Conference Call Transcript

Event: Bharti Infratel Limited First Quarter Ended June 30th, 2019 Earnings Conference Call

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PRESENTATION

Rajyita - Moderator

Good afternoon, ladies and gentlemen. I am Rajyita, the moderator for this conference. Welcome to the Bharti Infratel Limited first quarter ended June 30, 2019 earnings call. For the duration of the presentation, all participant' lines will be in the listen-only mode. After the presentation, the question and answer session will be conducted for all the participants on this call. In case of a natural disaster, the conference call will be culminated post an announcement. Present with us on the call today is the senior leadership team of Bharti Infratel Limited.

Before I hand over the call, I must remind you that the overview and discussions today may include certain forward-looking statements that must be viewed in conjunction with the risk that we face. I now hand over the call to our first speaker of the day, Mr. Akhil Gupta. Thank you. And over to you, Mr. Gupta!

Akhil Gupta - Chairman - Bharti Infratel Limited

Thank you very much, and a warm welcome to all of you, and thanks for joining us on the earnings call of Bharti Infratel for the first quarter ended June 30, 2019.

I think before I talk about the quarter and the key developments, let me quickly update you on the merger process with Indus Towers. As on date, we have received all the permissions, including the final NCLT order. We only now await the approval for enhancement of Foreign Direct Investment (FDI) limit from DoT (Department of Telecommunications). We do expect that overall, we should complete the merger, in all respects, within August 2019. A major development for us for the quarter, like for all the

Indian companies, has been a change in the accounting policy and financial reporting. We have adopted the new accounting standard, Ind AS 116 on leases from April 1, 2019. Most of you would be familiar with IFRS 16, and this standard replicates the global standard. This new standard primarily affects us on two counts, first is on the revenues, where the rental revenues, which we receive from our customers will be straight-lined over the remaining period of the contract. And the second is on the cost side, where the rentals that we pay to the landlords will now be treated similar to financial leases.

We have adopted, what is called the modified retrospective method allowed by the standard. And we believe that has been done by most of the large corporates in India. This approach does not require restatement of previous periods with respect to these new standards. However, maintaining the highest level of reporting standards and transparency, we have made various disclosures in our quarterly report under Section D to provide a like-to-like comparison with the last year.

I will request our CFO, Bala, to give a short update later on the specifics of the standards for a better understanding.

Moving on to the developments on the business side, the telecom industry in India clearly seems to be stabilizing. After very rocky few years, which have seen adjusted gross revenues decline by over 30% between financial year 2016 and 2019. This has been despite an exponential growth in both subscribers as well as the wireless data consumption per user per month. It is also reflected in our operational trends this quarter were after reporting net co-location declines for the last consecutive six quarters, we have for the first time now seen an increase in net co-locations on a quarter-to-quarter basis. We hope and believe that this trend would continue, as we feel that the need of the hour for the industry is to improve coverage and capacity across the nation.

Coming to some high-level financial and operational highlights for the quarter. As of June 30, 2019, the consolidated tower base stood at 92,632, with consolidated co-locations at 173,247, with a co-location factor of 1.87 at closing; just to remind, the consolidated here means, include 42% of Indus.

The co-location as stated earlier are lower by 13.7% on year-on-year basis, mainly on account of exits by Vodafone-Idea. The consolidated revenues for the quarter Rs.3,712 crores, grew 1% on reported basis. Excluding the impact of the Ind AS 116, the revenues for the quarter would have been Rs.3,630 crores, declining marginally by 1% year-on-year.

The EBITDA at Rs.1,953 crores grew 28% year-on-year on the reported basis, representing an operating margin of 52.6%. However, excluding the impact of Ind AS 116, EBITDA for the quarter would have been Rs.1,557 crores, up 2% year-on-year, with an operating margin of 42.9%, up 150 basis points year-on-year.

Similarly, the consolidated PBT at Rs.1,106 crores, grew 3% year-on-year. Excluding the impact of new accounting standard, the PBT would have been Rs.1,038 crores, down 3% year-on-year.

The PAT at Rs.887 crores grew 39% Y-o-Y; however, without the impact of the new standard, it would have been Rs.843 crores, up 32% Y-on-Y.

Operating Free Cash Flow (OFCF) at Rs.1,207 crores grew 22% and without impact, 15% year-on-year. The ROCE pre-tax and ROE post-tax were 26% and 27%, respectively, after moving to Ind AS 116.

As you would note from the above, while the co-location declined almost 14% on a year-on-year basis, as I mentioned primarily due to consolidation of Voda and Idea. However, we have very quickly recovered in terms of financial performance, which has shown marginal improvement vis-à-vis last year on a like-to-like basis. This along with the fact that we are now seeing revival of demand, augurs well for our industry and for our company. It is also reflective of the inherent soundness and maturity of our business model, which is being followed by all tower companies in India, including our company.

I would like to mention that in all likelihood, this would be the last investor call for Bharti Infratel in its current form where it has it has its own operations and owns 42% in Indus Towers. This is, as I mentioned earlier, on account of the impending merger with Indus, which should, we hope to be completed by end of August, that is within this current quarter.

The merged entity will be one of the largest in-country tower companies globally. Of course, China Tower being in a separate league altogether. We would, we believe, be second only to China Towers in terms of the 307,000-odd co-locations that we would have as of June 30, 2019 on a total basis.

