The 2G spectrum verdict- Victim of Policy Paralysis

Feb 03, 2012

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Key Takeaways – CARE Research

- The Supreme Court has cancelled 122 licenses (98 GSM and 24 CDMA) of the 334 licenses in total. TRAI has been asked to come out with a mechanism to reallocate the licenses.
- Cancellation of license accounts for 413.6 MHz of GSM and 60 MHZ of CDMA spectrum, which is 31% and 21% of total allocated spectrum respectively. The government might decide to auction some or all of this spectrum.
- The verdict is a setback for foreign players in India as they had to suffer because of the wrong processes set up by government although they bought their stakes after the licenses were issued. Cumulative FDI in telecom sector stands at more than US$10 billion.
- The banking sector has a significant exposure to the telecom sector, estimated to account for nearly three percent of the overall loan portfolio of the banks. Lenders who have given loans to the affected players for network roll out bear some risk.
- Total number of impacted subscriber stand at 66.6 million which is 7.5% of total subscribers. The number will be still lower as active subscribers are about 70% of total subscribers. Most of these subscribers will migrate to other networks as Mobile Number Portability (MNP) is in place.
- Cancellation of licenses will reduce the number of players in each circle. Also if cancelled licenses and spectrum is auctioned at market price, it will lead to substantial costs to the players. This might lead to tariff hikes as rate per minute has halved from Rs. 1 at the end of 2007 to Rs. 0.5 at the end of 2011.
- Incumbent players will be the biggest beneficiaries of the verdict as it is supposed to reduce the competition in the sector. They might get additional spectrum from the cancelled licenses if they are allowed and decide to participate in the auction. They will attract the existing subscribers (7.5%) of the affected players.
- This judgement is expected to pave the way for rationalization and the emergence of stability within the sector through the reduction of competitive pressures and the emergence of a rational pricing structure.

The verdict

In a landmark judgement on February 02, 2012, the Honorable Supreme Court came out with a verdict on 2G case, cancelling 122 telecom licenses (98 GSM and 24 CDMA) issued in 2008 during the tenure of then Union Telecom Minister A. Raja of UPA government. The Supreme Court is of the opinion that the license allocation process was carried out in arbitrary manner causing loss to public exchequer. It also fined Uninor, Etisalat DB and Tata Teleservices Rs. 50 million each. Some of the other players are also charged with varying amount of fine. The spectrum issued along with the licenses will also be cancelled. The apex court has asked telecom regulator TRAI to come out with fresh recommendations on allotment of licenses through market-based mechanism within a span of two months. Services by the affected players will be active for a period of four months. The impact of this judgement is expected to be manifold and will be felt not just by the operators themselves but also the other stakeholders including the subscribers, lenders, the telecom equipment providers, passive infrastructure players and other allied sectors catering to the telecom sector. The primary impact however is likely to be on the operators. Government of India has so far issued 334 telecom licenses in 22 Licenses Service Areas (LSA) out of which 122 (about 36%) stand cancelled.

Subscriber Base of affected telecom players as of Dec. 2011

Players	Technology	No. of Licenses Cancelled	Impacted Subs. (Mn.)	Total Subs. (Mn.)	% of Total Subs. Impacted	Circles with less than 1,000 Subs
Idea/Spice	GSM	13	6.7	106.4	6.3%	0
Uninor	GSM	22	36.3	36.3	100%	9
S. Tel	GSM	6	3.5	3.5	100%	1
Videocon Telecommunication	GSM	21	5.4	5.4	100%	3
Loop	GSM	21	0.0	3.2	0.2%	20
Etisalat DB	GSM	15	1.7	1.7	100%	0
Sistema Shyam	CDMA	21	12.7	15.0	84.3%	6
Tata	CDMA	3	0.3	83.5	0.4%	0
Total		**122.0**	**66.6**	**255.1**	**26.1%**	**39**
All India		**334.0**	**66.6**	**893.8**	**7.5%**	**107**

Source: TRAI and CARE Research

Much needed rationalization is on the way.

On an average, there were 15 players (both GSM and CDMA), in a telecom circle in India as compared to 3 in Singapore, 3 in China, 4 in Mexico and 5 in U.S. After cancellation of licenses, average number of operators will come down to around 9-10, though we expect that some of the affected players would make a comeback in the next auction. There are at least 5 operators namely Uninor, S. Tel, Videocon Telecommunications, Loop and Sistema Shyam, who had less than 1,000 subscribers in various licensed areas. Out of the total 122 cancelled licenses, 39 license areas (about 32%) were highly under-utilized as these five operators did not even have 1,000 subscribers in those circles as of December 2011, implying the services were not fully rolled out. The new entrants had unused spectrum, as we look at the number of subscribers from the cancelled license areas, it stands at 7.5% of total subscribers, whereas spectrum issued to these players stood at 31% and 21% of total spectrum allotted for GSM and CDMA respectively. In other words, the impacted players had 7.1 MHz per million subscribers as compared to the overall number of 1.8 MHz per million subscribers. Based on this statistics, we assume that not all the players whose licenses were cancelled will participate in the auction, as it would require them to put more money for buying the license and spectrum at market rate. This will reduce the number of players in almost every circle leading to some rationalization.

