ANNEXURE A

Idea Cellular response to the TRAI Pre-Consultation Paper on "Delinking of Licenses for Networks from delivery of services by way of VNOs"

At the outset, we would like to state that Authority has correctly questioned the "very need" of initiating any consultation on this issue.

Briefly stated a new Unified Licensing regime has just been initiated and not fully implemented for all operators due to various issues. Even as operators cope with changes in licensing regime, we are being asked to comment on further disruptive changes within a year of implementation of new policy. We see no rationale in delinking of licenses for networks from delivery of services.

It is even more puzzling that pre-consultation (on reference from DoT) comes at a time when the Regulator has repeatedly highlighted the need for consolidation in the sector. The existing level of competitive intensity and the financial health of telecom sector do not justify any need for introduction for "Virtual Network Operator" (VNO).

Our summary submissions in this regard are as under:

A. Objective

Every policy initiative has an objective. In the case of VNO, there is lack of clarity on the objective. The only objective of a VNO can be to increase competition by bringing in more service providers who do not need to make investments in networks. If this indeed is the objective, then it has to be seen in context of the current state of Indian telecom industry.

1. Too many operators in India

The level of competition is determined by the number of independent service providers who make independent decisions on service offerings and prices in the market. These service providers could either be "Network Operators" or "VNOs". The total number of service providers in India without VNOs is already very high. In India we have 171 service providers in 22 service areas giving an average of 7.8 TSPs in each service area. This is actually as high as 10 TSPs in a circle like Gujarat. Given this level of competition adding any more TSPs would only worsen the industry economics and health.

2. Competition and Financial Health of Operators

As already discussed above India has far too many TSPs than in most other countries The genesis of this problem is the licenses issued in 2008, whereby we saw fly by night operators coming in and either not launching services at all or exiting businesses after incurring huge losses. While such new entrants themselves incurred losses, the presence of so many operators resulted in hyper competition resulting in price cutting and constant deterioration in the financial health of the industry. The voice realized rate (for Idea which is broadly representative of the industry) came down steeply from a level of around 57p/min in 2008-09, which was already at the lowest level globally, to a level of around 35p/min in 2012-13. There has been a minor recovery in 2013-14 to 37 p/min post the cancellation of licenses and the number of operations coming down from 249 circle operations in Dec'11 to 171 circle operations in Mar'13. However, the financial health of the industry is still grave as can be seen from thefollowing data.

I. ROCE

Operator	FY12	FY13	FY14
Idea	5.3%	6.0%	7.2%
Bharti	7.1%	5.7%	6.7%
RCOm*	3.4%	3.8%	5.6%
TTML*	0.1%	-2.4%	-0.1%
MTNL*	-24.6%	-40.5%	-16.5%
BSNL*	-11.9%	-11.1%	DNA
Aircel*	-13.2%	-29.6%	-15.3%
TTSL*	-10.8%	-12.9%	DNA

Source:Annual Report/Calculated based on financial results filed with RoC

$$\text{*ROCE Computation} = \frac{\text{PAT+ Net Interest \& Finance Cost*(1-tax rate for the period)}}{\text{Shareholders' Funds + Net Debt}}$$

DNA = Data Not Available

The following are the takeaways from the above –

a. There are only 3 operators out of those listed above who are making any positive ROCE. All the remaining operators are incurring losses.
b. More importantly, even 3 operators who are earning profits are not able to even recover their cost of capital, with the best ROCE for FY14 being at 7.2%, much below the cost of capital of ~12%.
c. The most telling part is that these operators whose returns are below cost of capital are not new start ups, but are incumbent operators who have operated for 20 years with their licenses coming up for extension. One needs to also recognize that these are the levels of ROCE / Profits before the taking into account the investment to be made for extension of licenses based on market value of spectrum. The ROCE levels would decline further from FY14 levels once investment is made for extension of licenses and spectrum, which would result in significant increase in capital employed to continue the existing business. The recovery of cost of capital is nowhere in sight even after 20 years of operations, even for the market leaders.

If this is the situation of the most efficient players in the industry after 20 years of operation, then this industry can ill afford any further increase in competition through VNOs.

