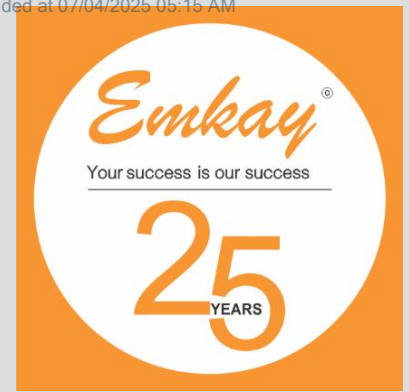


Telecommunications

Refer to important disclosures at the end of this report

Bharti to emerge stronger, VIL's outlook remains hazy

We appreciate your support in the [Asiamoney Brokers Poll 2020](#)

- **Development in Supreme Court:** Despite the telecom operators' inability to furnish bank guarantees, the judges seemed relatively positive about permitting staggered payment of AGR dues, subject to a down-payment of a "reasonable" amount. The companies have offered bank guarantees lying with DoT as security to the court. Staggered payment option seems to be getting acceptance while timeline around the same, bank guarantees, quantum of upfront payment still lack clarity.
- **Scenario analysis:** We have modeled various timelines, namely 20, 15 and 10 years, along with potential cash generation during the same period to assess the financial impact. In almost all situations, VIL is set to lose (Exhibit 2), given the heightened annual AGR payments accompanied by Rs168bn of annual deferred spectrum obligations that kick in from FY23. On the other hand, Bharti remains in a relatively comfortable position (Exhibit 1), having already coughed up Rs180bn toward AGR dues and spectrum payout being relatively lower at Rs76bn. For VIL, our scenarios do not take into account proceeds from the potential Indus stake sale and GST refund. Any positive news for VIL would be a benefit for Bharti as well, given the heightened payment already made by the latter (41% of total dues) and could potentially lead to deferment of annual installments (Exhibit 10).
- **Tariff hike and ARPU accretion:** We have already assumed another round of tariff hike in FY21. Tariff hike conversion in revenue growth is vital and till now, Bharti has delivered a strong conversion rate. While we are yet to see the flow-through of the Dec'19 hike for VIL, we are expecting it to be lower than Bharti. In order to fund AGR penalty and cash loss, VIL requires higher tariff hike, which we believe would happen over a period of time. It is important to note that voice subscribers make up 48% of Bharti's total base and 51% for VIL. Therefore, a price hike of over 25% over the span of 12 months could lead to accelerated SIM consolidation, in our view.
- Moreover, network quality will continue to play a crucial role in subscriber churn. Therefore, any restraint on capex with a view to control cash outgo at the hands of VIL, would lead to an adverse impact on the already shrinking subscriber base. Hence, VIL and Bharti will have to renew the spectrum in few circles in upcoming auctions, which would have some immediate pay-out as well.
- **Gap funding to meet AGR dues:** In our view, equity infusion by promoters or a strategic investor along with any potential surrender of unused spectrum to reduce future liability seems to be the only route to ensure survival for VIL, even after a tariff hike. It could be challenging to obtain a strategic investment, even after clarity on AGR overhang, due to continued market share and sustained cash loss. Regardless, a sizeable investment could lead to extensive dilution of equity. Bharti is in a relatively more comfortable position with recently completed \$3bn fund raise and potential FCF generation.
- **Bharti remains our top pick:** Better subscriber mix, gain in the postpaid segment, clear flow-through of tariff hikes, strengthening balance sheet and reducing net debt-to-EBITDA (3.2x vs. 4.3x in FY19) are some of the reasons for Bharti being our top pick in the sector.
- **Outlook:** It will be tough for VIL to provide upfront payment of 41% (similar to Bharti), in our opinion. Additionally, significant equity dilution to fund survival would not be providing any growth opportunity going forward. **Clarity on VIL's financial position and Indus merger would lead to a reasonable upside in Bharti Infratel and the stock could go back to pre-AGR verdict levels of Rs270-280. Additionally, we also await clarity on the exact AGR dues as the same has been revised multiple times since the original court verdict.**

Please see our sector model portfolio (Emkay Alpha Portfolio): [Telecommunications \(Page 9\)](#)

Bharti Airtel		BUY
CMP	Target Price	
571	684	

Bharti Infratel		SELL
CMP	Target Price	
219	145	

This report is solely produced by Emkay Global. The following person(s) are responsible for the production of the recommendation:

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Story in charts

Exhibit 1: Scenario analysis for Bharti: Better position to pay AGR dues in almost every scenario

