

EGoM Announcements – Optimism in the Air

Telecom sector in India had been the victim of ongoing policy paralysis and regulatory hangover for last couple of years. The cancellation of 122 telecom licenses in Feb 2012 by the Supreme Court had paved way for auction-determined pricing for spectrum, changing the rules of the game to some extent. As an aftermath of the steeper reserve prices set by the Telecom Regulatory Authority of India (TRAI) for auctions of available spectrum, the 2G auctions held in November 2012 and March 2013 received a lukewarm response. The auctions in November 2012 failed on many fronts including no bidder for CDMA spectrum, under-achievement of revenue target for the government, no bids for Mumbai, Delhi, Karnataka and Rajasthan circles. Government subsequently reduced the price of CDMA spectrum by 50% and for the four circles which did not attract any bid by 30%. No GSM player participated in the auction while Sistema Shyam was the sole bidder for CDMA spectrum in the March 2013 auctions. Spectrum in Mumbai, Delhi, Karnataka and Rajasthan again remained unsold despite a cut in base prices.

After a rough patch of couple of years, there is some relief with the recent regulatory announcements with regard to M&A guidelines and reserve price for auction of spectrum, expected to be held in early 2014. In order to avoid the setbacks confronted in the previously held 2G auctions, the Empowered Group of Ministers (EGoM) has formulated guidelines on pricing of spectrum in 900 MHz and 1800 MHz post recommendations from TRAI and the Telecom Commission, fuelling expectations for better participation in the auction process.

1. Decision pertaining to the Mergers & Acquisition Policy

Consolidation-hungry telecom sector waited long for clear M&A guidelines as hyper-competition kept bleeding everyone as tariffs nose-dived over the years. EGoM has cleared M&A guidelines which have enthused most of the stake-holders in the industry with increased market-share limits. Some highlights have been mentioned below:

- As per the EGoM approved M&A guidelines, the market share of a merged entity has now been raised to 50% of the subscriber and revenue base as against 35% ceiling that existed earlier. This proposal augurs well for large telecom players like Bharti Airtel, Vodafone and Idea, as they may not have to worry about the market share caps in case of mergers.
- Also, a telecom operator will be now be entitled to only one block of spectrum (4.4 MHz in GSM and 2.5 MHz in CDMA) which had been allotted at an administrative price, or without an auction process.

The merged entity would need to pay the market price for any additional bandwidth beyond that one block.

- (a) If an incumbent operator acquires another incumbent operator (both having acquired their spectrum through administrative mechanism), it will not have to pay for the 4.4 MHz GSM spectrum, or 2.5 MHz CDMA spectrum, the acquirer had got as part of its licence agreement. But it will have to pay market price for the spectrum being acquired over and above that. (b) If a new operator which has already bought spectrum through auctions wants to acquire an incumbent player, it will have to pay market-determined price for the spectrum held by the company it is acquiring. (c) If an incumbent operator buys a new operator (with spectrum bought through auctions), it will not have to pay anything for the spectrum it gets after acquisition.
- If a dual-technology holder acquires a single technology operator, or vice versa, the resultant entity would eventually have three blocks of spectrum and would have to pay a market price for two blocks.
- EGoM has also decided to allow a merged entity to hold up to two blocks of 3G and broadband wireless access (BWA) spectrum as against one block each currently as the spectrum was acquired through auctions.
- As far as spectrum cap is concerned, it has decided to retain the spectrum cap of a merged entity at 25% of total airwaves assigned for access services and 50% of the bandwidth assigned in a given band, by way of auction or otherwise, in the concerned service area.

CARE Research View

Telecom wireless space in India is getting divided on the following lines – (i) Top 3 incumbents with deep pockets – Bharti Airtel, Vodafone, Idea, (ii) Other incumbents with struggling balance sheets – Rcom, Tata Teleservices, Aircel, Loop, (iii) Government owned – BSNL and MTNL (iv) the new comers - Telewings and Sistema with backing from their foreign parents and, (v) new players with Indian parent like Videocon. Consolidation would be driven to acquire subscriber base or spectrum. Incumbents are the major contenders for the ‘consolidator’ tag. There might be possibilities of a three-way merger among Tier-II players like Tata Teleservices, Sistema, Aircel, HFCL etc.

