

Strategy

January 08, 2024

Privatization—the 3P challenges

We find the Street's hopes about privatization of PSUs quite misplaced given the issues of (1) policy, (2) practice and (3) price. (1) The government's stated policy on privatization of PSUs, (2) practical issues seen in previous attempts to privatize PSUs and (3) high prices of PSUs should provide plentiful caution against making privatization as an investment thesis for PSUs.

Sharp run-up in PSU stock prices; don't bank on privatization

We are not sure if the privatization thesis for PSUs is an *ex ante* reason for or a *post facto* justification for the sharp run-up in stock prices of PSUs in the past few months (see Exhibit 1). We are surprised by the privatization argument for PSUs in light of (1) stated policy of the government for PSUs, (2) practical challenges seen in the attempts to privatize BPCL, CCRI and (3) high prices (inflated valuations) of the PSUs with many PSUs trading at a large premium to their private sector counterparts, presumably the bidders for the PSUs.

Policy—one or more PSUs in four broad strategic sectors

We rule out privatization of most of the larger PSUs (see Exhibit 2 for a list of PSUs and their respective sectors) given the stated policy of the government to retain control over one or more PSUs in a strategic sector. Under its New Public Sector Enterprise Policy of February 2021, the government has classified certain sectors as strategic for national security, energy security, critical infrastructure, etc. reasons. These four broad sectors include (1) atomic energy, space and defense, (2) banking, insurance and financial services, (3) power, petroleum, coal and other minerals and (4) transport and communication.

Practice—not easy

We note severe practical challenges that have stymied and may stymie the government's privatization efforts. The case of CCRI is noteworthy, as the government had to rework several agreements between CCRI and Indian Railways (see Exhibit 3 for details) to enable the privatization of CCRI, which is yet to take place despite being cleared for privatization in November 2019. BPCL did not see much interest among potential bidders given the sunset nature of the oil refining and marketing sector. BPCL is a good example of the difference in approach to investment and ownership between strategic (long-term view of sector) and financial (relatively short-term view) investors.

Price—PSUs are trading at a premium to their private sector peers

We note that valuations of most PSUs have expanded sharply over the past few months (see Exhibit 4, which compares current, six-month ago and 12-month ago 1-year forward P/E or P/B of select PSUs). The high valuations of the PSUs may reduce the interest of potential bidders even assuming that the government was keen to privatize some of the PSUs. In fact, some of the possible candidates for privatization in the non-strategic sectors (metals, transportation) now trade at a large premium to their private sector peers (see Exhibit 5).

Key estimates summary

	2023	2024E	2025E
Nifty estimates			
Earnings growth (%)	11.3	18.4	11.0
Nifty EPS (Rs)	813	974	1,089
Nifty P/E (X)	26.5	22.1	19.8
Macro data			
Real GDP (%)	7.2	7.0	6.3
Avg CPI inflation (%)	6.7	5.4	4.5

Source: CEIC, Kotak Institutional Equities estimates

Quick Numbers

BSE PSU Sector Index is up 29%, 42% and 56% in the past three, six and 12 months

Four broad sectors and 10 sectors classified as strategic by the Indian government

CCRI trades at 38% premium to ADSEZ, NALCO at 21% premium to Hindalco and SAIL at 2.5% premium to TATA on 12-month forward P/E basis

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PSU stocks have seen sharp increase in their prices over the past few months

Exhibit 1: Performance of PSU stocks (sorted on market cap. basis) (%)

