Mobile data to drive profitability for Telcos; SMS RIP: CARE Ratings

With increasing penetration and a gradual fall in price, mobile data will drive up the share of the non-voice revenue for the telecom operators (Telcos); online video consumption is the likely key driver. CARE Ratings expects share of revenue from non-voice usage to increase to 25-30 % over the next couple of years from the current levels of around 20%. In CARE Ratings' opinion, the increasing data revenue is critical to supplement the traditional voice revenue; this shall provide telecom operators with diversity in growth avenues and better profitability.

The increasing adoption of mobile internet, the role of internet-based applications and social media platforms like whatsapp & facebook have been long awaited by the telecom industry to justify the introduction of 3Gs & 4Gs. The proliferation of affordable smart phones and lucrative data plan offers have fuelled the growth of the mobile data segment; mobile data now contributes around 50% of the total non-voice mobile revenue of telecom operators. On the flip side, higher usage of internet-based mobile apps has killed the prospects for Short Messaging Services (SMS).

Falling share of messaging; end of the road for SMS

SMS which was the major contributor to the non-voice revenue segment of the telecom service providers is gradually losing its significance in the wake of increasing adoption of internet-based cross-platform messaging applications. The impact is evident from the declining number of outgoing SMSs per subscriber per month, which fell from 39 in Q3FY13 (refers to the period October 1 to December 31) to 28 in Q3FY14 for GSM service providers and from 21 in Q3FY13 to 17 in Q3FY14 for CDMA service providers. The revenue from SMS for GSM service providers declined from 5.84% of total revenue in Q3FY13 to 3.39% in Q3FY14, while for CDMA service providers it declined from 1.80% to 1.66% for the same period.

Mobile data is emerging as a key contributor to the revenues of Telcos

Although the trend in overall non-voice revenue as a percentage of telecom revenue has not been consistent across telecom operators, the increase in share of data revenues driven by higher data traffic is a common feature. As on December 31 2013, on a total wireless subscriber base of 886 million, the number of subscribers who accessed internet through mobile devices was 220 million; as against 143 million on a total subscriber base of 868 million as on March 31, 2013. In line with the increase in the number of subscribers accessing mobile internet, the share of revenue from data usage in total ARPU[1] increased from 10.02% in Q1FY14 to 14.96% in Q3FY14 for GSM service. Similarly for CDMA full mobility service, the contribution of revenue from data usage to total ARPU increased from 36.28% in Q1FY14 to 37.91% in Q3FY14.

ARPU : Average Revenue Per User

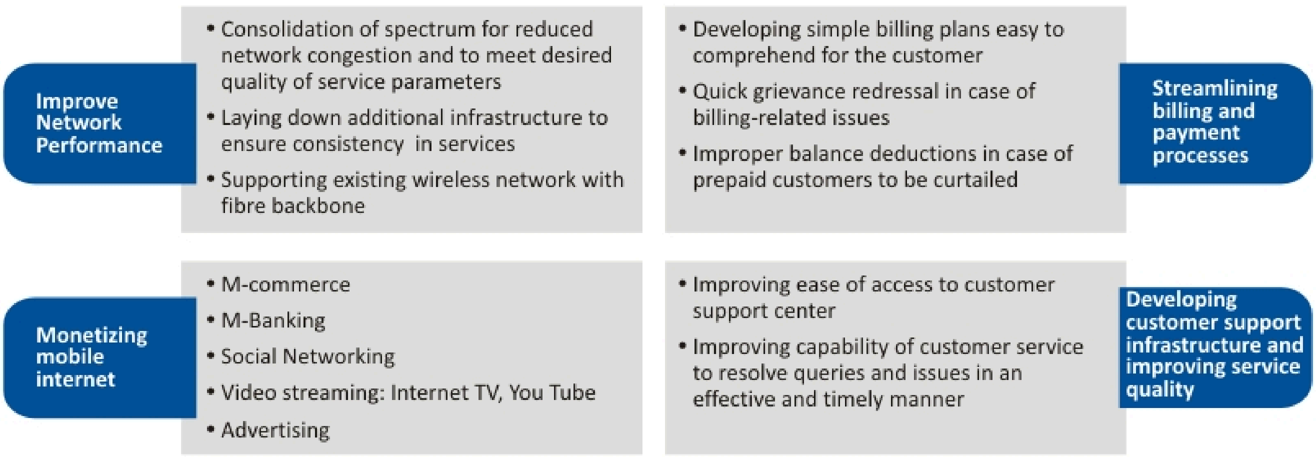
As the cost of smart phones comes down, network quality improves and appealing apps are introduced, the consumption of mobile data is slated to increase

