

Rating Rationale

January 24, 2020 | Mumbai

Vodafone Idea Limited

Rating downgraded to 'CRISIL BB'; Continues on 'Watch Negative'

Rating Action

Rs.3500 Crore Non Convertible Debentures	CRISIL BB (Downgraded from 'CRISIL BBB-'; Continues on 'Rating Watch with Negative Implications')
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1 crore = 10 million

Refer to annexure for Details of Instruments & Bank Facilities

Detailed Rationale

CRISIL has downgraded its rating on the Rs 3,500 crore non-convertible debentures of Vodafone Idea Limited (VIL) to **'CRISIL BB'** from 'CRISIL BBB-'. The rating continues to be on **'Rating Watch with Negative Implications'**.

The rating action reflects CRISIL's expectation of a significant deterioration in VIL's financial risk profile on account of the potential payout against the adjusted gross revenue (AGR)-related liability, to be payable shortly. This is despite CRISIL's expectation that the actual payment towards the AGR-related liability could be lower than the Rs 44,150 crore amount that has been provided for by the company. Moreover, CRISIL believes there could be some relief from the Department of Telecommunications (DoT) in the form of deferment of timelines for payment of these liabilities. CRISIL further expects the sponsors to provide financial support in case a significant relief, in terms of amount and timelines, is provided.

The review petition, which was filed by telecommunication companies (telcos), including VIL, regarding the AGR issue, has been dismissed by the Supreme Court (SC) on January 16, 2020, post which, they have filed an appeal to the SC for modification of the order dated, October 24, 2019. The hearing of the same is scheduled to happen next week. On January 23, 2020, the DoT issued a letter stating that no coercive action will be taken against telecom service providers for non-compliance of payment of AGR-related dues until further notice.

The rating remains on negative watch pending clarity on the outcome of the hearing of the appeal for modification of the order; payments for the spectrum usage charges; further relief, if any, to be provided by the government; and the funding mix of the final payment towards the DoT. CRISIL will remove the rating from negative watch and take a final rating action once there is clarity on these issues.

VIL had made a total provision of Rs 44,150 crore (Rs 27,610 crore towards licence fee and Rs 16,540 crore towards spectrum usage charges) till the quarter ended September 30, 2019, for the disputed liability towards AGR. The existing liquidity (about Rs 15,390 crore as on September 30, 2019) will be insufficient if there is a payout of licence fee liability of Rs 27,610 crore.

Operating performance continues to be weak. Earnings before interest, tax, depreciation, and amortisation (EBITDA) was Rs 1,050 crore in the second quarter of fiscal 2020, a sequential decline of Rs 200 crore over the quarter ended June 30, 2019. Furthermore, as per the Telecom Regulatory Authority of India (TRAI), the company lost 8.5 crore subscribers over the 12 months through November 2019. Continued subscriber loss has negated the benefits of higher average revenue per user (ARPU) and synergy benefits.

The recent industry-wide tariff hike could support the company's EBITDA, if pricing discipline is maintained by telcos and there is no significant churn in subscribers. However, the benefits will be more pronounced next fiscal, given the full-year impact of the tariff hike.

Despite the hike in tariffs, debt protection metrics are expected to remain weak on account of potential payout against the AGR-related dispute, and delay in planned monetisation of assets. As per our estimates, net debt to EBITDA and interest coverage ratios could remain over 20 times and below 1 time, respectively, for fiscal 2020.

The rating reflects VIL's established market position in the mobile services segment in India and support from strong sponsors. These strengths are partially offset by continued weak operating performance leading to modest debt protection metrics, and vulnerability to regulatory changes and technological risks.

Analytical Approach

CRISIL has combined the business and financial risk profiles of VIL and its subsidiaries because all these entities,

collectively referred to as VIL, operate in the same business and have a common management.

Please refer Annexure - List of entities consolidated, which captures the list of entities considered and their analytical treatment of consolidation.

Key Rating Drivers & Detailed Description

Strengths:

*** Established market position in the mobile services segment in India**

After the merger with Idea Cellular Ltd (ICL), VIL has emerged as one of the significant mobile operators in India. It had a gross revenue market share of 29.1% in the quarter ended September 30, 2019 (excluding National Long Distance and International Long Distance revenue), subscriber market share of 29.4% as on November 30, 2019, and spectrum holdings of 1,850 megahertz (MHz), of which around 1,715 MHz can be utilised for deploying any technology 2G, 3G, 4G, or 5G. The group has been providing wireless voice and broadband services across all 22 circles in India, and the quantum of spectrum available provides a cushion to handle future requirement.