Particulars (Rs mn)	Present	Assuming 20-year AGR penalty			Assuming 15-year AGR penalty			Assuming 10-year AGR penalty		
	FY20	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
ARPU (Rs)	135	169	184	198	169	184	198	169	184	198
Revenue	8,75,391	10,38,566	11,23,489	12,10,334	10,38,566	11,23,489	12,10,334	10,38,566	11,23,489	12,10,334
Reported EBITDA	3,66,096	4,63,642	5,44,309	5,95,300	4,63,642	5,44,309	5,95,300	4,63,642	5,44,309	5,95,300
IND-AS	60,492	60,492	60,492	60,492	60,492	60,492	60,492	60,492	60,492	60,492
EBITDA adjusted for IND-AS	3,05,604	4,03,150	4,83,817	5,34,808	4,03,150	4,83,817	5,34,808	4,03,150	4,83,817	5,34,808
Capex	2,40,720	2,25,720	2,25,720	2,05,720	2,25,720	2,25,720	2,05,720	2,25,720	2,25,720	2,05,720
Interest	1,23,820	1,04,766	92,370	78,024	1,04,766	92,370	78,024	1,04,766	92,370	78,024
Interest (excl. spectrum debt)		81,359	81,359	81,359	81,359	81,359	81,359	81,359	81,359	81,359
Interest (adj for IND-AS)	1,03,924									
Cash generated	-39,040	96,071	1,76,738	2,47,729	96,071	1,76,738	2,47,729	96,071	1,76,738	2,47,729
Deferred spectrum payout	58,162			75,867			75,867			75,867
AGR	1,80,040	27,515	27,515	27,515	31,562	31,562	31,562	40,260	40,260	40,260
Cash generated post payout	-2,77,242	68,555	1,49,222	1,44,346	64,509	1,45,176	1,40,300	55,810	1,36,477	1,31,602

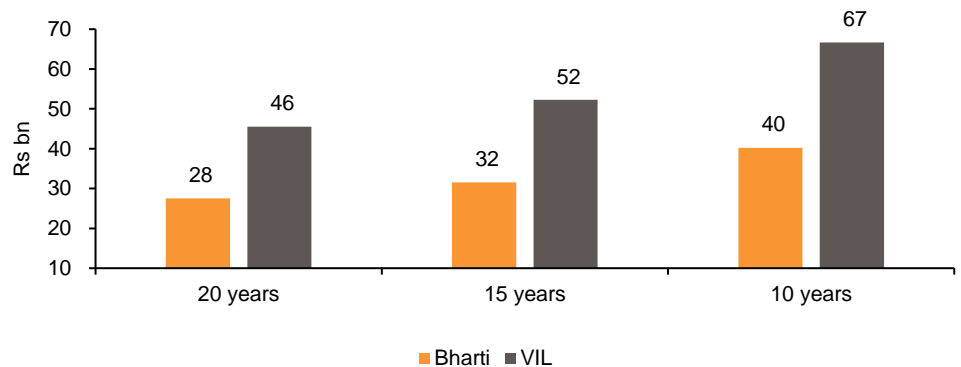
Source: Company, DoT, Emkay Research

Exhibit 2: Scenario analysis for Vodafone Idea: Losing cash in every scenario

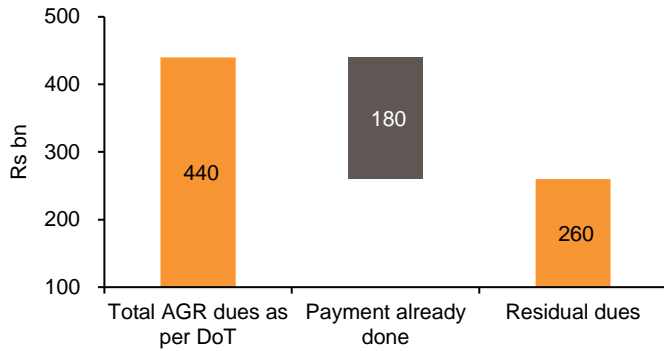
Particulars (Rs mn)	Present	Assuming 20-year AGR penalty			Assuming 15-year AGR penalty			Assuming 10-year AGR penalty		
	FY20E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
ARPU	110	131	148	169	131	148	169	131	148	169
Revenue	4,49,905	4,91,370	5,42,195	6,14,273	4,91,370	5,42,195	6,14,273	4,91,370	5,42,195	6,14,273
Reported EBITDA	1,43,439	1,88,779	2,45,366	2,94,124	1,88,779	2,45,366	2,94,124	1,88,779	2,45,366	2,94,124
IND-AS	96,400	96,400	96,400	96,400	96,400	96,400	96,400	96,400	96,400	96,400
EBITDA adjusted for IND-AS	47,039	92,379	1,48,966	1,97,724	92,379	1,48,966	1,97,724	92,379	1,48,966	1,97,724
Capex	1,33,934	1,31,934	83,934	83,934	1,31,934	83,934	83,934	1,31,934	83,934	83,934
Interest	1,39,869	1,34,829	1,27,373	1,12,351	1,34,829	1,27,373	1,12,351	1,34,829	1,27,373	1,12,351
Interest (excl. spectrum debt)		30,052	30,052	30,052	30,052	30,052	30,052	30,052	30,052	30,052
Interest (adj for IND-AS)	29,200									
Cash generated	-1,16,095	-69,607	34,980	83,738	-69,607	34,980	83,738	-69,607	34,980	83,738
Deferred spectrum payout	1,28,103			1,67,975			1,67,975			1,67,975
AGR	68,540	45,548	45,548	45,548	52,246	52,246	52,246	66,646	66,646	66,646
Cash generated post payout	-3,12,738	-1,15,155	-10,569	-1,29,785	-1,21,853	-17,266	-1,36,483	-1,36,253	-31,666	-1,50,883

