

Rating Rationale

August 06, 2019 | Mumbai

Vodafone Idea Limited

Rating downgraded to 'CRISIL A/Negative'

Rating Action

Rs.3500 Crore Non Convertible Debentures	CRISIL A/Negative (Downgraded from 'CRISIL A+/Negative')
Rs.2500 Crore Non Convertible Debentures	CRISIL A+/Negative (Withdrawn)

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 (NCDs) of Vodafone Idea Limited (VIL) to '**CRISIL A/Negative**' from 'CRISIL A+/Negative'. CRISIL has also **withdrawn** its rating on the Rs 2,500 crore NCDs of VIL at the company's request as there is nil outstanding against the facility. The withdrawal was in line with CRISIL's withdrawal policy.

The downgrade reflects CRISIL's expectation of deterioration in VIL's business and financial risk profiles over the medium term. Profitability is weaker than expectations although significant synergy benefits were accrued ahead of the earlier plan. Earnings before interest, tax, depreciation, and amortisation (EBITDA) was Rs 1,238 crore (*unadjusted for Ind-AS 116*) in the first quarter of fiscal 2020, as against Rs 1,590 crore in the fourth quarter of fiscal 2019.

The company achieved about 70% synergy realisation of the total Rs 8,400 crore guidance (on an annualised basis) by the end of June 2019. Given the pace at which synergy realisation has happened till date, VIL should realise its full synergy by the first quarter of fiscal 2021.

EBITDA margin declined by 250 basis points (bps) on-quarter (*unadjusted for Ind-AS 116*) in the first quarter of fiscal 2020. This drop could be attributed to a sequential 4% decline in revenue, primarily led by a churn in average revenue per user (ARPU) subscribers due to the introduction of *service validity vouchers*. However, EBITDA is likely to improve over the medium term on account of increase in synergy realisation and improvement in ARPUs; it may, however, remain contingent to subscriber retention and the pace of net 4G subscriber addition.

Equity of Rs 25,000 crore was raised in May 2019 through a rights issue; of this, the sponsors, Vodafone Group Plc (Vodafone; rated 'BBB/Stable/A-2' by S&P Global Ratings) and the Aditya Birla group (ABG), contributed up to Rs 11,000 crore and Rs 6,920 crore, respectively. The proceeds from the rights issue have been utilised for repayment of loans and strengthening liquidity. Net debt, however, remained high at Rs 99,260 crore as on June 30, 2019.

VIL plans to monetise its 11.15% stake in Indus Towers, post completion of the Bharti Infratel and Indus Towers merger. The proceeds from this transaction is estimated at about Rs 5,630 crore as on June 30, 2019. Besides, the company is also looking to sell its fibre assets. Despite these deleveraging plans, net debt may continue to exceed Rs 1 lakh crore by the end of March 31, 2020.

While the competitive intensity in the Indian telecom industry has moderated over the past few months, the credit risk profile of the combined entity will remain exposed to competitive pressures. Thus, organic EBITDA growth post, full synergy realisation, will remain a key rating sensitivity factor. Moreover, support provided to the combined entity by its sponsors, Vodafone and ABG, will continue to be critical.

The rating factors in Vodafone Idea's healthy market position in the mobile telephone segment in India and support from strong sponsors. These strengths may be partially offset by weak debt protection metrics over the medium term, and vulnerability to regulatory changes and technological risks.

Analytical Approach

CRISIL has combined the business and financial risk profiles of VIL and its subsidiaries. This is because the entities, collectively referred to as Vodafone Idea, operate in the same line of 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

* Strong market position in the mobile telephone segment in India

After the amalgamation, the VIL has emerged as one of the leading mobile operators in India. It has significant gross revenue market share (around 32% in the quarter ended March 31, 2019), subscriber market share (33.4% as on May 31, 2019), and spectrum holdings (1,850 megahertz [MHz], of which around 1,715 MHz can be utilised for deploying any technology, 2G, 3G, 4G, or 5G). Over 70% of the spectrum of the group has validity ranging from 2034-2036. It 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 June 2019, the group has already completed network integration in 10 circles, which accounts for more than 50% of 4G revenue. The ability to seamlessly transition to a unified network while maintaining the market position will be a key rating sensitivity factor.

* Support from strong sponsors

VIL has the backing of, and has received robust support from, Vodafone and ABG, which exercise equal management control. Before the completion of the merger, Vodafone brought in equity of Rs 8,600 crore into Vodafone India Ltd while ABG brought in Rs 3,250 crore in Idea Cellular Ltd (ICL). Furthermore, Rs 3,500 crore was raised by ICL through a qualified institutional placement in February 2018. In May 2019, VIL successfully raised equity of Rs 25,000 crore, out of which Vodafone and ABG contributed Rs 11,000 crore and Rs 6,920 crore, respectively. The presence of strong sponsors also aids financial flexibility. CRISIL will continue to closely monitor support received from both the sponsors.