Company	Sector	Performance (%)			
		1M	3M	6M	12M
NTPC	Electric Utilities	11	34	64	87
ONGC	Oil, Gas & Consumable Fuels	11	20	33	48
Coal India	Oil, Gas & Consumable Fuels	8	32	63	78
Power Grid Corp.	Electric Utilities	6	23	26	55
Hindustan Aeronautics	Capital goods	10	53	59	140
IOCL	Oil, Gas & Consumable Fuels	12	48	34	66
Bharat Electronics	Capital goods	16	32	48	86
GAIL (India)	Gas Utilities	14	29	45	65
BPCL	Oil, Gas & Consumable Fuels	(3)	31	16	32
IRCTC	Commercial & Professional Services	22	27	45	44
NHPC	Electric Utilities	12	33	53	78
BHEL	Capital goods	10	51	113	139
NMDC	Metals & Mining	17	48	101	77
Container Corp.	Transportation	3	22	30	18
Fertilizers & Chemicals Travancore	Fertilizers & Agricultural Chemicals	6	51	72	129
SAIL	Metals & Mining	17	29	32	33
Mazagon Dock	Capital goods	8	3	68	176
Oil India	Oil, Gas & Consumable Fuels	17	27	48	79
Rail Vikas Nigam	Construction & Engineering	6	7	49	151
SJVN	Electric Utilities	7	30	97	174
Bharat Dynamics	Capital goods	30	72	56	83
Neyveli Lignite Corp.	Electric Utilities	21	59	105	166
ITI	IT services	3	58	179	195
Hindustan Copper	Metals & Mining	44	73	124	131
National Aluminium Co.	Metals & Mining	27	30	49	52
KIOCL	Metals & Mining	(0)	16	102	75
Cochin Shipyard	Capital goods	2	21	123	158
IRCON International	Construction & Engineering	12	27	119	206
NBCC	Construction & Engineering	8	39	112	120
NMDC Steel	Metals & Mining	7	(3)	14	NA
GMDC	Oil, Gas & Consumable Fuels	9	37	172	203
BEML	Capital goods	29	36	106	113
RITES	Commercial & Professional Services	7	6	35	52
Railtel Corp.	Telecommunication Services	21	59	161	175
Engineers India	Construction & Engineering	30	39	64	137
CPCL	Oil, Gas & Consumable Fuels	5	48	62	246
Garden Reach Shipbuilders & Engineers	Capital goods	4	6	50	81
MMTC	Capital goods	15	14	107	87
Rashtriya Chemicals & Fertilizers	Fertilizers & Agricultural Chemicals	8	32	41	26
Shipping Corp.	Transportation	4	14	68	52
Mishra Dhatu Nigam	Metals & Mining	3	(3)	32	84
MOIL	Metals & Mining	2	44	72	86
HMT	Capital goods	(3)	(10)	78	51
National Fertilizer	Fertilizers & Agricultural Chemicals	26	39	35	34
Hemisphere Prop	Real Estate	20	50	66	60
MSTC	Capital goods	45	49	75	115
ITDC	Hotels & Restaurants	6	17	39	33
MTNL	Telecommunication Services	17	22	79	44
Andrew Yule & Co.	Consumer Staples	24	15	54	49
Madras Fertilizers	Fertilizers & Agricultural Chemicals	5	45	42	52
State Trading Corp.	Capital goods	10	20	79	59
Scooters India	Automobiles & Components	4	102	127	121
Hindustan Organic Chemicals	Commodity Chemicals	66	66	107	83
Bharat Immunolog	Pharmaceuticals	33	46	54	10
Punjab Communications	IT services	21	7	50	63
Hindustan Fluorocarbons	Commodity Chemicals	55	50	119	85
Banks/Finance					
State Bank of India	Banks	2	6	6	4
LIC	Insurance	7	28	32	16
PFC	Diversified financials	5	65	129	223
IRFC	Diversified financials	30	34	202	206
Bank of Baroda	Banks	5	4	7	22
Punjab National Bank	Banks	10	24	57	68
Union Bank	Banks	5	16	53	52
Canara Bank	Banks	3	20	35	41
Indian Overseas Bank	Banks	1	(7)	63	39
Indian Bank	Banks	(0)	0	38	45
GIC	Insurance	2	38	69	72
Bank of India	Banks	4	9	48	27
UCO Bank	Banks	2	(6)	40	30
Central Bank of India	Banks	7	1	63	60
New India Assurance	Insurance	(3)	59	87	74
Bank of Maharashtra	Banks	(1)	(5)	44	50
Punjab & Sind Bank	Banks	(0)	(5)	31	35
IREDA	Diversified financials	47	NA	NA	NA
HUDCO	Diversified financials	37	35	113	139
J&K Bank	Banks	11	11	85	128
IFCI	Diversified financials	11	23	140	118
Gujarat State Financial Corp.	Diversified financials	122	104	256	209

Source: Capitaline, Kotak Institutional Equities

Many of the larger PSUs fall in the category of strategic sectors

Exhibit 2: List of PSUs with more than 51% government holding (sorted on market cap.)

