Research

CRISIL
An S&P Global Company

Towerco consolidation no offset to margin dial-down

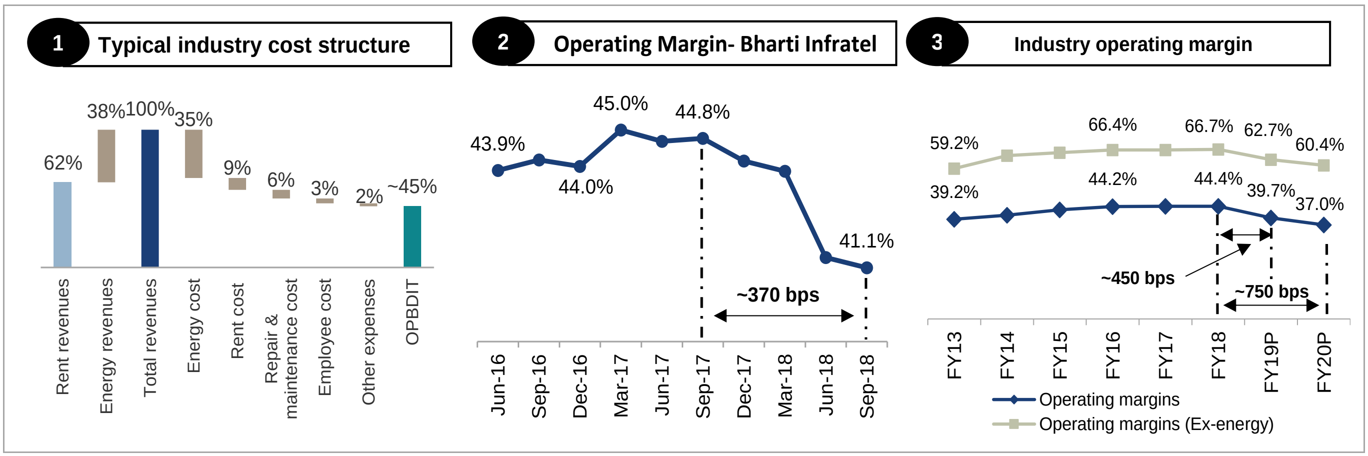
October 2018

Little offset to ~750 bps operating margin fall foreseen for towercos by FY20

The telecom tower business is characterised by high operating leverage, as energy and rentals for sites constitute major cost items (~44% of total revenue). Energy cost, however, doesn't have any substantial impact the margins of tower companies (towercos) as gets completely passed through to telcos.

The sector's overall operating margin was in the 43-44% range in the past four-five years ending March 2018. In fiscal 2018, it remained healthy at ~44%, as rental and energy margins expanded.

Industry margin to attain fiscal 2013 levels this fiscal; diesel prices won't hurt towercos



P: Projected; Note: Industry margins include financials of Bharti Infratel Ltd (Consolidated)
Source: Industry, Company reports, CRISIL Research

In fiscal 2019, CRISIL Research expects operating margins to contract ~450 bps because of:

1. **Co-location exits:** Vodafone Idea is in the process of exiting ~27,500 co-locations (nearly 3% of the industry), and is expected to announce more in the near term. In addition, there will be loss in tenancies of smaller players such as Aircel and Telenor as they, too, hang up.

2. **Decline in rentals per tower:** Industry's rental per tower is expected to decline by 7-9% on-year owing to co-locations exits and lower tenancies. However, increase in number of towers and exit penalties will limit the decline in rent revenues of the industry.

In the first half of fiscal 2019, towercos such as Bharti Infratel have already seen a ~350 bps on-year slide in operating margins. We believe the trend would continue in the second half of the year as well.

In fiscal 2020 as well, operating margins are expected to drop another ~300 bps primarily due to a dip in rentals (expected at ~1-1.5% on-year) and further loss in tenancies of Vodafone-Idea and Bharti-Tata, post-merger.

