

Telecom services IMPACT ANALYSIS

Revision of reserve price for 3G licences

Highlights

- Government revises reserve price upward to Rs 35 billion from Rs 20 billion
- CRISIL Research expects lucrative circles and areas with limited number of slots available for auction to witness aggressive bidding
- At bid value of Rs 68 billion, we expect an operator with 12-15 per cent market share to earn an IRR of 15 per cent from 3G operations

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Revision of reserve price for 3G licences

In December 2008, the Department of Telecommunications (DoT) released the 3G Information Memorandum, which entailed details of the auction. However, owing to differences in opinion within the government on the reserve price and number of slots to be auctioned per circle, the auction was delayed. Subsequently, the government set up an Empowered Group of Ministers (EGoM) to take a final decision on 3G auction.

On August 27, 2009, this EGoM announced the broad details of the planned 3G auction:

- The reserve price has been fixed at Rs 35 billion, 75 per cent higher than the earlier price of Rs 20 billion.
- The number of slots per circle has been restricted to 5 (including those reserved for MTNL/BSNL); however the exact number of slots per circle has not been announced.
- The auction is likely to be held by the end of November 2009.

In this update, CRISIL Research has analysed the business case for 3G services and assessed its impact on various stakeholders i.e. existing wireless operators, customers and the Government of India.

Business case for 3G services

3G licence bid estimated to be 2 times the reserve price

Given the higher revised reserve price and continued uncertainty in the global environment, CRISIL Research expects service providers to place rational bids. However, we maintain our view that lucrative circles and areas with limited number of slots available for auction will continue to witness keen interest. In our base case analysis, we have factored in a bid value of Rs 68 billion for a pan-India 3G licence, which is 2 times the reserve price fixed by the DoT. In addition, for the purpose of sensitivity of the internal rate of return (IRR) to bid value, we have also analysed the impact in the event of operators placing aggressive bids in the range of Rs 85-90 billion.

(Bid values have been arrived at, assuming the number of slots available for auction in each circle are as per the Information memorandum published by DoT in December 2008.)

CRISIL Research's estimate of 3G spectrum bidding value

	No. of circles	Govt's fixed Reserve Price (Rs million)	CRISIL Research's Estimate of multiple	Bidding value (CRISIL Research estimate - Rs million)
Mumbai, Delhi and Circle A	7	3,200	2.3	51,200
Kolkata and Circle B*	8	1,200	1.6	15,000
Circle C*	5	300	1.1	1,620
All India	20	33,500		67,820

Note:

Number of slots available for auction are based on the Information Memorandum published by DoT in December 2008.

* Rajasthan in Category 'B' circles and the north-eastern region in Category 'C' circles have been excluded due to non-availability of spectrum.

Source: CRISIL Research

3G services to earn an IRR of 15 per cent

Our base case analysis, which factors in an estimated bid amount of Rs 68 billion for a pan-India 3G licence, suggests an internal rate of return (IRR) of 15 per cent over a 10-year period for a player with a 12-15 per cent combined (2G+3G) market share. However, if an operator raises significantly higher debt to fund its licence fee and capital expenditure, the IRR would be lower.

In the event of an aggressive bidding scenario, with bid value in the range of Rs 85-90 billion, CRISIL Research expects an operator to earn an IRR of 12 per cent.

Determinants of 3G business case

CRISIL Research believes the following aspects to be the key determinants of the 3G business case:

- Subscriber uptake and increase in ARPU, which would be dependent on services offered
- Ability to attract high-spending subscribers of other operators
- Freeing up of 2G bandwidth, which would enhance the ability of operators to attract more subscribers without significant additional investments
- Strategies (entry, positioning, portfolio) chalked out by vendors in conjunction with service providers to ensure rapid rollout of 3G services
- The final bid amount and the restraint exercised by operators while trying to outbid one another

Impact of 3G spectrum allocation and pricing policy

CRISIL Research believes the policy will have the following impact:

On wireless operators

- Market impact
 - For successful operators, the policy provides an opportunity to earn higher ARPUs by offering differentiated services.
 - Allotment of 3G spectrum will alleviate pressure on 2G spectrum, especially in high traffic areas.
 - With the roll out of 3G services coinciding with the planned implementation of mobile number portability (MNP), operators will have the opportunity to attract high-end customers from other operators. However, only players who are able to demonstrate better quality of service (QoS) and range of content can expect to improve their market share.
 - With 3G penetration initially expected to be low, returns from investments made in 3G networks will take some time.
- Bidding impact
 - Metros like Mumbai and Delhi will witness aggressive bidding with only 4 and 2 slots respectively available for auction. In comparison, there already exist 8 operators in each of the circles.
 - In the event of a bidding war, considering that large existing operators already have the infrastructure in place and recurring cash flow, they might be in a position to outbid potential competitors.

On wireless subscribers

Wireless subscribers will witness an improvement in the quality of service since we believe that initially the 3G spectrum is expected to be used for voice services. Also, services such as video calling, gaming, high-speed Internet access and other data services will increase the range of content made available to consumers. However, in the initial phase, the offtake of 3G services will be limited to high-end subscribers due to the relatively high cost of handsets and pricing of 3G services.

On revenue inflow to the government

The government has stated that it expects to earn at least Rs 250 billion via auction of the 3G spectrum. We expect the bidding to be at multiple times that of the reserve price, considering the limited spectrum being made available.

Conclusion

CRISIL Research believes that there exists a strong business case for 3G services, provided operators are rational while bidding. Even at 2 times the reserve price, a service provider with a 12-15 per cent market share would earn a reasonable IRR of 15 per cent.

Eventually, the subscriber uptake of 3G services in India would depend on:

- The pace at which operators roll out services
- Ability to improve the QoS and the range of value-added services offered
- Pricing of 3G services and handsets
- The availability of relevant content and applications

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