Weaknesses

* Modest 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/CRISIL AAA(SO)/Stable/CRISIL A1+') launched its services, has eroded the industry's average ARPU.

Despite moderation in the competitive intensity in the first half of 2019, the operating performance of incumbent telecommunication companies remained weak. While the ARPU of VIL increased by Rs 19 in the first half of 2019, the total subscribers reduced by around 6.7 crore.

Quarterly profit of VIL declined by around Rs 350 crore on-quarter in the first quarter of fiscal 2020 due to a drop in revenue, led by subscriber loss of around 1.4 crore. The fall in operating performance weakened debt protection metrics further such that net debt to EBITDA and interest coverage ratios in the last 12 months remained over 20 times and below 1 time, respectively, as of the quarter ended June 30, 2019.

Though significant synergy benefits are expected over the medium term, debt protection metrics should remain weak. 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

The telecom industry remains susceptible to regulatory and technological changes. New technology could necessitate fresh investments or an overhaul of network. Advent of 4G, for instance, has seen operators investing substantially in upgrading infrastructure even before they could make significant returns on investments in 3G.

The telecom industry is a highly regulated market, and therefore, players remain vulnerable to changes in regulations. The government reduced termination charges per minute for domestic and international calls from 14 paise and 53 paise, respectively, to 6 paise and 30 paise, respectively; this has constrained the profitability of large incumbent players. Reduction in domestic termination charges (also called interconnect usage charges) to zero paise per minute with effect from January 01, 2020, should further impact the profitability of large incumbents and will continue to be key monitored.

Liquidity

Liquidity is comfortable, marked by liquid surplus of Rs 21,180 crore as on June 30, 2019, against principal repayment of Rs 4,500 crore in the 9 months ended March 31, 2020. A large part of the liquid surplus is likely to be unencumbered. Cash accrual is expected to improve only gradually while capex of Rs 13,000-15,000 crore is likely to be undertaken in the 9 months ended March 31, 2020. Liquidity is also supported by planned monetisation of assets and lean working capital cycle.

Outlook: Negative

CRISIL believes VIL's credit risk profile may be further constrained by weakening of operating performance. Furthermore, the quantum of synergy benefits and organic EBITDA growth post full synergy realisation, and cut in interconnect charges will continue to be monitored.

Downside scenario

- * Lower-than-expected synergy benefits or weakening of operating performance constraining cash accrual
- * Substantial capital expenditure arising from technological changes or spectrum acquisition, weakening debt protection metrics

- * Lower-than-expected deleveraging of the balance sheet

Upside scenario

- * More-than-expected reduction in leverage, led by increase in cash accrual and timely execution of deleveraging plans
- * Strengthening of business risk profile, driven by an arrest in subscriber loss and ARPU improvement.

About the Company

VIL is one of the leading mobile service providers in India in terms of revenue and subscriber market share. It operates in all 22 service areas in the country.

Vodafone owns 44.39% stake and ABG owns 27.18% stake on a fully diluted basis in VIL as on June 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.

Key Financial Indicators (Pro-forma Vodafone Idea Ltd)

As on/for the period ended March 31	Unit	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:

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Annexure - Details of Instrument(s)

ISIN	Name of instrument	Date of allotment	Coupon rate (%)	Maturity date	Issue size (Rs crore)	Rating assigned with outlook
INE713G08038	Debentures	12-Jun-15	8.15%	10-Jul-19	2,500.00	Withdrawn
INE713G08046	Debentures	12-Jun-15	8.25%	10-Jul-20	3,500.00	CRISIL A/Negative

Annexure - List of Entities Consolidated

Subsidiary Companies Idea Cellular Services Limited Idea Telesystems Limited You Broadband India Limited You System Integration Private Limited Vodafone Business Services Limited Mobile Commerce Solutions Limited Vodafone Towers Limited Vodafone Foundation Vodafone Technology Solutions Limited Vodafone m-pesa Limited Vodafone India Ventures Limited Vodafone India Digital Limited Connect (India) Mobile Technologies Private Limited
Associate Companies Aditya Birla Idea Payments Bank Limited
Joint Ventures Indus Towers Limited Firefly Networks Limited

Annexure - Rating History for last 3 Years

		Current		2019 (History)		2018		2017		2016		Start of 2016
Instrument	Type	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 06-08-19	CRISIL A/Negative	18-01-19	CRISIL A+/Negative	28-11-18	CRISIL A+/Negative	--	--	--
Short Term Debt	ST		--		--		--	--	14-11-16	Withdrawal 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:**

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