CareEdge RATINGS

Huge Divestment Potential but Hurdles Remain

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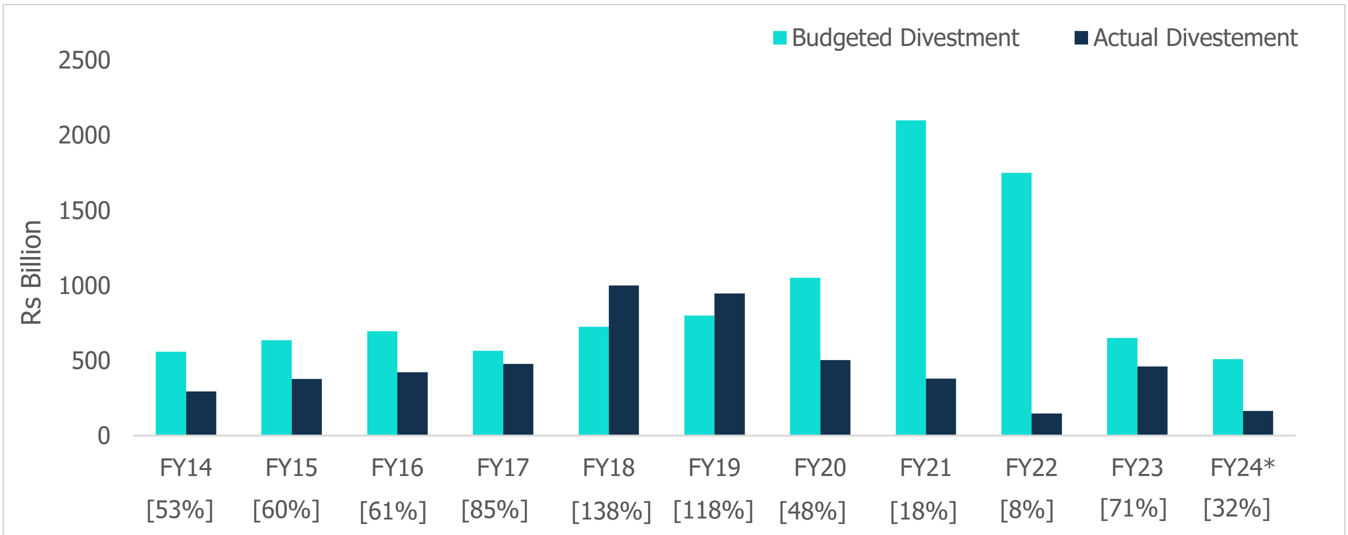
With the election season concluded, the finance minister is set to present the Union Budget this month. This provides an opportunity to look at the divestment plans and progress. The divestment has fallen short of the budget target for five consecutive years. Over the past few years, divestment has been impacted by financial market volatility due to macroeconomic and geopolitical headwinds, procedural delays, litigations by labour unions and other interest groups against divestment, delay in demerging non-core assets, and pricing issues. Of late, the government has been relying on a small ticket OFS route (Offer for Sale) for divestment. However, they are unlikely to generate substantial proceeds unless big-ticket divestments are undertaken.

We have analysed the potential for divestment, with the government staying in control over the governance of the public sector firms (assuming the government retains a 51% stake) at current market capitalisation. Our analysis shows a huge scope for divestment worth Rs 11.5 trillion in the years ahead. However, the decision to divest will depend on the industry's strategic nature, the firm's profitability, prevailing financial market conditions, and social considerations. Given the comfortable fiscal situation amid strong non-tax receipts due to dividends from RBI and public sector firms and ongoing spectrum auction, the government may not be inclined to push hard on divestment this year. Having said that, we believe the government will stick to the FY25 target of miscellaneous capital receipts (which includes divestment) of Rs 500 billion. With the demerger of the Shipping Corporation of India's land assets, its divestment looks likely in FY25. Other potential divestments include Pawan Hans and CONCOR.

A Brief Look at Past Performance of the Divestment

In the interim budget, the FY24 divestment estimate was revised downward to Rs 300 billion from the previously budgeted Rs 510 billion. Additionally, the target for FY25 was set at Rs 500 billion in the interim budget. According to data from the Department of Investment and Public Asset Management (DIPAM), total divestment in FY24 fell short of even the revised estimate, achieving approximately Rs 165 billion, which is about 32% of the initial target. The absence of any big-ticket divestment resulted in the government falling short of its target.

Figure 1: Budgeted Divestment vs Actual Divestment



Source: Union Budget, DIPAM, CareEdge. * 2024 actual numbers are derived from DIPAM's data on divestment. Figures in bracket show actual divestment (% of budgeted divestment).