Smartphones are now available at a price of as low as Rs.4,500, while several models of tablets are also available in the price band of Rs. 6,000-7,000. The increased affordabillity of smartphones and tablets is playing a major role in taking mobile internet to telecom subscribers. As per industry estimates, the number of smartphone users in India is expected to be over 100 million by the end of 2014.

As telecom service providers continue to invest in network infrastructure to improve 3G service delivery, 2G is being seen as an entry point for first-time users of mobile internet. Inconsistencies in 3G network performance leading to visibly less difference in internet speeds as compared to those on 2G network and the relatively higher cost of 3G services have been impediments in adoption of 3G services. It is expected that consumers will upgrade to 3G services once they are accustomed to mobile internet usage and start accessing bandwidth-heavy content. Several mobile operators undertook a price rationalisation exercise to reduce the pricing of 3G data services which led to a decline in the price differential between 2G and 3G data services. However, in terms of preference for technology used for internet access 3G services continue to lag behind 2G.

As the availability of content evolves into applications which are bandwidth-heavy like high-definition video streaming, video calls etc and the end-users engagement with the same increases, 3G network is likely to gain more traction. In the meantime, the deployment of 3G network has created a parallel capacity on which some amount of voice traffic from the older 2G network has been transferred. The vacated capacity on 2G is also being used to provide data services to subscribers.

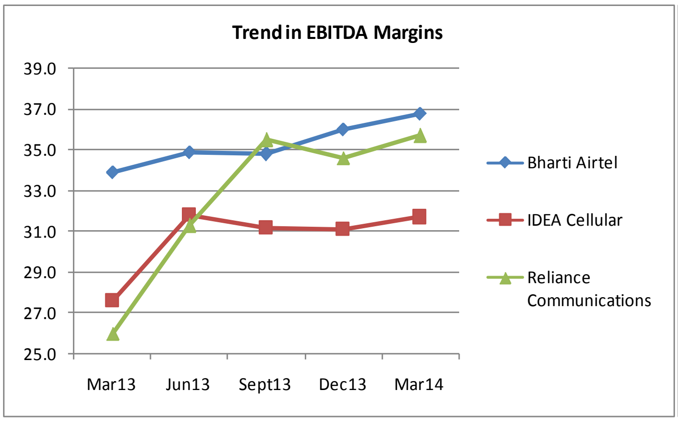
Exhibit: Focus areas for telecom service providers

