CRISIL Ratings

CRISIL Ratings criteria for mobile telephony services

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Executive summary

Mobile telephony services made a modest beginning in India in 1996, and have come a long way since. Administrative allocation of spectrum has been replaced by spectrum auctions. Feature phones have given way to smartphones. Most consumers have leapfrogged from 2G to 4G, significantly changing the mobile phone's end use.

The regulatory landscape has evolved, too, bringing clarity on issues such as spectrum trading/sharing, mergers and acquisitions, and mobile number portability. Entry of a new player with 4G-only offering at lower prices has paved the way for consolidation. A market that once had 9-10 players has now contracted to three private players.

The sector has undergone a raft of changes and the credit risk profiles of operators have fluctuated a lot, necessitating continuous monitoring.

CRISIL Ratings assesses the credit quality of mobile telephone operators by analysing their business and financial risks. When scrutinising business risks, CRISIL Ratings considers factors such as the ability of the operator to improve/maintain revenue as well as subscriber market share, upgrade network infrastructure to withstand competition and adopt new technologies, manage average revenue per user (ARPU), and adapt to the evolving regulatory environment.

When assessing financial risks, CRISIL Ratings considers the present and future financial positions of the operator, financial flexibility to refinance or fund capital expenditure (capex) and the ability of the promoters to infuse funds. The ratings are forward-looking, with special attention on the outlook for such services within the boundaries of regulatory considerations, promoter profiles and the geographical market for mobile telephone operators.

Scope

Though the broader criteria for manufacturing companies[1] applies to entities in the mobile telephony services sector, this note[2] outlines the criteria used by CRISIL Ratings to evaluate and rate mobile telephone operators. CRISIL Ratings gives due importance to both the business and financial risk profiles of operators in its rating process.

The criteria document highlights the parameters that are relevant for assessing the credit profile of issuers within the sector. These parameters serve as illustrative guidelines. The relevance of specific parameters varies based on the issuer's unique circumstances. For instance, if the liquidity of the company is weak, industry risk or other business-related factors may exert minimal influence on the final rating. Likewise, business parameters that hold substantial importance for one issuer may be less pertinent for another, potentially being encompassed within the broader category of industry risk.

[1] The detailed criteria is on the CRISIL Ratings website under the Criteria and Methodology section – 'Rating criteria for manufacturing and services sector companies' and 'CRISIL Ratings approach to financial ratios'
[2] For accessing the previous published document on the ratings criteria for mobile telephony services, kindly follow the link: https://www.crisilratings.com/content/dam/crisil/criteria_methodology/telecommunication-services/archive/CRISIL-Ratings-crieria-mobile-telephony-services_2007-feb2021.pdf

Business risk

While assessing the business risk profiles of mobile telephone operators, CRISIL Ratings first evaluates risk factors that are common to the entire industry and then analyses the specific issues that define an operator's market position. Given that the mobile telephony industry in India continues to evolve, risk factors are many, some of which are important from the credit perspective:

Operating efficiency

Operating costs for telecommunication (telecom) operators include network operating expenses, license fees and spectrum usage charges, marketing expenses, employee benefit expenses and other operating expenses

The network operating expenses, license fees and spectrum usage charges contribute majorly to the cost structure of mobile telephone operators. Network operating expenses primarily comprise costs relating to access charges, including interconnection traffic for calls originating but not terminating on own network and roaming costs relating to services provided by other network operators. Network operating expenses also include site lease, rental, fuel and security costs. The license fees and spectrum usage charges are variable and telecom operators are required to pay revenue share in the form of license fees at 8% of adjusted gross revenue and spectrum usage charges at 3-5% of adjusted gross revenue from the wireless access subscribers. Marketing expenses include costs incurred to acquire and retain customers. These include marketing, advertising, sales commissions and the cost of devices or equipment provided to new subscribers. Marketing and advertising costs may encompass expenses for campaigns across various channels, such as TV, radio, digital and print media. Overall, these costs are essential for telecom operators to attract and retain customers in a competitive market. Because of capital intensity, operating margin needs to be high to earn a reasonable return on capital employed.

Regulatory risk

CRISIL Ratings believes that, like other private sector infrastructure entities in the country, mobile telephony operators have been strongly influenced by the regulations governing their rights and obligations. Changes in regulations and their impact on businesses are duly factored in. Key areas governed by the Department of Telecommunications, in consultation with the Telecom Regulatory Authority of India, are interconnect usage charges, spectrum usage charges, spectrum auctions, mergers and acquisitions, spectrum sharing and trading. Presence of an independent regulator and substantial clearing up of the regulatory landscape augur well for the industry. Regulation has lagged technological change in this sector even in developed countries, and this seems to be the case in India as well.