CARE Research believes that the increased market share limit (50% from earlier 35%) would avail enough room for larger players like Bharti Airtel and Vodafone to go for acquisitions in most of the circles. Consolidation would provide much needed exit to some of the weaker players along with reducing the hyper-competitive environment in the sector. At the same time, with increased market-share larger players would get some pricing power but would not result in substantial change in the dynamics of the sector as voice and, to some extent, the data business being commoditized in nature. It would allow better spectral efficiencies for the sector as we can see in Appendix I, there is a large variance in the subscribers per MHz metrics. It will also lead to better utilization of passive infrastructure like telecom towers and networks.

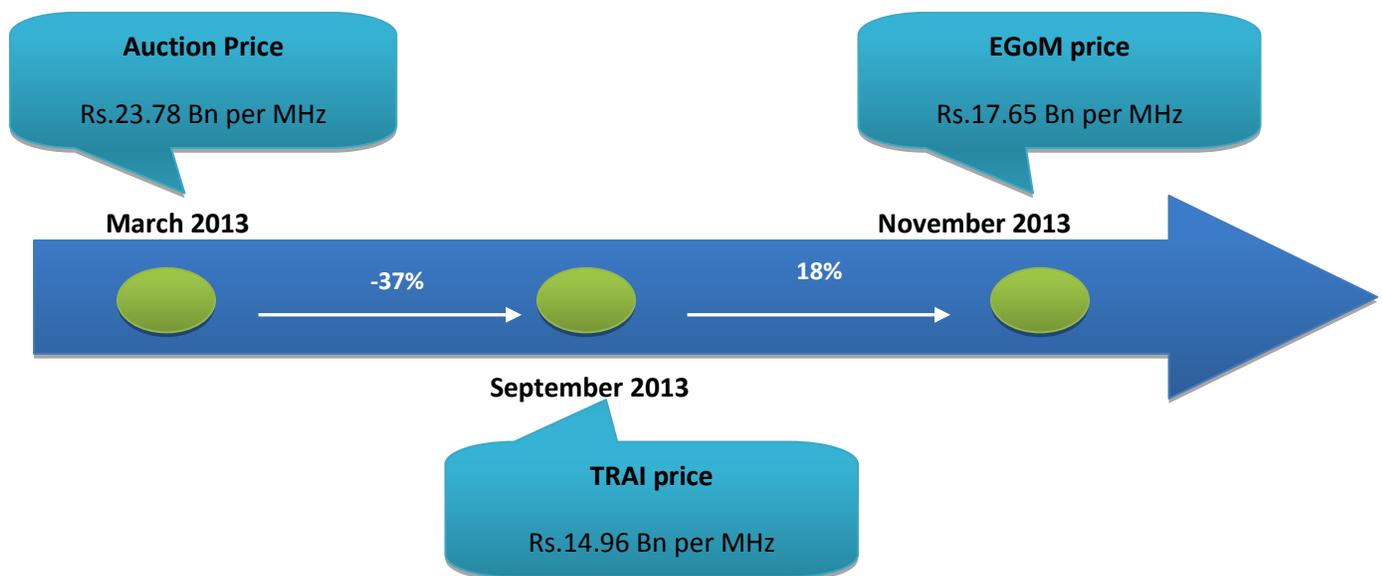
In spite of this CARE Research believes that M&A activity would take some time to pick up as players would wait for Lok sabha election results and clarifications on other issues like One-time charge for excess spectrum, detailed guidelines of spectrum trading etc.