For your clarity, as this being a merged entity as on April 1 itself, for this full quarter ended June 30, 2019, the revenue would have been Rs.6,400 crores; EBITDA of over Rs.3,200 crores; PAT of Rs.1,000 crores with OFCF of over 1,800 crores. The net debt for the merged entity, including lease liabilities, would have been about Rs.14,000 crores.

I would like to take this opportunity to thank our MD and CEO, DS Rawat, for steering this company very ably for the last several years for it to emerge as not only financially a very strong and stable company, particularly in these times when most of the companies are going through massive stress, but more importantly, for the shining example of highest levels of corporate governance with its quarterly full audits and unparalleled transparency with its financial and operational disclosures in the quarterly reports. As you were made aware, last quarter, DS had requested not to be considered for CEO role in the merged entity.

To conclude, we remain confident of the long-term potential of the Indian telecom industry. The ongoing digital revolution and the next-generation technologies will open up new avenues for infrastructure demand in the sector. And with the imminent merger of

Infratel and Indus, we believe the combined entity will have a unified, nationwide presence along with very strong financial muscle to invest in the requisite telecom passive infrastructure in the country.

Thank you all. I will now request Bala to brief on the accounting changes from this quarter before we will open the call for questions and answers.

S. Balasubramanian - Chief Financial Officer - Bharti Infratel Limited

Thanks, Akhil. Good evening everybody. Effective April 1, 2019, the Company has adopted new accounting standard Ind AS 116, which deals with leases as notified by the government. Under earlier standard Ind AS 17, operating leases were treated as revenue expenses, whereas under Ind AS 116, all long-term leases whether operating or finance leases are recorded in the balance sheet. The new standard impacts our performance as lessor and lessee.

As lessor, all our contracts with customers having escalation clause over lease term. Going forward, rental escalations over the remaining period of the lease term are straight-lined in the form of revenue equalization reserve and recognized under rental revenue. In the initial years of customer leases, the revenue from revenue equalization reserve will be higher and will be lower as it approaches the expiry term.

As lessee, all our lease agreements with the landlords for sites, etc., are long-term in nature. The Company has adopted modified retrospective approach as allowed by the standard. Accordingly, the Company has recognized right-of-use asset as on April 1, 2019, on a consolidated basis, representing the book value of the right-of-use assets as on that date. The right-of-use assets represent the present value of future lease payments over the lease term from the commencement of the lease. Going forward, the right-of-use assets are amortized over the lease term on a straight-line basis and reflected in the financials under depreciation and amortization.

The Company has also recognized lease liabilities as on April 1, 2019, on consolidated basis, representing the present value of remaining lease payments from April 1, 2019, to the end of the lease term. Interest is charged on the outstanding lease liabilities at the end of each period.

As on April 1, 2019, the Company has charged to the retained earnings, an amount of Rs.9,452 million, net of tax, being the difference between lease liabilities and right-of-use assets, which represents depreciation on such right-of-use assets till March 31, 2019.

Rental expenses paid to landlords will no longer be shown as operating expenses, and accordingly, EBITDA will be higher on this account. The actual amount paid towards rentals will be reduced from the lease liabilities.

With the above changes, the financial statements and related ratios are not comparable with the previous periods. For the better understanding and for the benefit of the reader, detailed information has been provided under the Section D. Thank you.

With this, we can open the floor for questions now.

Rajyita - Moderator

Thank you very much Sir. We will now begin the question and answer interactive session for all the participants who are connected to the audio conference service from Airtel. Due to time constraints, we would request, if you could limit the number of questions to two to enable more participation. Hence, management will take only two questions per participant to ensure maximum participation. Participants who wish to ask questions, may please press "*" "1" on their touchtone enabled telephone keypad. On pressing "*" "1" participants will get a chance to present their questions on a first in line basis. To ask a question participant may please press "*" "1" now. The first question comes from Mr. Manish Adukia from Goldman Sachs Mumbai. Mr. Adukia you may ask your question now.

Manish Adukia - Goldman Sachs - Mumbai

Good afternoon. Thanks for taking my question. I have two questions, please. My first question is on the rent per customer. That seems to have seen another sharp jump in this quarter. Just wanted to clarify if that is just a function of the rentals getting reset higher for existing customers because of exits? Or are there any one-offs in that? And I am referring that the number that you give us adjusted for the accounting change. And my second question is on the gross adds. That number seems to have seen another quarter of moderation. In the past, you have talked about operators needing maybe north of 250,000 towers for a pan-India 4G coverage. What would, in your view, be driving this moderation, especially at the time when two of the three operators seem to be long time away from those targets? Thank you.

S. Balasubramanian - Chief Financial Officer - Bharti Infratel Limited

Manish, this is Bala. On the ARPT which is the rental revenue, this is largely coming on account of loadings and increments, which happened in the quarter. So this is a function of growth in tenancies and loadings. Rental reset, you will see it in the net churn, as there are not much lately, is largely coming from the ongoing business.

Devender Singh Rawat - Managing Director and Chief Executive Officer - Bharti Infratel Limited

On your second question, Manish, we do see new tower build-out picking up, and that is visible from Infratel standalone numbers where we are building towers for operators, but yes, not to the levels that we have not seen in the past. And, also one of the leading operators is still in the process of merger and integration of the network. We have not seen significant additions coming in from there. We are also looking forward to, with the capital infusion from the leading operators. We are now hoping that going forward this will translate into meaningful rollout for coverage and capacity as we move forward from here.

