

## Telecom Industry in transformational phase; entry of Reliance Jio to increase competition

**DEC 9, 2014**

Telecom is one of the fastest-growing industries in India. Today, India stands as the second-largest telecommunications market in the world. The mobile phone industry in India, which is estimated to contribute \$400 billion in terms of gross domestic product (GDP) of the country in 2014, is expected to generate about 4.1 million additional jobs by 2020. The sheer rate at which the telecom industry is growing, is due to the government's efforts to increase rural penetration along with the growth in the smart-phone numbers and internet usage.

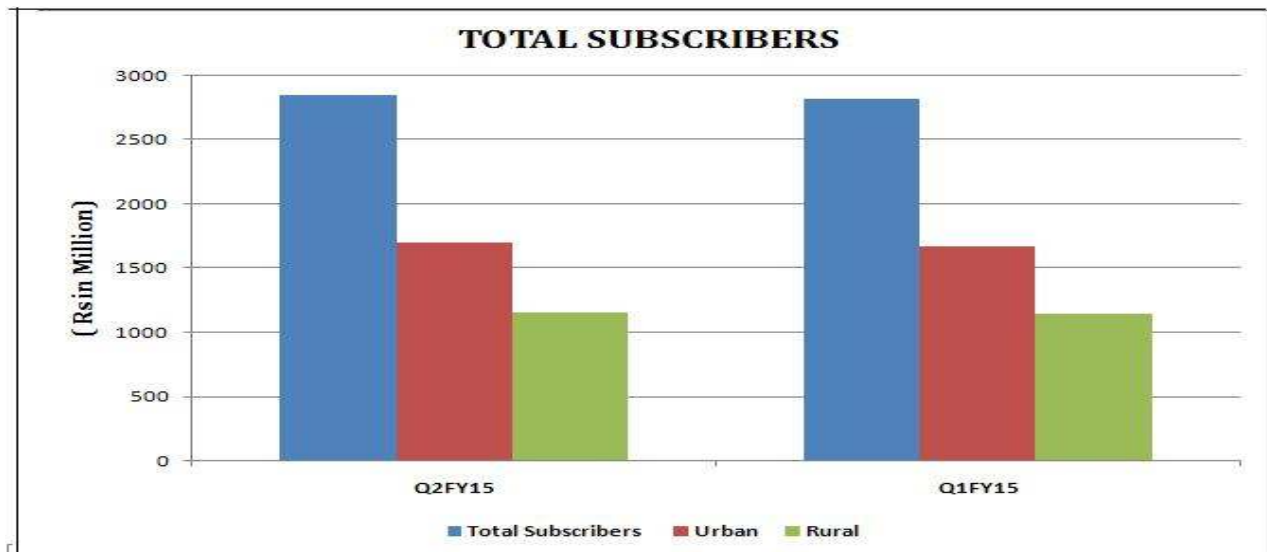
Telecom has also been crucial in attracting large amount of FDI in India. The sector alone is responsible for more than 7% FDI flows in the country. As per the figures put out by DIPP, the cumulative FDI inflow during April 2000 to September 2014 has been \$16, 628 million.

Over the past decade the telecom sector has experienced rapid growth owing to regulatory liberalization, however the sector has been in turbulent phase for nearly two to three years, marked by legality of 3G roaming agreements, one-time spectrum cost, reframing of allotted spectrum in the 900 MHz band.