Source: Company, DoT, Emkay Research

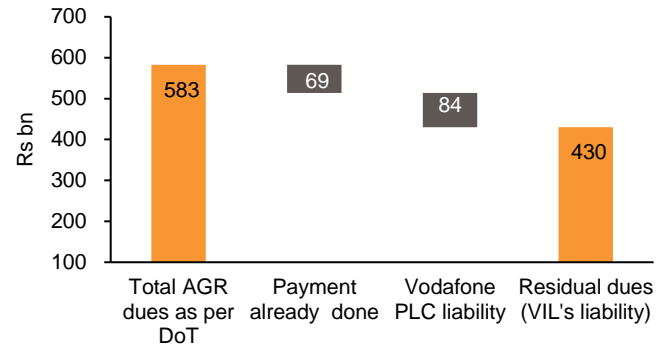
Exhibit 3: Annual AGR pay-out under different durations. It will be a challenging task for VIL to pay dues in any of the scenario



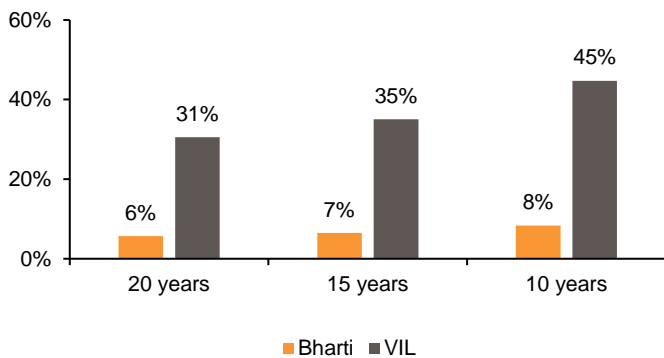
Source: Company, Emkay Research

Exhibit 4: Bharti's outstanding payment that is used for calculating annual instalments

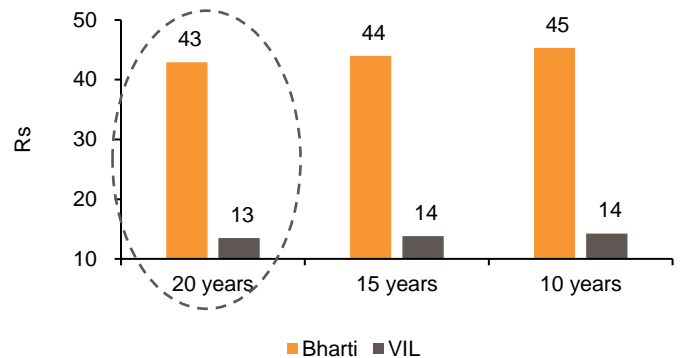
Source: Company, DoT, Emkay Research

Exhibit 5: VIL's instalments are calculated after accounting for payment from PLC and principal amount already paid

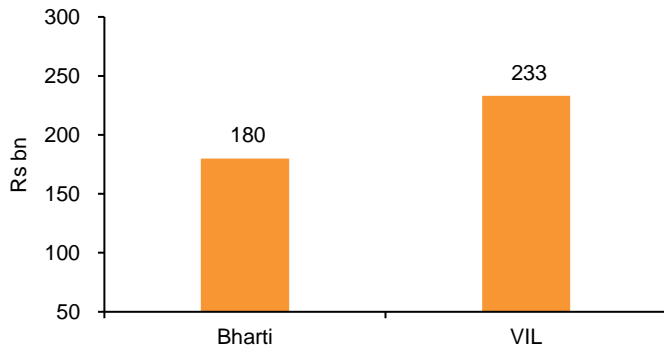
Source: Company, DoT, Emkay Research

Exhibit 6: Annual AGR pay-out as % of FY22E EBITDA (adj. for IND AS 116) – Bharti is better placed

