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Bharti Airtel hurt by price war and regulation changes

by Xu Zijun, Lisa

Bharti Airtel Ltd (Airtel), the largest operator in the Indian telecom market that used to generate the most revenue in India telecommunication industry, reported its lowest quarterly consolidated net profit over the least 14 years in the January to March quarter. As of May 18 2018, RMI-CRI 1-year Probability of Default (PD) for Airtel has rose to the highest level in 5 years at 359.96bps (see Figure 1).

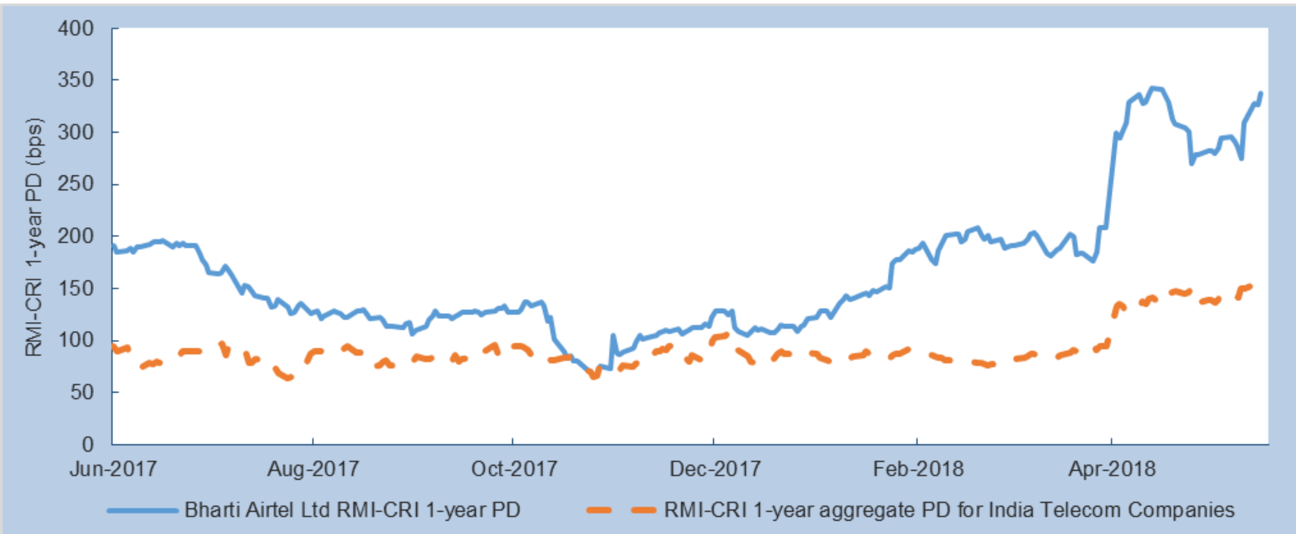

Figure 1: RMI-CRI 1-year PD for Bharti Airtel Ltd and RMI-CRI 1-year aggregate PD for 28 India public telecom companies *Source: RMI-CRI*

On the earnings call made by Airtel on April 25 this year, the company cites the continuing pricing pressure within the India telecommunication industry as one of the main reasons for its decline in profits. The price war is ignited by the entry of Reliance Jio, a private telecommunications company backed by Reliance Industries Ltd which is owned by the richest man in India. Reliance Jio commercially launched its services in September 2016 and quickly captured 13.71% of market share as of the end of 2017 by providing packages with free voice offers and cheap data tariffs. With little differentiation in services and packages offered by competitors, these telecom companies have to match the plan with similar prices to retain their subscribers. Incumbents of the India telecommunication industry saw the average revenue per user (ARPU), a key operational indicator, decrease rapidly. As of the latest quarter Airtel's average ARPU dropped to INR 116, compared to INR 158 a year earlier.

Besides the price pressure, Airtel encountered further setback from regulatory changes. The Telecom Regulatory Authority of India (TRAI) introduced changes to regulations which more than halved the domestic inter-carrier connection (IUC, or mobile termination charge MTC) from mobile to mobile to INR 0.06 per minute from INR 0.14 per minute effective from 1 October, 2017 and reduced the international IUC to INR 0.3 per minute to INR 0.53 per minute effective February 1, 2018. Typically, telecom operators in India do not charge subscribers for incoming calls but instead charge the MTC on the other operator which the call originate from. MTC reductions have hit the revenue of incumbent players in the industry who have more subscribers and calls. However, this reduction in MTC benefited Reliance Jio. As a new entrant in the telecom sector, Reliance Jio offers free voice calls plan to capture market share. The reduction in MTC means that Reliance Jio will now pay much lesser to other operators after the changes given that it has almost 92% of calls outgoing and only 8% is incoming. After the announcement made by TRAI, Airtel criticized the act directly by saying the change would only benefit Reliance Jio alone as it enjoys a huge traffic asymmetry in its favor. According to earning calls form Airtel, the domestic reduction of IUC together with the lower ARPU has led to a 22% decline in India wireless business in the September to December quarter of 2017 and the reduction of international IUC has led to a drop of INR 1235mn in revenue in January to March quarter of 2018.