Manish Adukia - Goldman Sachs - Mumbai

If I can quickly ask one more question. I think on the tower industry per se, how would you describe the competitive dynamics on the tower side, so for example, from the likes of American Tower Corporation, potentially Jio's towers coming?

Devender Singh Rawat - Managing Director and Chief Executive Officer - Bharti Infratel Limited

So, with consolidation, the good news is that ATC becomes similar in terms of size and scale and Jio's own towers will also be in terms of size and scale very similar to what we are. And you see our return ratios in terms of what we have done. Mostly our build out has been organic, and at that, we are at the current ratios at the current price points. So, we have not seen any change on pricing part in the market, if that's where you are leading into.

Tower capacity, we have said in the past, are not fungible capacity that easily. And wherever we have an existing tower under requirement, we still continue to gain market share on tenancies that are available against whatever operators are building out on their own. Whatever is coming out, we still think we are gaining market share. We do not have a public report, which I can quote and show that we are gaining market share there.

In terms of competitive dynamics, we still think, with all this consolidation playing out, effectively, with 5G, when there is more requirement of towers and more densification of towers for capacity, we will see that depending on scale and size of the operator, we will be able to gain large part of what comes up as growth.

Manish Adukia - Goldman Sachs - Mumbai

Thank you.

Rajyita - Moderator

Thank you very much Mr. Adukia. The next question comes from Mr. Kunal Vora from BNP Paribas Mumbai. Mr. Vora you may ask your question now.

Kunal Vora - BNP Paribas - Mumbai

Thanks for the opportunity. First question is just wanted to check if there are any one-off during the quarter or can we look at the numbers as sustainable numbers on the business that you can build to like depreciation, other income, finance, anything one-off in the quarter numbers?

S. Balasubramanian - Chief Financial Officer - Bharti Infratel Limited

Kunal, there are no one-offs other than those disclosed in terms of the changes in the Ind AS 116 on depreciation, you would have seen the amortization of right-of-use and finance charges on the interest on lease liability. Other than that, there are no one-offs on the depreciation or interest.

Kunal Vora - BNP Paribas - Mumbai

Okay. Second question, your average residual service contract period has been declining over the years and now it is below five years. With operators having to recognize the lease liability on the balance sheet, do you think they would prefer to sign shorter-term contracts instead of the standard 5-10 year contracts?

Devender Singh Rawat - Managing Director and Chief Executive Officer - Bharti Infratel Limited

First, to your question of average residual life coming shorter is also because there has been lesser growth on tenancies. And as the tenancies age every year, our entire largest base of tenancies is what gets reduced by year every time you move forward.

On your specific impact on India space, I really do not know if there is a propensity for operators to sign up and have a shorter lease. It comes with its own risk of saying you could have higher rates coming up in the future, too. So, it is a trade-off that operators need to do and, in our case, by the MSA, there is a higher tariff that an operator needs to pay if he chooses a period lesser than certain years as defined in the contract.

Akhil Gupta - Chairman - Bharti Infratel Limited

And also, the charges go up at this time for a shorter period, which I doubt if any operators would do.

Kunal Vora - BNP Paribas - Mumbai

Sure. So, considering that some of them are going through financial strain and their balance sheets will look even weaker with large lease payment liabilities?

Akhil Gupta - Chairman - Bharti Infratel Limited

No. No, I do not think any responsible company will take business decisions on account of accounting decisions. And in any case, the EBITDA also goes up, so it does not matter as the net debt to EBITDA ratio remains same or actually better.

Kunal Vora - BNP Paribas - Mumbai

Sure, okay. Just one last question, if I can. Look, like you mentioned the net debt number would be Rs.14,000 crores, including lease liabilities. So, including the Rs.5,000 crores payments, which might be made to Vodafone-Idea, your debt will increase around Rs.19,000 crores. Would you be comfortable with that level? Or would you look to take it to a higher level?

Akhil Gupta - Chairman - Bharti Infratel Limited

No. I think the complaint always has been that we do not have enough debt and if you see, as I pointed out, the EBITDA will be about Rs.3,200 crores per quarter. So, you can imagine such a large EBITDA, absolutely no problem with that kind of debt, especially when that debt is mainly on account of lease liability being created.

Kunal Vora - BNP Paribas - Mumbai

Sure. So, the target debt-to-EBITDA has been 2x. So, is that still on? Like, are you looking at acquisitions to take it to that level?

Akhil Gupta - Chairman - Bharti Infratel Limited

No comments on that. But yes, over a period of time, if there is more capital required, say, for organic growth, which I believe, looking at what is coming in the industry, we will need to, yes, we would like to do this by debt rather than raising the equity.

Kunal Vora - BNP Paribas - Mumbai

That is, it from my side. Thank you very much.

Rajyita - Moderator

Thank you very much Mr. Vora. The next question comes from Mr. Pranav Kshatriya from Edelweiss Securities, Mumbai. Mr. Kshatriya you may ask your question now.

Pranav Kshatriya - Edelweiss Securities - Mumbai

Thanks for the opportunity. Sir, can you please elaborate a little on this reassessment of your cost amounting to Rs.1,246 million? What is the nature of reassessment? And why there is such a sharp reversal? That is my first question. Second is can you elaborate how exactly the interest rate movement will impact the lease interest, which is there in your books, if it impacts at all? And lastly, if you can give some color on how the accounting for the exit charges happens in this case. Is that having any impact of the Ind AS 116? Thank you.