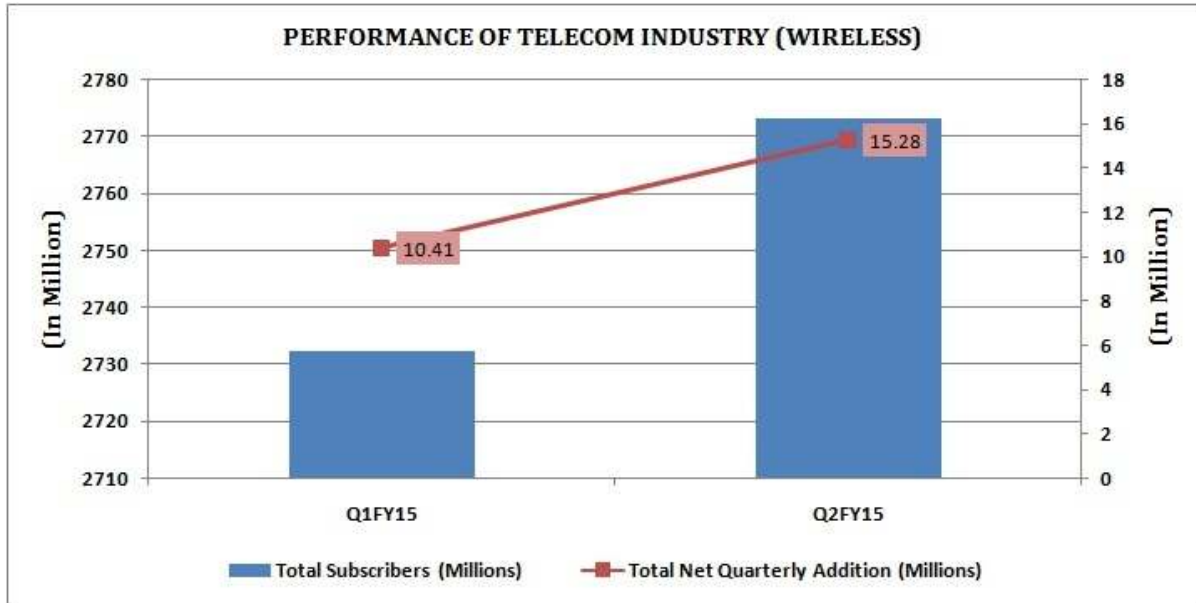
Nevertheless, the tide has turned in the favour of the telecom industry as growth and profitability has accelerated in recent times. However, new battles are being fought in the country's booming data segment along with existing voice segment, which continued to be dominated by three major private players-Bharti, Reliance and Vodafone - with a formidable 57% share of the market between them. State-owned enterprises -BSNL and MTNL -have also been making their presence felt with a combined market share of more than 10%.

### Performance of Telecom Industry

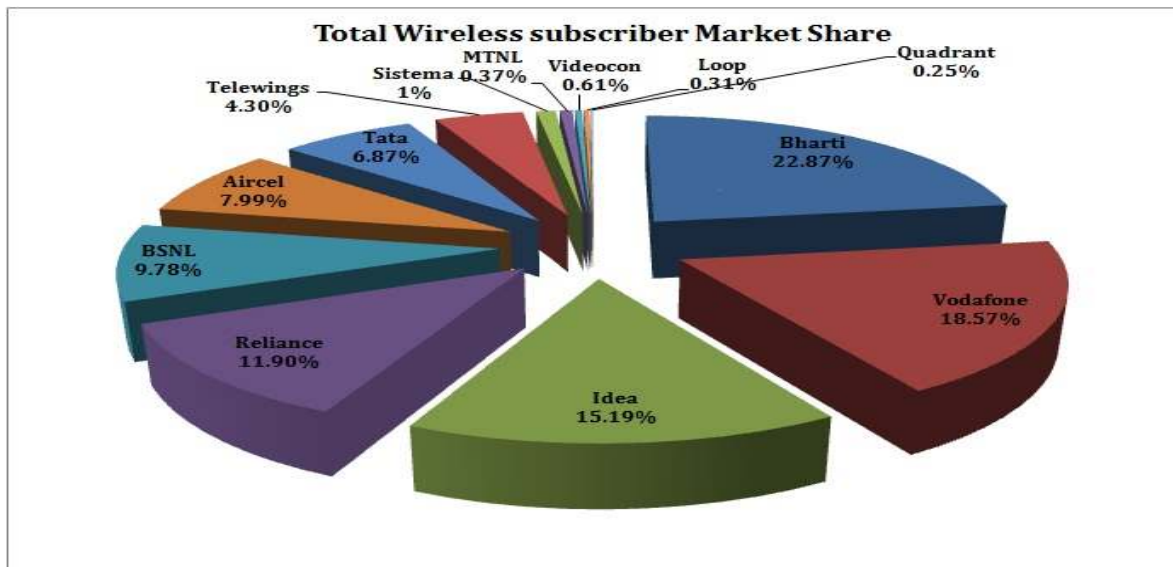
Driven by wireless connections, the total telecom subscriber base (Wireless+ Wire-line) registered a quarterly growth of 1.38% at 2855.85 million subscribers as compared to 2817.1 million subscribers in Q1FY15. Of the total, the urban subscribers grew by 1.57% at 1698.59 million for quarter ended September, 2014, while the total number of rural subscribers grew around 1.09% at 1157.27 million subscribers as compared to 1144.8 million in Q1FY15.



