In what is being claimed as the largest-ever consolidation in the Indian telecom space, Reliance Communications (RCOM) signed a definitive agreement with Aircel to merge its wireless operations with Aircel's wireless business in mid-September 2016. The deal, which is likely to be completed in March 2017, is expected to have a deep impact on the Indian telecom industry's competitive landscape.

As per the agreement, RCOM and Maxis Communications Berhad, the Malaysia-based parent company of Aircel, will create a separate entity for managing their wireless operations, and will hold a 50 per cent stake each in the merged entity, with equal representation on the board of directors and all committees. The merged entity will be considered a special purpose vehicle (SPV), which will be managed by an independent professional team under the board's supervision. While the name and the head for the combined entity are yet to be decided, it is reported that it is not likely to share any identity with either of its parent companies.

Key metrics

According to RCOM, the combined entity will be ranked amongst India's top four operators by customer base and revenues. The combined subscriber base is estimated at 180 million along with a revenue market share of 6 per cent. RCOM is currently India's fourth biggest telecom operator in terms of wireless subscriber base with 98.7 million customers while Aircel ranks sixth, with 88 million subscribers. The combined entity is likely to surpass Idea Cellular as the third operator in the sector in terms of subscriber base. Further, in terms of revenue, it will rank amongst the top three operators in the 12 key circles.

In addition, the merged company will have the second-largest spectrum holding aggregating 448 MHz across the 850 MHz, 900 MHz, 1,800 MHz and 2,100 MHz bands. It will have an asset base of over Rs 650 billion and a net worth of Rs 350 billion, making it one of the largest private sector companies in the country.

Following the completion of the transaction in 2017, RCOM will transfer Rs 200 billion of its debt to the new entity. Of this, Rs 140 billion is long-term debt and Rs 60 billion includes instalments payable to the Department of Telecommunications over 10 years for spectrum purchases. Meanwhile, Aircel will transfer Rs 140 billion of its debt to the entity. Aircel's debt currently stands at around Rs 200 billion and will be reduced by its parent, Maxis, by up to Rs 60 billion before the merger. To this end, either Aircel will divest around 2,000 telecom towers or Maxis will infuse funds in order to reduce the debt. Earlier this year, Aircel had repaid a part of its debt after selling 4G spectrum to Bharti Airtel in eight circles for Rs 35 billion. Also, the merged entity may reportedly later look for a third partner by diluting about 25 per cent equity to raise around Rs 60 billion.

The deal will include the merger of the two operators' wireless operations only, and RCOM's tower, optic fibre portfolio and undersea cables arm Global Cloud XChange will remain out of its scope.

Key drivers

The merger is being seen as a strategic step by both operators to reduce their debt and improve their competitiveness. Post the much-awaited launch of Reliance Jio Infocomm Limited's (RJIL) 4G services, competition in the Indian telecom space has intensified. Therefore, smaller operators are finding it increasingly difficult to operate in the market given their over-stretched balance sheets and huge debt burdens.

In its financial results for the quarter ended June 2016, RCOM reported only a 6.4 per cent increase in the consolidated net profit from Rs 510 million during the quarter ended June 2015 to Rs 542 million during the quarter ended June 2016. This was primarily attributed to a 4.84 per cent decline in the company's total expenses, from Rs 48.55 billion to Rs 46.31 billion during the same period. The total income of the operator, on the other hand, declined by 4.75 per cent from Rs 55.7 billion to Rs 53.61 billion. Moreover, finance costs increased from Rs 7.17 billion to Rs 7.59 billion during the period, thus increasing the debt burden.

Meanwhile, the operator's revenue from Indian operations recorded a year-on-year decline of 2.5 per cent from Rs 48.11 billion to Rs 46.93 billion. This resulted in a 20.8 per cent decline in earnings before interest, tax, depreciation and amortisation (EBITDA) from Rs 17.08 billion to Rs 13.53 billion. The EBITDA margin also reduced from 35.5 per cent during the quarter ended June 2015 to 28.8 per cent during the corresponding quarter in 2016. Global operations, on the other hand, recorded a positive performance with a 5.3 per cent increase in gross revenue from Rs 11.25 billion to Rs 11.84 billion during the same period. Meanwhile, the EBITDA margin improved from 16.7 per cent in June 2015 to 17.5 per cent in June 2016.

The operator witnessed a reduction in the overall subscriber base as a result of the migration to

4G. The total subscriber base fell from 111.1 million as of June 2015 to 99.9 million as of June 2016. The total minutes of usage on RCOM's network also declined from 105 billion to 100 billion during the same period while the voice ARPU fell from Rs 103 to Rs 100. However, the total number of data customers increased from 35.4 million as of June 2015 to 38.9 million as of June 2016. Its 3G/4G customer base also rose from 17.9 million to 25.4 million. This resulted in the total data traffic increasing from 92.79 billion MB during the quarter ended June 2015 to 102.43 billion MB during the corresponding quarter in 2016, thus increasing the share of non-voice revenue to the total revenue, rising from 26.4 per cent to 32.6 per cent during the period.

The rising demand for data and the need to stay relevant in the hypercompetitive telecom space are being seen as the key drivers for the merger.

Conclusion

Earlier, RCOM had also announced the acquisition of Russia-based Sistema Shyam TeleServices' (SSTL) Indian telecom unit in an all-stock deal valued at around Rs 45 billion. As per the deal, SSTL's promoters will hold a 10 per cent stake in RCOM and pay off its existing debt before closing the deal. The deal will give RCOM access to spectrum in the 850 MHz band, which can be used for offering 4G services.

SSTL currently offers voice and data services across nine telecom circles in the country. The deal is in its final leg of completion, having received almost all the required approvals. While the granular details of the three-way merger are yet to be worked out, it is clear that the development marks a major consolidation in the telecom industry.

RCOM is now focusing on completing the sale of its tower assets, which comprise about 44,000 towers. The company has signed a non-binding term sheet agreement with the Canada-based Brookfield Infrastructure Group to sell 51 per cent stake in its tower business and will retain the remaining 49 per cent stake. As per the agreement, RCOM will receive an upfront cash payment of Rs 110 billion from the transaction. Following the closure of the deal, RCOM's tower assets will be transferred from Reliance Infratel Limited to a separate SPV, which will be owned by Brookfield. RCOM will continue to be an anchor tenant for these tower assets under a long-term master service agreement. The operator will use the proceeds from the sale to reduce its debt.

Moreover, RCOM and RJIL have completed the execution of spectrum sharing arrangements in the 850 MHz band for offering 4G/LTE services. Operationally, the spectrum arrangements between the two operators will result in network synergies, enhanced network capacity, optimal spectrum utilisation and capex efficiencies. Financially, RCOM will achieve considerable savings in operating costs and future investments in networks, which are expected to bolster the operator's bottom line and help generate positive cash flows.

While RCOM has taken strategic steps towards enhancing its market position, industry analysts are still wary of the operator's leverage. Even though the merger is expected to generate enough scale for both RCOM and Aircel, there would be challenges pertaining to the sub-optimal quality of subscribers, limited share in the fast growing Category A and B circles, complexities of the three-way merger, the establishment of a new brand and the large debt burden.

Going forward, RCOM will need to invest substantially in upgrading its infrastructure and expanding operations to compete with market leaders like Airtel and Vodafone. It remains to be seen how far the operator will be able dent the position of the top three operators in the country.

By Mridula Pandey