Source: Company, Emkay Research

Exhibit 7: NPV per share for pay-out of AGR penalty under various scenarios

Source: Company, Emkay Research, Circled is the base case in our assumptions

Exhibit 8: Upfront payment to be made by VIL, not accounting for amount already paid, to match Bharti's current payment (41%)

Source: Company, DoT, Emkay Research

Exhibit 9: Annual AGR pay-out over different scenarios, post upfront payment of 41% by both the operators

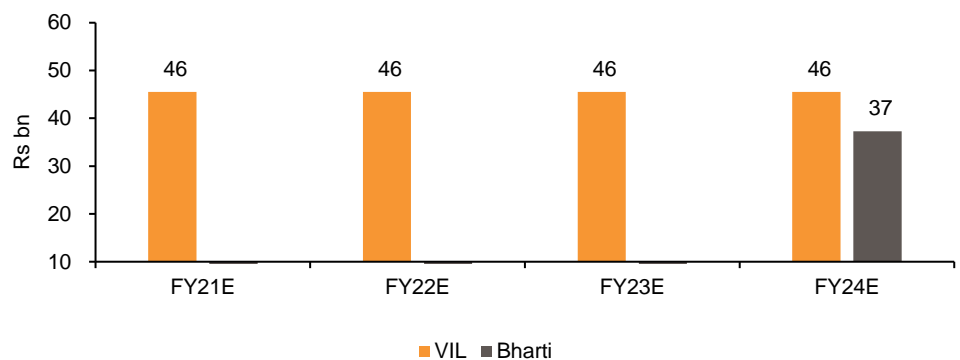
Source: Company, Emkay Research

VIL's limited ability to provide additional down-payment could benefit Bharti's cash flow in near term

Given the stretched balance sheet of VIL, there is a possibility that the company may not be able to make an upfront payment equivalent of Bharti (41% of total AGR dues), as the same amounts to Rs170bn, after accounting for the principal amount already paid. In such a situation, there is a probability of the court forgoing down-payment and permitting VIL to make annual instalments for the total residual amount.

If the above does take place, it could benefit Bharti as their instalments will not commence until VIL plays "catch up" to the amount that is already paid by the former. As per our calculations, Bharti's equated yearly pay-outs will not begin until FY24E (assuming a 20 year timeline for staggered payment), therefore giving enough time for an improvement in cash generation and balance sheet.

Exhibit 10: Bharti's annual instalments shall begin from FY24E (assuming 20 year timeline)