Meanwhile, continuing its gaining streak for twelfth consecutive month, India's telecom industry witnessed additions in wireless segment for the quarter-ended September and performed better on Q-o-Q basis. The wireless subscriber base increased from 2773.24 million in Q2FY15 to 2732.52 million in Q1FY15, registering growth of 1.49%.



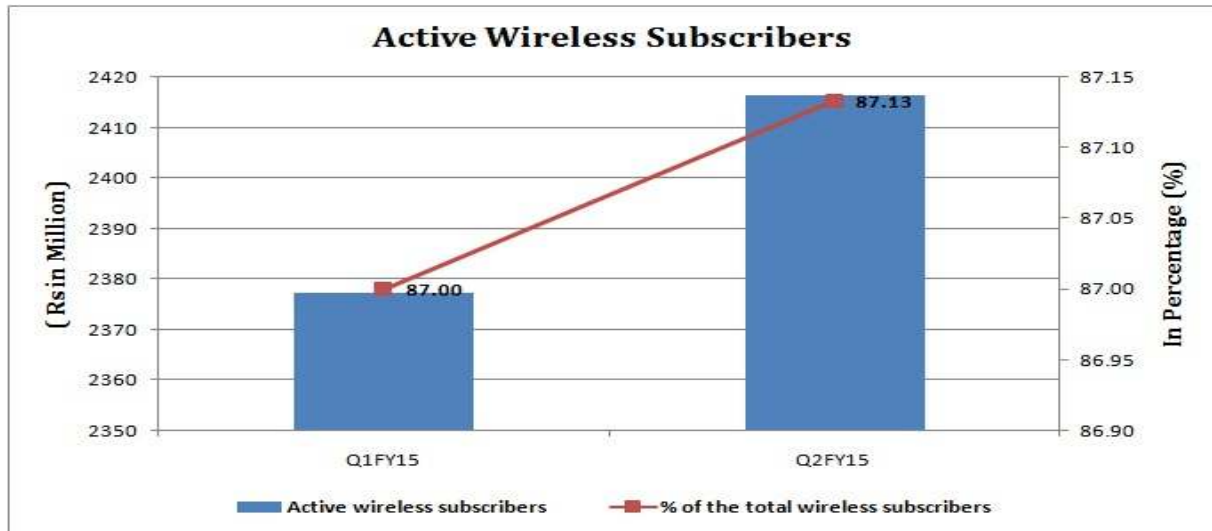
Out of the total wireless subscriber market share, private operators hold 90.31%, whereas BSNL and MTNL, the two PSU operators hold only 9.69%. Among the private telephone operators Bharti Airtel dominated the market share, by registering the highest subscriber base. Bharti held 22.87% share, followed by Vodafone and Idea Cellular, which held 18.57% and 15.19% respectively of share in market.



Vodafone added maximum subscribers in September, with 13.53 lakh new users joining its network to take its base to 17.38 crore. Bharti Airtel added 10.12 lakh to take its subscriber base to 21.15 crore at the end of September, whereas Idea Cellular added 10.22 lakh and its overall base stood at 14.35 crore. However, Loop and Sistema lost 1.43 lakh and 0.80 users and its user base has shrunk to 15.82 lakh and 91.30 lakh respectively. Meanwhile, state-run BSNL and MTNL too lost 8.55 lakh and 0.13 users respectively during the month.