Company	Sector	Market Cap.		Govt holding (%)	Stake sale	
		(Rs bn)	(US\$ bn)		Entire	up to 51%
Non-financial PSUs						
NTPC	Electric Utilities	3,069	37	51.1	1,568	3
ONGC	Oil, Gas & Consumable Fuels	2,742	33	58.9	1,615	216
Coal India	Oil, Gas & Consumable Fuels	2,344	28	63.1	1,480	284
Power Grid Corp.	Electric Utilities	2,254	27	51.3	1,157	8
Hindustan Aeronautics	Capital goods (defense)	2,003	24	71.6	1,435	413
IOCL	Oil, Gas & Consumable Fuels	1,873	23	51.5	965	9
Bharat Electronics	Capital goods (defense)	1,342	16	51.1	686	2
GAIL (India)	Gas Utilities	1,057	13	51.5	544	5
BPCL	Oil, Gas & Consumable Fuels	987	12	53.0	523	20
IRCTC	Commercial & Professional Services	733	9	62.4	458	84
NHPC	Electric Utilities	709	9	71.0	503	141
BHEL	Capital goods	680	8	63.2	429	83
NMDC	Metals & Mining	631	8	60.8	383	62
Container Corp.	Transportation	531	6	54.8	291	20
Fertilizers & Chemicals Travancore	Fertilizers & Agricultural Chemicals	522	6	90.0	470	204
SAIL	Metals & Mining	472	6	65.0	307	66
Mazagon Dock	Capital goods	448	5	84.8	380	151
Oil India	Oil, Gas & Consumable Fuels	406	5	56.7	230	23
Rail Vikas Nigam	Construction & Engineering	380	5	72.8	277	83
SJVN	Electric Utilities	371	4	81.9	304	115
Bharat Dynamics	Capital goods (defense)	315	4	74.9	236	75
Neyveli Lignite Corp.	Electric Utilities	306	4	79.2	242	86
ITI	IT services	291	3	90.3	263	114
Hindustan Copper	Metals & Mining	259	3	66.1	171	39
KIOCL	Metals & Mining	228	3	99.0	226	109
National Aluminium Co.	Metals & Mining	227	3	51.3	117	1
Cochin Shipyard	Capital goods (defense)	170	2	72.9	124	37
IRCON International	Construction & Engineering	169	2	73.2	124	37
NBCC	Construction & Engineering	153	2	61.8	95	16
NMDC Steel	Metals & Mining	146	2	60.8	89	14
GMDC	Oil, Gas & Consumable Fuels	144	2	74.0	106	33
BEML	Capital goods	132	2	54.0	71	4
RITES	Commercial & Professional Services	122	1	72.2	88	26
Railtel Corp.	Telecommunication Services	111	1	72.8	81	24
Engineers India	Construction & Engineering	112	1	51.3	57	0
CPCL	Oil, Gas & Consumable Fuels	107	1	51.9	55	1
MMTC	Capital goods	101	1	89.9	90	39
Garden Reach Shipbuilders & Engineers	Capital goods (defense)	99	1	74.5	74	23
Rashtriya Chemicals & Fertilizers	Fertilizers & Agricultural Chemicals	91	1	75.0	68	22
Shipping Corp.	Transportation	78	1	63.8	50	10
Mishra Dhatu Nigam	Metals & Mining	75	1	74.0	56	17
MOIL	Metals & Mining	63	1	64.7	41	9
HMT	Capital goods	61	1	93.7	58	26
Hemisphere Prop	Real Estate	49	1	51.1	25	0
National Fertilizer	Fertilizers & Agricultural Chemicals	48	1	74.7	36	11
MSTC	Capital goods	44	1	64.8	29	6
ITDC	Hotels & Restaurants	39	0	87.0	34	14
MTNL	Telecommunication Services	22	0	56.3	13	1
Andrew Yule & Co.	Consumer Staples	19	0	89.3	17	7
Madras Fertilizers	Fertilizers & Agricultural Chemicals	18	0	59.5	10	1
Total		27,373	329		16,766	2,806
Financial PSUs						
State Bank of India	Banks	5,596	67	56.9	3,185	331
LIC	Insurance	5,211	63	96.5	5,028	2,371
PFC	Diversified financials	1,339	16	56.0	750	67
IRFC	Diversified financials	1,306	16	86.4	1,128	462
Bank of Baroda	Banks	1,156	14	64.0	739	150
Punjab National Bank	Banks	1,046	13	73.2	765	232
Union Bank	Banks	908	11	77.0	699	236
Canara Bank	Banks	817	10	62.9	514	97
Indian Overseas Bank	Banks	816	10	96.4	786	370
Indian Bank	Banks	574	7	73.8	424	131
GIC	Insurance	546	7	85.8	468	190
Bank of India	Banks	539	6	73.4	395	121
UCO Bank	Banks	484	6	95.4	461	215
Central Bank of India	Banks	438	5	93.1	407	184
New India Assurance	Insurance	366	4	85.4	313	126
Bank of Maharashtra	Banks	325	4	86.5	281	115
Punjab & Sind Bank	Banks	292	4	98.3	287	138
IREDA	Diversified financials	282	3	75.0	212	68
HUDCO	Diversified financials	249	3	81.8	203	77
J&K Bank	Banks	139	2	59.4	83	12
IFCI	Diversified financials	75	1	70.3	53	15
Total		22,517	271		17,192	5,708
Total		49,890	600		33,958	8,514

