45333234

Disclaimer

This report is prepared by Credit Analysis & Research Limited (CARE Ratings). CARE Ratings has taken utmost care to ensure accuracy and objectivity while developing this report based on information available in public domain. However, neither the accuracy nor completeness of information contained in this report is guaranteed. CARE Ratings is not responsible for any errors or omissions in analysis/inferences/views or for results obtained from the use of information contained in this report and especially states that CARE Ratings has no financial liability whatsoever to the user of this report.