Cicrle wise Players and Spectrum Availability - Post Verdict

		GSM						CDMA					
	Circles	No. of Players	No of Licenses Cancelled	No. of Players post Verdict	Spectrum available from cancelled licenses (MHz)	Spectrum Already Allocated (MHz)	% Spectrum available from cancelled licenses	No. of Players	No of Licenses cancelled	No. of Players post-verdict	Spectrum available from cancelled licenses (MHz)	Spectrum Already Allocated (MHz)	% Spectrum available from cancelled licenses
Metro	Delhi	12	5	7	4.4	53.6	8%	4	1	3	2.5	15	17%
	Mumbai	11	3	8	13.2	72.4	18%	4	1	3	2.5	15	17%
	Kolkata	10	4	6	17.6	60.4	29%	4	1	3	2.5	13.75	18%
Circle A	Maharashtra	12	5	7	22	69.4	32%	4	1	3	2.5	15	17%
	Gujarat	11	4	7	17.6	60.4	29%	4	1	3	2.5	12.5	20%
	A.P.	12	5	7	22	69.4	32%	4	1	3	2.5	13.75	18%
	Karnataka	12	5	7	22	69.4	32%	4	1	3	2.5	13.75	18%
	T.N.	11	5	6	22	67	33%	4	1	3	2.5	12.5	20%
Circle B	Kerala	11	4	7	17.6	61.2	29%	4	1	3	2.5	15	17%
	Punjab	12	4	8	17.6	63.2	28%	5	1	4	2.5	15	17%
	Haryana	12	5	7	22	63.8	34%	4	1	3	2.5	12.5	20%
	U.P.(West)	11	4	7	17.6	61.2	29%	4	1	3	2.5	13.75	18%
	U.P.(East)	11	4	7	17.6	62.4	28%	4	1	3	2.5	13.75	18%
	Rajasthan	12	4	8	17.6	63.8	28%	4		4		15	0%
	M.P.	11	4	7	17.6	63	28%	4	1	3	2.5	12.5	20%
	W.B. & A & N	10	4	6	17.6	53	33%	4	1	3	2.5	11.25	22%
Circle C	H.P.	11	4	7	17.6	57.6	31%	4	1	3	2.5	10	25%
	Bihar	12	5	7	22	66.8	33%	4	1	3	2.5	13.75	18%
	Orissa	11	5	6	22	59.4	37%	4	1	3	2.5	11.25	22%
	Assam	10	5	5	22	55	40%	4	2	2	5	10	50%
	N.E.	10	5	5	22	53.2	41%	4	2	2	5	10	50%
	J&K	10	5	5	22	49.4	45%	4	2	2	5	10	50%
	Total	**245**	**98**	**147**	**413.6**	**1,355**	31%	**89**	**24**	**65**	**60**	**285**	21%

Source: TRAI & CARE Research

Verdict is a negative for foreign investment in India

Riding on the stride of telecom growth, the telecom sector in India witnessed a cumulative Foreign Direct Investment (FDI) of about US$10 billion upto November 2011, from some of the major global players including Vodafone Group, Telenor, Maxis Malaysia, Etisalat, Bahrain Telecommunications

Company (Batelco) and NTT Docomo. Most of the foreign players entered India as partners of local telecom firms after the license allotment. As in the last few years, India is already suffering from 'policy paralysis', the verdict will adversely impact the sentiments of foreign investors in India.

Lenders will suffer to some extent

The banking sector has a significant exposure to the telecom sector, estimated to account for nearly three percent of the overall loan portfolio of the banks. The total exposure also includes the non fund based limits which are the guarantees issued to the DoT on behalf of the operators. Although the non fund based exposure will automatically stand cancelled if the licenses of the operators are cancelled, the fund based exposure of the banks to the companies that do not re-bid for the licensees may be at risk. Also, the extent and severity of the impact will be determined once clarity on the reallocation of the licensees emerges. As few of the affected players have not rolled out their services in 39 LSAs out of 122 cancelled licenses (i.e. 32% of total), banks probably can roll back the credit assigned to the same.

