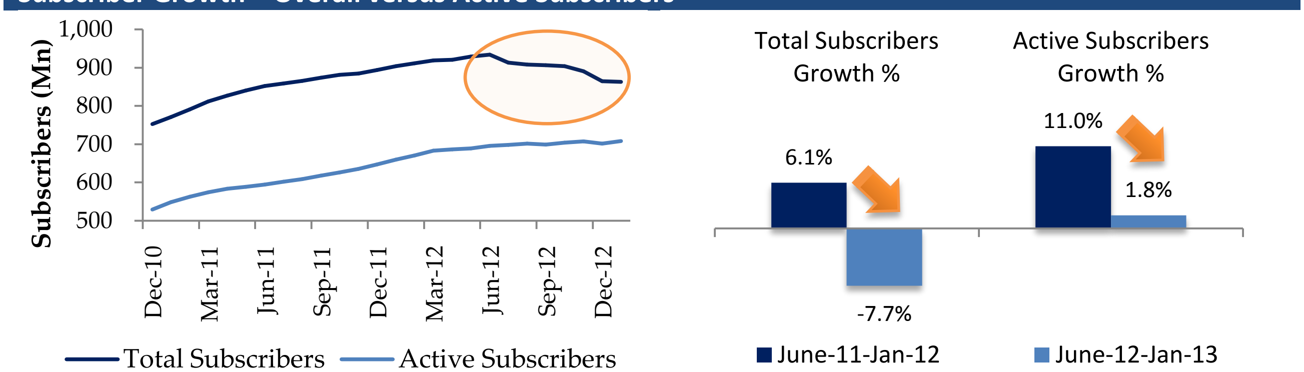
Indian Telecom Wireless Industry – Story of policy surprises and subdued growth continues…

FY2013 may be remembered as the ‘lost year’ in the history of Indian telecom. The momentum gained over the years was arrested with a series of policy actions. Alleged corruption and mis-handling of 2G license allocation in 2008 led to judiciary intervention, paving the way for opening the third front in the fierce battle between government and the telecom operators, taking their clashes to courtrooms. A sector that contributed couple of percentage points to India’s GDP growth through unprecedented rise in teledensity, is baffled with ambiguity in policies, hindering the much needed investment in the sector as visible from 95% YoY decline in FDI during April 2012 to January 2013 period. A goose that laid golden eggs deserves to be nurtured well rather than making it a victim of greed and infighting.

Indian telecom industry had been stuck up for long in the trap of linear growth where subscriber addition was the primary mode of increasing revenue. Enhancing data usage would be the key challenge for the industry to break the linearity where close to 90% revenue comes from voice services. With more than 60 million Facebook users, around 16 million twitter users and more than 700 million TV viewers, social media and Video-on-Demand can be the key enablers for growth of VAS in India which can take the telecom sector to the next level of growth.

Decline in wireless subscriber growth, muted active subscriber growth

Subscriber Growth – Overall versus Active Subscribers



Source: TRAI and CARE Research

Subscriber base started shrinking since June 2012 and continued till Jan-13, falling by more than 20 million in July and December 2012. The decline was primarily on account of inactive subscribers as active subscribers witnessed a growth of 1.8% during the above-mentioned period as against the fall of 7.7% in total wireless subscribers. Though, broad-based, it was primarily fuelled by some of the operators like Rcom and Tata, in order to get rid of inactive subscribers which collectively stood at 25% in June 2012. Major reasons for shedding off inactive subscribers were to improve per subscriber operational performance, comply with subscriber verification norms and crunch of 10-digit numbers. Even if we consider active subscriber growth, the same has come down to 1.8% during the June-12 to Jan-13 period from 11% a year ago. Probable reasons for the moderation of growth in active subscribers are increase in tariffs and cut down of free minutes, new entrants curtailing their operations to few circles, slow expansion by the operators due to stretched balance sheets and policy uncertainties. Rural hinterlands continue to offer hope un terms of better subscriber growth of 3.2% during March-12 to Jan-13 as against 11.2% decline in urban areas.

