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# 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 telecos (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 telecos 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 telecos 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 telecos 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 telecos.

**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**

| | | P/E (x) | | EV/EBITDA (x) | | EV/sub |
|---|---|---|---|---|---|---|
| **Company** | **CMP (INR)** | **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 | WEAKNESSES |
|---|---|
| Integrated operator with pan-Indian telecom infrastructure | 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 |
| Strong rural reach— presence in over 0.6mn villages | Social rollout obligation in unprofitable rural areas |
| 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 | Continued attrition of high ARPU wireline customers, owing to fixed-to-mobile substitution |
| Cash rich PSU—cash-in-hand of USD 10 bn, which should provide ample support for expansion plans | Not present in the profitable metro circles of Mumbai and Delhi |

| OPPORTUNITIES | THREATS |
|---|---|
| Sector fundamentals on strong footing, large under-penetrated addressable market | Private operators continue to have an edge in terms of pace of network rollout and brand presence |
| Competitive advantage, given vast pan-Indian telecom infrastructure—larger than any competitor | With the phase-out of ADC, BSNL no longer enjoys support for its subsidised rural operations |
| With preferential allotment of 3G spectrum, BSNL could gain a first mover advantage in the offering of 3G services | Weakening wireless operating metrics, with addition of marginal low-usage customers, and continued attrition of higher ARPU profitable wireline customers could negatively impact profitability |
| Possible long-pending merger with MTNL could provide entry into the lucrative telecom markets of Delhi and Mumbai | |

*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 cities/towns; 0.6mn villages | 5,000 census towns and 0.36mn villages | 5,048 census towns and 0.36 mn non-census towns | 2,476 census towns and 13,308 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; *Result Update* | 438 | Accum. |
| 07-Aug-08 | **Telecom** | TRAI recommendations on MVNOs *Sector Update* | | |
| 05-Aug-08 | **Telecom** | 3G policy: Key highlights *Sector Update* | | |
| 01-Aug-08 | **Tulip Telecom** | On track; *Result Update* | 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 |