II. Leverage ratios

Operator	Year	Net Debt (RsCrs)	EBITDA (RsCrs)	Net Debt/ EBITDA
Idea	FY14	20,231	8,334	2.43
Bharti	FY14	73,455	27,777	2.64
RCOm	FY14	40,178	7,285	5.52
TTML	FY14	6,520	714	9.14
MTNL	FY14	13,953	-505	*
MTS	FY14	3,614	-745	*
Aircel**	FY14	33,670	926	36.38
Vodafone***	FY13	30,424	8,988	3.38
BSNL**	FY13	3,103	775	4.00
TTSL**	FY13	22,235	-487	*

* implies that as the EBITDA is negative, the Leverage ratio cannot be calculated.
**Based on Financial Results filed with RoC
***Based on Financial Results filed with RoC and Quarterly disclosures

As can be seen the absolute level of leverage in the industry is very high. This will increase further when operators borrow for payment of spectrum to extend their licenses. Given this background the operators will have severe constraints on capital to make investments in networks to fulfill national policy objectives of rural coverage and digital India.

This also impacts the banks and other investors who will have to write off a significant part of these debts. There have already been exits by licensees where banks are saddled with NPAs.

The Authority has himself recognized the need for further consolidation in the industry to make the industry healthier. Consumer interest can hardly be served by increasing competition to a level where the prices are low, but industry players are either loss making or making meager profits not enough to cover even the cost of capital. Hence, any policy initiative to force more competition in the already hyper competitive industry is not desirable and will ultimately harm the consumer interest.

B. <u>The reference to NTP – 2012 – Need for holistic understanding</u>

1. **Relevant clauses -** While the TRAI has highlighted the DoT reference which hinges on the strategies highlighted in NTP 2012, we wish to highlight various other provisions of the very same NTP 2012 as under :

   i) Refer NTP 2012 document – III. **Objectives at sr. nos. 11**

Simplify the licensing framework*to further extend converged high quality services across the nation including rural and remote areas.*

The proposal for introduction of VNO in no way would lead to simplification of licensing regime. In fact it would only lead to complexities in terms of roll-out, security obligations and even AGR assessments.

ii) Refer NTP 2012 document – III. **Objectives at sr. nos. 32**

Evolve a ***policy framework for financing the sector*** consistent with long term sustainability.

With the current financial health of Industry being accentuated by abysmal RoCE figures the VNO proposition talks about additional competition. We fail to understand as to how VNO policy would lead to long term sustainability for telecom operators.

iii) Refer NTP 2012 document – IV. Strategies at sr. nos. 3 – Licensing, sub item 3.9 **Objectives at sr. nos. 32**

To ***frame appropriate Policies*** *for new licensing framework, migration of existing licensees to new framework, exit policy, measures for ensuring adequate competition etc. in consultation with TRAI.*

The Authority has stated at various times that the Industry is in dire need of consolidation and that the level of competition is too intense. In this background we fail to understand as how the introduction of VNO can justified to be a move for ensuring "adequate" competition.

iv) Refer NTP 2012 document – Quote at last page of document.

"*The primary objective of NTP-2012 is* ***maximizing public good by making available affordable, reliable and secure telecommunication and broadband services across the entire country.****The main thrust of the Policy is on the multiplier effect and transformational impact of such services on the overall economy.* ***It recognizes the role of such services in furthering the national development agenda*** *while enhancing equity and inclusiveness"*

The Authority needs to consider as to public good would be maximized with introduction of VNO. The main aim of any new proposed policy change should be to endeavorand ensure sound business viability and sustenance of telecom service providers through introduction of comprehensive and integrated policies that further the cause for affordable services.

This is clearly not in line with the Government's declared intent to "recognized the role of telecom services in furthering the national development agenda".

C. Need for Regulatory "Certainty & Predictability".

As acknowledged by the Authority in its Pre-CP it is necessary that regulatory policies are "predictable" and "stable" in nature. Operators make investments based on predictability of regulatory regime.