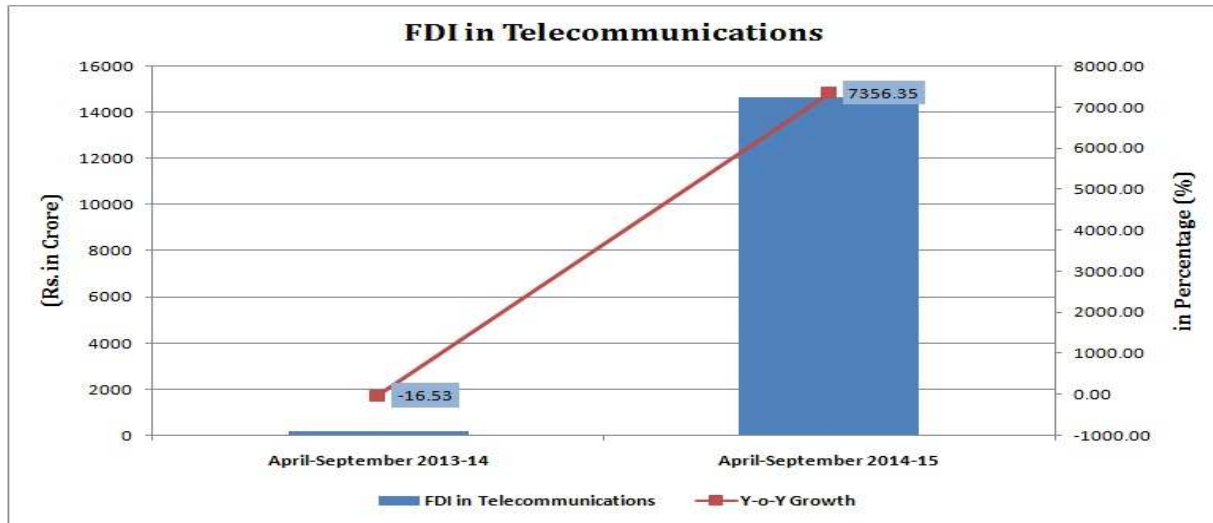
### Positives for the Sector

**Growing numbers of Active wireless subscribers:** Incrementally, top mobile operators have stopped focusing on merely increasing the number of subscribers and instead turned their focus to keeping their users signed on to the network. This has paid off. Today, the active users for Airtel, Idea, Vodafone and RCom make up 85-90% of their subscriber base, higher than the 80-85% a year ago. These operators have churned out irregular or dormant subscribers from their networks with even smaller and regional operators looking to make their subscriber base more lucrative. Simultaneously, they have reduced or even done away with discounts and inordinate free talk time on their networks. As a result, call rates have gone up across operators.



According to the Indian telecom regulator TRAI, India added a significant 4.76 million 'active' connections during the month of September 2014, while it added 5.88 million total connections during the month. What's significant here is the dominance of the top three and the top four telecom operators in the country who tend to increase rates together: Airtel, Idea and Vodafone combined, account for 56.86% of the total mobile connections in India, and 62.9% of the active connections.

**Sharp uptick in FDI:** After registering a huge decline in the recent past, foreign direct investment in the telecom sector grew manifold to Rs 14,689 crore in the first half of the 2014-15 fiscal. The FDI in the corresponding period of the previous year stood at Rs 197 crore.



In 2013-14, the sector has received total FDI of Rs 7987 crore, which shot up by three folds from FDI of Rs 1654 crore recorded in FY12-13. Meanwhile, FDI in the telecom sector, which includes radio paging, cellular mobile, and basic telephone services, cumulatively accounts for 7% of the total FDI at Rs 81,407 crore.

**Improving Profitability:** Improving performance parameters and the thrust on data have seen operators show substantial improvement in their profits, with both the top players Bharti Airtel, and Idea Cellular reporting better than expected Q2FY15 numbers. However the gone by quarter was complete disappointment for Reliance Communication.

India's top telecommunications carrier, Bharti Airtel reported a more than doubling of quarterly profit, on higher voice call prices and rapid growth in mobile data usage at Rs 1383 crore for quarter ended September 30. While, Idea Cellular, India's No.3 mobile operator, posted a 69% rise in quarterly profit after adding subscribers faster than its competitors and as its data plans attracted more users. On the flip side, Reliance Communications' second-quarter net profit shrank to less than a quarter of what it posted a year earlier when a restructuring-related write back had boosted its numbers. Nevertheless, sequentially, the profit rose 16%, helped in part by lower finance cost.