	06/30/2017	09/30/2017	12/31/2017	03/31/2018
Net Profit (in INR mn)	3673	3430	3058	829
Operating Margin (%)	13.39	14.85	12.95	10.73

Table 1: Profitability measures for Bharti Airtel Ltd. *Source: Bloomberg*

The financial impact of fierce competition of the India telecom sector and IUC cut can by gauged by looking at the profitability metrics of Airtel (see Table 1). A broad deteriorating in profitability measures were captured in the latest quarter compared to previous quarters. In addition to the deteriorating profitability, Airtel bears much higher level debt compare to its peers due to a series of acquisitions, spectrum buying and refinancing activities (see Table 2). As of March 2018, company owes net debt of more than USD 15bn and its leverage ratios stand at a significant higher level. Along with a deteriorating financial profile, the RMI-CRI 1-year PD for Airtel rose sharply to a much higher level compare to the industry, a median of the PDs for 28 India public telecom companies (see Figure 1). Airtel also saw its market capitalization shrink more than USD 10bn from its highest level in 2017 as of May 18 2018.

	Net Debt/EBIT (X)	Net Debt/Shareholders Equity (%)
Median of Indian Telecom Industry	2.67	38.78
Bharti Airtel Ltd	8.96	124.78

Table 2: Leverage ratios for Bharti Airtel Ltd and the median of 28 telecom companies of India. *Source: Bloomberg*

Looking forward, Airtel may see its market share and revenue shrink further as the operating environment stays competitive. The current situation is causing more problems for Airtel as the company also bears high debt. As Figure 2 shows below, the term structure of the RMI-CRI Forward 1-year Probability of Default (Forward PD) for Airtel decreased slightly for the first three months before starting to rise in the coming five-year time. Intuitively, the Forward PD computes the credit risk of the firm on a future period, which works like a forward interest rate. For instance, the 3-month forward 1-Year PD is the probability that the firm defaults during the period from 3 months onwards to 1 year plus 3 months, conditional on the firm surviving the next 3 months. The increasing Forward PD for Airtel suggests, based on market information on May 21, Airtel may see its default risk going higher in the following five years due to the deterioration in profitability and its current high debt level.

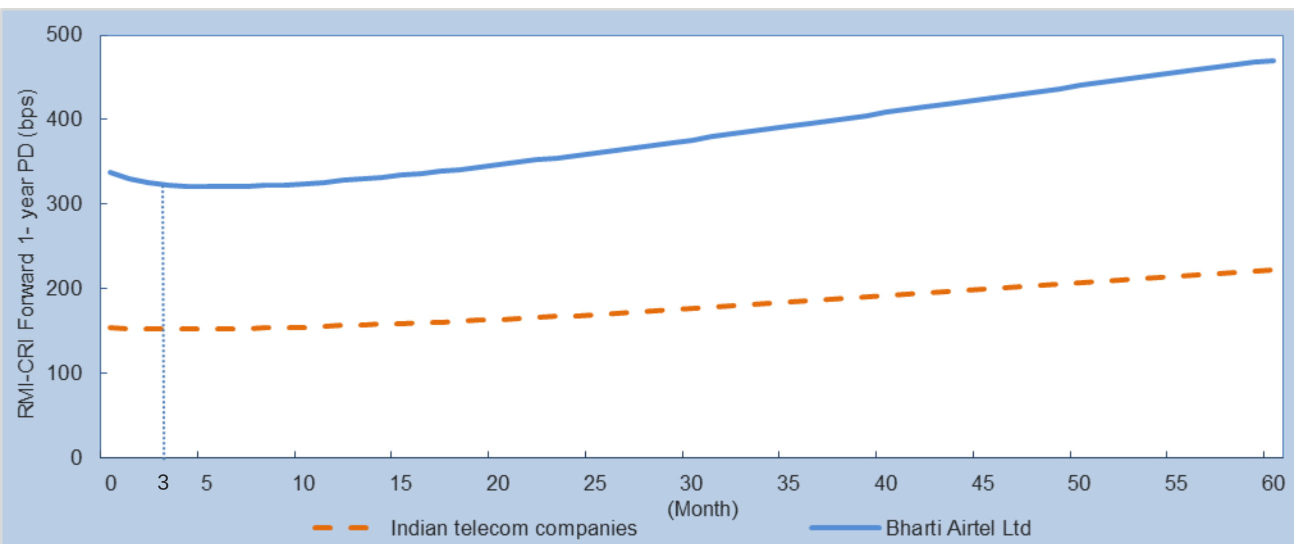

Figure 2: RMI-CRI Forward 1-year PD term structure for Bharti Airtel Ltd and Forward 1-year PD term structure for 28 India public telecom companies on May 21, 2018 *Source: RMI-CRI*

Earlier this year, more aggressive offers from the telecom operators intensified the competition. Reliance Jio started to offer more data for existing customers at the same price, followed by a new prepaid offer at a 50% discount rate compared to other operators with similar package. In response, Airtel also launched [a new plan with more data offering](). [According to Jefferies](), a global investment banking firm, the discount offer would hurt the ARPU for other telecom operators further, as other competitors match the price to maintain its subscriber base. Facing stiff competition, Airtel needs to find a solution to survive this price war in order to maintain its market share in India and it might be even tougher to do so due to its high debt.