CARE Research believes that total subscriber growth will be in the negative territory for FY13 and continue in FY14 too. It will revive to a marginally positive number in FY15, primarily on account of loss in inactive subscribers. Active subscribers will grow moderately over the next 2 years.

Financial and Operating Metrics – Moderate growth to continue

- **Revenue Growth:** Telecom sector revenue gradually increased over last 2-3 years and grew at a CAGR of 8.2% mainly on account of huge subscriber addition amidst falling ARPU. Two factors - the recent tariff hikes (and more to follow) on the back of declining competition -12 players earlier to 8-9 per circle post-auction and increase in the contribution of VAS due to rising data usage, expected to increase from current 12% to more than 20% over next couple of years- would enhance revenues for telecom sector. CARE Research expects telecom sector gross revenue to increase by high single digit over next 2-3 years.
- **ARPUs:** ARPUs have declined at a CAGR of nearly 20% over the last five years as tariffs declined at similar rates as the competition intensified and the new subscriber addition was primarily from low ARPU category. Rise in active subscribers will boost ARPUs also aided by tariff hikes and rising VAS contribution.
- **Profitability:** Most of the operators are managing their costs by outsourcing the activities related to network operations and keeping a check on sales and promotional expenses. As further cost reduction is not easy to come, rise in tariffs would definitely help the operators in enhancing profitability. The recent deregulation of diesel prices to the extent of Rs. 10 per litre would hit the margins by 1-2% as the power costs for telecom towers are pass-through.

Greener Pastures for Telecom Sector

- **3G – Momentum is building but contribution to remain marginal**

3G in India is still miles away from the mainstream 2G telephony as the adoption of the former is mere 2% of total wireless subscribers. On the brighter side, 3G traffic has grown more than 200% in the last year, predominantly, after the massive tariff cuts of 70-80% in May 2012. Also, the data usage for 3G stands at around 400 MB per user per month which is around 4 times that of a 2G data user. There is still a long way for 3G in India due to various reasons like poor penetration of 3G enabled handsets especially smartphones, poor user experience due to incomplete roll-out as 3G BTS are less than 15% of total BTS deployed in India, poor VAS content generation and larger social issues like lower literacy, language barriers etc. CARE Research believes that 3G adoption in India will pick up gradually over next 2-3 years growing at a CAGR of more than 40% as the base is small.

- **4G- The Great Indian Broadband Dream**

As the world awakes to the rising data needs, Long Term Evolution (LTE), one of the most prominent 4G technologies is getting adopted in 125 countries by 412 operators. As the data traffic grew by astounding 70% in 2012, 4G accounted for 14% of mobile data traffic though it contributed meagre 0.9% of total connections. Biggest challenge for 4G globally remains to be lack of coherent ecosystem as the 4G is offered across various spectrum bands like 700 MHz in U.S., 1800 MHz in Europe, 2300 MHz in India etc limiting mass production of devices for global markets. On the brighter side, worldwide 666 LTE enabled devices (including smartphones, routers, dongles, tablets etc) have been announced as of Jan-2013 as compared to 269 devices in Jan 2012.

India began its tryst with 4G after successful auctions of the spectrum in 2010 though the roll-out so far had been a non-starter with just one player starting services in few large cities. Unlike our global peers where data usage accounts 20-30% of total revenue, India is still a voice-centric telecom markets that contributes nearly 90%. Though 4G offers a great promise in terms of taking the world to next level of data usage, lack of voice offering is a major lacuna in the Indian market. In spite of Voice-over-LTE being recently allowed by the Indian government, the technology is still in nascent stage globally. Nevertheless, 4G remains the as the hope to bring the data revolution in the country.

4G - Addressable Market

Though primitive at this stage, 4G can cater to a gigantic addressable market comprising 730 million TV viewers (with its Video-On-Demand offering), 137 million internet users, 40 million smartphone users, 25 million SME units (combined with cloud based services) and so on. Despite its challenges, 4G offers a great value proposition in India with a good mix affordable device, reasonable tariff and suitable content.