2. Decisions pertaining to spectrum in 1800 MHz band

After a subdued response to auctions held in November 2012 and March 2013, Government is again planning to auction spectrum in the 1800 MHz band associated with cancelled licenses. The spectrum being licensed would include spectrum which had remained unsold during last two auctions and some additional spectrum freed from other agencies such as defence. The incumbent operators (Bharti Airtel, Vodafone, Loop, Idea etc) whose licenses are going to expire over next few years have to participate in the auction to acquire the spectrum. As higher reserve price was presumed to be predominant reason for muted participation, government asked TRAI to come out with new pricing. Telecom Commission has increased the reserve price partially and the same was approved by EGoM.

- EGoM has fixed the pan-India price in the 1800 MHz band at Rs. 17.65 Bn per MHz, as against Rs. 14.96 Bn suggested by TRAI. This price is around 26% lower than the reserve price in March 2013 auction price of Rs. 23.78 Bn but remains 18% higher than the price suggested by the TRAI in September 2013.
- EGoM has approved a total of 403.2 MHz of spectrum to be auctioned in the 1800 MHz band in the January 2014 auctions, as against the 285 MHz that was proposed earlier by TRAI. The amount of spectrum is expected to generate approximately Rs.360 Bn valued at reserve price approved by EGoM.

Movement of Pan – India Reserve price for spectrum in 1800 MHz band



Source: TRAI and CARE Research

CARE Research View

CARE Research believes that the reduction in reserve price is a welcome move for the industry which is already reeling under the debt-burden raised for 3G-BWA auctions and subsequent roll outs. Government's decision to put more spectrum on table would help in price discovery as it would remove the artificial scarcity of spectrum. Additional spectrum would help players reduce on network expansion costs as there is a trade-off between spectrum and additional towers. As the data usage increases, players would need additional spectrum. Also, the players whose licenses are expiring over next few years (Appendix II and III) can plan in advance and participate in the auction.

In the Appendix I, players, who have more than 1 million subscribers per MHz of spectrum are more likely to go for acquiring additional spectrum and are primarily among the incumbent players category. PSU players BSNL and MTNL have sufficient spectrum and are not expected to participate in the auctions. Among the new players, Telewings might go for selective circles like Maharashtra, U.P. (E), U.P. (W) where it has higher subscriber concentration per MHz of spectrum.

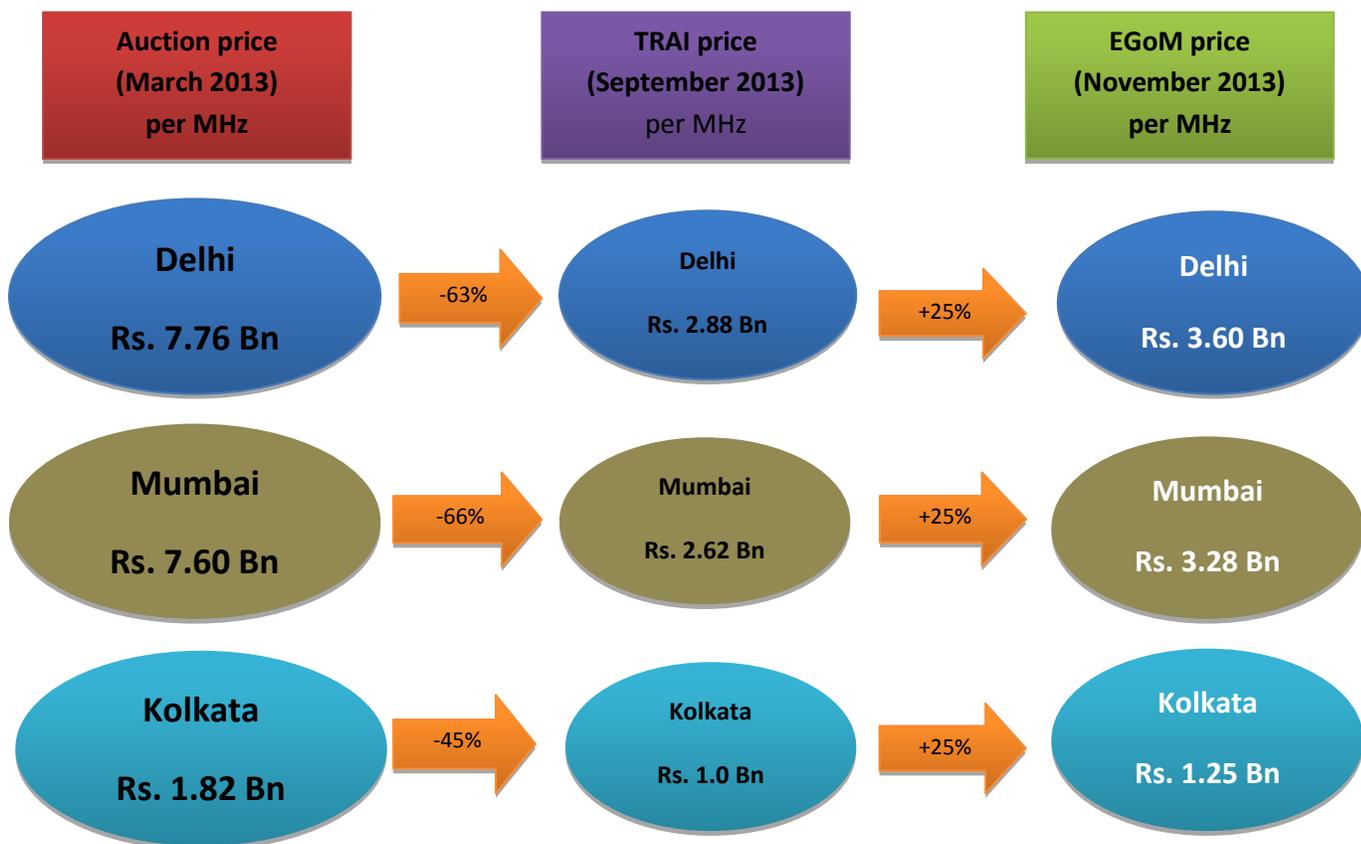
Also, incumbent operators Bharti Airtel, Vodafone and Loop whose licenses would expire in 2014, would most likely try to regain their spectrum in this band.