S. Balasubramanian - Bharti Infratel Limited

Hi, this is Bala. The reassessment is an annual exercise that as a company we undertake in terms of as a part of review of accounting policies and estimates. And basis that we have identified certain provisions, which we were carrying excess and could be written back into the P&L. So hence, it is a regular event, but this is not a quarter-on-quarter repetitive one.

On the second question, which is relating to the interest rate movement on leases, the accounting standard prescribes the incremental or marginal rate of interest as the criteria to be adopted, which means that tomorrow, if there is a new lease that we enter into, it will be based upon the interest rate prevailing at the time of taking on the new lease. So, it won't be any historical rate or any rate which is prevailing as of today.

Third, on the exit; if the lease gets terminated which is officially a landlord lease, both the right-of-use asset, which is sitting in the asset side of the balance sheet and the corresponding lease liability which is sitting will also be netted off and it will be written off in the balance sheet on a net basis.

Pranav Kshatriya - Edelweiss Securities - Mumbai

Sir, I was basically, referring to this Rs.90 crores revenue what you are getting on exit charges paid by different operators, the settlement which you have done with operators?

Akhil Gupta - Chairman - Bharti Infratel Limited

That will continue. That is an ongoing amount every quarter, which will keep coming for 3 years.

Pranav Kshatriya - Edelweiss Securities - Mumbai

Okay. So, this Ind AS, has no impact on that? Just wanted to confirm that.

Akhil Gupta - Chairman - Bharti Infratel Limited

Yes, there is no impact on that.

Pranav Kshatriya - Edelweiss Securities - Mumbai

Thank you so much.

Rajyita - Moderator

Thank you very much, Mr. Kshatriya. The next question comes from Mr. Sanjay Chawla from JM Financial, Mumbai. Mr. Chawla you may ask your question now.

Sanjay Chawla - JM Financial - Mumbai

Thank you for the opportunity. My first question is on the tenancy churn that you have reported, and I am looking at your numbers on Infratel plus 100% Indus basis. So, we have seen almost 1,500 exits this quarter compared to 10,300 in the previous 2 quarters. Vodafone-Idea had said that they were looking at shutting down additional 22000-23000 sites during the merger integration. So, what would be your sense or estimate of how much more churn or exits we should expect or build in for Infratel plus Indus over the next 2-3 quarters on account of what Vodafone-Idea had indicated? And second question is your thoughts on what kind of impact the supply from Jio towers or SPV that they have created could have on the renewal pricing that we would have to see or face in FY2022? So, if you could give some color on that.

Devender Singh Rawat - Managing Director and Chief Executive Officer - Bharti Infratel Limited

First, on exits of operator, I know this is slightly dated information when there were 22,000 colocations announced by Voda-Idea. For us, we think large part has played out, and this is something that will have to be confirmed by Vodafone-Idea itself. We are seeing tapering off exits that come out, and that is why you see a positive net addition for the first time in 6 quarters now. We hope that this is the tailwind and the end of it. There could be some small exits which keep coming in on account of operators trying to adjust their network, but that could be small numbers. But that is more an expectation and it is for the operators to look at. We think large part of it has already played out. On your second question of SPV, we will have to wait and watch how this plays out. There are certain bulk negotiations and I have said, it is not easy to shift capacities from one location to another. We will have to play it by the market at that time. Today, we have not seen any meaningful shift on any tenancies for any of the tower companies unless the service quality has been terribly bad. If they are not able to service their customers that have been the reason why we have seen shifting of capacities being done by operator, it is a fairly tedious exercise even for an operator to re-home and re-create the network from other towercos unless there are huge differential gains. So, we will have to wait and watch how this plays out whenever that event comes in. It is early for us to be speculating. We do not even know what the price points are for the new SPV so we will wait and watch.

Akhil Gupta - Chairman - Bharti Infratel Limited

Let me just add my view on this InvIT, which has been done by Jio. I think these towers as you know, have always been there, it is not that certainly they have come into being. The InvIT very clearly is a financial restructuring exercise. What we have seen there, at least what is reported, is that the terms are as per the MSAs, which are generally in the market. There is nothing really new here. And that is why we really do not expect any meaningful difference on the competitive scenario on account of this development.

Sanjay Chawla - JM Financial - Mumbai

Akhil, where I was coming from is that there is a SPV, which is currently fully supported by, let us say, a single tenant. So really nothing stops them from offering 20000 rates, maybe 25,000, but no escalation for, let us say, few years, to get a new tenant because anything incremental is going to be profit for them. So, from that point of view, would you not perceive it as a risk?

Akhil Gupta - Chairman - Bharti Infratel Limited

Well, you seriously expect very sharp operators like Jio to be happy that its competitors get it at a cheaper price. Absolutely impossible.

Sanjay Chawla - JM Financial - Mumbai

Yes. But obviously, a lot of the benefit of that new tenant or the rental from new tenant would go to Jio itself?

Akhil Gupta - Chairman - Bharti Infratel Limited

Well, if that was the case, all over the world, people would pay less themselves and charge more to the other operators. It does not make commercial sense at all.

Sanjay Chawla - JM Financial - Mumbai

Okay. And just one other question, which was asked earlier on this Rs.125 crores provision reversal or write back. Could you just provide some breakdown of this credit item in terms of the expenses, power and fuel, employee and R&M and others how much one should allocate towards each of the guidance?

S. Balasubramanian - Chief Financial Officer - Bharti Infratel Limited

Significantly, it is almost 50-50 between energy and other operating expenditures. And out of the second one it will largely be on the network expenses.