The Authority is aware that the new "Unified Licensing regime" has been introduced in September last year. The Authority would also acknowledge that the adopters of said regime are only new operators (renewal or fresh license for a service area). No existing licensee has shown its intent to migrate to Unified Licensingregime and there is no incentive to do so either. Thus operators is sceptical even on the Unified License regime. In such a situation to add layers of complexity and discuss VNO is completely unnecessary. Perhaps a discussion is required on as to how onerous conditions in Unified regime can be worked upon so that operators willingly look towards migrating to Unified License regime.

The Authority has rightly pointed out in its Pre-CP that the interval between the introduction of the Unified Licensing Regime and the proposed change appears to be too short.

D. Proposed Change works at cross purposes toconsolidation in the sector

Adequate competition is critical to the telecom sector's sustenance.The Authority has itself highlighted this as at various occasions. In order to support efficient sharing of infrastructure, government needs to create an environment to facilitate consolidation in telecom sector. A Flexible and realistic M&A policy is necessary and all efforts should be made to facilitate mergers.

It needs to be noted that the proposed VNO concept works is at cross-purposes to consolidation in the sector. If the very basis of consolidation is to provide opportunities for operators to have efficient operations, then the concept of splitting network and services in the licensing regime, adds to further unwanted costs. The government needs to reconsider this concept and the Regulator needs to drive a proper understanding of the unwanted ramifications emerging out of such a proposed step to the Government.

E. Promote efficient competition by ushering TRAI recommendations.

The Authority needs to seriously consider as to how the proposed change will help the state of the telecom market in India– Telecom sector is a core infrastructure that helps all economic and social activities, connects different parts of the society and economy, generates employment and directly contributes to GDP growth - we cannot have a situation where the existing operators are already struggling to make profits or break even and new operators are introduced by way of MVNOs. The Regulatorhas already acknowledged that hyper-Competition has created a significant dent in the profitability of some of the telecom service provider. Thus there exists no business case for allowing standalone VNOs for access services.

Further, the Authority may also take notice of the fact that if more efficient use of resources (active and passive infra) is the intent of the Government for such a move, then the Authority's recommendations on "Spectrum Sharing", "Spectrum Trading", "E-GSM", etc need to be first dealt by it in earnest. Further, in the current scenario, the operators themselves are "spectrum starved" and hence there exists no scope for allowing or sparing infrastructure for new SDOs.

In view of the above, we summarize as follows :

1. The Telecom industry is going through a most difficult phase and the access providers in the Indian telecom sector are already reeling under huge debts and either negative returns or returns significantly below cost of capital for Operators.

2. The viability of business and sustenance of service providers is extremely essential to reap the benefits of any policy statement to end customers/ users. Any further dent on already precarious financial position of industry players would result in lack of funds for investment in roll out of networks.

3. As acknowledged by the Authority itself in its pre-consultation document, the Telecom sector is highly capital intensive where pay-offs take a long time. The Authority will agree that operators have made huge investments over the last few years on setting up networks based on the current licensing regime. All of a sudden, any new regulatory regime cannot be foisted on licensees, when existing investments have not been recovered as yet.

4. The proposal on introduction of VNO seems to be without any clear policy objective. If the only objective of a VNO is to increase competition by bringing in more service providers who do not need to make investments in networks, then the Authority needs to recognize that the total number of service providers in India without VNOs is already very high. Hence, it is quite clear that India already has more TSPs than required for a healthy industry and any more TSPs would only worsen the industry economics and health.

5. The new Unified Licensing Regime needs to be simplified and existing operators need to be incentivized to migrate to the same. The aim of licensing policy has to be to "simplify" the regime rather than complicate things as seems to be the end result of the proposed regime that aims at delinking licenses for networks from the delivery of services through the introduction of VNOs.

6. This in our view, the Authority should focus on ensuring Regulatory certainty and aim for ensuring efficient roll out of networks based on adequate spectrum availability and seek to

pursue implementation of its recommendations on spectrum sharing, trading etc. rather than consider introduction of VNO.

7. As highlighted above, there is absolutely no rationale for introduction of VNO at this stage.

We submit that in the current Indian Telecom context, any new policy intervention should only aim at establishing policies that promote healthy competition, innovation and investment in telecom services and facilities and at the same time remove obsolete barriers of regulation and provide equitable and fair opportunities to all stakeholders and not the other way round as is being proposed herewith.