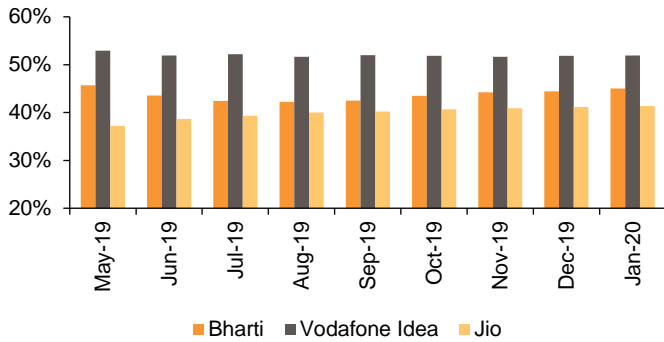
Source: Company, Emkay Research

Exhibit 11: Timeline for AGR court case and subsequent developments

Date	Particulars
2006	DoT took the litigation to TDSAT which ruled the hearing in the favor of Telecom operators on 30th Aug 2007
2008	Supreme Court (SC) stays TDSAT ruling on AGR regime in an interim order
2011	SC set aside TDSAT's earlier order and ruled that TDSAT to pass a fresh order as per law. Subsequently Telecom operators filed petitions before the TDSAT.
2011	TDSAT ruled that non-core revenues such as rent, dividend, profits on sale of assets, etc. would be counted as a part of the AGR. Telecom companies then approached the SC against this judgment.
2015	TRAI came out with its recommendations that items (like interest and dividends) must be excluded when calculating AGR.
2018	DoT moved the SC stating that it cannot enforce demands for dues, unless the SC passes its final order.
Aug-19	Reserved its order in August on the dispute over the definition of AGR
24 Oct, 2019	Supreme Court reserved its order on dispute over the definition of AGR
16 Jan, 2020	Review petitions filed by telecom operators get dismissed by Supreme Court
21 Jan, 2020	Telecom operators file modification petition. They miss the 23rd January deadline as they await Supreme Court verdict on the petition
23 Jan, 2020	DoT orders no coercive action against operators for non-payment of dues
14 Feb, 2020	Supreme Court orders telecom players to pay AGR dues by 17th March; asks MD & directors of telecom companies to show cause as to why contempt proceedings should not be initiated against them
17-21 Feb, 2020	Bharti pays Rs100bn while VIL coughs up Rs35bn
29 Feb, 2020	Bharti submits self-assessment showing total payables as Rs130bn. They make an additional payment of Rs30bn and also deposit Rs50bn as ad-hoc payment taking total amount paid to Rs180bn
6 Mar, 2020	VIL completes its self-assessment and estimates its dues at Rs215bn
16 Mar, 2020	VIL pays Rs33.5bn taking total payment made to Rs68.5bn, thereby covering the self-assessed principal amount
16 Mar, 2020	DoT seeks Supreme Court nod for allowing staggering of payments over a period of 20 years along with 8% interest so as to protect NPV
18 Mar, 2020	Supreme Court disallows self-assessment; says that payment needs to be made as per pre-decided amounts. They are emphatic about the gross violations made by companies by not having paid their dues and plan to hold MDs personally responsible for further non-payment. Plea seeking staggering of payments shall be heard in the next hearing
Apr-20	Plea hearing gets postponed amid Covid-19 outbreak
11 Jun, 2020	Supreme Court is negative on timeframe of 20 years, but is open to allowing staggered payment. However, the court is very clear on need for bank guarantee and even goes to the extent of asking for personal guarantees from company directors. Counsels suggest cancellation of spectrum and licenses in case of non-payment of dues. Court asks telecom companies to submit roadmap of payment, appropriate time frame and provision of security.
18 Jun, 2020	Telecom players state that it would be unfeasible to furnish bank guarantees. Supreme Court asks for an up-front payment of a "reasonable amount". Counsel for VIL states that the company is in a precarious situation and will fold operations if asked to make payment immediately. Counsel for Bharti asks for 20 year time period. Next hearing gets scheduled for 3 rd week of July, giving DoT ample time to go through the proposals put forth by companies.

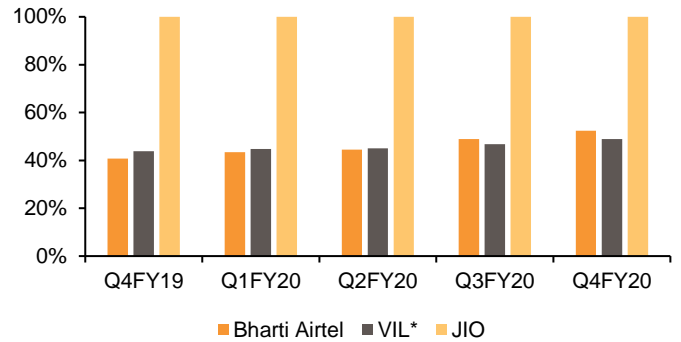
Source: Company, Media Reports, Supreme Court orders, Emkay Research

Exhibit 12: VIL has the highest proportion of rural subscribers, which could lead to SIM consolidation, in case of sizeable tariff hike



Source: Company, TRAI, Emkay Research

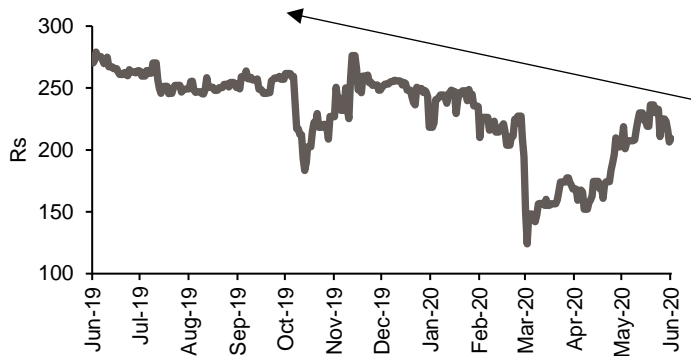
Exhibit 13: A hefty tariff increase could impact VIL more than peers due to higher proportion of voice subscribers