Sanjay Chawla - JM Financial - Mumbai

Okay. And for how many quarters does this amount pertain to, prior quarters?

S. Balasubramanian - Chief Financial Officer - Bharti Infratel Limited

This is cumulative balances. It is not pertaining to any specific quarter. It is an accumulation as of March 31, 2019, which is reassessed at the beginning of each year.

Sanjay Chawla - JM Financial - Mumbai

Okay. And if I could just squeeze in one little question on the energy spread for Indus, we are getting a negative energy spread in the case of Indus of almost Rs.27-28 crores negative. Can you confirm this figure? And secondly, what is the reason for this negative spread? When does it get normalized?

Devender Singh Rawat - Managing Director and Chief Executive Officer - Bharti Infratel Limited

So normally, first quarter is when the contracts, some of these contracts do come up for annual renegotiation as part of the fixed energy model. And you do see this coming up from time to time depending on which operators' contract are coming up for renewal. There have been a few renewals in the case of Indus. And there was also a small amount of one-off I am told previous quarter on their energy, which were showing the margins in. We have said in the past that energy margins have to be seen on a full year basis. And there, we believe, this will again turn into a positive for a full year basis.

Sanjay Chawla - JM Financial - Mumbai

Okay. So, what is your outlook on the energy margins now going forward on a full year basis?

Devender Singh Rawat - Managing Director and Chief Executive Officer - Bharti Infratel Limited

Again, we have said 3% to 5% is a fair estimation. If we are able to get into initiatives which yield us better results, that is what shows up as excessive. And these margins are visible to operators, too. So, every time these contracts come up for renegotiation, it's kind of plateaus down to the same levels again.

Sanjay Chawla - JM Financial - Mumbai

Thank you very much and all the very best.

Rajyita - Moderator

Thank you very much, Mr. Chawla. The next question comes from Mr. Deepak Dagar from Crédit Suisse, Mumbai. Mr. Dagar, you may ask your question now.

Deepak Dagar - Crédit Suisse - Mumbai

Thank you for providing an opportunity to ask the question. It is just a follow-up of the Jio-Brookfield deal which you spoke about. We would love to hear your thoughts on a couple of points. A) Obviously, with this deal, from a consolidation perspective in your industry, I think that Jio-Brookfield entity kind of stands more better positioned. So, what is your thought in terms of their aggression about consolidating? B) Obviously, with this deal there is a kind of a deleveraging at Reliance's end coupled with what the fiber things they will do, so then we say that the telecom industry kind of seems to have stabilized, and we are seeing tenancy growth, do you think probably this is just the beginning of probably another round of some fighting at the telecom industry end?

Akhil Gupta - Chairman - Bharti Infratel Limited

So let me take the second part first. My feeling is that what is happening and the eye on paring down the debt is signs of more discipline coming into the industry, and every player trying to look at its leverage and the results. And my personal view is that this would indicate the more disciplined approach in the market rather than a fresh round of irrational pricing. But that is my view. I think time has come when we could be looking at some kind of correction in the pricing in the market and not vice versa.

Deepak Dagar - Crédit Suisse - Mumbai

Okay. Okay. And that you are talking both from a tower and telecom operator's perspective?

Akhil Gupta - Chairman - Bharti Infratel Limited

The tower is joined at the hip with the telecom industry, so obviously, when we view the telecom industry the immediate impact on the tower industry is very visible. When the telecom industry scenario improves, naturally for the passive infrastructure providers, it augurs very well.

Devender Singh Rawat - Managing Director and Chief Executive Officer - Bharti Infratel Limited

So, Deepak, to add to your question on the first one on aggression, we will have to wait and watch, as I said earlier, too. In the past, too, we have not gone in for an organic growth with tower companies within the country. And mostly, it is because there is an overlap invariably, given our scale and size. When I say "our", means Infratel standalone and Indus, on a pan-India basis. Any options that we have evaluated, there is some amount of overlap and that is where you look at the discounting over our current prices for looking at any acquisition. For smaller companies, it did make sense to inorganically look at growth because the organic growth was very slow for them. It made sense. Going forward, will this new entity be aggressive, RCom towers, yes, they are visible. Jio is already a tenant there. It probably makes sense for them to look at that far more aggressively. Would it have overlap with us? Yes, there would be a certain amount of overlap, too.

So, we will keep evaluating our own options in terms of what value it adds to us in terms of going for these acquisitions. Given our scale and size, if there are towers to be taken, these will be primarily for capacity to be built in some of the areas because the smaller tower companies were pretty much focused in the city and CBD areas and were not deep down rural. Some of the rollout that we are seeing now is primarily towards category B and C circles into the rural, trying to get in and in the cities, in the CBD area to fill up coverage and capacity requirements that are coming up, a) because of higher frequency and, b) because of high utilization, which seems to be the bigger reason that we see why operators are getting aggressive.

Lastly, I think with 5G, the requirement of towers could move up. The world is already talking about moving to 5G and doing some early trials. In the next couple of years, that could be the market that would increase densification of cell sites. There, again, these could be assets which could be leveraged very easily by operators to reach out.

Akhil Gupta - Chairman - Bharti Infratel Limited

I think one more point what I would like to add. If you look at the Jio composition in terms of the towers they have, a whole lot of them were on monopoles and so on. And there would be serious consideration whether there can be other operators who can come there. Also, the fact that Jio has deployed several technologies, 800, 1800, 2300 or 2600, so that these will also need to be seen as to how much is the real potential left for other operators to come on.

