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Idea Cellular: Facing a tough competitive environment

by Yong Kit Siong

Idea Cellular Ltd. (Idea), India's third largest mobile operator reported an 88% decline in YOY profit in the July to September quarter. The company, along with two other telecommunication companies Bharti Airtel and Vodafone India, has been engulfed in a price war as new market player Reliance Jio Infocomm (Reliance Jio) is employing aggressive pricing tactics to woo subscribers. Reliance Jio is backed by India's richest man, Mukesh Ambani, and offers free voice calls and cut-throat data tariffs. The entry of Reliance Jio forced Idea and the other firms to respond with competitive plans as well.

In Idea's latest quarterly financial report, the company claimed that competitive pressure caused its voice business revenue to decline by 5.3% owing to the fall of realization rate. As these companies try to outdo each other in every aspect, pricing of their services could quickly get into a downward spiral, as each firm hopes to undercut its competitors' prices and consequently capture a huge subscriber base. The resultant overall lower pricing of services, however, only leads to lower total revenue and profitability for all the market players involved. Idea, Reliance Jio and the other market players could all have better outcomes if they did not engage in this price war. But this could be practically hard to avoid as the services offered by these companies are not that differentiated.

The financial impact of tougher competition can be gauged by looking at the profitability metrics of Idea in the latest quarter from July to September (see Table 1). All measures of profitability of the company deteriorated in the latest quarter. Idea also saw its lowest quarterly revenue growth at 7.2 percent YOY, attributed again to the presence of intense competition. Amid a deteriorating financial profile, the RMI-CRI 1-year Probability of Default (PD) for Idea Cellular rose from around 20bps in April 2015 to the highest level in 5 years at 203.8bps (see Figure 1). During the same period, Idea Cellular also saw its market capitalization shrink by approximately 61%.

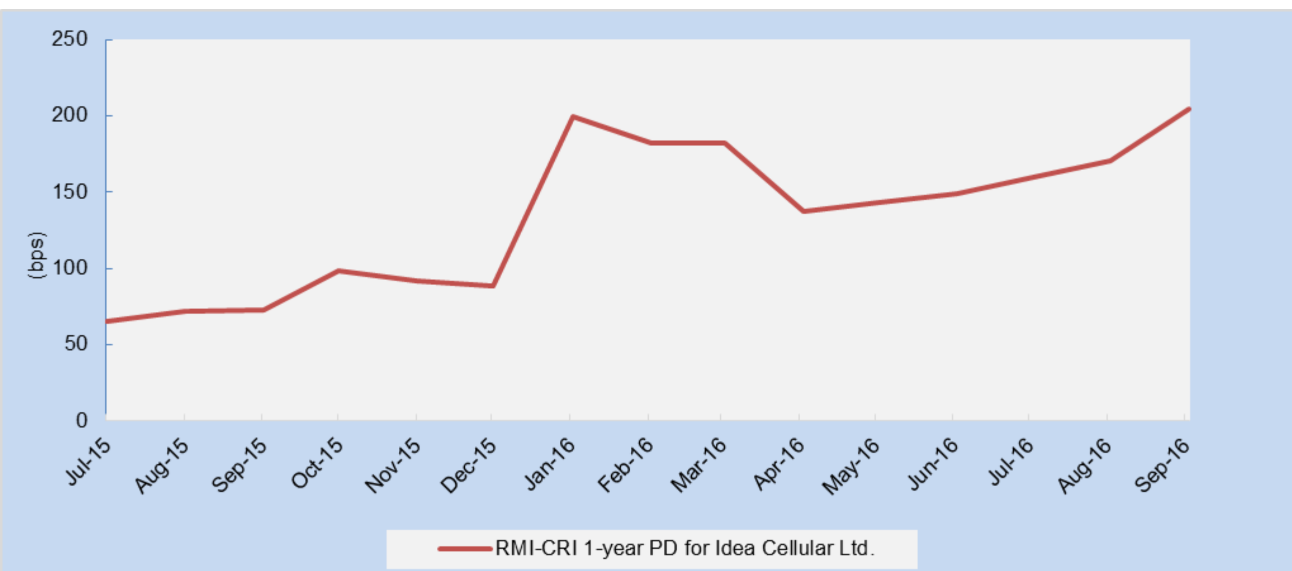

Figure 1: RMI-CRI 1-year PD for Idea Cellular Ltd. *Source: RMI-CRI*

3 months ending	09/30/2015	12/31/2015	03/31/2016	06/30/2016	09/30/2016
Profit Margin (%)	8.79	8.49	6.08	2.32	0.98
Operating Margin (%)	15.62	16.72	17.36	12.18	9.53
Return on Common Equity (%)	14.34	13.87	12.12	9.73	6.83
Net Income (INR mn)	7,622.8	7,642.1	5,756.3	2,204.2	914.6
Operating Income (INR mn)	13,547.7	15,054.0	16,423.3	11,550.7	8,858.2

Table 1: Profitability measures for Idea Cellular Ltd. *Source: Bloomberg*

In the recently concluded auction, Idea and its competitors were reported to be involved in a spectrum acquisition race. According to Moody's Investors Service, the high cost incurred in the spectrum acquisitions is credit negative for Idea Cellular as debt levels of its already stretched balance sheets will climb further. From Table 2, it can be seen that the leverage of the company has significantly increased in the latest financial year. Due to an increase in long-term debt, net debt to EBITDA (Earnings before interest, taxes, depreciation and amortization), a key indicator of balance sheet stress, rose from 1.27X in FY2015 to 3.01X in FY 2016. However, Idea's managing director Himanshu Kapania says the recent spectrum investment will not affect its short-term liquidity as interest payment for the new debt will start only after 2020. To accommodate incremental equipment spending, Idea also stated an upward revision of its capital expenditure from INR 65,000-70,000mn to INR 75,000-80,000mn in the company's latest quarterly financial report.