3. Decisions pertaining to spectrum in 900 MHz band

Telecom licenses issued in 1994 to incumbent players Bharti Airtel, Vodafone (then Hutch) and Loop in Delhi, Mumbai and Kolkata circles would expire in 2014. These operators collectively hold 46 MHz of spectrum in the more efficient 900 MHz band in these three metro circles and were constantly pushing for an extension of another 10 years. Due to the limited availability (around 20 MHz in each circle) of the spectrum in this band, most of it is lying with incumbent operators (first 2-3 operators) which puts them in advantageous position as against new players. In order to create a level playing field, government has decided to auction the spectrum as and when the licenses expire.

- With respect to the reserve price for 900 MHz, the EGoM has fixed the price at Rs.3.6 Bn per MHz for Delhi, Rs.3.28 Bn per MHz for Mumbai and Rs.1.25 Bn per MHz for Kolkata. The price fixed for 900 MHz is around 25% higher than what was recommended by TRAI.
- The EGoM has accepted the recommendations of TRAI with respect to not providing reservation of spectrum to the existing operators. Also, an operator in this band can now bid for a maximum of 5 MHz in the 900 MHz band.

Movement of Reserve price for spectrum in 900 MHz band



Source: TRAI, DoT and CARE Research

CARE Research View

CARE Research believes that removal of reservation for incumbents who already hold the spectrum is slightly negative whereas a cap of 5 MHz for 900 MHz spectrum would act as a dampener for the incumbent players. Even if the existing holders of the spectrum go for maximum spectrum they can bid for, there would be 6 MHz, 6 MHz and 4 MHz spectrum remaining in Delhi, Mumbai and Kolkata circles respectively. This implies expected participation from other operators like Idea and Rcom and even slightly stretched possibility of Reliance Jio participating in the auction.