Deepak Dagar - Crédit Suisse - Mumbai

Sir, understood. And just one follow-up question, if I understand it correctly, about odd 40,000 towers are just exclusively for Jio within that. There are no other tenants on there. So, with this deal, do you see that exclusivity kind of a trend continuing northward, southward, kind of remain stagnant?

Devender Singh Rawat - Managing Director and Chief Executive Officer - Bharti Infratel Limited

Hard for us to comment at this time, Deepak honestly, I do not even know the contours of the exact deal. It is not in the public domain. InvIT structure again, can they do fresh rollout? My own understanding is limited there, but I understand the towers that are transferred into InvIT will be locked in, and that would be the revenue-generating source. Additional rollouts might have to happen under a separate structure. So, we will have to wait, as I said, before we can give a commentary on any of these things.

Deepak Dagar - Crédit Suisse - Mumbai

That is helpful. Thanks a lot.

Rajyita - Moderator

Thank you very much, Mr. Dagar. The next question comes from Mr. Aliasgar Shakir from Motilal Oswal, Mumbai. Mr. Shakir you may ask your question now.

Aliasgar Shakir - Motilal Oswal - Mumbai

Thanks for the opportunity. I just have a question on Bharti Infratel's competitive position going forward. You did mention that we have gained market share. But in the backdrop of Vodafone-Idea giving us lesser tenancies and also, the point that the particular circles of Vodafone-Idea's independent towers, which have gone to ATC, I understand those particular circles, ATC now has the first right of refusal. So, in that context, do you think that incrementally Vodafone-Idea's further tenancies would go to ATC and therefore, we would lose some competitive position there?

Devender Singh Rawat - Managing Director and Chief Executive Officer - Bharti Infratel Limited

To the first point that you said, the towers that ATC required from Vodafone-Idea already is a 1-tenant tower because it is either Vodafone or Idea as a merged entity there. Any operator who is wanting to expand or create capacity has two options. One is to bring in more loading, which is more likely to happen on those towers, where they are already present whereas if they want additional capacity and coverage, they will have to get into a neighboring site or a new site, which is where an Infratel tower becomes more attractive for the larger growth. And as you understand, the business is that if you get tenancies there is a quantum jump in terms of how the profitability is. For loading, yes, it is profitable but then you get a small delta in terms of 10% to 15% additional revenue.

So we actually think unless new rollouts are done in these areas next to our sites, given as I said, we build the sites for the leader in most of the circles, any subsequent operator who is trying to do a catch-up would invariably find these sites to be the most suited to come in as a fresh tenant. And once they are locked in as tenants, in case of any competitors too, that is true that expansion capacities are far cheaper to come by adding if you have got additional spectrum by adding more electronics on the existing site.

So, we do not think this has caused any aggression or a change in competitive scenario for us. In fact, it turns a little healthier because now from a scale and price standpoint, the pains and gains become very similar for all the tower companies. And also, given that there is a premium to the cost of building that is being paid, the return ratios, even at the existing price points that we have, would be dilutive for someone if we take the tower at a premium to the value that it cost us to build.

So, we think there will be more clarity with scale and size between operators. And because there are three large dominant players in the market, they are negotiating for us too. Your ability to do gross discounting or giving one operator undue benefit over another person will become more and more difficult because the larger customers will obviously demand the same benefits for the entire base, which will be very disruptive to the value of the tower company.

So, we think there will be more sanity. Our own registration calls for providing service on a non-discriminatory basis. So, we have been abiding by that, and we have not seen any change in the marketplace.

Aliasgar Shakir - Motilal Oswal - Mumbai

Do you think there could be more price competition that we have never seen in the industry so far given that ATC would want tenants and therefore they would probably I mean I think that it is better to have another tenant at lower cost, lower price than not have anyone?

Devender Singh Rawat - Managing Director and Chief Executive Officer - Bharti Infratel Limited

Precisely the point that I was trying to tell a couple of minutes back was that if you give a discount to one operator today, the tenancy growth rates are anywhere between 5% and 10%. For that 10%, if you give a discount rate your large customer who is holding, say, 60% or 50% of your tenancy base would demand that on the entire base. And that is the point I said; the power of strong customers negotiating is that they can use this as a tool to get the benefit for the entire base, which will actually become even revenue negative forget about EBITDA. Second, because they have paid a premium to buying a tower, the ability to discount becomes that much more lower.

Aliasgar Shakir - Motilal Oswal - Mumbai

Thanks. That is very useful.

Rajyita - Moderator

Thank you very much Mr. Shakir. The next question comes from Mr. Sanjesh Jain from ICICI Securities, Mumbai. Mr. Jain you may ask your question now.

Sanjesh Jain - ICICI Securities - Mumbai

Good afternoon. Thanks for the opportunity. My question again is on the cost reversal. We said that 50% of this relates to power and fuel, 50% is on the network cost. So, if I see our network costs adjusted for this reversal has gone up by 11.7% quarter-on-quarter. We have never seen this kind of inflation in our numbers. Is there any change in the model in terms of an in-house versus outsourcing or Capex versus Opex? Anything changing in the cost structure there?

S. Balasubramanian - Chief Financial Officer - Bharti Infratel Limited

There is no change in cost structure. If you look at it in terms of the total opex, which you are seeing in the quarterly report, is largely coming out of repairs and maintenance, which is coming out of the reversal which is the 50% we talked about. There are no other changes in the operating model whether the Capex versus Opex and out-source vs in-source.

