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Government relief to ensure VIL survival for now…

The Union Cabinet announced the telecom relief package. While most of the relief has prospective impact, the major move was moratorium of four years for telecom dues (AGR and deferred spectrum liabilities) which, in our view, is a key cash flow relief measure for Vodafone Idea (VIL). Furthermore, the option to pay interest through equity to the government and the government option to convert the dues into equity after four years, also ensures survival visibility for VIL beyond four years albeit with massive equity dilution for the existing shareholder.

Key highlights of package

- Extension of the moratorium on spectrum and AGR liabilities by another four years, effective October 2021
- An option for telcos to convert the interest amount accrued during the moratorium period into equity while the government, at the end of the moratorium, has the option to convert dues into equity
- Rationalisation of AGR definition to exclude all non-telecom revenue prospectively
- Extension of spectrum license period to 30 years from 20 years for new licenses and providing an auction calendar with schedule of spectrum auction in the last quarter every year
- Allowing spectrum to be returned after a 10-year lock-in period
- Scrapping SUC on all future spectrum acquisitions and doing away with additional SUC of 0.5% for spectrum sharing
- Allowing 100% FDI through automatic route

VIL to get maximum relief but structural resurgence still away

VIL, which had annual commitment of ~₹ 24000 crore towards spectrum payment and AGR dues, will be the key beneficiary. **While the current rate of EBITDA/capex implies that cash burn will come down to ~₹ 1400 crore, the lagging network spends (its capex is one-fourth of Airtel's India capex) will keep the risk of churn high. Moreover, it would also need immediate fund infusion as it has ~₹ 6000 crore NCD repayment due in the next few months along with bank guarantee renewal of ~₹ 12000 crore**. Importantly, post four years, the payout will balloon to ~₹ 47000 crore annually, if not converted into equity. The conversion of interest and/or overall dues post moratorium period, however, would ensure survival but imply a sharp equity dilution for existing shareholder. **Thus, key monitorable, going ahead, will be timing/quantum of tariff hike and fund raise to meet near term commitments.** The likely improvement in survival possibility of VIL will also improve the overall value visibility for Indus Towers.

Airtel to utilise relief to cut external debt, expedite network investments

Airtel is comfortable in terms of cash flow generation (current ~₹ 18000 crore annualised cash flow is comfortable to meet ~₹ 11000 crore of spectrum and AGR dues annual payouts). The management commentary, however, suggests that the company will opt for moratorium to cut external debt and accelerate network investment. This clearly implies that 5G spectrum and network spends by Airtel will be accelerated and likely in line to keep pace with Jio's spends. **We expect the relative market share gain for Airtel to continue, unless VIL arranges for immediate fund raise and substantial tariff hike decision is made. We also highlight that both Airtel and VIL have been rooting for stepped up tariff hike in near term. However, likely launch of JioPhone next, extended pandemic situation and already available moratorium benefit does push the likely sharp increase in tariff in near term.**

Sector Update

Research Analysts

Bhupendra Tiwary, CFA
bhupendra.tiwary@icicisecurities.com

Exhibit 1: Structural measures and implications

Measures	Impact
1. **Rationalization of Adjusted Gross Revenue:** Non-telecom revenue will be excluded on prospective basis from the definition of AGR.	We see no impact of the same on incumbents except for VIL which still has ~11-12% of non telco revenues in total, implying ~110-120 bps margin benefits. The other incumbents have moved their non-telco business to subsidiaries.
2. **Bank Guarantees (BGs) rationalized**: Huge reduction in BG requirements (80%) against License Fee (LF) and other similar Levies. No requirements for multiple BGs in different Licenced Service Areas (LSAs) regions in the country. Instead, One BG will be enough.	Apart from easing the financing needs of VIL, it will also lead to reduction in bank gurangee charges payout (which is marginal compared to overall interest cost)
3. **Interest rates rationalized/ Penalties removed:** From 1st October, 2021, Delayed payments of License Fee (LF)/Spectrum Usage Charge (SUC) will attract interest rate of SBI's MCLR plus 2% instead of MCLR plus 4%; interest compounded annually instead of monthly; penalty and interest on penalty removed.	Will aid in easing the financing needs.
4. **For Auctions held henceforth, no BGs will be required** to secure instalment payments.	Will aid in easing the financing need for future spectrum needs. Benefits likley to accrue more to Bharti/Jio
5. **Spectrum Tenure:** In future Auctions, tenure of spectrum increased from 20 to 30 years.	Positive, unless there is no pro-rata impact on spectrum pricing. Thus, clarity is needed.
6. **Surrender of spectrum** will be permitted after 10 years for spectrum acquired in the future auctions.	Flexibility to manage capex cycle and upgrade the technological shift
7. **No Spectrum Usage Charge (SUC)** for spectrum acquired in **future spectrum auctions.**	Lowers the levies on revenues generated by newer spectrum, in future
8. Additional SUC of 0.5% for spectrum sharing removed.	While it is to encourage spectrum sharing, sufficient spectrum with limited players implies no major beenfit accruing from this move
9. **100% Foreign Direct Investment (FDI) under automatic rout**e permitted in Telecom Sector	This would reduce the overall time to complete any FDI.

Source: Cabinet Press Briefing and Release, ICICI Direct Research

What's the way ahead for VIL?

Exhibit 2: Moratorium provides massive CF relief for VIL

₹ crore	Pre-moratorium	Post- Moratorium
Annualised EBITDA	5120	5120
Add: incremental cost savings	1200	1200
Less: Int of external borrowing	2340	2340
Less: Interest on bank gurantee & other bank charges	500	400
Less: Spectrum payout	15700	
Less AGR Payout	8400	
Current Capex runrate	5000	5000
Cash Gap	**-25620**	**-1420**

Source: Company, ICICI Direct Research

Exhibit 3: VIL debt breakup

VIL Outstanding debt (₹ crore)	Q4FY21	Q1FY22
Spectrum Debt	96270	106010
AGR Dues	60960	62180
External Debt	23080	23400
Gross Debt	**180310**	**191590**
Net Cash	350	920
Net Debt	**179960**	**190670**

Source: Cabinet Press Briefing, ICICI Direct Research

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Pankaj Pandey | **Head – Research** | **pankaj.pandey@icicisecurities.com**

ICICI Direct Research Desk,
ICICI Securities Limited,
1st Floor, Akruti Trade Centre,
Road No 7, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com

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