Availability of 900 MHz spectrum for Auctions in 2014				
Circle	Players	Spectrum To Expire in 2014 (MHz)	Max. spectrum existing holders can acquire (MHz)	Spectrum Remaining (MHz)
Delhi	Bharti Airtel	8	5	3
Delhi	Vodafone	8	5	3
Delhi Total		16	10	6
Mumbai	Vodafone	8	5	3
Mumbai	Loop	8	5	3
Mumbai Total		16	10	6
Kolkata	Bharti Airtel	6.2	5	1.2
Kolkata	Vodafone	7.8	5	2.8
Kolkata Total		14	10	4

Source: TRAI and CARE Research

Incumbents are expected to witness additional CAPEX

As the incumbents holding 900 MHz of spectrum will be allowed to bid for maximum of 5 MHz in that band as against their current holding 6.2 MHz to 8 MHz, they will have to acquire remaining spectrum in the 1800 MHz range. Players would need to change some of the 900 MHz based Base Transceiver Stations (BTS) to 1800 MHz based BTS. Also spectrum in 1800 MHz range is less efficient as compared to that in 900 MHz range in terms of propagation characteristics and requires additional BTS to provide similar coverage. Based on the additional BTS roll-out, incumbent players are expected to incur capex of Rs. 939 million, Rs. 521 Million and Rs. 467 million per MHz for switching from 900 MHz to 1800 MHz in Delhi, Mumbai and Kolkata circles respectively.

Additional Capex as a result of Refarming		
Circle	Category	Approximate additional cost per MHz in 1800 MHz as compared to 900 MHz (Rs. Mn)
Delhi	Metro	939.1
Mumbai	Metro	521.7
Kolkata	Metro	467.1

Source: TRAI

4. Decision pertaining to Spectrum Usage Charge (SUC)

- In case of Spectrum Usage Charge (SUC), the EGoM has decided to continue with the current cascading SUC charges until the Department of Telecom (DoT) decides on the flat rate. The current SUC ranges from 3 to 8% of the adjusted gross revenue (AGR), depending on the quantum of spectrum held by a licensee. However, TRAI had recommended a flat SUC of 3% for all (including 3G and BWA players) acquiring spectrum through auctions and 3-5 % for spectrum without auctions, so that the disincentive to buy additional spectrum in the existing SUC regime gets eliminated. Currently average SUC collected by the government is around 3.6% of AGR.
- If approved, this will be beneficial to the most of the telecom players, especially incumbent players, who are paying more than 5% SUC on Administered spectrum. BWA players like Reliance Jio will however be at a disadvantage as it implies an increase of SUC from the earlier 1% to 3% of AGR.
- On the flip side, approval of the flat 3-5% SUC rate would result in a loss of nearly Rs.13.56 Bn for the government.

5. Other TRAI recommendations that stand pending:

- TRAI had recommended that spectrum trading should be permitted in the country with respect to only outright transfer of spectrum initially. It also suggested that trading transactions should be subject to the spectrum cap of 50% of the spectrum in a band and 25% of the total commercial spectrum assigned in a circle. As of currently, the EGoM has accepted TRAI's recommendation to allow spectrum trading in the country, but TRAI is yet to come out with detailed guidelines for the same.
- The EGoM will refer the 800 MHz spectrum for pricing once again to the TRAI as the regulator has not recommended a reserve price for the 800 MHz band.

Incumbents preparing the ground...

- Bharti Airtel plans to raise up to \$1 Bn by selling bonds mainly to European investors, as it seeks to boost its financial flexibility. The proposed bond issue is a part of the company's strategy to prepare for upcoming spectrum auctions and for potential acquisitions.
- Vodafone India plans to invest a minimum of Rs 40 Bn to Rs 60Bn every year to expand its operations in India. The company has played the role of consolidator in the telecom markets globally and has clarified its intentions to grow both organically and inorganically in India.