Sanjesh Jain - ICICI Securities - Mumbai

So, what led to this inflation then?

S. Balasubramanian - Chief Financial Officer - Bharti Infratel Limited

So, there are only two line items, which is the repairs and maintenance, which is the network expenditure, and there are some other one-offs, small one-off in the other expenses which is, again, as per the policy that is being done.

Sanjesh Jain - ICICI Securities - Mumbai

So, will it be fair to assume that this cost structure will sustain? Or how should we see the cost structure from here?

S. Balasubramanian - Chief Financial Officer - Bharti Infratel Limited

The cost structure will I do not think dramatically will change other than because of the policy changes. So, you will have to assume that whatever in the previous quarter, we have reflected that will continue. This is one-off in terms of the policy changes that have happened in this quarter.

Devender Singh Rawat - Managing Director and Chief Executive Officer - Bharti Infratel Limited

But just to add on a full year basis, it will probably be fair to compare adjusted for Ind AS 116 adjustments. We should not be way off. There are certain things, which you do advance a little bit in terms of seasonality and other aspects. So, there could be certain expenses that come in. There is also HR cost increase that we run through an appraisal cycle, in the last quarter too. So, there are some of these. But on a full year basis, we do not see any significant change.

Sanjesh Jain - ICICI Securities - Mumbai

Okay. Just one last question on the same, I understand we had a different operating model for Indus and Infratel, where I guess Infratel was more in-house and Indus was more outsourcing. Is there any thought over there, what will be the merged entity model will look like?

Devender Singh Rawat - Managing Director and Chief Executive Officer - Bharti Infratel Limited

Again, at this stage, it is difficult for me to comment. We are continuing. There are pros and cons of both the models. This is something that has been widely debated and discussed right now. You have to play the horses for the courses. Right now, there are other integration matters, which are on priority, which we are trying to finish for the day zero for regulatory and other requirements. But this is definitely one of the agenda items that are there.

Infratel too in few geographies have tried out some part of the outsourced model. But we have realized there are benefits, pros and cons of both. So we will come back and communicate once there is a change, and you would be able to see that also on the numbers that we disclose on manpower side because there is a bearing on the numbers that we report on manpower and also in terms of classification of costs a little bit between network to the manpower cost.

So, we will communicate as and when that change happens. As of today, this is pre-merger, so as of today, we are managing both the operations absolutely independently till the day the deal is announced.

Akhil Gupta - Chairman - Bharti Infratel Limited

But I think it would be fair to assume that for the foreseeable future we will continue the way it is, because we do not want to rock the boat. There other integration priorities, so the hybrid system will be continuing for the time being.

Sanjesh Jain - ICICI Securities - Mumbai

Ok. That is fair. Thank you and best of luck

Rajyita - Moderator

Thank you, very much Mr. Jain. The next question comes from Mr. Himanshu Shah from Dolat Capital, Mumbai. Mr. Shah you may ask your question now.

Himanshu Shah - Dolat Capital - Mumbai

Thank you, Sir. Thanks for the opportunity. Just a couple of questions. Why the energy spread in Indus Towers is negative this quarter, anything specific over there.

Devender Singh Rawat - Managing Director and Chief Executive Officer - Bharti Infratel Limited

We did answer this question. We said normally Q1 contracts do come up for renewals and also Q1's energy costs are also slightly higher. And that is why you see that energy margin to be seen on a full year basis. On a full year, we do expect that we will make between 3% and 5% as the margin. Anything beyond that as part of the negotiation gets offered back to the operators.

Himanshu Shah - Dolat Capital - Mumbai

Secondly, again this quarter, there has been some increase in your debtor level. So, if some color can be provided like on the sustainable debtor levels?

Devender Singh Rawat - Managing Director and Chief Executive Officer - Bharti Infratel Limited

Himanshu, can you repeat the question? Your voice was crackling in between, so if you could please repeat so that we can hear that clearly.

Himanshu Shah - Dolat Capital - Mumbai

Sure, sir. So again, this quarter, we have seen some increase in the debtors, so some colour can be provided on the sustainable debtor levels?

S. Balasubramanian - Chief Financial Officer - Bharti Infratel Limited

Himanshu, this increase in debtor is largely is a temporary phenomenon, I would assume because we have been following with the customers on the collection side and there are delays from the customers in terms of collection, but on a sustainable level, I do not think, I can make a comment at this point of time, because there are no changes to any of the arrangement with the customers.

Himanshu Shah - Dolat Capital - Mumbai

And lastly, can you provide some colour on the tax rate post-merger? Should it be the corporate effective tax rate?

S. Balasubramanian - Chief Financial Officer - Bharti Infratel Limited

The marginal rate for us in tax is 35%, that will not change.

Himanshu Shah - Dolat Capital - Mumbai

So, post-merger, because of DDT benefit will be taken, so we should reach the marginal tax rate?

S. Balasubramanian - Chief Financial Officer - Bharti Infratel Limited

Yes, because the DDT will go away. It will be only to the extent of our 42% share in Indus that DDT will go away but for the remaining payout it will still remain there.

Himanshu Shah - Dolat Capital - Mumbai

Thank you. That is, it from my side. All the best.

Rajyita - Moderator

Thank you, very much Mr. Shah. The last question comes from Mr. Gaurav Singhal from DK Partners, Hong Kong. Mr. Singhal you may ask your question now.

