

BSNL

Mega IPO in the pipeline

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Largest integrated telecom operator in India

Bharat Sanchar Nigam (BSNL) is India's largest telecom operator with a subscriber base of 73 mn (in June '08), annualised 9MFY08 topline of INR 332 bn, and estimated net profit of INR 75 bn. BSNL, owned by the Government of India (GoI), was carved out of the Department of Telecom in October 2000. It is an integrated teleco, operating a vast pan-India telecom network (barring Delhi and Mumbai), and providing a comprehensive range of telecom services like wireline, wireless (CDMA and GSM), broadband, carrier, MPLS-VPN, VSAT, VoIP services, etc.

Media reports indicate BSNL's valuation at USD 35.5-47.5 bn

BSNL is likely to come out with its initial public offer (IPO), whereby the GoI will divest ~10% stake in the company. As per media reports, the telecom minister has indicated a price band of INR 300-400/share, which on a paid-up equity of INR 50 bn (FV of INR 10) implies a market cap of INR 1.5-2 tn (USD 35.5-47.5 bn). This is less than half the earlier reported valuation of USD 100 bn, but it will still place BSNL at a higher market cap than Bharti Airtel (Bharti; USD 37 bn) and Reliance (RCOM; USD 21 bn). The IPO size, estimated at USD 3.5-4.7 bn, will be the largest in India so far. The IPO has currently hit a roadblock on account of opposition from the BSNL employee union.

Potential listing implications

We believe that reported valuations for BSNL are at a significant premium to current valuations of the listed Indian telcos (please refer table 2). However, if BSNL does go public at reported valuations, we believe two scenarios arise (1) Valuation re-rating of other listed telcos upwards to match BSNL's valuations, or (2) BSNL's valuations align with peers post listing. We believe the former is unlikely in context of current equity environment.

We are also likely to see some reallocation of telecom investment portfolios in order to accommodate BSNL. With the listing of BSNL, the scope for investors to participate in the fastest-growing telecom market becomes wider. While BSNL will provide a sizeable listed alternative to BHARTI (foreign ownership at peak levels) and RCOM, we believe the implications for listed telcos will be a mixed bag.

We believe that market leader Bharti Airtel (BHARTI) would be less impacted by the availability of a sub-par alternative in the form of BSNL. BSNL's wireless subscriber growth rate, profitability and return ratios are significantly lower than that of BHARTI. Besides, the rapid decline of a sizeable fixed-line subscriber base owing to fixed-to-mobile substitution increases the risk quotient for BSNL.

However, pure wireless operators could stand at risk as investors seek telcos with integrated business models vis-à-vis pure play access service providers. BSNL could command a premium valuation vis-à-vis pure wireless plays like Idea/MTNL, on the ownership strength of India's largest telecom network with rural reach and last mile ownership far ahead of private telcos.

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Table 1: Implied valuations at indicated price band of INR 300-400/share

	At lower end of price band (INR 300/share)	At upper end of price band (INR 400/share)
Price (INR)	300	400
Equity capital (INR mn)	50,000	50,000
Market cap (bn)	1,500	2,000
Debt (INR bn, FY08E)	60	60
Cash (INR bn, FY08E)	386	386
EV (INR bn)	1,174	1,674
FY09E Revenue*	381	381
FY09E EBITDA**	144	144
FY09E Net profit**	86	86
Preference dividend	6.8	6.8
Net profit after pref. dividend	79	79
PE (x)	18.9	25.2
EV/EBITDA (x)	8.1	11.6

*Assuming 15% growth over annualized 9MFY08 revenue

**Assuming flat operating and net profit margin Y-o-Y

Source: Industry, Edelweiss research

Table 2: Comparative valuations

Company	CMP (INR)	P/E (x)	EV/EBITDA (x)			EV/sub
		FY08	FY09E	FY08	FY09E	FY09E
BHARTI	818	23.2	18.6	14.1	10.5	302
RCOM	438	17.5	15.4	12.4	9.4	386
IDEA	86	22.1	17.9	12.7	9.4	318
BSNL (at lower end)	300	22.1	18.9	9.3	8.1	320
BSNL (at upper end)	400	29.4	25.2	13.3	11.6	457

Source: Edelweiss research

SWOT analysis**STRENGTHS**

Integrated operator with pan-Indian telecom infrastructure

Strong rural reach— presence in over 0.6mn villages

Populist government support—recent sops include preferential allotment for spectrum (3G & BWA), exemption from license fees for rural lines, and USO fund support of INR 20 bn per annum