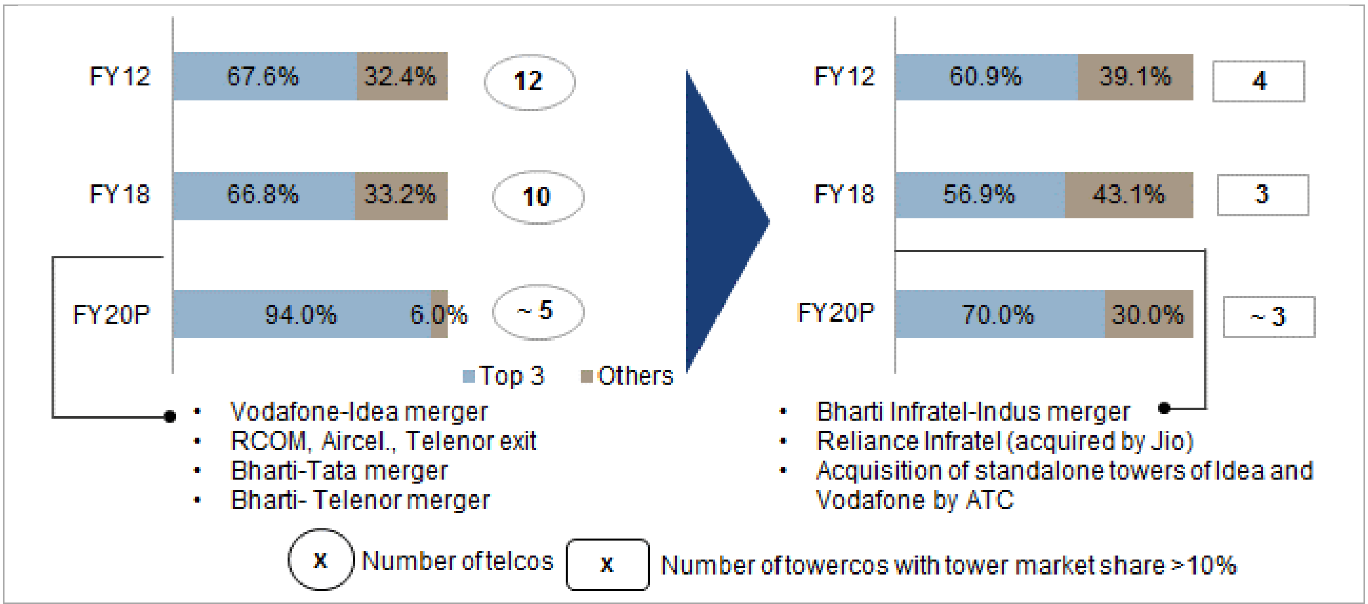
Telecom consolidation- a real threat for towercos

The Indian telecom industry has consolidated into six players and is expected to reduce to four by 2023. The revenue market share (based on gross revenues) of top three players is expected to reach ~94% by fiscal 2020, up from 67% in fiscal 2018 (already at ~90% in the first half of this fiscal).

The ongoing price war in the telecom industry led to stressed financials at telcos and expedited consolidation/exit. Telcos are exercising options such as asset sales. This includes selling their standalone towers or reducing stake in existing tower subsidiaries to pare debt. This in turn is changing tower dynamics.

While Indus Towers retained its leadership position between fiscals 2012 and 2018, ATC India (with the acquisition of Viom Networks in 2015) has now replaced Reliance Infratel at the second slot. The top three towercos' market share has increased ~420 bps over fiscals 2012-2018. However, once Bharti Infratel and Indus Towers merge (expected by 2019), the industry will have three large players controlling a tower market share of over 70% by fiscal 2020. The balance will be shared among smaller towercos and the telcos having captive towers.

Towercos follow telcos in consolidation



P: Projected; Note: The telcos bars represent revenue market share (based on gross revenues) while towercos bars represent tower market share.
Source: TRAI, Company reports, Industry, CRISIL Research

Tower additions may not help because BTS additions would moderate

In India, the number of telecom towers grew by ~15,000 in fiscal 2018 to a total of ~4.63 lakh towers (excluding the telcos' captive towers). It is expected to reach ~4.9 lakh towers by fiscal 2019 amid buyout of standalone towers of Vodafone and Idea by ATC besides construction of new towers. However, after fiscal 2019, net tower addition will be 8,000-10,000 per year over the next four-five years, much lower than past five years.

