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Moody's predicts 'difficult' times ahead for cellular operators

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Ratings agency Moody's said on Monday, 3 February, that the next three years would be "difficult" for MTN and Vodacom to maintain or increase their market share and compete more aggressively on price without reducing their margins and returns on investment.

The financial implications of lower termination rates may make it difficult for MTN and Vodacom to compete with smaller operators. Image: Wiki Images.

This comes after the Independent Communications Authority of SA cut the termination rates that mobile operators pay to carry each others' calls to 20c a minute from 40c. Moreover, MTN and Vodacom will have to pay small rivals Cell C and Telkom Mobile 44c, in what is described as asymmetric termination rates. The difference in rates is aimed at boosting the small companies' competitive advantage.

Dion Bate, vice-president and senior analyst at Moody's, said in markets such as those in Europe, mobile termination rates cuts, combined with the macroeconomic slowdown and heightened competition, have been negative for larger mobile operators, lowering margins and reducing investments in infrastructure, which can erode service quality.

Vodacom is expected to be the hardest hit because it has the largest market share of about 47% by revenue, followed by MTN, which has 37%. Moreover, the bulk of Vodacom's cash flow comes from SA.

The changes in termination rates are credit negative for MTN and Vodacom because they are net receivers of interconnection fees, which was the difference between mobile termination rate fees received and paid, said Bate.

Termination rates to decline

The termination rates will gradually decline over the next three years to 10c a minute. Bate said the overall effect on MTN's group earnings before interest, tax, depreciation and amortisation (ebitda) would be small because its South African operations accounted for just less than one quarter of its total group ebitda.

"We also expect only a limited effect on margins because although revenues will fall, costs will also decline owing to the lower termination rates it pays to Vodacom," says Bate.

Cell C and Telkom Mobile will benefit the most from the rate cuts.

Bate said the biggest benefit to Cell C's mobile operations and Telkom's mobile and fixed-line operations would be from cost savings from 50% lower charges they pay to the larger mobile operators.

Telkom is positioned to benefit the most, given the fact it paid fees of R1.1bn to other operators in the six months to September 2013, or 9% of its total operating costs.

"Although this will improve ebitda margins for both Telkom and Cell C, we expect the companies to pass on most of the savings to consumers through more aggressive pricing to increase market share," Bate said.