Telecom Industry returning to healthy monetization; tariff hike needed across players: MOFSL

After more than 12-13 years, the telecom industry is once again in a sweet spot. It is returning to a healthy monetization stage thanks to reduced capex due to the end of the heavy investment cycle of the last 10 years coupled with EBITDA growth, as per a report by Motilal Oswal Financial Services. Thus, **Bharti's FCF yield is expected at 7% and RJio's RoCE at ~11% in FY22E**. The expected tariff hikes of >50% over the next few years may bring Bharti and RJio's RoCE above the cost of capital for the first time in 10 years. However, VIL needs >50% price hike to overcome the challenge of declining market share, high cost structure coupled with steep leverage.

In a recent discussion with the **TRAI secretary, MOFSL learnt that the Consultation Paper** on floor pricing is on their priority list; a decision will be taken soon post the open house discussion. The secretary also stated that TRAI has received recommendations from different stakeholders. While telcos are inclined toward some minimum fixed floor prices for data services, consumers and other stake holders have a contrasting view. Furthermore, he also emphasized on the importance of the forbearance policy and indicated that telcos have all options to increase tariffs under the current guidelines and could also customize different plans at various prices to increase their top line. Thus, it appeared that the secretary hinted at leaving it to telcos to decide on pricing instead of a floor price driven price increase.

Sharing below the detailed rationale of why each player needs to hike tariff:

VIL needs it to survive: VIL's weak cash position with outstanding cash and cash equivalents of INR26.6b in FY20 and EBITDA (pre Ind-AS 116) of INR58.1b would be insufficient to service its estimated cash requirement of ~INR135b for FY21/22E.

Also, VIL **cash requirement would be ~INR300b for FY23E and beyond (as the 2-year deferred spectrum payment moratorium ends)**. Therefore, VIL would need price increase of 50% to keep it afloat (assuming limited bank refinancing and subscriber churn).

Exhibit 3: Price hike required by VIL to survive

(Amount in INR b)	FY22
Capex	52
Cash Interest	30
Deferred spectrum liability	165
AGR payment	52
Total EBITDA requirement	**300**
EBITDA (pre IND AS 116)	132
Incremental EBITDA required	168
Incremental revenue required	239
ARPU (INR)	124
Subscribers (m)	306
ARPU hike required (INR)	**65**
New ARPU (INR)	190
Increase in ARPU required (%)	**53%**

Source: MOFSL, Company

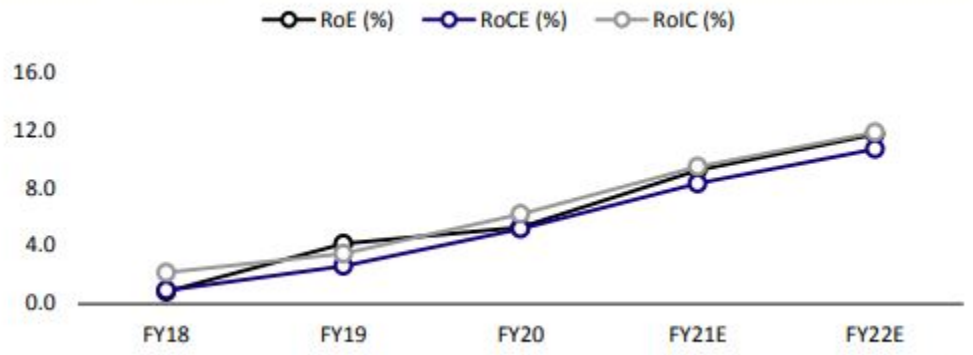
Exhibit 4: At INR70, ARPU increase (needed by VIL to survive), BHARTI/RJio's incremental EBITDA

Company	Bharti	RJio
(Amount in INR b)	FY22	FY22
EBITDA	471	447
ARPU (INR)	184	148
Increase in ARPU due to VIL price hike	**65**	**65**
New ARPU	**250**	**214**
Subscribers (m)	301	462
Incremental revenue	236	362
Incremental EBITDA	**153**	**253**
New EBITDA	624	700
Increase in EBITDA (%)	**33%**	**57%**

Source: MOFSL, Company

RJio needs it to justify recent investments: With subscriber growth addition tapering off, RJio has to utilize other avenues of incremental growth to justify the current valuations that it commanded in recent deals. According to our estimate, **for an 8x EV/EBITDA, it would require to triple its EBITDA. This may require over 40% ARPU hikes**, even if we assume a large portion of the incremental revenue comes from its ambitions in Jiofiber and other digital avenues. Being a market leader and price maker, this adds credence to the welcoming tariff action possibility in the industry.

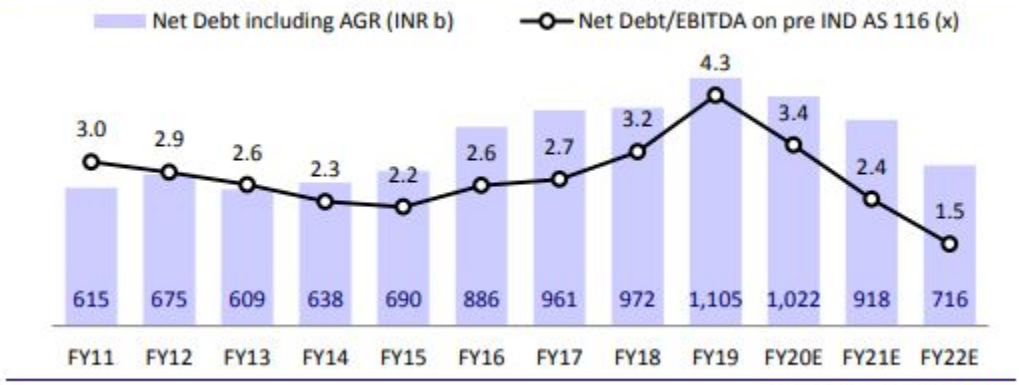
Exhibit 5: RJio's RoCE estimated to reach 10.7% in FY22E



Source: Company, MOFSL

Bharti needs it to deleverage: In FY19, **Bharti raised INR394b from QIP and rights issue and another USD750m from the Africa IPO** to reduce its leverage (net debt to EBITDA) from 4.3x in FY19 to 2.8x in FY20. Post the AGR liability, its net debt stands at INR1,022b (as per the company's provisioning) and leverage at 3.4x (pre Ind-AS 116). Net debt could further **increase by ~INR100b if AGR dues** are assumed as per DoT while incremental FCF could be utilized for deleveraging. Further, management has consistently reiterated reaching ARPU of INR200 in the near term and INR300 in the long term to reach respectable RoCEs that can cover its cost of capital.

Exhibit 6: Bharti net debt/EBITDA to reduce to 1.5x in FY22E



Source: Company, MOFSL

In the last few months of the lockdown, while other businesses were shut, the telecom industry remained operational. However, it weathered impact of (a) lower recharges, (b) consolidation of dual sim cards, and (c) lower 4G off-take due to lack of physical counters/financial constraints with potential impact of ~4-5% on revenues. In the coming quarters, GDP is expected to contract, leading to lower disposable income and lower consumer spending power. In such a scenario, a price hike of 20-25% could take away ~INR350-450b of annual household income, and would be difficult for consumers to absorb. Thus, a tariff hike will have to wait at least a couple of quarters to fructify.

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