Cash rich PSU—cash-in-hand of USD 10 bn, which should provide ample support for expansion plans

OPPORTUNITIES

Sector fundamentals on strong footing, large under-penetrated addressable market

Competitive advantage, given vast pan-Indian telecom infrastructure—larger than any competitor

With preferential allotment of 3G spectrum, BSNL could gain a first mover advantage in the offering of 3G services

Possible long-pending merger with MTNL could provide entry into the lucrative telecom markets of Delhi and Mumbai

WEAKNESSES

Inefficiencies in operations negatively impacts competitive position—delay in rollout of critical wireless network and other expansion plans places BSNL at a competitive disadvantage vis-à-vis private operators

Social rollout obligation in unprofitable rural areas

Continued attrition of high ARPU wireline customers, owing to fixed-to-mobile substitution

Not present in the profitable metro circles of Mumbai and Delhi

THREATS

Private operators continue to have an edge in terms of pace of network rollout and brand presence

With the phase-out of ADC, BSNL no longer enjoys support for its subsidised rural operations

Weakening wireless operating metrics, with addition of marginal low-usage customers, and continued attrition of higher ARPU profitable wireline customers could negatively impact profitability

Source: Edelweiss research

Key metrics

	BSNL	RCOM	BHARTI	Idea
FY08 Financials (INR mn)				
Revenue*	331,587	190,677	270,250	67,200
EBITDA**	125,286	81,989	113,714	22,517
Net profit**	74,772	54,011	67,007	10,423
EBITDA margin (%)	37.8	43.0	42.1	33.5
Net profit margin (%)	22.5	28.3	24.8	15.5
Subscriber base (June '08)				
Wireless (GSM) (mn)	37.4	7.7	69.4	27.2
Wireless (CDMA) (mn)	4.6	42.7	0.0	0.0
Wireline (mn)	30.9	1.0	2.3	0.0
Market share				
Wireless market share (%)	14.6	17.7	24.1	9.5
Wireline market share (%)	79.5	2.5	5.9	0.0
Infrastructure (March '08)				
Estm. towers ('000)	40.0	36.0	52.0	12.0
Domestic Fibre network ('000 kms)	600	78.5	110	NM
Locations	7,330 villages	5,000 census towns and villages	5,048 census towns and census towns	2,476 census towns and population centers

*9MFY08 annualised for BSNL

**assuming flat operating and net margins Y-o-Y for BSNL

Source: Media reports, TRAI, Edelweiss research

Financial Statements

Income statement		(INR mn)				
Year to March	FY03	FY04	FY05	FY06	FY07	
Net revenues	252,931	313,993	334,500	361,389	346,162	
Direct costs	34,316	37,131	33,024	35,231	33,117	
Employee costs	62,660	63,766	83,930	74,206	73,090	
Other expenses	54,655	71,118	80,520	104,969	109,163	
Total operating expenses	151,631	172,015	197,473	214,406	215,369	
EBITDA	101,300	141,978	137,027	146,984	130,793	
Depreciation and amortisation	95,513	98,737	96,249	10,898	7,794	
EBIT	5,787	43,241	40,778	136,086	122,999	
Interest expenses	3,646	882	293	93,767	91,493	
Other income	5,995	25,192	26,400	40,377	50,989	
Profit before tax	8,136	67,551	66,886	82,695	82,495	
Provision for tax	12,135	30,196	(22,632)	(4,927)	3,479	
Core profit	(3,998)	37,354	89,518	87,622	79,015	
Extraordinary items	23,000	23,000	17,659	5,830	0	
Prior period adjustments	(4,557)	(589)	(5,344)	(4,055)	(956)	
Profit after tax	14,444	59,765	101,833	89,397	78,059	
Profit after minority interest	14,444	59,765	101,833	89,397	78,059	
Equity shares outstanding (mn)	5,000	5,000	5,000	5,000	5,000	
EPS (INR) basic	(0.8)	7.5	17.9	17.5	15.8	
Diluted shares (mn)	5,000	5,000	5,000	5,000	5,000	
EPS (INR) fully diluted	(0.8)	7.5	17.9	17.5	15.8	
CEPS (INR)	18.3	27.2	37.2	19.7	17.4	