Gaurav Singhal - DK Partners - Hong Kong

Thank you for taking my question. I just wanted to follow up on a comment you made in an earlier question saying that tower companies and MNOs (Mobile Network Operators) are really part of the same industry. And if the environment improves it is going to benefit both, but if I just flip that statement around and look at the environment over the last three or four years, the mobile operators have been in a very bad environment, their earnings and return on capital has gone down quite substantially, but if I look at Infratel the EBITDA return numbers have not really declined anywhere to the same degree. So when your contracts come up for renewal, do you think there would be downward pressure on pricing just because your customers have seen their earnings go down quite substantially? I have a follow up after this.

Akhil Gupta - Chairman - Bharti Infratel Limited

I think if you look at the business model of the tower company, everything does not come up for renewal at the same time, and the problem which DS had pointed out was to reduce the prices in one, you have to reduce it for everything. But I do not see that happening. Besides this rates in the Indian tower industry are among the lowest in the world and therefore it is not that these rates are high. The increase in or the healthy ROCE is because of the sheer business model because the same asset is shared amongst various operators. I do not see that as a big risk.

Gaurav Singhal - DK Partners - Hong Kong

Got it. Then the other question I had was on Reliance Infratel. As you know, the resolution professional has put out a public notice inviting resolution applicants for the case, for the towers that Reliance Infratel has you mentioned there might be a lot of overlaps with your towers, so maybe it may not be a strategic fit for you, but do you think it makes sense for you to bid early as a financial investment if the towers are available, you know, something like $20000 or less per tower. Would you think you will be interested in submitting the bid in the next one week, before the deadline?

Akhil Gupta - Chairman - Bharti Infratel Limited

As you can see, we are not an NBFC so we will definitely not look at it as a financial investment. If it makes sense as an operational investment then yes, certainly we have a look.

Gaurav Singhal - DK Partners - Hong Kong

Just because I think the resolution applicants need to submit an indication of interest, I think, in the next one week, can you share, would you be submitting like an indication of interest before the deadline?

Akhil Gupta - Chairman - Bharti Infratel Limited

Well, one week is a long time to assess, but I really cannot give you any indication whether we will, or we won't.

Gaurav Singhal - DK Partners - Hong Kong

Just one last question, obviously after the merger your shareholding would change quite substantially in terms of the promoter entity and both your promoter entities have said that they are going to cut their shareholding down, Bharti Airtel as well as Vodafone PLC, I think, to a combined number of like 25-26%. I was just curious that it would obviously make the combined Indus-Infratel more independent. I am just curious if that were to happen and that is clearly the stated intention of Airtel as well as Vodafone PLC. If the shareholding of the Company was to become less MNO heavy and does that have implication on the earning returns like will they become closer to the US Tower Companies or other Global Tower Companies which are independent in terms of returns and pricing?

Akhil Gupta - Chairman - Bharti Infratel Limited

As you know the way Infratel and Indus have been run, they have always been very, very independent, irrespective of the shareholding percentages and we did not want that as a group to be independent, we would not have listed this company and of course, at the current moment in Infratel there was a majority ownership by Airtel, which in the new company, there will be nobody having the majority ownership, so that can only technically make it more independent and not less. But both these companies have always been run very, very independently without any kind of favour or pressure from any shareholder.

Gaurav Singhal - DK Partners - Hong Kong

Sir, just one last question, if I may, for Indus do you mind sharing, which month do they basically tend to pay their annual dividend, like is it August or is it July and also for the combined entity, what would be roughly our dividend policy that we are thinking?

Akhil Gupta - Chairman - Bharti Infratel Limited

I think the merged entity will have to have a look at the dividend policy, but I do not foresee any big change in that with the kind of free cash flow which we have and the fact that we are underleveraged I would expect the same policy as is prevalent today to continue.

Gaurav Singhal - DK Partners - Hong Kong

Got it, sorry, the Indus dividend is paid out in which month, is it July or is it August?

Akhil Gupta - Chairman - Bharti Infratel Limited

Normally it would have been paid out after the March full results, but I think now it can only be done after the merger.

Gaurav Singhal - DK Partners - Hong Kong

Thank you, Sir. Thank you very much.

Rajyita - Moderator

Thank you very much Mr. Singhal. At this moment, I would like to hand over the call proceedings to Mr. D.S. Rawat for the final remarks.

Devender Singh Rawat - Managing Director and Chief Executive Officer - Bharti Infratel Limited

Thank you very much. As Akhil cited, despite losing 14% of tenancies on a year-on-year basis we have managed to close the quarter with consolidated revenue at Rs.3,712 crores up 1% year-on-year and profit after tax at Rs.887 crores. This establishes the robustness of the business model. With the positive net additions during this quarter, we hope and believe that this trend would continue as the operators post consolidation and raising of significant capital recently will now focus on their growth strategy ensuring a strong 4G pan India presence by expanding coverage and capacity. We are best placed to capitalize on these opportunities by playing a key role in building and sharing wider telecom infrastructure with all customers on a non-discriminatory basis. Lastly, since this would be my last earning call, I wanted to take this opportunity to thank each one of you for the support extended in creating this fantastic company, Bharti Infratel and look forward to you support in taking this to newer heights that it truly deserves as a merged entity with pan-India footprint. Thank you very much.

Rajyita - Moderator

Ladies and gentlemen this conclude the conference call. You may now disconnect your lines. Thank you for connecting to audio conference service from Airtel and have a pleasant evening.