CARE Research

Infrastructure Status to Telecom Tower Industry– Bit Too Late

When the telecom sector is saddled with regulatory overhang and experiencing the worst form of policy paralysis, on Oct. 12, 2012, on a slightly positive note, Telecom ministry announced granting of infrastructure status to the telecom tower industry. The sector will be eligible for a number of benefits under the infrastructure umbrella. Though Telecom sector in India has emerged as one of the biggest success stories of corporate India, cut-throat competition and regulatory overhang has hammered the sector in the last 1-2 years. With around 400,000 towers in its kitty, tower industry in India remains at the receiving end, being a mute spectator of the slow-down in its end-user telecom wireless industry. Infrastructure status will perhaps help the tower industry to get off the ventilator, though the sickness will persist for some more time.

Infrastructure Status – What it means for the tower industry

Accelerated Depreciation and Tax Holiday under Section 80I-A: As many towers have already been depreciated considerably, CARE Research expects that this will have a limited impact with less capex expected by the existing players. Tower companies can also avail tax holiday under section 80I-A. Many players in the tower space, being loss making, are hardly paying any taxes, the real benefits will come when they turn profit making.

Improved Lending: As per our interaction with or sources in the banking space, infrastructure status will help tower companies get a benefit of 2-3% on the domestic loans, on a case-to-case basis, whereas external commercial borrowings will be at a much softer rate as against current domestic borrowing rate of 12-13%. There will also be increase in the tenure of the loan from 7-8 years currently to 10-12 years, again on case-to-case basis. This will allow the tower companies to spread the loan tenure over almost the entire useful life of the asset which is around 15 years.

Tax Exemptions: It will allow lower import duties and exemptions on excise duty on telecom infrastructure equipments.

Viability Gap Funding: Tower companies will be eligible for viability gap funding (VGF) reducing the capex for new tower projects. This facility is meant to reduce capital cost of the projects by credit enhancement, and to make them viable and attractive for private investments through supplementary grant funding.

VGF can take various forms, including capital grant, subordinated loans, Operation and maintenance (O&M) support grants, interest subsidy etc.

Implications for the Telecom Tower Industry

- **Declining Tower Addition**

After witnessing a stupendous growth during 2006-2010 period, the tower industry started feeling the heat in FY 2011 as it added less than 10,000 towers in a year due to oversupply of towers in urban areas and viability issues in rural areas. This was primarily on account of: i) huge capacity addition in the previous 3-4 years in expectation of increased demand from 3G services and aggressive expansion plans of new telecom operator leading to oversupply situation in most of the urban areas; ii) profitability of telecom services providers declined over the years and their balance sheets were burdened with debts related to 3G-BWA auction and network expansion; iii) increased focus on enhancing tenancies rather than adding more towers. CARE Research estimates that there will be around ~443,000 towers in the next couple of years, as compared to ~400,000 towers today, most of the growth predominantly coming from Category B and C circles. This slower growth of around 5% annually in the new capacity addition implies only marginal benefits for the telecom tower industry from the infrastructure status.

- **Leverage in the Industry**

Most of the tower companies have highly leveraged their balance sheets in order to expand during the high growth phase of 2006-2010. Though most of them are not having huge capex plans in the coming years, it will provide some relief to their existing capex plans. Even this minimal expansion would have been really difficult task without the infrastructure status.

Leverage in the Tower Industry

	GTL Infra	Bharti Infratel	Indus Towers*
Total Debt (Rs. Mn)	107,976	31,593	87,274
Net Debt (Rs. Mn)	106,470	31,112	86,558
Debt to equity	15.2	0.2	8.3

** For Indus Towers, the numbers are on standalone basis, for rest, it is consolidated*

Source: Company Data

- **Payback Period to improve for new towers**

In the current situation, CARE Research estimates that single tenant tower will never be able to breakeven whereas a tenancy of around 1.7x will allow the tower company payback the debt within stipulated tenure of 7-8 years and will breakeven in around 11 years. A longer tenure loan with soft interest rates, with the grant of infrastructure status to tower industry, will definitely improve the payback period and the break-even will even be possible at lower tenancies, making some of the new towers viable, especially in the rural and remote areas.