As of September 2019, the group has already completed network integration in 14 circles. The ability to seamlessly transition to a unified network while sustaining market position will be a key rating sensitivity factor.

Weaknesses

*** Continued weak operating performance leading to below-average debt protection metrics**

The domestic telecom industry has been through a roller coaster ride over the past few years. The price war, which started after Reliance Jio Infocomm Ltd ('CRISIL AAA/Stable/CRISIL A1+') launched its services, has eroded the industry's revenue. This, along with reduction in call termination charges, led to a significant decline in ARPU.

VIL reported an ARPU of Rs 88 for the quarter ended September 2018, the first quarter after the merger. Though measures, such as introduction of minimum recharge packs, have increased ARPU to Rs 108 for the quarter ended June 2019, it again declined marginally to Rs 107 for the next quarter. Besides, the company has also seen significant loss of more than 11 crore subscribers over the 12 months through September 2019. As a result, revenue and operating profit were lower by Rs 426 crore and Rs 200 crore, respectively, in the quarter ended September 30, 2019, compared with the previous quarter.

The recent tariff hike by VIL with effect from December 3, 2019, is expected to improve profitability, assuming there will be no significant churn in subscribers, pricing discipline is maintained by telcos, and subscribers do not shift to lower price packs. However, the benefits will be more pronounced next fiscal, given the full-year impact of the tariff hike.

Operating performance is likely to remain moderate, though the quantum of synergy benefits, improvement in profitability, and materialisation of deleveraging plans will remain key rating sensitivity factors over the medium term.

*** Exposure to technological changes and regulatory risks**

New technology could necessitate fresh investments or an overhaul of the network. The advent of 4G, for instance, saw telcos investing substantially in upgrading infrastructure even before they could make significant returns on investments in 3G.

Furthermore, telecom is a highly regulated market. The government reduced call termination charges for domestic calls to 6 paisa from 14 paisa, and for international calls to 30 paisa from 53 paisa; which constrained profitability of large incumbent players.

However, the TRAI has deferred the plan of reduction in IUC (also called interconnect usage charges) to zero paisa per minute to January 1, 2021, earlier planned to be effective from January 1, 2020, which will be beneficial to VIL.

On November 8, 2019, TRAI has issued another consultation paper focused on review of the existing regulatory regime for international termination charges. The final outcome in this regard will continue to be monitored.

Liquidity Stretched

Though the group had cash and cash equivalent of Rs 15,390 crore as on September 30, 2019, against deferred spectrum repayment of Rs 5,630 crore (including principal and interest) and external debt repayment of Rs 945 crore in the second-half of fiscal 2020, any payout towards the AGR liability could significantly impact liquidity. Existing liquid resources are insufficient if there is a payout of licence fees liability of Rs 27,610 crore. Besides, delay in planned monetisation of assets might further stretch liquidity. Any accelerated debt servicing payments, triggered by the breach of debt covenants, may also constrain liquidity.

Rating Sensitivity factors

Upward factors:

- * Favourable outcome of the AGR issue by the SC and the DoT, resulting in higher-than-expected relief in terms of lower liability or deferment of the liabilities
- * Sustenance of debt to EBITDA ratio at below 7 times
- * Significant financial support from promoters, leading to better capital structure

Downward factors:

- * Debt to EBITDA ratio remaining above 10 times
- * Further weakening of the operating performance, constraining cash accrual
- * Lower-than-required relief, regarding the AGR issue, impacting liquidity

About the Company

VIL is one of the leading mobile service providers in India. It operates in all 22 service areas in the country.

Vodafone and ABG owned 44.39% and 27.18% stake, respectively, on a fully diluted basis in VIL, as on September 30, 2019. Vodafone is a globally renowned international mobile communications conglomerate with operations in 25 countries, over 65 crore customers, and more than 41 partner networks. ABG is a large Indian conglomerate with operations in 34 countries across 5 continents.

Net loss was Rs 50,922 crore in the quarter ended September 30, 2019, driven by accounting for AGR liability, reversal of deferred tax assets recognised earlier, and accelerated depreciation on certain assets.

Key Financial Indicators - (pro-forma Vodafone Idea Ltd)

As on / for the period ended March 31		2019	2018
Revenue	Rs crore	48,747	63,138
Profit after tax (PAT)	Rs crore	-13,371	-12,285
PAT margin	%	-27.4	-19.4
Debt/EBITDA	Times	23.1	10.3
Adjusted interest coverage	Times	0.49	1.25

Any other information: Not applicable

Note on complexity levels of the rated instrument:

CRISIL complexity levels are assigned to various types of financial instruments. The CRISIL complexity levels are available on www.crisil.com/complexity-levels. Users are advised to refer to the CRISIL complexity levels for instruments that they consider for investment. Users may also call the Customer Service Helpdesk with queries on specific instruments.