Source: Company, Emkay Research. VIL's Q4FY20 number is an estimate

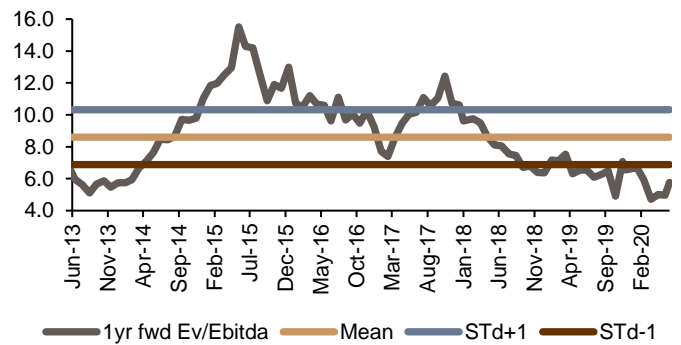
Clarity on VIL's financial position would lead to a reasonable upside in Bharti Infratel (BHIN) and the stock could go back to pre-AGR verdict levels of Rs270-280. VIL's survival will remove overhang of accelerated incremental tenancy exits, deterioration in the return ratios due to lower tenancy and risk of default on receivables. Having said that, VIL's improved financial position will not provide upside to our current tenancy additions as gap funding for VIL will be for survival and not for growth.

Exhibit 14: If VIL were to survive along with Indus merger, BHIN could go back to pre AGR verdict levels of Rs270-280



Source: Company, Emkay Research

Exhibit 15: 1-year forward EV/EBITDA valuation band for Bharti Infratel



Source: Company, Emkay Research

Essentials for VIL's survival

As per our calculations, the following are imperative to ensure VIL's survival:

- Equity Infusion of a sizeable amount
- Significant ARPU hikes (one more round is assumed already)
- Monetisation of stake from the successful merger of Bharti Infratel and Indus Towers
- GST credit being refunded or being offset against AGR dues

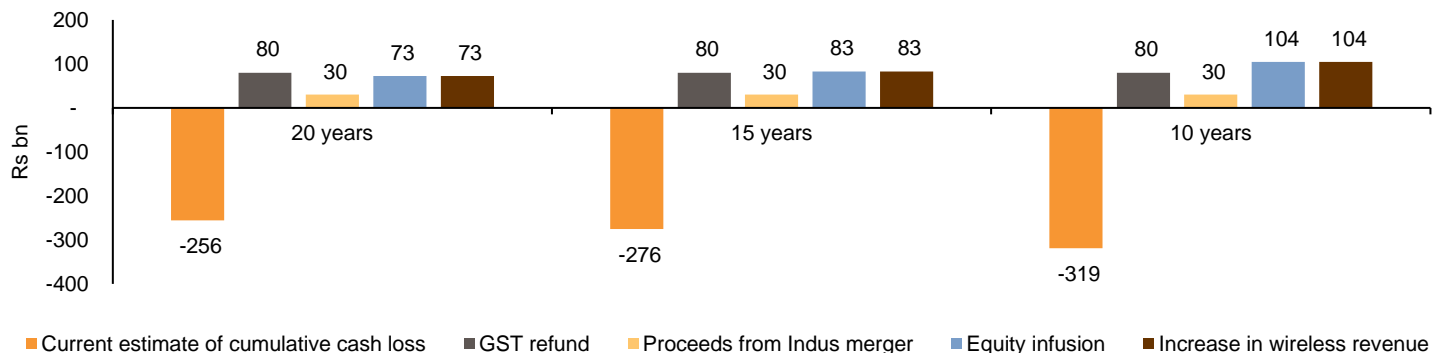
In our opinion, an equity infusion seems to be the only logical way to continue to keep VIL as a going concern. This equity infusion can come from the promoter's personal capacity or via a strategic investor. Possibility of strategic investment seems bleak as funding will be for survival and not for growth. Consistent losses in the subscriber market share will restrict the conversion rate of tariff hikes.

We have modelled the required equity injection and increase in wireless revenue as per each timeline. Under all the situations, there is sizeable cash burn, which leads to a cumulative cash loss of Rs256bn, Rs276bn and Rs319bn in 20, 15 and 10 years, respectively, over FY21-23E.

In order to break-even over the same period and with an assumption of Indus merger and full GST refund from the government, we believe that there needs to be an equity infusion of at least 50% of the remaining cash loss, which ranges from Rs73bn to Rs104bn. The rest of the shortfall required shall be met through considerable tariff rises over the years.

In our realistic assumptions, an average ARPU hike of ~69% (over FY20) across all timelines is needed along with a 50% equity infusion so as to meet the required funding shortfall. We believe that it would be tough for the company to be able to successfully manage such significant increases in tariffs over the next few years, without any SIM consolidation. Hence, we believe that if push comes to shove, a reduction in AGR penalty amount would be the only option to ensure its survival.

