

### By Devangshu Datta

The last financial year has seen a major consolidation, including one mega merger, in the telecom services industry. After a shakeout in which many service providers went bankrupt, there are only three private sector players left - Vodafone Idea Limited (VIL), Bharti Airtel and Reliance Jio Infocomm (Jio) – aside from the two PSUs, which are incurring heavy losses.

As of March 2019, these three private sector players hold about 90 per cent of the wireless subscriber base of 1.16 trillion, with VIL claiming 395 million subscribers, Airtel 325 million, and Jio 307 million. Excluding domestic long distance revenues, the revenue market share stands at: Jio 39.8 per cent, VIL 28.9 per cent and Airtel 24 per cent. In the broadband segment specifically, Jio holds 54.45 per cent market share, VIL holds 19.57 per cent and Bharti Airtel has 20.35 per cent market share.

The sector is going through difficult times. Growth has eased off with saturation levels being hit in terms of mobile users. Urban teledensity is at over 160 per cent for example, and rural subscriber growth too has plateaued.

Operators have substantial debt on their balance sheets and two of them, Airtel and VIL, are struggling to stay profitable. They have to continue investing and they are seeking ways to improve profit margins and generate new revenue streams.

The strategic imperatives are clear for service providers. The market remains highly competitive and it will not be easy to charge higher tariffs. Getting more subscribers on board will not necessarily help since new subscribers are usually low-ARPU users.

Instead, service providers need to improve the ARPUs of the existing subscriber base. Data is the only segment growing at reasonable rates and ideally, service providers need to convert every subscriber into a committed data customer. This may actually be possible.

Over the past three years, data usage has soared. India has become the largest data market in the world. This surge has been driven by several factors. One is lower tariffs. When Jio launched services in September 2016, Indian telecom was a voice-only market. Data was expensive at Rs 34 per GB and average data usage was around 147 MB per month. By December 2018, data costs dropped to Rs 10 per GB (with wide variations, depending on data plans) and average data usage climbed to 8 GB per month.

Apart from lower costs, better connectivity and growing smartphone penetration, there have been other demand drivers. One is sheer need – more public services are available online, making it a necessity for citizens to use data. The government clearly has a role to play here.

A second driver is burgeoning e-commerce. More goods and services are available online. This is particularly true in Tier 2 urban and semi-rural locations where physical stores may not exist. A third driver is the desire for entertainment and the growing Indian appetite for news, music videos, movies and sports. The increasing use of social media platforms like WhatsApp, Facebook, Instagram and Twitter has also contributed to this phenomenon. Many Indians also play online games.

There is every reason to believe that demand for data will grow rapidly. India has a very young population, which has an affinity for gaming and social media, and a willingness to transact online, using fintech solutions.

Service providers are also pushing the fibre-to-the-home segment, which could be an additional source of revenue. As and when 5G networks roll out, there should be faster, more efficient broadband services at lower costs. Of course, this will entail massive investments and policy support too.

At the same time, service providers are trying to shed low-ARPU, voice-only subscribers. They appear to have been relatively successful in this in the past couple of quarters, by altering tariff plans to ensure a minimum commitment from subscribers.

Both VIL and Airtel have reduced their subscriber bases substantially and as a result have seen improvements in ARPUs. Jio, which has a completely data-driven subscriber base, has over the same time seen a fall in ARPUs. Overall, data from the Telecom Regulatory Authority of India

(TRAI) indicates that the mobile subscriber base reduced by 22 million in March 2019. Airtel and VIL lost close to 30 million subscribers while Jio gained 9.5 million.

ARPU's may have stabilised. The industry average dipped from Rs 80.77 in December 2017 to a low of Rs 71.62 in March 2018 and recovered to Rs 72.82 by December 2018. The three private operators have better ARPU's than the average, which have been pulled down by the low ARPU's of Bharat Sanchar Nigam Limited (BSNL) and Mahanagar Telephone Nigam Limited (MTNL). This is the best sign of sector recovery, as is visible from the latest financial results. Airtel has also indicated that it sees some firming up of tariffs going forward.

In absolute terms, however, the financials indicate that both VIL and Airtel are finding it hard to sustain operations, make necessary capital expenditures, service outstanding debt, and make profits. Both Airtel and VIL have raised huge sums and started to monetise non-core assets by selling stakes in their fibre and tower assets.

Jio's financials appear to be in better shape but that is also because it has the backing of its parent, Reliance Industries Limited (RIL), which has very deep pockets. While Jio claims to be profitable, it is clear that it is still cash flow negative due to the vast investments it is making. But in terms of ARPU's and revenue market share, Jio is clearly doing much better than its rivals.

During the fourth quarter of 2018-19 (January-March 2019), VIL registered a net loss of Rs 48.82 billion. In the preceding two quarters, it had incurred a net loss of Rs 50.05 billion (October-December 2018) and Rs 49.74 billion (July-September 2018). It is not very meaningful to compare these with prior financials, since the third quarter was the first full quarter of operations for the company after the merger.

VIL posted a marginal quarter-on-quarter increase in revenues to Rs 117.75 billion in the quarter ended March 2019 from Rs 117.65 billion in the quarter ended December 2018. The merged entity shed 88 million subscribers over the six-month period. This helped it to improve ARPU's substantially to Rs 104 in the fourth quarter, from Rs 89 in the third quarter and Rs 88 in the second quarter.