Company Name	Q2FY15 PAT	Q2FY14 PAT	Y-o-Y Growth (%)
Bharti Airtel	1174.40	336.30	249.21
Idea Cellular	755.88	447.61	68.87
Reliance Communication	212.00	714.00	-70.31

While, country's third-biggest mobile phone operator by users and revenue, Idea Cellular benefiting from fewer competitors, higher call rates and more customers using data plans, reported 57% jump in consolidated first-quarter profit at Rs 728 crore from Rs 463 crore a year earlier, Bharti Airtel's consolidated net profit rose 28.62% to Rs 1012.40 crore. Besides, Reliance Communications too posted a 26% rise in consolidated net profit at Rs 164 crore, beating street

estimates, during a seasonally weak first quarter helped by higher voice call rates. The telecom company, controlled by billionaire Anil Ambani, had posted a net profit of Rs 130 crore during the comparable quarter a year ago.

### Negatives

**Dearth of Adequate Towers:** In what could be a biggest challenge for the industry, the country has been witnessing dearth of adequate towers to handle growing cell phone usage. There are a total of 425,000 telecom towers in India. However, India is in need for 200,000 additional towers for robust connectivity. At an average cost of Rs 15 lakh per tower an additional investment of Rs 30,000 crore is thus required.

However, cell operators are struggling to keep up towers previously put up, due to health concerns. The last one year has witnessed court orders shutting down telecom towers based on fears that the radiation from them could cause cancer.

**Spectrum Shortage:** Spectrum availability in India for commercial use, as a whole is lowest in the world. The constrained supply of spectrum poses a real threat to the continuity of services being provided to millions of subscribers.

It is in view of this, telecom players such as Vodafone and Bharti have demanded more spectrum for the auctions next February as most of the sale will comprise of spectrum with the existing operators that have to be vacated under existing contracts. However, a situation could arise where an operator shuts down its service on account of the failure to win back spectrum from the auction.

It is in this context, the telecom regulator recently proposed that spectrum be available for free, which did not find favor with the government keen to wring out the maximum amount of money through auctions. It is important to recognize that auctions are not the only way spectrum can be allocated. Even in jurisdictions where far larger quantities of spectrum are available for commercial deployment, different approaches are being taken.

**OTT challenge:** Until now, over-the-top (OTT) providers have had a relatively unobstructed run at the market, with apps that supply instant messaging, the ability to send and receive photos, video conferencing and other popular services. This is definitely eating into the margins of telecom companies, which feel that their revenue of mobile services are not growing in the pace compared to growth of mobile connections.

According to telecom industry estimates, telcos currently lose around Rs 5,000 crore annually due to these free apps and the figure is expected to cross Rs 16,400 crore in the next two years, as mobile subscribers using smartphone with internet are growing rapidly. It is in view of this, the Telecom Regulatory Authority of India (Trai) is planning to initiate the process of bringing in a regulation for OTT companies or providers of apps like WhatsApp and Viber to pay connectivity charges to telecom companies and share revenue with the government as well.

## Recent Development

**TRAI to speed up price recommendation:** The government, which is keen to auction 3G airwaves along with 2G in February has urged telecom regulator to expedite the process for its recommendations on the reserve price of 2100 MHz (3G) band and related issues so that the auction of spectrum in this band could be conducted along with the auction of spectrum in the 800/900/1800 MHz (2G) bands scheduled in February 2015.

Due to the urgency, TRAI has floated a consultation paper seeking comments from stakeholders by December 15 and counter comments by December 19, stressing that no extensions will be given. Meanwhile, an open house discussion on the subject is scheduled to be held on December 22.

DoT has put up three scenarios for TRAI to arrive at the starting price of 3G spectrum. One, no auction, if no spectrum is released by defence; two, if defence releases 5 MHz in 17 circles, then one block of 5 MHz spectrum, which could accommodate one telecom operator which could be available for auction in those services areas; and last, if defence swaps 3G spectrum it holds with 2G (1900 MHz) that DoT holds, then DoT may release 15 MHz, which could accommodate three more operators. The telecom and defence ministries have made a partial breakthrough in their talks, with the latter agreeing to free up 5 MHz of the high-speed bandwidth for commercial use in 17 out of India's 22 telecom circles. However, there's still no breakthrough in DoT's swap negotiations.

