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India Ratings Assigns Vivo Mobile's NCDs Final 'IND BB'; Outlook Stable

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By Akash Krishnatry

India Ratings and Research (Ind-Ra) has assigned Vivo Mobile India Private Limited's (Vivo India) INR7 billion unsecured non-convertible debentures (NCDs) a final 'IND BB' rating with a Stable Outlook. The agency maintains a Long-Term Issuer Rating of 'IND BB' with a Stable Outlook on Vivo.

The final rating has been assigned after the receipt of final documents, except the debenture trustee deed. The pay-in date of the bonds was 22 December 2016. Although the debenture trustee deed has not been signed yet, Ind-Ra is relying on the final version of the unexecuted debenture trustee deed and the undertaking from the issuer that there will be no changes from the execution version shared with the agency. The management has confirmed that the final version shared with Ind-Ra will be executed shortly. The extant regulations allow the debenture trust deed to be executed within a specified time period after the allotment of bonds.

The documents shared are in conformity with the assumptions based on which the provisional rating was assigned. The final rating is, therefore, the same as the provisional rating assigned on 16 June 2016. The NCD proceeds are to be used for meeting capex and working capital requirements. The NCDs are being issued with a face value of INR1 million, and entail a coupon of 3% to be paid annually and a tenor of three years. The NCDs will be listed on the Bombay Stock Exchange, and Axis Trustee Services Limited has been appointed trustee for this issue.

KEY RATING DRIVERS

Vivo India is a relatively new player in the Indian mobile handset space. However, the Vivo brand of mobile phones is well-established in China, with a market share of about 16.2% in 2QFY17. It is placed second in terms of market position in China and fifth globally. Vivo India registered INR9.4 billion in revenue for FY16 (FY15: INR0.6 million); FY16 was its first full year of operations. Vivo India has been registering steep sales volume growth on account of technology-based product differentiation and considerable advertising and marketing spending. However, India's smartphone market is overcrowded with more than 25 brands and is, hence, extremely price sensitive, along with changing customer preferences and low brand loyalty. Therefore, gaining market share on a sustained basis would be challenging for any new player.

Vivo India registered EBITDA losses of INR1.65 billion and net losses of INR1.66 billion for FY16. The company expects to break even in FY17, with a quick pickup in mobile phone sales, though advertising and sales promotion expenditure will continue to remain high (FY16: INR845.5 million; FY15: INR377 million). The management has indicated that it would continue to spend 10%-15% of revenue on sales promotions over FY17-FY20. Heavy investment in brand building indicates Vivo India's seriousness to establish itself in the Indian market over the long term. However, such investment would continue to moderate its profitability over the short to medium term.

In December 2015, Vivo India set up a handset manufacturing plant in Greater Noida. The facility's existing annual capacity is 4.6 million handsets. The company plans to expand capacity to meet rapid pickup in demand. Vivo India invested about INR562 million in the setup of the facility in FY16 to save on import duties and reap the benefits of localised manufacturing. Handset imports are subject to a 13.5% duty, while domestic manufacturing is only subjected to a 2% excise duty. Vivo India manufactures about 90% of its handsets.

Vivo India is a net cash positive entity. Its working capital cycle is funded through high trade payable days (FY16: 207 days; FY15: 200 days). Vivo India has significant sales volume growth targets for the next five years and aims to gain a 10% market share by end-CY17 (1QFY17: about 3.5%).

Therefore, infusion of medium-term funds through INR7 billion NCDs would support its capex, marketing expenditure and growing working capital requirements. The management expects marginal profitability, along with capex requirements, in the short to medium term. This would lead to negative free cash flows and weak debt service coverage ratio, posing a refinancing risk.

The ratings factor in industry risks such as rapid technological changes, changing consumer preferences and competitive pricing pressures. Other risks include forex risks as a result of handset imports. This risk is partially mitigated by increasing the mix of indigenous sourcing/manufacturing.

RATING SENSITIVITIES

Positive: A turnaround in EBITDA and increased ability to service debt obligations from internal accruals could be positive for the ratings.

Negative: Lower traction in revenue leading to continued EBITDA losses and lack of timely funding support from the parent and/or suppliers could be negative for the rating.

COMPANY PROFILE

Incorporated in August 2014, Vivo India is engaged in the manufacture and sale of smartphones and wholesale trading of mobile spare parts and accessories. It plans to increase its production facility's capacity in line with demand.

SOLICITATION DISCLOSURES

Additional information is available at www.indiaratings.co.in. The ratings above were solicited by, or on behalf of, the issuer, and therefore, India Ratings has been compensated for the provision of the ratings.

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Rating Outstanding

(As on 29/Dec/2016)

Long Term Issuer Rating	IND BB / Stable	
Non Convertible Debenture	IND BB / Stable	INR 7000 m

Applicable Criteria

Corporate Rating Methodology

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