Annexure - Details of Instrument(s)

ISIN	Name of instrument	Date of allotment	Coupon rate	Maturity date	Issue size (Rs crore)	Rating assigned with outlook
INE713G08046	Debentures	12-Jun-15	8.25%	10-Jul-20	3,500.00	CRISIL BB/Watch Negative

Annexure - List of entities consolidated

Names of Entities Consolidated	Extent of Consolidation	Rationale for Consolidation
Idea Cellular Services Ltd	Fully consolidated	Strong financial and business linkages
Idea Telesystems Ltd	Fully consolidated	Strong financial and business linkages
You Broadband India Ltd	Fully consolidated	Strong financial and business linkages
You System Integration Private Ltd	Fully consolidated	Strong financial and business linkages
Vodafone Business Services Ltd	Fully consolidated	Strong financial and business linkages
Mobile Commerce Solutions Ltd	Fully consolidated	Strong financial and business linkages
Vodafone Towers Ltd	Fully consolidated	Strong financial and business linkages
Vodafone Foundation	Fully consolidated	Strong financial and business linkages
Vodafone Technology Solutions Ltd	Fully consolidated	Strong financial and business linkages
Vodafone m-pesa Ltd	Fully consolidated	Strong financial and business linkages
Vodafone India Ventures Ltd	Fully consolidated	Strong financial and business linkages
Vodafone India Digital Ltd	Fully consolidated	Strong financial and business linkages
Connect (India) Mobile Technologies Pvt Ltd	Fully consolidated	Strong financial and business linkages

Aditya Birla Idea Payments Bank Ltd	Equity method	Proportionate consolidation
Indus Towers Ltd	Equity method	Proportionate consolidation
Firefly Networks Ltd	Equity method	Proportionate consolidation

Annexure - Rating History for last 3 Years

Instrument	Type	Current		2020 (History)		2019		2018		2017		Start of 2017
		Outstanding Amount	Rating	Date	Rating	Date	Rating	Date	Rating	Date	Rating	Rating
Commercial Paper	ST		--		--	18-01-19	Withdrawal	28-11-18	CRISIL A1+		--	--
Non Convertible Debentures	LT	3500.00 24-01-20	CRISIL BB/(Watch) Negative			22-11-19	CRISIL BBB-/Watch Negative	28-11-18	CRISIL A+/Negative		--	--
						01-11-19	CRISIL BBB+/Watch Negative					
						06-08-19	CRISIL A/Negative					
						18-01-19	CRISIL A+/Negative					
Short Term Debt	ST											CRISIL A1+

All amounts are in Rs.Cr.

Links to related criteria

[CRISILs Approach to Financial Ratios](#)

[Rating criteria for manufacturing and service sector companies](#)

[Rating Criteria for Mobile Telephony Services](#)

[CRISILs Criteria for Consolidation](#)

[CRISILs Criteria for rating short term debt](#)

For further information contact:

Media Relations	Analytical Contacts	Customer Service Helpdesk
Saman Khan Media Relations CRISIL Limited D: +91 22 3342 3895 B: +91 22 3342 3000 saman.khan@crisil.com	Sachin Gupta Senior Director - CRISIL Ratings CRISIL Limited D: +91 22 3342 3023 Sachin.Gupta@crisil.com	Timings: 10.00 am to 7.00 pm Toll free Number: 1800 267 1301 For a copy of Rationales / Rating Reports: CRISILratingdesk@crisil.com
Naireen Ahmed Media Relations CRISIL Limited D: +91 22 3342 1818 B: +91 22 3342 3000 naireen.ahmed@crisil.com	Nitesh Jain Director - CRISIL Ratings CRISIL Limited D: +91 22 3342 3329 nitesh.jain@crisil.com	For Analytical queries: ratingsinvestordesk@crisil.com
	Rounak Agarwal Rating Analyst - CRISIL Ratings CRISIL Limited D: +91 22 3342 4162 ROUNAK.AGARWAL@crisil.com	

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CRISIL is a leading agile and innovative, global analytics company driven by its mission of making markets function better. We are India's foremost provider of ratings, data, research, analytics and solutions. A strong track record of growth, culture of innovation and global footprint sets us apart. We have delivered independent opinions, actionable insights, and efficient solutions to over 1,00,000 customers.