Most of the towers will be added in rural areas given low tower penetration in these regions. Besides, the rural areas will drive the wireless subscriber growth as wireless tele-density there still lags behind at 58.25% (as of August 2018).

This will also lead to the telcos to add towers in these areas. Player strategy on having captive towers and their investment capability would decide share of standalone towercos in total additions. Currently, about 8-10% of towers are captive in nature. However, baring exceptions, high debt levels may restrict telecom players to set up their own towers.

Further, in the urban areas, right of way issues may limit tower additions. Telcos are expected to focus on deployment of other technologies such as MIMO and small cells, to improve network capacities in order to keep up with surging data usage. Focus on back-haul infra for connecting towers within cities with wirelines will also remain a focus area.

India's tower density is ~15 towers per sq km in metros and ~0.17 (average) for the rest of the circles. In contrast, other emerging countries such as China have ~0.2 towers per sq km. This further revalidates need for tower being set up more in rural areas than in their urban counter parts.

Sharp drop in BTS additions

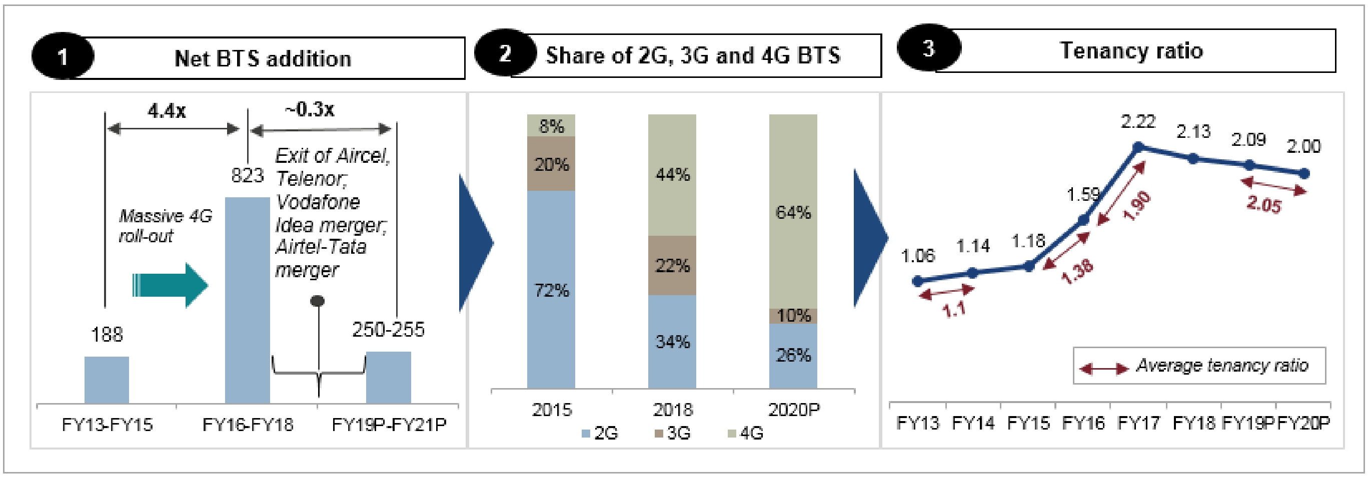
India has ~1.68 million base transceiver stations (BTSs) as of fiscal 2018, an increase of ~8.2 lakh from 2015, led by the massive roll-out of 4G services in the country. Meanwhile, the number of tenants per tower (tenancy ratio) also nearly doubled from 1.2 times in fiscal 2015 to 2.13 in fiscal 2018. However, with the migration of 2G/3G subscribers to 4G, there has been a gradual decline in number of 2G and 3G BTSs. They are either being replaced by 4G BTSs (by existing telecom operator) or completely taken off from the sites (by telcos who have exited the industry). As a result, the aggregate share of 2G and 3G BTSs reduced from ~92% in fiscal 2015 to ~56% in fiscal 2018.