- **Much Needed Capital for Green Initiatives**

As ~60% of the total power supplied to telecom towers is off-grid in India, telecom service providers and the tower companies (though partially) are incurring huge energy related costs. Most of the renewable sources like solar panel, wind energy, biomass etc require considerable capex in the beginning (e.g. approximately an investment of Rs. 3-5 million required for a solar-wind hybrid system to cater to 6 KW of power requirement). In the existing set-up, the renewable power systems have a payback period of 6-8 years. As the energy costs for telecom towers are pass-through, serious initiatives were lacking from the tower companies to go green. Easy capital will allow the tower companies to speed up efforts in this direction which will reduce the energy related costs of the telecom sector as a whole. It will also prompt the telecom service provider to go for expansion in semi-urban and rural areas, where the energy related costs are substantially higher and stand as a deterrent for expansion.

- **Expansion in Rural Areas**

Indian villages account for more than 2/3rd of the total population but still contribute around 1/3rd of the total wireless subscribers. Teledensity in rural areas is abysmally low at 39% against 156% in urban areas as on August 2012. As most of the urban areas are saturated as the teledensity is much above 100%, rural areas offer growth potential for the service providers. Sparsely populated villages, lower tenancy ratios and higher operating expenses due to unavailability of consistent grid power and security related costs make rural expansion a difficult proposition for the tower companies. Universal Service Obligation Fund (USOF) has so far financed ~7,300 towers in rural areas which is less than 2% of the total tower capacity in the country and is certainly not enough to serve the vast rural hinterlands. As per our interaction with the industry sources, infrastructure status with its slew of benefits especially viability gap funding will encourage tower companies to venture into the unviable rural areas. This will, of course, again be dependent on the tenancy assurance from the telecom service providers.

- **3G and 4G Expansion**

In the 3G space, most of the players have already deployed their network, as 3G services have reached more than 1,000 towns and cities in India and are waiting for 3G subscriber growth to pick up. As 3G operators are already providing 2G services in the respective circles, most of them do not require additional towers for the expansion of 3G services as the 3G BTS can be co-mounted in the same shelter. Many of the 4G licensees like RIL, Tikona, who do not provide 2G services, will require fresh tenancies for their expansion either on the existing towers or new towers. Reliance Infotel is speculated to build its own tower network of around 100,000 towers to support its 4G expansion partly on its own. If true, it will be the largest beneficiary of infrastructure status in the tower space.

- **Import of equipments/parts of Telecom Towers**

As new tower construction requires a capex of Rs. 2.5-3 million for ground-based tower and Rs. 1.4-1.8 million for a roof-top tower, some of the tower companies might tap Chinese vendors which claim to supply tower equipments at almost one-third to one-fourth of the cost required in India. Infrastructure status to tower industry will reduce the import duties on such towers lowering the overall capex for the tower firms. Also, the excise duty benefits will bring down the capex for domestically built towers.

Conclusion

- As the expansionary phase of the tower industry is already behind, given the annual growth in the number of towers is expected to be less than 5% over next 2 years, there will be limited benefits for the existing tower companies with fewer expansion plans. If allowed, it will facilitate tower companies to invest proactively in the green initiatives and will be a major cost saver for the telecom industry as a whole.
- Growth of tower industry is highly linked to the expansion of telecom service providers. Huge cash outgoes are expected out of major events like spectrum auction, one time fees for excess spectrum and spectrum renewal alongwith refarming, leaving little room for the telecom service providers for expansion. To some extent, it will help both telecom service providers and tower companies tapping newer avenues of growth like rural areas. This will also help the government achieving its goals of better rural connectivity.
- Other concerns like inclusion of tower business in the Unified Licensing Regime and subsequent imposition of license fees as a percentage of revenue is probably the biggest regulatory overhang for the sector will keep haunting it unless resolved. Other regulatory issues like stream-lining of regulatory approvals from various state and local agencies are extremely important for the faster execution of new projects.

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