Source: Capitaline, Kotak Institutional Equities

Several hurdles had to be overcome to enable privatization of CCRI

Exhibit 3: Key events in the timeline of proposed divestment of stake in Concor

	Event	Impact
Mar-20	Ministry of Railways decided to levy land license fee (LLF) at 6% of market value and 7% annual inflation	Land license fee (LLF) for Concor increased manifold, lowering the cost disadvantage for its peers in the private sector
Nov-20	Concor's results release suggests Indian Railways' demand of LLF of Rs7.6 bn for two terminals against Rs2 bn of LLF payment Concor made for all its terminals in the previous year	The formula for calculating market value of land in select terminals became a matter of discussion between Concor and Indian Railways
Sep-22	Ministry of Railways decided to (1) give option to Concor to lower land license fee to 1.5% from 6% in lieu of it letting the concession to be rebid on parameter of terminal charges (out of handling income earned from customers), (2) follow a process of bidding incremental concessions of railway land on similar terms	The endeavour was to enable Concor's peers to bid for incremental concessions. Concor decided to hold on to most terminals to start with. However, it let go of the key Tughlakabad terminal in Delhi while setting a substitute facility to cater to related traffic

Source: Industry reports, Kotak Institutional Equities

Sharp rerating in most non-financial PSU stocks over the past year

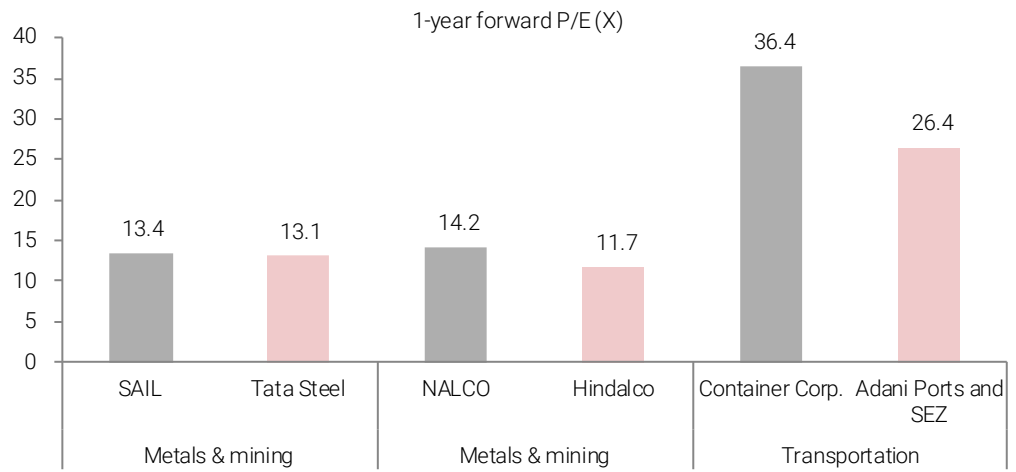
Exhibit 4: Valuation of PSU stocks (sorted on mcap.) over the past 12 months (X)