CRISIL Research estimates a net BTS addition of ~2.55 lakh over fiscals 2019-2021, a decline of ~70% over the net additions during fiscals 2016-2018. The slower additions can be attributed to:

- The exit of smaller telcos, whose BTS can now be replaced by existing telcos
- Replacement of existing telcos' 2G/3G BTSs with 4G BTSs as subscriber mix tilt towards 4G
- Exit of redundant overlapping tenancies of the merged entities
- Launch of 5G likely only post 2020 in India

Thus, the tenancy ratio is also expected to decline gradually to ~2.0 and the share of 2G and 3G BTSs (combined) is likely to go down to ~35% by fiscal 2020.

Exit of tenancies (smaller players) leading to decline in BTS net addition resulting in lower tenancies



Net BTS additions are in '000. P: Projected; Source: Industry, CRISIL Research

CRISIL
An S&P Global Company

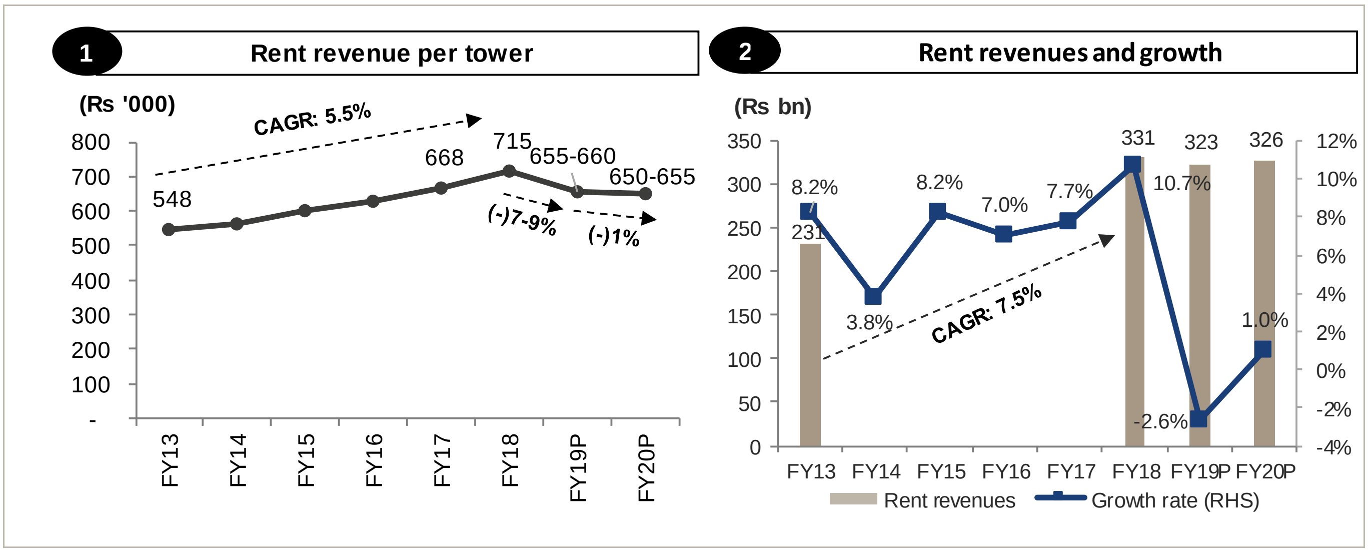
Rentals per tower may continue to dip in the medium term

The rent revenue per tower has grown at a CAGR of ~5.5% between fiscals 2013 and 2018 owing to increase in loading of towers. Over the past three fiscals, majority of the existing towers were loaded for 4G roll-out. Although, the incremental rental per tenant is at a discount of 70-80% of a single tenancy, the increase in number of tenants per tower (as shown in chart above) lead to the growth.

In fiscal 2019, however, rent revenue per tower is estimated to decline 7-9%, owing to loss of tenancies of Vodafone-Idea and other smaller telcos. The towercos will not have bargaining power to levy the forgone opportune rental (from exit of tenancies) on the existing ones as the telcos' financials are already stressed. We believe the trend of Reliance Jio setting up its captive towers would also add to the pressure of telecom tower operators exerting pressure on rental growth.

Additionally, the majority of new tower addition in the industry will be in the rural areas having lower rentals than the urban rental per tower. This structural change in the tower mix will also pull down the rent revenues per tower. However, addition of towers will limit the decline in revenues. Thus, CRISIL Research expects the rent revenues of the industry to decline ~2-3% on-year in fiscal 2019 and remain flattish in fiscal 2020 amid dropping rental per tower.