Common size metrics- as % of net revenues

Year to March	FY03	FY04	FY05	FY06	FY07
Operating expenses	59.9	54.8	59.0	59.3	62.2
Depreciation	37.8	31.4	28.8	3.0	2.3
Interest expenditure	1.4	0.3	0.1	25.9	26.4
EBITDA margins	40.1	45.2	41.0	40.7	37.8
Net profit margins	5.7	19.0	30.4	24.7	22.5

Growth metrics (%)

Year to March	FY03	FY04	FY05	FY06	FY07
Revenues	4.1	24.1	6.5	8.0	(4.2)
EBITDA	(22.4)	40.2	(3.5)	7.3	(11.0)
PBT	(80.7)	730.2	(1.0)	23.6	(0.2)
Net profit	(77.1)	313.8	70.4	(12.2)	(12.7)
EPS	(110.9)	(1,034.3)	139.6	(2.1)	(9.8)

Balance sheet

As on 31st March	FY03	FY04	FY05	FY06	FY07
Equity capital	50,000	50,000	50,000	50,000	50,000
Preference capital	75,000	75,000	75,000	75,000	75,000
Reserves & surplus	434,218	505,189	602,791	682,565	744,480
Shareholders funds	559,218	630,189	727,791	807,565	869,480
Unsecured loans	78,864	75,371	82,209	72,839	55,437
Borrowings	83,964	75,371	82,209	72,839	55,437
Deferred tax liability	45,489	55,234	30,440	17,040	12,461
Sources of funds	688,672	760,794	840,440	897,444	937,377
Gross block	853,407	952,879	1,041,022	1,116,920	1,186,490
Accumulated depreciation	223,306	324,262	423,331	515,035	607,151
Net block	630,101	628,617	617,691	601,885	579,339
Capital work in progress	92,651	60,027	46,527	38,939	26,330
Total fixed assets	722,751	688,644	664,218	640,824	605,669
Investments	2,000	2,000	2,000	2,000	2,000
Inventories	31,703	23,432	22,454	27,892	24,285
Sundry debtors	53,671	39,795	66,370	63,021	62,299
Cash and equivalents	34,397	115,575	220,748	312,158	385,944
Loans and advances	43,867	97,045	75,216	92,321	64,951
Total current assets	163,638	275,847	384,788	495,391	537,479
Sundry creditors and others	173,101	149,281	146,154	161,232	166,792
Provisions	33,899	58,866	73,862	88,822	51,486
Total CL & provisions	207,000	208,147	220,016	250,055	218,278
Net current assets	(43,362)	67,700	164,772	245,336	319,201
Intra-Intercircle remittance	7,282	2,449	9,450	9,284	10,507
Uses of funds	688,672	760,794	840,440	897,444	937,377
Book value per share (BV) (INR)	110	126	144	160	172

Profitability & liquidity ratios

Year to March	FY03	FY04	FY05	FY06	FY07
ROAE (%)	(0.7)	5.9	12.3	10.9	9.1
ROACE (%)	0.8	6.0	5.1	15.7	13.4
Current ratio	0.8	1.3	1.7	2.0	2.5
Debtors (days)	80	54	58	65	66
Fixed assets t/o (x)	0.4	0.4	0.5	0.6	0.6
Average working capital t/o (x)	(6.9)	25.8	2.9	1.8	1.2
Debt/Equity	0.2	0.1	0.1	0.1	0.1
Debt/EBITDA	0.8	0.5	0.6	0.5	0.4
Adjusted debt/Equity	0.2	0.1	0.1	0.1	0.1

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Coverage group(s) of stocks by primary analyst(s): *Telecomm:*

Bharti Airtel, Mahanagar Telephone Nigam, Reliance Communications, Tulip IT services and Tata Communications

Recent Research

Date	Company	Title	Price (INR)	Recos
09-Aug-08	RCom	Unimpressive quarter; outlook cautious; <i>Result Update</i>	438	Accum.
07-Aug-08	Telecom	TRAI recommendations on MVNOs <i>Sector Update</i>		
05-Aug-08	Telecom	3G policy: Key highlights <i>Sector Update</i>		
01-Aug-08	Tulip Telecom	On track; <i>Result Update</i>	950	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	101	56	14	7	189

* 10 stocks under review / 1 rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	82	71	36

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 20% over a 12-month period
Accumulate	appreciate up to 20% over a 12-month period
Reduce	depreciate up to 10% over a 12-month period
Sell	depreciate more than 10% over a 12-month period

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