Exhibit 16: Equity infusion and sequential rises in ARPU are a must for VIL over FY21E-23E to reduce its current cumulative cash loss to nil



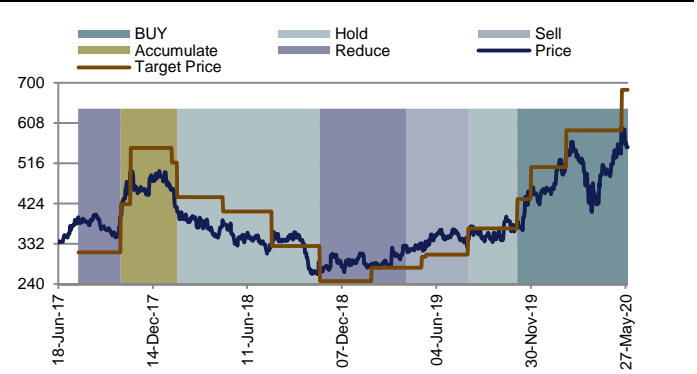
Source: Company, Emkay Research.

It would be important to mention that injecting 50% equity capital in the company at the current price would lead to sizeable dilution in stake and would not materially benefit the company for the next couple of years as the funds would only be utilized to keep the company afloat, instead of generating any returns.

Bharti Airtel**RECOMMENDATION HISTORY TABLE**

Date	Closing Price	TP	Period (months)	Rating	Analyst
20-May-20	594	684	12m	Buy	Naval Seth
10-Mar-20	496	591	12m	Buy	Naval Seth
05-Feb-20	533	591	12m	Buy	Naval Seth
30-Dec-19	461	507	12m	Buy	Naval Seth
30-Nov-19	442	507	12m	Buy	Naval Seth
22-Nov-19	421	434	12m	Buy	Naval Seth
15-Nov-19	393	434	12m	Buy	Naval Seth
04-Nov-19	378	434	12m	Buy	Naval Seth
18-Sep-19	336	367	12m	Hold	Naval Seth
03-Aug-19	344	367	12m	Hold	Naval Seth
25-Jun-19	349	307	12m	Sell	Naval Seth
09-Jun-19	357	307	12m	Sell	Naval Seth
15-May-19	331	307	12m	Sell	Naval Seth
07-May-19	325	302	12m	Sell	Naval Seth
08-Apr-19	326	277	12m	Sell	Naval Seth
01-Feb-19	286	277	12m	Reduce	Naval Seth
27-Nov-18	301	246	12m	Reduce	Naval Seth
26-Oct-18	274	246	12m	Reduce	Naval Seth
29-Aug-18	344	327	12m	Hold	Naval Seth
27-Jul-18	335	327	12m	Hold	Naval Seth
26-Apr-18	376	406	12m	Hold	Naval Seth
26-Feb-18	389	439	12m	Hold	Naval Seth
29-Jan-18	405	439	12m	Hold	Naval Seth
19-Jan-18	457	518	12m	Accumulate	Naval Seth
24-Nov-17	456	551	12m	Accumulate	Naval Seth
02-Nov-17	499	551	12m	Accumulate	Naval Seth
14-Oct-17	396	422	12m	Accumulate	Naval Seth
21-Sep-17	367	312	12m	Reduce	Naval Seth
26-Jul-17	391	312	12m	Reduce	Naval Seth