Credit News

Loan funds attract new money as interest rates rise

May 18. Investors are putting more money into bank loan funds as rising interest rates increased the lure of floating-rate assets over traditional bonds. A net inflows of USD 925mn, the largest over the past 55 weeks, had been injected into loan funds. This is in line with expectations of Federal Reserve rate hikes as the benchmark 10-year Treasury hit a seven-year high above 3%. Loans which typically pay a floating rate increases along with underlying rates. Bank loans also tend to be senior to other forms of borrowing thus putting them higher in the order of payments if a company defaults. However, concerns are building as the value of the US leveraged loan market passed the USD 1tn mark and lending standards can deteriorate when demand for loans is strong. There may also be fewer investor protection with the increase of covenant-lite loans. (FT)

India's bad-loan levels have peaked, says SBI chairman

May 18. According to the head of State Bank of India, the recognition of bad loans is effectively complete and the rise in the sector's bad loan ratios has come to an end as it reached USD 130bn at the end of March 2018. The Reserve Bank of India's new rules stipulate that if a debt goes unserviced for 180 days, lenders must take action under India's new bankruptcy code, forcing the sale or liquidation of the company. The new rules left little scope for any defaulters to hide anymore. Important lessons had also been learned from the surge in non-performing loans in sectors such as steel and infrastructure. In particular, banks now insist controlling shareholders put substantial equity in new projects rather than depending excessively on bank credit. (FT)

China sees rise in mainland companies defaulting on bonds

May 18. As authorities clamp down on excessive borrowing and the murky shadow banking sector, there is a rise in Chinese mainland companies defaulting on their bonds. According to Standard Chartered, the value of defaults marks a 32% increase year on year and more defaults might come from the private sector. Most of these privately owned companies aggressively increased leverage during the credit cycle boom in 2015-16 via bond and shadow-banking funding. In recent years, the Chinese government's campaign to restrain debt growth and curb financial risk has created re-financing difficulties for weaker borrowers. With increasing concern about credit risk, the spread between Chinese government bonds and low-rated notes is close to a two-year high. (FT)

China builder plans rare floating-rate bond in shaky market

May 17. China Vanke is issuing a five year floating bond at 155bps over the three month Libor rate in a rising interest rate environment. Chinese developers have sold USD 22.3bn of bonds in 2018, 96 percent more from the level a year ago and issuers may not have many funding options. Onshore borrowing costs have increased as the government has embarked on a campaign to curb financial leverage. Other developers like China Overseas Grand Ocean Group have postponed their bond offerings due to unfavorable market conditions. (Bloomberg)

Hot US housing bonds are getting riskier

May 16. Investors are piling into credit risk transfer securities (CRT), or bonds linked to risky mortgages that do not have government guarantees but meet the minimum standards from Fannie Mae or Freddie Mac. Demand for CRT bonds have grown as investors are betting that the housing market stays strong, borrowers continue making their home loan payments and the high value of collateral for the mortgages limit losses for lenders. However, critics say that that the CRT market could result in another financial crisis, an outcome similar to the failure of the toxic mortgages market that brought down the financial system in the last decade. (Bloomberg)

Fitch says EM is vulnerable as debt balloons to USD 19tn (Bloomberg)

India's Reliance Communications to face bankruptcy proceedings (FT)

China to encourage equity financing to ease debt reliance: report (Reuters)

Regulatory Updates

Brussels to unveil 'safe-asset' plan for pooled bonds

May 21. The European Commission is to unveil plans this week to create sovereign bond-backed securities (SBBS) by bundling bonds issued by different member states. The European Commission hopes that SBBS will help diversify away Eurozone banks' portfolio from bonds sold by their home governments. This is part of the commission's attempt to deepen financial integration in the Eurozone. However, the plan faces resistance from richer states led by Germany, which have long been wary of any attempts to create Eurobonds to mutualize government borrowing across the 19 Eurozone countries. While SBBS would not require governments to pool borrowing, countries including Germany, the Netherlands, Austria, and Finland dread that they would end up supporting more indebted countries, such as Portugal and Italy. (FT)

SEBI proposes uniform pricing for debt securities

May 17. The Securities and Exchange Board of India (SEBI) has proposed a uniform methodology to determine pricing of non-traded and thinly traded non-convertible debt securities. The current practice of pricing of corporate bonds varies for different classes of regulated entities and impacts trading in the secondary market. It has been recommended that a uniform pricing methodology is set such that it provides pricing on a daily basis and be followed by all regulated entities. The pricing agency would be set up and be regulated by either SEBI or the RBI. (The Economic Times)

China says opening up of financial sector will need reciprocity (Reuters)

Fed to resist adding capital demand for biggest banks (Bloomberg)

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Contributing Editor: Liu Hanlei