

Govt relief a boost for Vodafone Idea, sizeable tariff hikes key for long-term sustainability

The package includes a four-year moratorium on dues

By Nachiket Kelkar | September 16, 2021 11:38 IST

Vodafone Idea's shares surged 15 per cent on Thursday morning as investors heaved a sigh of relief following the much-awaited announcement of the relief package for the telecom sector by the government. The package, which includes a four-year moratorium on dues and rationalisation of the definition of adjusted gross revenue (AGR), which will now exclude non-telecom revenue of companies, is expected to benefit Vodafone Idea the most and may have blown away the clouds of uncertainty over its survival.

"This (moratorium and redefining of AGR) will immediately ease out the stress on the cash flows of the telcos to a great extent especially Vodafone Idea," Vipula Sharma, director – ratings at Brickwork Ratings said.

Last year the Supreme Court had dealt a big blow to the incumbent telecom companies like VIL and Bharti Airtel when it ruled in favour of the government over the definition of AGR. Later, it also turned down the petitions of telecom companies that had sought recalculation of AGR dues. VIL, which had a gross debt of Rs 1.91 lakh crore as of June 30, 2021 was the most impacted. The debt includes deferred spectrum payment obligations of Rs 1.06 lakh crore and AGR liability of Rs 62,180 crore, according to the company's stock exchange filings. Its debt from banks and financial institutions stood at Rs 23,400 crore. In contrast, the cash and cash equivalents stood at just Rs 920 crore.

The company had to shell out around Rs 8,000-9,000 crore towards the AGR payments by March 31, 2022 and over Rs 15,000 crore during 2022-23 towards the spectrum payments, pointed Sharma. "The moratorium will help the company in conserving the liquidity, which in turn can be used for debt repayments and capex requirements," Sharma added.

VIL has been in talks for some time now to raise funds, but with the uncertainties around its future prospects, no investor had come forward to strike a deal. The government's relief package should come as a breather now, for the existing promoters as well as any potential investor.

The government has also allowed 100 per cent foreign direct investment in telecom via the automatic route, which should also help attract new investors in the sector.

The other measures include annual compounding of interest rates on dues, instead of monthly compounding, the spectrum auctions will now be for 30 years from 20 years and there will also be no penalties on dues.

"The package provides huge relief to VIL for the next four years as the annual cash outgo towards government dues will reduce from Rs 25,300 crore to Rs 3,100 crore, with an option of converting the same into equity for the government," said analysts at Emkay Global Financial Services.

While the government's relief measures are surely a much needed lifeline for the sector, importantly for VIL, the Emkay analysts do point that the annual payout to the government is likely to increase substantially to Rs 47,700 crore from the financial year 2027.

Dayanand Mittal, analyst at JM Financial Institutional Securities noted that the moratorium will improve VIL's cash flow by Rs 9,100 crore in the current financial year, while over FY2023-2026, the cash flow is likely to improve by Rs 24,900 crore annually.

While the relief gives VIL a much needed breather, it could help Bharti Airtel in terms of debt repayments and more investments in capex.

"While Bharti has sufficient liquidity to meet near-term payments, the Rs 11,500 crore to Rs 13,000 crore extra cash flow per annum over FY23-26 could provide Bharti with more leeway to either pay down the debt or utilise for faster capex ramp up in 5G/ fibre-to-the-home and hence fortify the leadership amongst premium customers," said Mittal.

For VIL, the longer term concerns do remain. "The moratorium helps to solve the immediate liquidity woes of VIL, but its ballooning debt and annual EMI after four years will be difficult to address," said analysts at Motilal Oswal Financial Services.

The government has tried to cushion this by offering an option to convert the interest component accrued during the moratorium period into equity. But, the Motilal Oswal analysts note that VIL's interest component will be huge at around Rs 50,000 crore against its current market capitalisation of Rs 39,000 crore.

"Hence, the conversion of interest accrued into equity could have a significant impact on the shareholding," the analysts said.

So, despite the relief, telecom companies will have to raise tariffs sizeably, which will be essential to make additional investments in strengthening the existing infrastructure and making investments towards 5G. Companies that opt for the moratorium also need to pay interest at the rate of the marginal cost of funds based lending rate (MCLR) plus 2 per cent.

"Despite immediate cash outgo relief, telcos would still need to raise tariffs for sustainable improvements in cash flows," said Nitesh Jain, director, CRISIL Ratings.

In the last few months, there has been some selective increase in base prepaid tariffs. But, a broad-based tariff hike in the prepaid segment last happened only in December 2019. VIL has been among the weakest in terms of average revenue per user (ARPU); it has an ARPU of Rs 104, compared with Bharti Airtel's ARPU of Rs 146 and Reliance Jio's Rs 138. "We expect telcos to raise tariffs by at least 20 per cent equivalent to a Rs 25-30 increase in monthly ARPU by the end of this fiscal and dial up the sector's return on capital employed from a paltry 3 per cent last fiscal to 8 per cent next fiscal," said Jain.

The Emkay analysts have factored in 15-18 per cent tariff hikes in the second half of the year ending March 2022.

Mittal of JM Financial feels, the government needs to implement more structural reforms like introduction of a floor tariff across the sector or setting up a mechanism to ensure tariff hikes are taken in a sustainable manner going forward.

The other major concern for VIL has been its continued decline in subscribers and will need to take measures to strengthen its network and in turn stem the subscriber outflow.

Vodafone Idea's shares were trading 15 per cent higher in the morning trade at Rs 10.23. As of Wednesday's close, the stock had gained 46 per cent this month. Bharti Airtel, which had gained 9 per cent in the same period, was down 0.2 per cent to Rs 724 on Thursday morning. Reliance Industries was also down 0.1 per cent to Rs 2,376.65.