The next round of spectrum auction is tentatively scheduled for February 2015 and the government expects to generate at least Rs 9,355 crore from sale of 2G band-width. But the biggest bit of income from the auction might be squeezed out of the Defense Ministry's 2100MHz chunk of 3G spectrum which is expected to be worth Rs 5000 crore. With this development, telecom companies, including Bharti Airtel, Vodafone, Idea and Reliance Communications, which had feared a shortage of spectrum would lead to cut-throat competition and raise auction prices, can breathe easy.

**DoT and defence ministry come to agreement on spectrum swap issue:** In a significant breakthrough, the defence ministry and the department of telecommunications (DoT) has partially resolved the contentious issue of spectrum swapping. Accordingly, the armed forces would free up 15 MHz in the 2,100 MHz band in return for an equal amount of spectrum in the 1,900 MHz band. Telecom regulator TRAI has recommended that spectrum in 2100MHz band, a part of which is with the Defence Ministry, should be put up for auction along with two sets of spectrum bands- 900MHz and 1800MHz in February next year. February 23 could be the date starting from which bidding proposals will be accepted and the winning parties may be required to make the payment of the final price within 10 days after the auction ends.

Earlier, the Defence Ministry had vacated 15MHz of 3G spectrum which was auctioned in 2010. The Defence had also vacated 15MHz of 2G spectrum, which was allocated to new operators. Under the agreement with DoT, the remaining spectrum - 10MHz spectrum in 3G and 5MHz in 2G - is to be vacated only after the alternate communication network is completed.

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### Other Major Development

**Reliance Jio Infocomm applies for network test ahead of 4G launch:** Gearing up for its pan-India 4G services launch in coming months, Reliance Jio Infocomm has approached the Department of Telecom for a network test conducted along with security agencies. Mukesh Ambani-led Reliance Jio Infocomm has plans to start 4G services across most of the telecom circles by March 2015. RIL has already announced that it will launch commercial 4G telecom service of Reliance Jio Infocomm in 2015 entailing investment of Rs 70,000 crore.

Reliance Jio Infocomm will initially cover about 5,000 towns and cities, accounting for over 90 percent of urban India, as well as over 215,000 villages in India and the target is to expand this to over 600,000 villages. It is the only company which holds pan-India broadband wireless access spectrum that can be used for 4G services. As per rules, 2015 is last year for all companies who won BWA spectrum to roll out the services in at least 90% of the service areas, failing which the DoT will have the right to withdraw the radiowaves.

Reliance Jio Infocomm, Aircel, Airtel, Tikona Digital and Augere Mauritius won BWA spectrum in mid-2010. Airtel and Aircel have partially launched 4G services using BWA airwaves.

### Outlook:

Outlook for India's telecom industry is positive as the sector is in transformational phase, which would see it leap from a chronic spectrum crunch to an abundance of the airwaves, which though will add to the debt burden of these mobile phone companies, but will also offer them opportunities to follow global business models and offer data services across radio frequency bands.

However, the entry of Reliance Jio Infocomm in the telecom space, could pose a threat for the existing players as this would intensify competition and might bring data tariffs down by at least 20%, which in turn could weigh on profitability of the industry, which had just started improving on the back of recovering pricing power in the mature voice telephony segment combined with strong growth potential in the emerging data business, widely seen as harbinger of a good period ahead for the industry.

**Companies Financial Data In Industry**

Company Name	CMP	MCAP	BOOK VALUE	DIV. YEILD %	TTM EPS	TTM PE
Mahanagar Telephone Nigam Ltd.	28.55	1798.65	53.89	0.00	134.30	0.21
Bharti Airtel Ltd.	369.95	147883.82	183.32	0.49	27.40	13.50
Tata Communications Ltd.	447.45	12752.33	289.89	1.01	23.07	19.39
Idea Cellular Ltd.	147.10	52914.04	57.34	0.27	6.13	24.00
Reliance Communications Ltd.	99.05	23794.91	142.81	0.00	-0.96	0.00
Tata Teleservices (Maharashtra) Ltd.	8.35	1632.36	-13.48	0.00	-2.81	0.00
Hathway Cable & Datacom Ltd.	361.95	6011.95	79.31	0.00	-7.60	0.00
GTL Ltd.	18.55	291.79	-1.75	0.00	-26.07	0.00

Sorted with TTM EPS (High to Low)

Source – Ace Equity

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