Rating Rationale

November 01, 2019 | Mumbai

Vodafone Idea Limited

Rating downgraded to 'CRISIL BBB+'; Placed on 'Watch Negative'

Detailed Rationale

CRISIL has downgraded its rating on the Rs 3,500 crore non-convertible debentures (NCDs) of Vodafone Idea Limited (VIL) to **'CRISIL BBB+'** from 'CRISIL A/Negative'. The rating has subsequently been placed on **'Rating Watch with Negative Implications'**.

The downgrade reflects VIL's weakening credit profile on account of continued modest operating performance, delays in monetisation of stake in Indus Towers Ltd (CRISIL AA+/Stable/CRISIL A1+) and the resultant stretch in its debt protection metrics.

VIL's operating profitability is likely to be lower than expectation. Earnings before interest tax depreciation and amortisation (EBITDA - operating profit) declined by Rs 350 crore, on-quarter, in the first quarter of fiscal 2020. VIL has lost 66.6 million subscribers over the 12 months through August 2019. The continued subscriber loss has negated the benefits of higher average revenue per user (ARPU) and synergy benefits.

VIL plans to monetise its 11.15% stake in Indus Towers, post completion of the Bharti Infratel and Indus Towers merger. However, the merger is still awaiting certain approvals. Now, the long stop date for the proposed merger has been shifted by 60 days to December 24, 2019. Consequently, VIL's plan to sell stake in Indus Tower is also delayed. Further, the likely realisations from the stake sale would now be lower than expectations.

As a result, debt protection metrics are now expected to be weaker. Net debt to EBITDA and interest coverage ratios are expected to remain over 10 times and below 1 time, respectively, for fiscal 2020.

The watch negative follows the Supreme Court's ruling on AGR matter against telecom operators (including VIL) in a long pending dispute with the Department of Telecommunication's (DoT). VIL's financial risk profile could significantly deteriorate on account of a potential payout. The company is in discussion with DoT to evaluate options to address the situation.

The Supreme Court has upheld DoT's definition of adjusted gross revenue (AGR). AGR forms the basis for revenue sharing arrangements, between telecom operators and the government, such as license fee and spectrum usage charges. As per the DoT's demand raised during the proceedings of the case for License fee dues, VIL may be required to pay Rs 28,309 crore (including license fee, interest amount, penalty and interest on penalty). It is to be noted that while the judgement has made clear the definition of AGR, clarity is awaited regarding the exact liability and the payment terms. The Supreme Court has further stated that the telecom operators have three months to comply with the judgement. Telecom operators are also contemplating various remedial options, including filing a review petition, approaching government for elongated payment terms, waiver of interest and penalty amounts, amongst others.

CRISIL will resolve the watch and take a final rating action once clarity emerges around the amount of dues, payment terms and company's funding plan to meet such liability.

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

Rating Action

Rs.3500 Crore Non Convertible Debentures	**CRISIL BBB+ (Downgraded from 'CRISIL A/Negative'; Placed on 'Rating Watch with Negative Implications')**

1 crore = 10 million

Refer to annexure for Details of Instruments & Bank Facilities

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:

*** Established market position in the mobile telephone segment in India**
After the amalgamation, VIL has emerged as one of the significant mobile operators in India. It has gross revenue market share (around 29.4% in the quarter ended June 30, 2019), subscriber market share (32% as on August 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 of 2034-2036 MHz. 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 sustaining 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 Group Plc (Vodafone; rated 'BBB/Stable/A-2' by S&P Global Ratings) and the Aditya Birla group (ABG), which exercise equal management control. 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. 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). The presence of strong sponsors also aids financial flexibility. CRISIL will continue to closely monitor support being received from both the sponsors.

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(CE)/CRISIL AAA/Stable/CRISIL A1+') launched its services, has eroded industry's revenue. This, along with reduction in call termination charges, led to a significant decline in ARPU. Company reported an ARPU of Rs 88 for the quarter ended September 2018, i.e. first quarter after the amalgamation.

Though measures such as introduction of minimum recharge packs has increased ARPU to Rs 108 for the quarter ended June 2019, it has also led to significant increase in subscriber churn with loss of around 66.6 million subscriber over the 12 month ended August 2019.

As a result of intense competition, company's revenue and operating profits were lower by Rs 500 crore and Rs 340 crore on quarter, respectively, in the first quarter of fiscal 2020. CRISIL expects the operating performance 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**
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 highly regulated, 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. DoT had earlier planned to reduce domestic termination charges (also called interconnect usage charges) to zero paisa per minute with effect from January 01, 2020. However, telecom regulatory authority of India has floated a consultation paper for potential postponement of the earlier plan. This could have a significant bearing on VIL's profitability as it earns more than Rs 250 crore per quarter from the interconnect usage charges. Final outcome in this regard will continue to be monitored.

Liquidity Adequate

Liquidity is comfortable, marked by liquid surplus of Rs 21,180 crore as on June 30, 2019, against principal repayment of Rs 4,200 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 around Rs 13,000 crore is likely to be undertaken in the 9 months ended March 31, 2020. However, the recent Supreme Court ruling could potentially impact liquidity if required to pay in the short term. Liquidity is also supported by planned monetisation of assets and lean working capital cycle.

Rating sensitivity factors

Upward factor

* Substantial relief from government leading to sustained improvement in cash accruals
* Debt to EBITDA ratio sustaining below 5 times
* Significant financial support from the promoters leading to correction in capital structure

Downward factor

* Debt to EBITDA ratio sustaining above 10 times
* Lower-than-expected synergy benefits
* Further weakening of operating performance constraining cash accrual

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 own 44.39% and 27.18% stake, respectively, 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.

Net loss was Rs 4,874 crore on revenue of Rs 11,270 crore in the quarter ended June 30, 2019.

Key Financial Indicators

As on / for the period ended March 31	Units	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
INE713G08046	Debentures	12-Jun-15	8.25%	10-Jul-20	3,500.00	CRISIL BBB+/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

	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	Withdrawn	28-11-18	CRISIL A1+		--		--	--
Non Convertible Debentures	LT	3500.00 01-11-19	CRISIL BBB+/Watch Negative	06-08-19	CRISIL A/Negative	28-11-18	CRISIL A+/Negative		--		--	--
				18-01-19	CRISIL A+/Negative							
Short Term Debt	ST		--		--		--		--	14-11-16	Withdrawn	CRISIL A1+

All amounts are in Rs.Cr.

Links to related criteria
[CRISILs Approach to Financial Ratios]
[Rating criteria for manufaturing and service sector companies]
[Rating Criteria for Mobile Telephony Services]
[CRISILs Criteria for Consolidation]
[CRISILs Criteria for rating short term debt]

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