~730 Mn TV Viewers	•On-Demand-Video will be the most significant driver for 4G if local and vernacular content is made available at reasonable rates.
~137 Mn Internet users	•As 4G offers the best broadband speeds on wireless networks, it will cannibalize on other broadband networks
~40 Mn Smartphone Users	•Smartphone users are the primary users of data and will be early adopters of 4G. The only issue with this target market is lack of affordable devices on 4G.
~25 Mn SME units	•4G offers best in class speeds with Internet-On the Move. Will be beneficial in taking the fruits of new technologies like cloud computing to SMEs.

Source: Industry and CARE Research

- **VAS – The Next growth engine**

CARE Research estimates that the size of Indian mobile VAS industry was pegged at Rs. 260 billion by end of December 2012. In the last 6 years, the VAS industry has grown at a CAGR of more than 45% and is expected to grow at similar rates over next 2-3 years. One of the biggest inhibitors for VAS industry in India is the inverted revenue-sharing arrangement between VAS value chain and the telecom operators, where the latter retain 60-70% of the VAS revenue unlike the practice in other major countries. This is arresting the creation of VAS content which is abysmally low considering the potential in India as non-voice revenue contributes around 12% of the total.

Regulatory Overhang – Intricacies in policy decisions

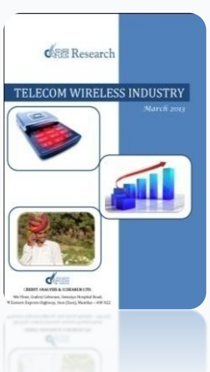
The most prominent setback for India telecom sector had been the handling of regulatory issues arisen out of alleged mismanagement and corruption in 2G allocation in 2008 and subsequent cancellation of licenses by the Supreme Court. The apex court's order to auction the spectrum going forward added a price tag to the spectrum making it the priciest asset amounting to cash outlay of billions rupees for the operators. There are 3 major outgos for operators looming over next couple of years – (i) Auction of spectrum in various bands released by government due to cancellation of licenses and additional spectrum as promised in the NTP 2012 (ii) Spectrum refarming-replacing spectrum in the efficient 900 MHz band with that from 1800 MHz, allowing maximum 5 MHz in 900 MHz per operator, when the licenses of incumbent operators come for renewal over next 2-3 years.

Operators have to pay auction determined price for this spectrum. This will also need additional investments in the network (iii) One time fees for excess spectrum held by operators applied prospectively based on market price and retrospectively since 2008 based on administered price.

The biggest worry for the Indian telecom sector is spectrum price of near Rs. 140 billion for pan-India 1800 MHz spectrum determined through the auctions held in November 2012, which will act as base price for spectrum auctions going forward. Looking at the limited returns with ARPUs below Rs. 100, the spectrum looks pricier to many operators considering their overleveraged positions. A good traction in data usage and higher tariffs, thereby improving ARPUs would improve the viability of bidding for the expensive spectrum.

As the operators are taking policy decisions to the doors of judiciary, the policy making is getting complicated and is being delayed, with rising number of pending cases like 3G Intra-circle roaming arrangements between Bharti, Idea and Vodafone, Vodafone acquisition of Hutch, Idea-Spice merger. There are few other issues like free national roaming as envisaged in the NTP 2012, merger and acquisition policy for providing exit to the operators, inclusion of IP-I licensee (tower companies) in the Unified Licensing Regime etc which need detailed guidelines and more consultations between the interested parties.

A sector where licenses were issued for 20 years, spectrum is allotted for 20 years, infrastructure is set up for life of more than 15 years, we need more stable policy regime which help the operators take a long term call on the sector that benefits the country in the longer run. The social benefits and also the obligations of the telecom sector are not merely restricted to 'Social Media' in the urban class but also 'Social Inclusion' of rural masses and urban poors which demand stable policy regime considering the long-term interest of the consumers and players.



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