Exit/consolidation of telcos likely to result in rent revenue loss in FY19



P: Projected; Source: Industry, CRISIL Research

In fiscal 2020, rent revenue is seen staying muted as rentals will continue to decline, though tower additions will support growth. As per industry interactions, the major impact of the Vodafone-Idea co-location losses will be seen in fiscal 2019. However, depending on the timing of contract terminations, exit penalties realised by the towercos and new business from the merged entity, the effect of loss in tenancy may spill over into fiscal 2020 as well.

Right of way, fibreisation continue to be key monitorables

Getting the right of way (RoW) to set up passive infrastructure has been a challenge for the Indian telecom sector participants. Delays as a result of complex procedures across states, non-uniformity in levies, have been major impediments in planning and setting up towers and laying fibre across the country.

Currently, less than 25% of the towers are fibreised in India compared with more than 75% in China and the US. In order to leverage the use cases post deployment of 5G, India needs to have a minimum 70% fibreisation.
Industry interactions suggest even though the average cost for laying intra-city optic fibre is ~Rs 20-25 lakh per km, that quadruples in metros.

While nationwide coverage needs enormous investments by both the government and the private sector, infrastructure sharing will be key to achieving high fibreisation levels and hence remains a key monitorable for future BTS additions amid roll-out of 5G.

Media contacts

Saman Khan
Media Relations
CRISIL Limited
D: +91 22 3342 3895
M: +91 95940 60612
B: +91 22 3342 3000
saman.khan@crisil.com

Hiral Jani Vasani
Media Relations
CRISIL Limited
D: +91 22 3342 5916
M: +91 982003 9681
B: +91 22 3342 3000
hiral.vasani@crisil.com

Parmeshwari Bhumkar
Media Relations
CRISIL Limited
D: +91 22 3342 1812
M: +91 841184 3388
B: +91 22 3342 3000
parmeshwari.bhumkar@ext-crisil.com

About CRISIL Limited

CRISIL is a leading, agile and innovative global analytics company driven by its mission of making markets function better.

It is India's foremost provider of ratings, data, research, analytics and solutions, with a strong track record of growth, culture of innovation and global footprint.

It has delivered independent opinions, actionable insights, and efficient solutions to over 100,000 customers.

It is majority owned by S&P Global Inc, a leading provider of transparent and independent ratings, benchmarks, analytics and data to the capital and commodity markets worldwide.

About CRISIL Research

CRISILL Research is India's largest independent integrated research house. We provide insights, opinion and analysis on the Indian economy, industry, capital markets and companies. We also conduct training programs to financial sector professionals on a wide array of technical issues. We are India's most credible provider of economy and industry research. Our industry research covers 86 sectors and is known for its rich insights and perspectives. Our analysis is supported by inputs from our large network sources, including industry experts, industry associations and trade channels. We play a key role in India's fixed income markets. We are the largest provider of valuation of fixed income securities to the mutual fund, insurance and banking industries in the country. We are also the sole provider of debt and hybrid indices to India's mutual fund and life insurance industries. We pioneered independent equity research in India, and are today the country's largest independent equity research house. Our defining trait is the ability to convert information and data into expert judgments and forecasts with complete objectivity. We leverage our deep understanding of the macro-economy and our extensive sector coverage to provide unique insights on micro-macro and cross-sectoral linkages. Our talent pool comprises economists, sector experts, company analysts and information management specialists.

CRISIL Privacy

CRISIL respects your privacy. We may use your contact information, such as your name, address, and email id to fulfil your request and service your account and to provide you with additional information from CRISIL. For further information on CRISIL's privacy policy please visit www.crisil.com.

Disclaimer

Argentina | China | Hong Kong | **India** | Poland | Singapore | UK | USA | UAE

CRISIL Limited: CRISIL House, Central Avenue, Hiranandani Business Park, Powai, Mumbai – 400076. India

Phone: + 91 22 3342 3000 | Fax: + 91 22 3342 3001 | www.crisil.com

/company/crisil @CRISILLimited /CRISILLimited /user/CRISILLimited Follow us on @lifeatcrisil

CRISIL
An S&P Global Company