Appendix I

Summary of Million Subscribers / MHz Spectrum in 1800 MHz*								
	Circle	Bharti Airtel	Idea	Vodafone	Telewings	Videocon	MTNL/BSNL	Loop
		Million Subscribers per MHz of spectrum (1800 MHz)						
Metros	Delhi	0.59	0.65	0.62			0.08	
	Kolkata	0.34	0.25	0.32			0.06	
	Mumbai	0.43	0.66	0.45			0.05	0.10
Circle A	AP	1.33	1.04	0.86	0.54		0.48	
	Gujarat	1.10	0.91	1.13	0.66	0.10	0.26	
	Karnataka	1.18	0.68	0.80			0.30	
	Maharashtra	1.23	1.26	1.31	0.78		0.36	
	TN	1.09	0.40	1.30			0.41	
Circle B	Haryana	0.36	0.40	0.38		0.13	0.12	
	Kerala	0.57	0.75	0.57			0.40	
	MP	1.22	1.49	0.56		0.13	0.21	
	Punjab	0.57	0.48	0.58			0.26	
	Rajasthan	1.25	0.92	0.97			0.25	
	UP (E)	1.37	1.19	1.15	1.10		0.34	
	UP (W)	0.93	0.95	0.76	0.81		0.18	
	WB	1.09	0.40	1.06			0.15	
Circle C	Assam	0.49	0.08	0.35			0.07	
	Bihar	1.58	1.04	0.92	0.66		0.15	
	HP	0.22	0.12	0.09			0.09	
	J&K	0.26	0.05	0.09			0.07	
	NE	0.33	0.06	0.14			0.07	
	Orissa	0.63	0.17	0.41			0.20	

Source: DoT, TRAI and CARE Research

*Spectrum in 900 MHz had been converted into 1800 MHz by applying a multiple of 1.5 xs.

Appendix II

Licence Expiring in 2014			
Circle	Operator	Spectrum To Expire in 2014 (MHz)	
		900 MHz	1800 MHz
Delhi	Bharti Airtel	8	2
Delhi	Vodafone	8	2
Delhi Total		16	4
Mumbai	Vodafone	8	2
Mumbai	Loop	8	2
Mumbai Total		16	4
Kolkata	Bharti Airtel	6.2	1.8
Kolkata	Vodafone	7.8	2
Kolkata Total		14	3.8
Source: TRAI			

Appendix III

Licences Expiring in 2015-2016					
No.	Operator	Player	Date of Expiry	Spectrum holding (MHz)	
				900 MHz	1800 MHz
1	Andhra Pradesh	Bharti Airtel	11/12/2015	7.8	2.2
		Idea	18/12/2015	6.2	1.8
2	Assam	Rcom	11/12/2015	6.2	
3	Bihar	Rcom	11/12/2015	6.2	1.8
4	Gujarat	Idea	11/12/2015	6.2	
		Vodafone	18/12/2015	7.8	2
5	Haryana	Idea	11/12/2015	6.2	
		Vodafone	11/12/2015	6.2	
6	Himachal Pradesh	Bharti Airtel	11/12/2015	6.2	
		Rcom	11/12/2015	6.2	
7	Karnataka	Bharti Airtel	14/02/2016	7.8	2.2
		Idea	8/4/2016	6.2	
8	Kerala	Idea	11/12/2015	6.2	1.8
		Vodafone	11/12/2015	6.2	
9	Madhya Pradesh	Idea	11/12/2015	6.2	1.8
		Rcom	11/12/2015	6.2	
10	Maharashtra	Idea	11/12/2015	7.8	2
		Vodafone	18/02/2015	6.2	
11	North East	Bharti Airtel	11/12/2015	4.4	1.8
		Rcom	11/12/2015	4.4	1.8
12	Orissa	Rcom	11/12/2015	6.2	
13	Punjab	Bharti Airtel	11/12/2015	7.8	
		Idea	8/4/2016	7.8	
14	Rajasthan	Bharti Airtel	21/04/2016	6.2	2
		Vodafone	11/12/2015	6.2	
15	Tamilnadu	Vodafone	11/12/2015	6.2	1
16	Uttar Pradesh (East)	Vodafone	11/12/2015	6.2	2
17	Uttar Pradesh (West)	Idea	11/12/2015	6.2	1.8
18	West Bengal	Rcom	11/12/2015	4.4	1.8
	Grand Total			184	27.8

Source: TRAI

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