12 months Ending	03/31/2013	03/31/2014	03/31/2015	03/31/2016
Net debt to EBITDA (x)	2.14	2.43	1.27	3.01
Net debt to shareholders equity (%)	90.02	122.71	59.86	152.73
Total debt to total assets (%)	38.61	44.32	44.42	50.22

Table 2: Leverage ratios for Idea Cellular Ltd. *Source: Bloomberg*

Looking ahead, a difficult business environment is expected for Idea due to stiff competition. However, Idea's managing director is optimistic that growth momentum for data services will accelerate and sees the company's share of revenue from data services doubling to 40 percent over the next five years. In a latest development that could tar Idea's image, the company was alleged to have tried countering competitive pressure by denying adequate interconnection points to Reliance Jio, a violation of quality of services (QoS) under Telecom Regulatory Authority of India (TRAI). Lastly, how well Idea's business will turn out ultimately hinges on the future development of this price war initiated by Rio.

Credit News

Singapore Inc. faces USD 12bn debt scramble

Oct 30. Singapore companies that are exposed to slowing global trade and a downbeat commodity market have seen their debt level fast increase in 2017. More than USD 12bn bonds are approaching maturity and banks have turned cautious about lending to the resources sector, a fact that adds more concerns to Singapore, which has witnessed some high-profile corporate defaults. Reuters' study of 228 non-financial companies' half-year earnings shows that 74 firms had net debt more than five times their core profit, a level that usually prompts concern among credit analysts. (Reuters)

Oil rebound to USD 50 seen too little to ease exporter default risk

Oct 27. The recent strengthening oil prices haven't been enough to reverse a growing risk of government loan defaults faced by oil-exporting countries spanning Latin America and Africa whose economies have been battered by the downturn. Even after almost doubling since a 12-year low of USD 27.10 a barrel in January to above USD 50 recently, Brent crude is well below the record high USD 147.50 reached in 2008. Richer oil exporters such as Norway and Saudi Arabia have turned to their sovereign wealth funds to weather the oil price slump. However, for those countries which do not have sovereign wealth funds to weather the headwinds, the default risk remains. (Business Times)

Ezra bond holders positive on firm's debt restructuring plan

Oct 26. Offshore contractor Ezra Holdings sought leniency from holders of its SGD 150mn notes due in 2018 as it works out a refinancing plan with banks. Ezra Holding's management persuaded bond holders to waive certain financial covenants as well as their right to demand immediate repayment following any events of default arising from Ezra's efforts at debt restructuring. According to Ezra chief executive Lionel Lee, responses at the informal meeting was "calm and positive". Explanations were also given on the company's stance towards waiving certain financial covenants rather than "reset" them, citing the long downturn in the industry with covenants being repeatedly tested despite two consent solicitation exercises over the past year. (Straits Times)

Mozambique approaches creditors over debt restructuring

Oct 25. Mozambique has sought help from international creditors, stating its debt is unsustainable. According to a presentation on Mozambique's finance-ministry website, debt will be more than double Mozambique's gross domestic product this year. Upon Mozambique's disclosure, the International Monetary Fund (IMF) and international donors have taken action with the IMF suspending a bailout approved in 2015 for Mozambique and .international donors such as the UK and EU following suit and suspending their budget-support programs, dealing a blow to the country's finances. (WSJ)

Spain's Abengoa says has creditor support needed to avoid bankruptcy

Oct 25. Based on a preliminary tally, Spanish renewable energy and engineering firm Abengoa stated that it had the support of over 75% of its creditors for a debt restructuring program. Abengoa had been persuading creditors to approve its restructure plans, which would allow new and old lenders to take control of the firm. In the event that that Abengoa's plans does not receive approval from three quarters of its financial creditors, the indebted firm would have to file for Spain's biggest ever bankruptcy.(Reuters)

American Apparel prepares to file for bankruptcy, again (Bloomberg)

Saudis take new steps to ease bank liquidity crunch (Reuters)

ValuePart files for bankruptcy protection (WSJ)

Regulatory Updates

China banks in stand-off with regulators on loan loss provisions

Oct 31. China banks are in a deadlock with regulators over the level of provisions that banks must put aside to protect themselves against non-performing loans. While the regulator requires banks to maintain provisions of at least 150% of NPL, large banks are pressing for more lenient rules. Industrial and Commercial Bank has violated the rule for three quarters and finds it difficult to stay in line with the regulation. The outstanding amount of non-performing loans in China has doubled in the two years before June, hitting RMB 1.4tn. (FT)

BNP's capital relief should be contagious

Oct 28. BNP Paribas expects its main capital requirement to fall from 10% this year to 8% next year. The reduction in capital is attributed to technical changes made by the European regulators on structure capital requirement. The reduction will lower the level where banks are forced to stop paying coupons on their junior convertible bonds as well as dividends and bonuses. The new regulation involves splitting the capital requirement into two parts: a public requirement that banks must always meet and a private one that regulators use to deal with bank-specific risks. BNP's announcement will be likely followed by other banks that have performed well in the stress tests. (WSJ)

BoE seeks details of UK exposure to Deutsche and Italian banks (FT)

UAE President issues bankruptcy law by decree (Gulf Business)

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