Investments by impacted players to be delayed or sunk

Substantial investment was planned by some of the affected players like Idea, Sistema Shyam and S. Tel, to roll out their networks, in the next 2-3 years, which might get delayed or cancelled. As per Centre for Monitoring Indian Economy (CMIE) data, Idea, Sistema Shyam and S. Tel have planned investments of Rs. 12 billion, Rs. 275 billion and Rs. 20 billion for their network expansion and service roll out till 2014. Another area of concern is the growth of the sector as a whole as the service operators together had expected to incur capital expenditure of around Rs.60 billion in 2012, which is now likely to be affected to some extent by this judgement resulting in an overall slowdown of the growth and expansion of the sector in the short to medium term. This in turn will impact the allied industries, including the telecom equipment providers and the passive infrastructure players.

Limited revenue impact for the sector

The incumbents like Idea Cellular Limited and Tata Teleservices Ltd, are expected to be only marginally impacted as the circles where the licences were cancelled do not contribute significantly to the revenues and profits of both these companies. The other new entrants were in the initial phase of the expansion with substantially lower share of revenue compared to their incumbent peers. For Idea, the revenue loss from cancelled licenses stands at less 2% whereas total revenue loss from Idea, S. Tel, Uninor, Videocon Telecommunications and Etisalat DB stands at Rs. 8.24 billion which is 0.7% of all India Adjusted Gross Revenue (AGR) for the sector. We do not think this will be a permanent loss of revenue for the sector as subscribers will migrate to other networks. Below is revenue impact analysis for some of the impacted GSM players.

Revenue of affected players - FY 2011			
Telecom Operator	**Affected Revenue FY2011 (Rs. mn)**	**Total Company Revenue FY2011 (Rs. Mn)**	**Revenue Impact as % of total**
Idea/Spice	2,131	116,282	1.8%
S-Tel	522	522	100.0%
Uninor	5,311	5,311	100.0%
Videocon Telecommunications	228	228	100.0%
Etisalat DB	49	49	100.0%
All India	**8,242**	**1,216,141**	**0.7%**

Source: TRAI, COAI & CARE Research

Individual co. revenue numbers are from COAI data, all India revenue numbers are from TRAI data.

Limited impact of tower companies

Some of the tower companies might be affected due to the verdict as they lose some of the new entrants as tenants, bringing down the already low occupancy rates.

Incumbents will be the beneficiaries, India as investment destination suffers

Supreme Court verdict has negative implications for telecom sector, lenders and overall business sentiments in country, shattering India's image as an attractive investment destination. The verdict will bring some cheers to incumbent players as it will lead to much needed rationalization in the overcrowded telecom sector as it will bring down the number of players per circle by a few. At the same time, it might have some negative repercussions for the incumbents as Supreme Court has objections to the government policy of 'First-come-first-serve' which was used for all 2G license allocation, in future the incumbent players might also be dragged into the controversy, as they were unaffected this time because they were not a party to the case.

Rating Implications: CARE Ratings

The following is the portfolio of the telecom service providers rated by CARE Ratings.

Service Provider	Outstanding Rating	No of circles where licence has been cancelled
Aircel (includes Aircel Ltd, Aircel Cellular Ltd and Dishnet Wireless Ltd)	**CARE A-/CARE A1 [credit watch]**	-
Idea Cellular Limited (ICL)	**CARE AA/ CARE A1+**	9 circles
Loop Mobile (India) Ltd	**CARE BBB-/CARE A3 [credit watch]**	-
Reliance Communications Ltd	**CARE AA/CARE A1+ [credit watch]**	-
Sistema Shyam Teleservices Limited (SSTL)	**CARE A1+ (SO)**[backed by a 100% cash collateral to the extent of the PBG]/**CARE A2 (SO)** [backed by a guarantee from Sistema JSFC]	21 circles
STel Private Limited (S Tel)	**CARE BBB [credit watch]**	6 circles
Tata Teleservices Limited (TTSL)	**CARE A+/CARE A1+**	3 circles
Tata Teleservices (Maharashtra) Limited	**CARE A/CARE A1**	-

Of the companies which have been rated by CARE Ratings and whose licences have been revoked, the ratings of S Tel Limited had been proactively put on "Credit watch" by CARE even before the present verdict of the Supreme Court. CARE Ratings believes that the ratings of Idea Cellular Limited (ICL) and Tata Teleservices Limited (TTSL) will not be impacted by the cancellation of some of their licences as the impact on revenues of the circles related to the cancelled licences is not significant.

The ratings of Sistema Shyam Teleservices Limited (SSTL) are either backed by 100% cash collateral or by guarantee from the promoters and hence derive their strength from the structure and not from operations of SSTL in India. CARE therefore believes that the ratings may not warrant any change, but is examining the case.

About CARE

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