Company	Sector	P/E (X)			Company	Sector	P/B (X)		
		12-m prior	6-m prior	Current			12-m prior	6-m prior	Current
Non-financial companies				Banks/Finance					
NTPC	Electric Utilities	9.0	9.7	14.6	State Bank of India	Banks	1.6	1.5	1.4
ONGC	Oil, Gas & Consumable Fuels	3.9	4.4	5.7	LIC	Insurance	12.9	5.1	5.0
Coal India	Oil, Gas & Consumable Fuels	5.7	6.5	8.8	PFC	Diversified financial	0.6	0.8	1.5
Power Grid Corp.	Electric Utilities	9.8	11.5	13.9	Bank of Baroda	Banks	1.0	1.0	1.0
Hindustan Aeronautics	Capital goods	16.9	23.1	33.9	Punjab National Bank	Banks	0.7	0.7	1.0
IOCL	Oil, Gas & Consumable Fuels	6.9	6.3	6.8	Union Bank	Banks	0.8	0.7	1.0
Bharat Electronics	Capital goods	22.0	25.5	34.2	Canara Bank	Banks	0.8	0.8	0.9
GAIL (India)	Gas Utilities	8.4	8.5	11.5	Indian Overseas Bank	Banks	2.5	NA	NA
BPCL	Oil, Gas & Consumable Fuels	11.4	8.1	6.8	Indian Bank	Banks	0.8	0.8	1.0
IRCTC	Commercial & Professional Serv	50.6	44.2	56.5	GIC	Insurance	0.8	0.7	1.0
NHPC	Electric Utilities	9.6	10.8	15.8	Bank of India	Banks	0.7	0.5	0.8
BHEL	Capital goods	32.5	37.9	71.9	Central Bank of India	Banks	0.9	NA	NA
NMDC	Metals & Mining	7.0	6.1	10.0	New India Assurance	Insurance	0.7	0.6	1.1
Container Corp.	Transportation	29.6	29.1	36.4	Bank of Maharashtra	Banks	NA	NA	1.5
SAIL	Metals & Mining	7.2	8.7	13.4	J&K Bank	Banks	NA	NA	1.1
Mazagon Dock	Capital goods	16.9	23.9	30.0					
Oil India	Oil, Gas & Consumable Fuels	3.9	4.6	6.3					
Rail Vikas Nigam	Construction & Engineering	NA	NA	25.2					
SJVN	Electric Utilities	11.2	12.5	22.3					
Bharat Dynamics	Capital goods	22.4	30.0	41.5					
Neyveli Lignite Corp.	Electric Utilities	NA	NA	14.2					
National Aluminium Co.	Metals & Mining	8.6	7.3	14.2					
Cochin Shipyard	Capital goods	12.6	15.8	27.4					
IRCON International	Construction & Engineering	8.3	10.8	19.8					
NBCC	Construction & Engineering	19.4	16.5	32.1					
GMDC	Oil, Gas & Consumable Fuels	5.2	7.8	22.0					
BEML	Capital goods	27.4	24.7	31.6					
RITES	Commercial & Professional Serv	13.2	15.4	21.8					
Engineers India	Construction & Engineering	11.6	14.5	23.1					
CPCL	Oil, Gas & Consumable Fuels	2.2	6.1	6.9					
Garden Reach Shipbuilders & Engineers	Capital goods	10.8	15.2	20.5					
Mishra Dhatu Nigam	Metals & Mining	18.9	30.4	38.0					
MOIL	Metals & Mining	9.6	8.5	13.3					

Source: Factset, Kotak Institutional Equities

A number of PSU stocks are trading at a premium to their private sector counterparts

Exhibit 5: 1-year forward P/E of PSU stocks versus their private peers, January 2024 (X)



Source: Factset, Kotak Institutional Equities estimates

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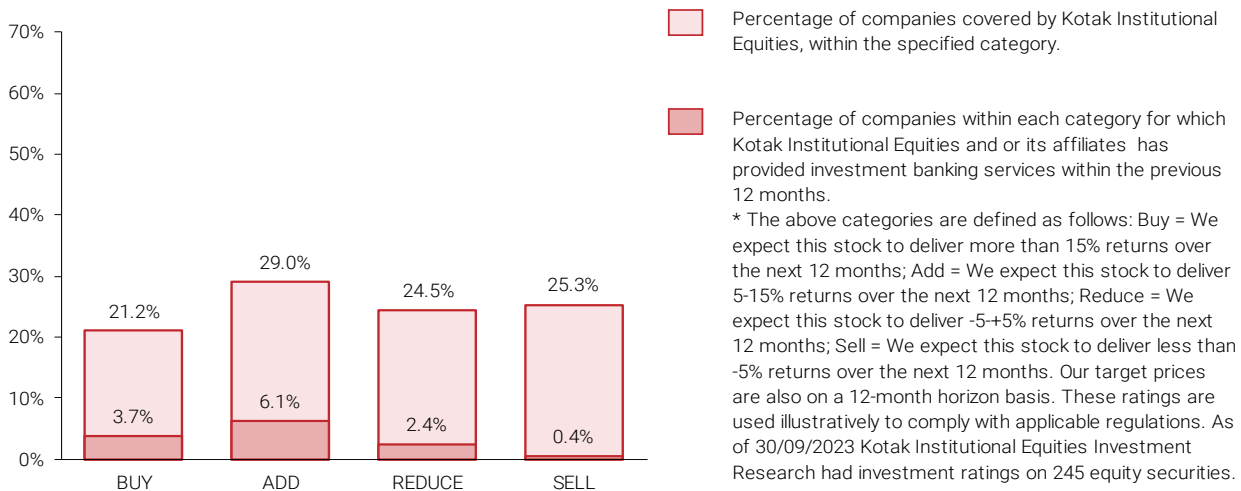
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