

Telecom

Reduction in termination charges to hit incumbents

We attempt to build a scenario in which we try to assess the impact of reduction in the mobile termination charges (MTC) on Bharti Airtel. Bharti Airtel is an indicative example. Negative impact of reduced MTC will be seen on all the big operators. Key assumptions are:

- Local price-usage elasticity of 0.5x and STD price-usage elasticity of 0.2x.
- The entire impact of reduction in termination charges is reflected in the tariffs, in terms of reduced off-net local and STD call rates.
- Minutes of usage (MOU) break-up (local versus STD, on-net versus off-net, etc.) is taken from TRAI's quarterly performance indicator report for 2QFY09.

Scenario

(%)	MTC= Re 0.30	MTC=Re 0.25	MTC=Re 0.20	MTC=Re 0.15	MTC=Re 0.10	MTC=Re 0.05	MTC= Re 0.00
ARPU (Rs)	324	319	312	304	294	283	271
Deviation from present case		(1.7)	(3.8)	(6.3)	(9.2)	(12.5)	(16.3)
MOU (min)	505	522	539	556	573	590	607
Deviation from present case		3.3	6.7	10.1	13.5	16.9	20.2
ARPM (Rs/min)	0.64	0.61	0.58	0.55	0.51	0.48	0.45
Deviation from present case		(4.8)	(9.8)	(14.8)	(19.9)	(25.1)	(30.4)

B&K's view

- With the focus on increasing penetration (read rural penetration) by reducing tariffs, we expect the Government to reduce the MTC. The fact that majority of the Government's policy initiatives in the last two years have favoured new players also supports our view.
- Any reduction in MTC will be negative for large GSM operators (Bharti Airtel, Idea Cellular, Vodafone Essar and RCOM's CDMA operations), as they are net receivers of termination charges on account of their high subscriber base. On the other hand, any reduction in MTC benefits new operators (including RCOM's recently launched GSM operation).
- We understand that the issue of reduction in MTC is in the consulting stage and it will be sometime (at least three months) before we see the actual implementation. However, at this point, we want to stress on the fact that there is a high likelihood that MTC will be reduced in due time. We expect TRAI to release a recommendation paper in the near future.
- Reduction in MTC will also have a negative impact on the ARPUs of incremental subscribers (mostly rural). As per our estimates, termination ARPU contributes ~12% to Bharti's overall ARPU; however, this figure can go up to 33% for rural subscribers (source: Cellular Operators Association of India's presentation submitted to TRAI, on 25 February 2009).
- We will wait for further clarity (TRAI's recommendation paper to the Government) before we change our estimates. Bharti Airtel remains our top pick in the Indian telecom space.

What is MTC?

MTC is what an operator charges to another operator for allowing the call from latter's network to terminate on its own network. Currently, MTC is fixed at Re 0.30 per minute.

Understanding the assumptions

- **Price-usage elasticity assumptions:** Elasticity in STD space is lower compared to that for local usage (Source: Bharti Airtel 2QFY09 earnings call). We have taken a local elasticity of 0.5x and STD elasticity of 0.2x. For example, if termination charge drops by 20%, local off-net usage will increase by 10% ($20\% * 0.5$).
- **Increase in off-net MOUs:** We expect the entire impact of reduction in MTC to be reflected in reduced off-net tariffs (local and STD). We do not change the tariff estimates for on-net calls (local and STD). Reduction in tariffs will result in increased off-net MOUs (local and STD), as per the elasticity discussed above.
- **MOU break-up:** Minutes of usage break-up (local versus STD, on-net versus off-net, etc.) is taken from TRAI's quarterly performance indicator report for 2QFY09.

Tariff assumptions for base-case

Local, on-net	Re 0.3 per minute
Local, off-net	Re 0.8 per minute
STD, on-net	Re 1 per minute
STD, off-net	Rs 1.5 per minute

MOU details

I/c MOU, as % of total MOU (%)	51.50
Off-net i/c MOU, as % of i/c MOU (B&K assumption) (%)	60
O/g MOU, as % of total MOU (%)	48.50
Local o/g MOU, as % of o/g MOU (%)	85.90
Local o/g on-net MOU, as % of local o/g MOU (%)	57
STD o/g MOU, as % of o/g MOU (%)	13.60
STD o/g on-net MOU, as % of STD o/g MOU (%)	31
ILD o/g MOU, as % of o/g MOU (%)	0.50

- We maintain i/c to o/g MOU ratio even after the reduction in MTC.
- We also maintain our assumption of 60%, for off-net i/c MOU, as % of i/c MOU.
- ARPU from call charges is maintained at 59%.