Source: Company, Emkay Research

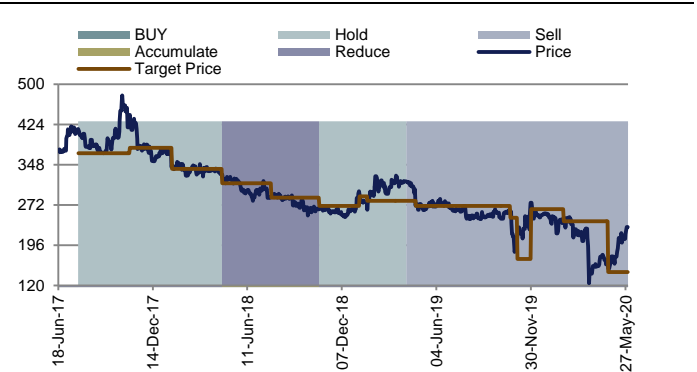
RECOMMENDATION HISTORY CHART

Source: Bloomberg, Company, Emkay Research

Bharti Infratel**RECOMMENDATION HISTORY TABLE**

Date	Closing Price	TP	Period (months)	Rating	Analyst
24-Apr-20	152	145	12m	Sell	Naval Seth
31-Jan-20	248	241	12m	Sell	Naval Seth
30-Nov-19	276	264	12m	Sell	Naval Seth
04-Nov-19	215	170	12m	Sell	Naval Seth
22-Oct-19	259	248	12m	Sell	Naval Seth
23-Sep-19	264	270	12m	Sell	Naval Seth
26-Jul-19	270	270	12m	Sell	Naval Seth
26-Apr-19	273	270	12m	Sell	Naval Seth
08-Apr-19	316	280	12m	Sell	Naval Seth
24-Jan-19	263	280	12m	Hold	Naval Seth
09-Jan-19	290	288	12m	Hold	Naval Seth
25-Oct-18	265	270	12m	Hold	Naval Seth
26-Jul-18	287	286	12m	Reduce	Naval Seth
02-May-18	314	313	12m	Reduce	Naval Seth
24-Apr-18	329	313	12m	Reduce	Naval Seth
19-Jan-18	346	340	12m	Hold	Naval Seth
31-Oct-17	442	380	12m	Hold	Naval Seth
26-Jul-17	414	370	12m	Hold	Naval Seth

Source: Company, Emkay Research

RECOMMENDATION HISTORY CHART

Source: Bloomberg, Company, Emkay Research

Emkay Alpha Portfolio – Telecommunications



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Sector

Consumer Durables, Media & Entertainment, SMID and Telecom

Analyst bio

Naval holds an MBA in Finance and has more than 11 years of experience in equity research. His team currently covers 18 stocks spread across three different sectors.

EAP sector portfolio

Company Name	BSE200 Weight	EAP Weight	OW/UW (%)	OW/UW (bps)	EAP Weight (Normalised)
Telecommunications	2.96	2.96	0%	0	100.00
Bharti Airtel	2.49	2.66	7%	17	90.00
Bharti Infratel	0.33	0.30	-10%	-3	10.00
Tata Communications*	0.00	0.00	NA	0	0.00
Vodafone Idea	0.14	0.00	-100%	-14	0.00
Cash	0.00	0.00	NA	0	0.00

Source: Emkay Research

* Not under coverage: Equal Weight

■ High Conviction/Strong Over Weight ■ High Conviction/Strong Under Weight

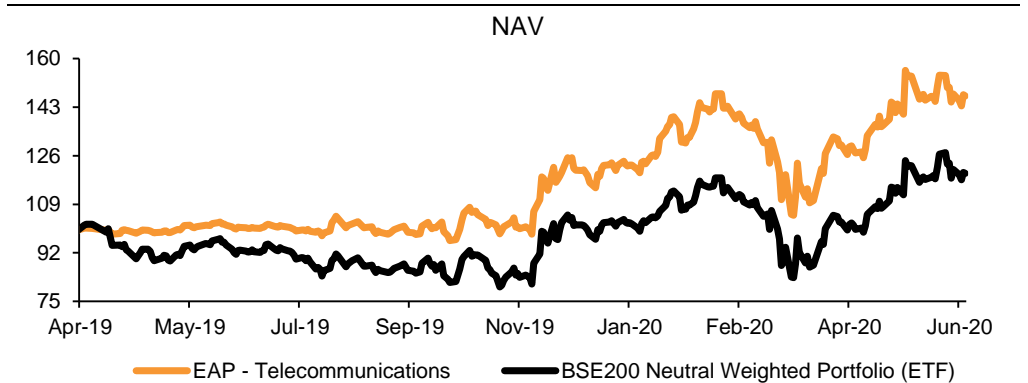
Sector portfolio NAV

	Base					Latest
	1-Apr-19	17-Sep-19	19-Dec-19	19-Mar-20	19-May-20	18-Jun-20
EAP - Telecommunications	100.0	98.4	121.4	114.2	155.9	146.9
BSE200 Neutral Weighted Portfolio (ETF)	100.0	84.8	101.6	89.0	124.3	119.9

*Performance measurement base date 1st April 2019

Source: Emkay Research

NAV chart



Source: Emkay Research

Please see our model portfolio (Emkay Alpha Portfolio): [SMID](#)

Please see our model portfolio (Emkay Alpha Portfolio): [Nifty](#)

“Emkay Alpha Portfolio – SMID and Nifty are a supporting document to the Emkay Alpha Portfolios Report and is updated on regular intervals”

Emkay Rating Distribution

Ratings	Expected Return within the next 12-18 months.
BUY	Over 15%
HOLD	Between -5% to 15%
SELL	Below -5%

Completed Date: 19 Jun 2020 23:10:53 (SGT)

Dissemination Date: 19 Jun 2020 23:11:53 (SGT)

Sources for all charts and tables are Emkay Research unless otherwise specified.

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