Technology risk

Mobile telephone technology has rapidly evolved in the recent past. While 3G technology did not find many takers, the introduction of Long-Term Evolution (LTE) or 4G technology at lower cost saw customers leapfrogging a generation from 2G to LTE. However, incumbent operators struggled to keep up with the competition arising from the new technology that had superior features and lower costs, which led to significant consolidation in the industry. The key challenge for an operator, therefore, is the ability to upgrade network to match the features being offered by competitors and remain cost-competitive. Hence, networks with cheaper and easier migration path towards higher versions such as 5G will be at a significant advantage.

Market position

The competitive scenario plays an important role in defining the characteristics of any industry. Thus, entry of new operators, pace of expansion by existing operators, and the consequent impact on tariffs, net subscriber addition share, customer acquisition cost and industry ARPU are factored in while assessing the business risk profiles of mobile telephone operators.

As industry risks are common to all mobile telephone operators, CRISIL Ratings analyses the market position of operators based on the profiles of their service areas, performance track record, subscriber and revenue market share in their areas of operations, and marketing strategies vis-à-vis competitors. An operator's ability to maintain momentum in subscriber additions and garner a higher share of the net subscriber additions reflects its competitive position. Demographic and income profiles of the operational circles are also taken into account as they have a direct impact on the ARPU.

The target consumer mix, divided into prepaid and post-paid customers, is an indicator of the operator's likely average tariff as well as ability to extract more through service differentiation. As prepaid ARPU is lower than post-paid, prepaid customers are more price-sensitive while post-paid customers are service-oriented and stickier. Therefore, a larger share of post-paid customers in the overall subscriber mix is viewed favourably by CRISIL Ratings.

An operator's business risk profile is also influenced by its ability to manage ARPU by having the right post-paid-prepaid mix, 2G-3G-4G mix, as well as ability to charge slightly higher tariffs while maintaining market share on the back of better coverage and service, and superior churn-management strategies. The overall footprint is also considered as larger operators benefit from lower operating cost per subscriber due to economies of scale.

CRISIL Ratings holds the view that the ability of a mobile telephone operator to continuously attract new customers, uptrade existing customers to higher technologies, mitigate subscriber churn through healthy additions, manage ARPU and derive economies of scale from a growing customer base will have a critical impact on its credit quality.

Financial risk

Existing financial risk profile

CRISIL Ratings analyses the capital structure of mobile telephone operators, including equity and debt financing. The proportion of deferred payment liabilities, adjusted gross revenue (AGR) and related liabilities in total debt is also assessed as such liabilities have favourable repayment terms.

Moreover, CRISIL Ratings assesses interest coverage and debt to earnings before interest, tax, depreciation and amortisation (Ebitda) ratios.

Future financial position

CRISIL Ratings analyses projected financials with reference to an operator's plans, funding requirement for expansion of infrastructure as well as for rolling out new technologies, and coverage and profitability ratios.

Cash flow adequacy and financial flexibility

CRISIL Ratings pays special attention to the financial strength of promoters and their ability to infuse need-based funds. In several cases, debt-financing facilities are contingent on specified performance and capital structure requirements and may involve additional equity infusion by the promoters. CRISIL Ratings specifically assesses the ability of the promoters to address all performance and capital structure covenants and maintain a steady drawdown from specified debt facilities. The manner in which a promoter intends to fund initial losses and the contingencies available, in case the gestation period is longer than anticipated, would be a critical consideration.

Funding requirements of group companies and the importance of the mobile telephone venture to the promoters are also evaluated.

CRISIL Ratings also analyses the flexibility of the promoters to defer capex and delay roll-out. This recognises the modular nature of telecom technology, whereby an operator can delay a part of capex in case of resource constraints and limited business opportunities.

Management risk

To analyse the management risk profile of a mobile telecom operator, CRISIL Ratings follows the standard criteria used for all manufacturing companies, which is presented in detail in our publication, ‘Rating criteria for manufacturing and services sector companies’.

Conclusion

CRISIL Ratings believes the credit quality of a mobile telephone operator is determined by its ability to maintain/improve revenue market share and achieve operating efficiency amid competition. The ability to adapt to an ever-changing technological landscape and regulatory overreach are also critical factors. An operator’s existing and future financial positions and financial flexibility also play a role in the rating.

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