Impact of reduced MTC on tariff

	Assumptions	Base case	ARPM@ Re 0.25/ min	ARPM@ Re 0.20/ min	ARPM@ Re 0.15/ min	ARPM@ Re 0.10/ min	ARPM@ Re 0.05/ min	ARPM@ Re 0.00/ min
Termination charges (Rs/min)		0.30	0.25	0.20	0.15	0.10	0.05	-
Change from base case (%)			(16.7)	(33.3)	(50.0)	(66.7)	(83.3)	(100.0)
Elasticity-local (x)	0.5							
Elasticity-STD (x)	0.2							
Increase in local off-net minutes (%)		-	8.3	16.7	25.0	33.3	41.7	50.0
Increase in STD off-net minutes (%)		-	3.3	6.7	10.0	13.3	16.7	20.0
Local off-net tariffs (Rs/min)		0.80	0.75	0.70	0.65	0.60	0.55	0.50
STD off-net tariffs (Rs/min)		1.50	1.45	1.40	1.35	1.30	1.25	1.20
MOU (min)	3QFY09	505	522	539	556	573	590	607
I/c MOU (min)	52% of total MOU (Source: TRAI)	260	269	277	286	295	304	313
I/c Off-net MOU (min)	60% of i/c MOU (Source: TRAI)	156	161	166	172	177	182	188
Termination ARPU (Rs)		47	40	33	26	18	9	-
O/g MOU (min)		245	253	261	270	278	286	295
Local o/g MOU (min)	85.9% of o/g MOU (Source: TRAI)	210	218	226	233	241	248	256
Local o/g on-net MOU (min)	57% of local o/g MOU (Source: TRAI)	120	120	120	120	120	120	120
Local o/g on-net ARPU (Rs)	Tariff of Re 0.3 per min (B&K assumption)	36	36	36	36	36	36	36
Local o/g off-net MOU (min)		90	98	106	113	121	128	136
Local o/g off-net ARPU (Rs)	Tariff assumptions mentioned above	72	74	74	74	72	71	68
STD o/g MOU (min)	13.6% of o/g MOU (Source:TRAI)	33	34	35	36	36	37	38
STD o/g on-net MOU (min)	31% of STD o/g MOU	10	10	10	10	10	10	10
STD o/g on-net ARPU (Rs)	Tariff of Re 1 per min (B&K assumption)	10	10	10	10	10	10	10
STD o/g off-net MOU (min)		23	24	24	25	26	27	27
STD o/g off-net ARPU (Rs)	Tariff assumptions mentioned above	34	34	34	34	34	33	33
ILD o/g MOU (min)	0.51% of o/g MOU (source: TRAI)	1	1	1	1	1	1	1
ILD o/g ARPU (Rs)	Tariff of Rs 7 per min (B&K assumption)	9	9	9	9	9	9	9
ARPU from call charges (Rs)		209	203	196	188	179	168	156
as % of overall ARPU	As per TRAI, for GSM players, this figure is 59%	64.4	63.8	63.0	62.0	60.8	59.3	57.5
ARPU from rentals, roaming, SMS and others (Rs)		115	115	115	115	115	115	115
as % of overall ARPU		35.6	36.2	37.0	38.0	39.2	40.7	42.5
ARPU (Rs)	3QFY09	324	319	312	304	294	283	271
ARPM (Rs/min)	ARPU/MOU	0.64	0.61	0.58	0.55	0.51	0.48	0.45

Key points from presentations submitted by various operators to TRAI Bharti Airtel, Idea Cellular, Vodafone Essar and Aircel (25 February 2009)

- MTR should be maintained at the current level, Re 0.30 per minute.
- The current ceiling of carriage charge (Re 0.65 per minute) should be maintained.
- Any further reduction in MTC will hamper the rural penetration.
- Long run incremental cost (LRIC) based model suggests MTC charges to be around Re 0.35 per minute in India.
- MTC should be increased for incoming ILD calls. MTC in other countries is 10-13 times higher than what it is in India. Telecom operators in India are net out-payers of termination charges, even when India, as a country, is net importer of ILD minutes with incoming to outgoing ratio for ILD minutes at 3:1.

Reliance Communications (18 February 2009)

- High MTC is anti-customer in post MNP regime. Subsidy through MTC for improving coverage is no longer valid now.
- Methods to determine MTC:
 - o Cost based: relevant with low competition and fewer technology options
 - Symmetric: at floor LRIC level: Re 0.08/min
 - Asymmetric: LRIC implied MTC
 - Incumbents: Re 0.22/min
 - New operators: Re 0.08/min
 - o Non-cost based: Bill & Keep
- Low MTC charges will bridge the digital divide between urban and rural subscribers. Even low income group subscribers will make outgoing calls.

Datacom, Loop, Swan and Unitech (20 February 2009)

- Reduce termination charges. Higher the termination charge, higher will be the retail tariffs and therefore, anti-customer.
- Introduce Asymmetrical termination charges; higher for incumbents and lower for new players to create a level playing field.
- Regulate SMS termination to Book & Keep model, which is without any charges.
- Lower the ceiling of carriage charges. Current carriage charges on high traffic routes are in the range of Re 0.35-0.40 per minute; however, incumbents are demanding Re 0.65 per min from new operators.

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