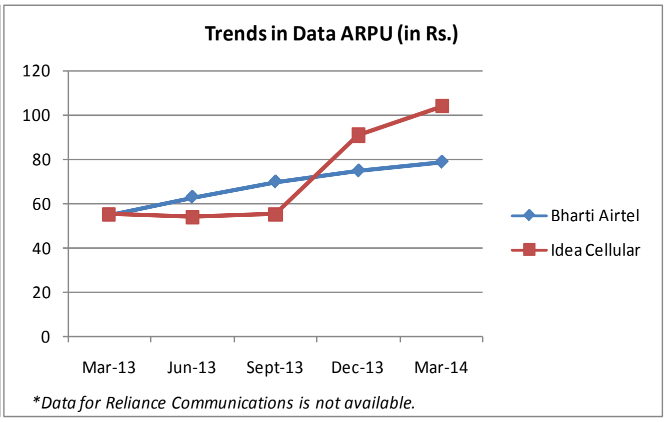


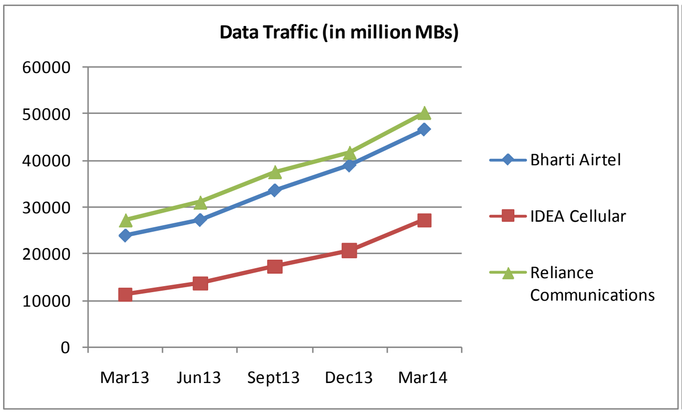
Mobile data to lead to better profitability

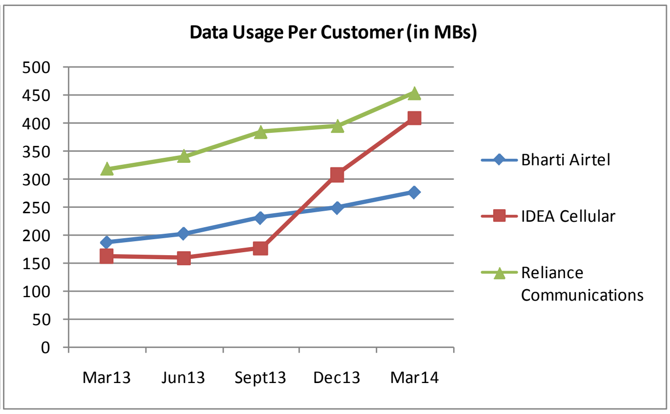
Higher mobile data traffic driven by the factors mentioned earlier will provide alternative revenue streams of telecom service providers and contribute to better profitability. The contribution of mobile data services to the improvements in the financial metrics of telecom service providers is now increasingly visible as depicted in the charts below[2].

2 *Improvement in voice ARPU and various cost reduction measures have too contributed to the trend.*









Source: Company reports and CARE Ratings

CARE Ratings believes that with the growth in data traffic, driven by both - increasing number of customers accessing mobile data and higher amount of data consumption per customer, albeit with decline in average realizations on data, revenue earned from providing data services will provide a boost to profitability of Telcos. As can be seen from the charts above, for the past few quarters, improvements witnessed in EBITDA margins of Telcos are concomitant with the increase in data usage per customer and data traffic aided by growth in data ARPUs. Furthermore, it is noteworthy that a majority of the internet access at present is on the already established 2G network which will provide better return on capital. Improvements in network quality, development of device ecosystem both in terms of device capability & pricing and availability of engaging content which would require higher network performance in terms of internet speed will further help in increasing the penetration and usage of data among customers through 3G/4G technology.

CARE Ratings believe that these new cash flow streams have a positive bearing on the credit profile of CARE-rated Telcos. Having assumed large amount of debt for acquisition of additional spectrum Telcos' operating leverage will now come to fore.

Annexure: Outstanding ratings on telecom service providers

Service Provider	**Outstanding Ratings**
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 Communitions 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:

Amod Khanorkar
General Manager
amod.khanorkar@careratings.com
+91-22-67543520

Gaurav Dixit
Assistant General Manager
gaurav.dixit@careratings.com
+91-11-45333235

Saurabh Pandey
Analyst
saurabh.pandey@careratings.com
+91-11-45333262