

Telecom: Show Us the Money (Dividend)

Telecom companies like Bharti Airtel, Reliance Communications and Idea have huge market capitalisation despite having no ability to pay dividends. More importantly the high valuation for these mobile telephone companies is encouraging them to take decisions which are not rational. These decisions increase revenue of these companies in short term, however in long term these decisions would harm holders of shares of these companies. High stock prices would eventually cure themselves.

Take the case of Bharti Airtel, which in our opinion is the best of the lot. It has been in operation for last 14 years. It is yet to pay its maiden dividend. There has been no cash generation in the company on net basis during all this time. The cash that is generated from operation is reinvested back to create more telecom infrastructure. Optimists might argue that this telecom infrastructure would one day generate cash adequate enough to reward the shareholders. That could happen. However we think chances of that happening are slim for two important reasons.

The first reason is high and increasing competition in mobile telephony. Among the major markets India has the lowest average revenue per customer. Bharti Airtel has much lower revenue per customer compared to its global peers. At the same time amount of talk time that each customer uses is high compared to other markets. So while the revenue is low the usage is high. This eventually means that mobile phones companies have to use higher proportion of their revenue on infrastructure. With the entry of newer players this situation would become worse. Even now every month the tariff rates are falling. New schemes are being floated which give unlimited talk time options. The regulator, TRAI, is insisting on better coverage and better service to customers. Any increase of tariff seems unlikely. In this scenario the cash flow situation would only get worse. For Bharti Airtel, this would mean going from slightly negative cash flow to hugely negative cash flow. For Reliance Communications it would probably mean going from significantly negative cash flow to disaster.

The second reason is high share prices have made capital availability too easy for these companies and with this no requirement to pay dividends the financial discipline has been lost. This indiscipline has lead companies to take irrational decision for which price would be paid. Similar companies in other parts of world like China Mobile, SingTel, etc. have been paying significant dividends. These companies have also grown at similar rates and have still paid dividends. This has been due to greater efficiency. In country like China, which has only two major players China Mobile and China Unicom these players have shared their mobile towers. In India however till now almost every company has built its own infrastructure. We have a situation where one can see at many places four or five mobile towers at the same place. At railway stations and airport all we can see is advertisements for mobile telephone companies. This is a waste of capital which has been promoted by high share prices. When holders of these shares face this reality there would be trouble.

The total valuation of Bharti Airtel is more than one lakh sixty thousand crores while for Reliance Communication the valuation is more than one lakh crores. These are huge numbers for companies which are not paying any dividend (like Bharti) or paying skin of peanuts (like Reliance Communications). These valuations imply that investors expect that these companies would churn out huge amount of cash flows. Given the current situation this seems unlikely. Since the stock market continues to value these companies very highly they don't even feel the need for reforming themselves. In fact they continue to commit even bigger mistakes. Customers are enjoying all this. They should enjoy it while it lasts. Holders of shares would ultimately pay customers bill.