In April 2019, VIL raised Rs 250 billion from the market through a rights issue, which issued 87 new shares for every 38 shares held. The company has outstanding debt of about Rs 1.15

trillion. The infusion should allow it to pare some debt and sustain operations going forward. VIL expects synergies from the merger to lead to savings of Rs 84 billion during 2020-21, and synergies of around Rs 30 billion were visible by December 2018.

VIL's required capex is likely to be around Rs 400 billion by 2020-21. Market opinion is divided on whether the funds infusion, large as it is, will be enough to sustain operations until full synergies come into play and VIL starts to hopefully make profits.

VIL has the lowest ratio of data subscribers to all subscribers, since about 45 per cent of its subscribers are not on data plans. While Jio users consume 10.8 GB of data per month and Airtel users consume 10.5 GB, VIL's subscribers consume only 6.2 GB. If VIL can persuade its customers to migrate to data-based plans, it has potential for revenue growth.

Airtel's fourth-quarter results were buoyed up by better returns from its Africa operations. The company reported a net profit of Rs 1.07 billion during this quarter. It had reported a profit of Rs 830 million in the corresponding quarter last year (this was reliant on extraordinary income). The consolidated revenue for the fourth quarter of financial year 2018-19 stood at Rs 206 billion, up 6.6 per cent on a year-on-year basis. The consolidated EBITDA stood at Rs 68.06 billion while the consolidated EBITDA margin was 33 per cent, down 3.2 per cent from a year ago.

Airtel has lower debt than VIL, with a consolidated debt of about Rs 1.06 trillion. Its rights issue of Rs 250 billion will help pay off some debt and an initial public offer (IPO) by its Airtel Africa arm in London for a targeted \$750 million should be achievable. That will enable it to fund future capex and operations comfortably. Meanwhile, the ARPUs of its India wireless business have improved noticeably, from Rs 104 in the third quarter to Rs 123 in the fourth quarter.

Jio reported a 64.7 per cent year-on-year increase in net profit at Rs 8.4 billion in the fourth quarter, compared to a net profit of Rs 5.1 billion a year ago. The fourth-quarter revenue rose 55.8 per cent to Rs 111.06 billion versus Rs 71.28 billion a year ago. While Jio has the lowest subscriber base at 307 million, all its subscribers are on data plans and this gives it a clear advantage in terms of revenue market share. The company's ARPU during the fourth quarter stood at Rs 126.20, down from Rs 130 in the previous quarter.

Debt calculations are not meaningful since Jio is a subsidiary of RIL and it can raise any cash

necessary on the basis of its parent's balance sheet. However, RIL is clearly taking steps to monetise its assets by hiving off Jio's fibre and tower undertakings into two separate companies. It could, going forward, sell stakes in those companies to raise more cash if required.

### Expectations from the government

To ensure that sector dynamics become more robust, policy support will be critical. That involves clarifying several tax-related issues and reducing the applicable GST rate, as well as offering infrastructure status to the sector. The government could also offer easier payment terms for spectrum usage charges and licence fees, and set lower base prices for the next round of spectrum auctions.

The sector has, in fact, lobbied for multiple policy changes that could enable it to become sustainable. The interim budget disappointed, but the industry hopes some of this will be cleared in the July 2019 budget.

One plea is that service providers be allowed to carry forward minimum alternate tax (MAT) credits beyond the normal 15-year lifespan until such time as MAT can be fully adjusted against profits. Another plea involves withholding taxes from distributors' margin on SIM cards and prepaid vouchers. The industry contention is that this is not a commission and these transactions should not attract withholding tax, or such taxes should be levied at low rates. At the very least, it is seeking clarity on this ground.

Another area of litigation has been the payment of interconnection usage charges (IUC) by Indian telecom operators to foreign telecom operators. The tax authorities have been taxing such receipts as royalties/fee for technical services. There should be clarity on this matter and since such IUC fees paid to Indian service providers by overseas operators are not taxed abroad, it would be ideal if these charges are not taxed in India as well.

Clarity in other areas would require a proactive approach from TRAI, the Department of Telecommunications and the GST Council. In addition, the central government could play a major role in persuading the states to streamline right-of-way (RoW) implementation for network roll-outs.

The industry has long deserved infrastructure status, which would enable the import of equipment without the levy of customs duties. When it comes to RoW implementation, transactions between local bodies and service providers should not be subject to taxes, and clear guidelines in this regard would be helpful.

On the GST front, the industry is hoping for a reduction in levy, from 18 per cent at present to 12 per cent – a plea that needs to be addressed to the GST Council. There are also large GST input tax credits accumulated and unrecovered, and the council could expedite their adjustment. Moreover, towers are treated as immovable property and are not eligible for input credits for GST.

The industry is also concerned about the proposed base prices for the next spectrum auction, which is likely to take place by end 2019. Industry analysts claim that the proposed base prices for 5G spectrum in India are six times higher than the average global rates.

Operators will have to pay over Rs 500 billion to utilise the entire 5G spectrum on offer at these prices and perhaps invest \$25 billion-\$30 billion more to build a pan-Indian network. Moreover, since 5G is to be largely used for social services such as health, transportation, waste management and smart cities, the returns on investments for operators will be lower.

Overall, the industry is looking at a situation where it earned revenues of roughly Rs 2.3 trillion in 2018-19. It has an outstanding debt of Rs 5 trillion (and another Rs 3 trillion for spectrum charges and licence fees) to be serviced. This is unsustainable, unless profitability improves dramatically or payment terms and conditions are eased.

While the sector is showing some early signs of a turnaround, the government has a significant role to play in facilitating this. Telecom is a vital infrastructure sector and the industry going sick, as it well may, would impact the entire economy and indeed, every citizen.

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