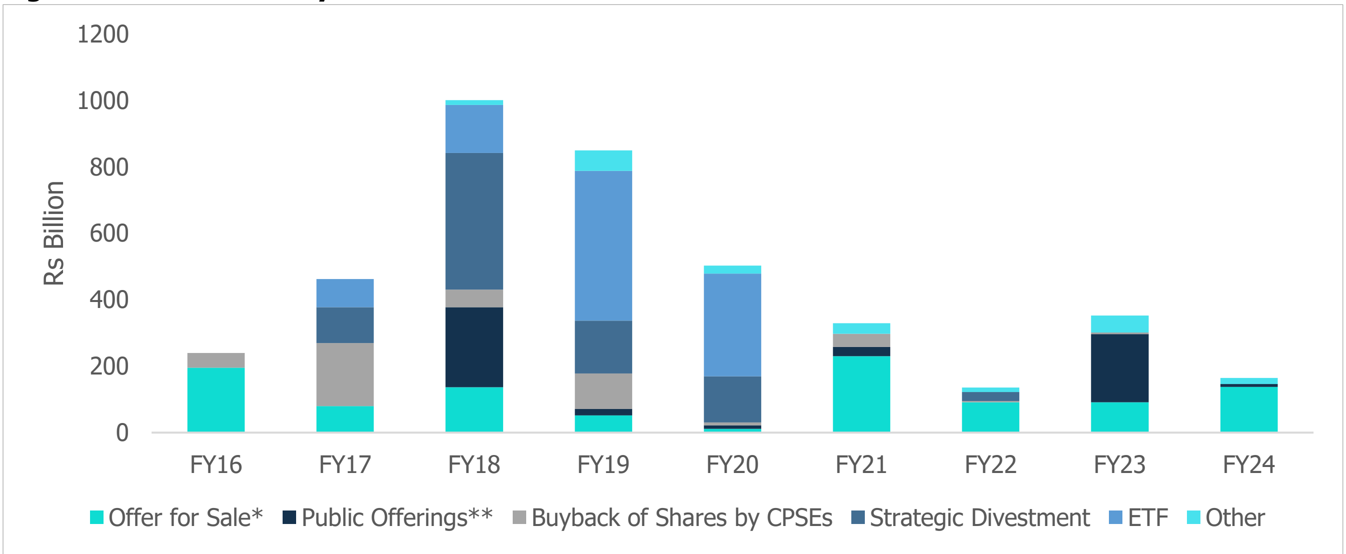
Following a strong performance in FY18-FY19, actual divestment as a percentage of the budgeted target has been below the long-term average of 63% in four of the past five years (Figure 1). Although it exceeded the long-term average in FY23, it lagged again in FY24. The sharp reduction in the budgeted divestment target for FY23 to Rs 650 billion, down from an average of Rs 1.6 trillion in FY20-FY22, resulted in better-than-expected performance for that year. However, the government's divestment plans, as outlined in the Union Budgets, have generally been ambitious and have missed their targets for five consecutive years since FY20.

In FY24, the PSUs under the Ministry of Coal led the divestment, where a 3% divestment of Coal India and a 7% divestment of NLC India Limited through the Offer for Sale (OFS) route led to receipts of about Rs 42 billion and Rs 21.3 billion, respectively. Additionally, a 3.5% divestment of NHPC Limited contributed about Rs 25 billion to the central coffers.

Hurdles for Divestment Plans and the Need to Look Beyond OFS

Poor performance of the divestment since FY20 can be largely attributed to financial market volatility arising from unfavourable macroeconomic conditions, firstly due to pandemic-related disruptions followed by rising geopolitical tensions and commodity price shocks globally. Apart from macroeconomic factors, divestment was also impacted by procedural delays, litigations by labour unions and other interest groups against divestment, delay in demerger of non-core and land assets, and pricing issues. It is also important to note that strong non-tax revenue collections, particularly in the form of dividends from Public Sector Undertakings (PSUs) and the Reserve Bank of India (RBI), have provided a cushion to the government finances. This has reduced the reliance on non-debt capital receipts from divestment, thereby decreasing the urgency for the government to fast-track its divestment plans.

Figure 2: Divestment by Routes



Source: DIPAM, CareEdge. * Offer for Sale includes Employee OFS. ** Public Offerings include Initial Public Offering (IPO) and New Fund Offer (NFO).

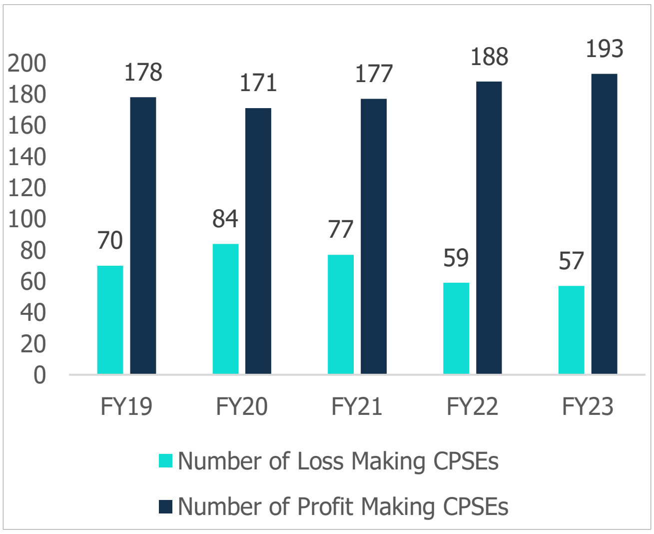
Divestment typically occurs through two main routes: Strategic Divestment and Minority Stake Sale. In Strategic Divestment, the government sells a significant shareholding in PSUs along with a transfer of management control. Strategic divestments are often big-ticket and politically sensitive. On the other hand, Minority Stake Sales involve using SEBI-approved routes such as public offerings (IPO and FPO), Offer for Sale (OFS), buyback of shares, and Exchange Traded Funds (ETFs). OFS, specifically, is a simpler approach where the government sells small stakes in the secondary market via exchanges without relinquishing management control. In recent years, the government has increasingly utilized the OFS route for divestment. However, due to the smaller size of these minority stake sales, they are unlikely to generate substantial divestment proceeds when compared to the Strategic Divestment route.

The strong performance in FY18-FY19 was driven by substantial divestments through public offerings, share buybacks, and strategic divestments. In terms of major strategic divestments, the government has undertaken divestment of Specified Undertaking of Unit Trust of India (SUUTI) holdings, ONGC's acquisition of the government's 51% stake in HPCL and Power Finance Corporation's (PFC) acquisition of majority stake in Rural Electrification Corporation (REC). The government has also explored the ETF route and share buybacks by CPSEs during the period. The government had introduced two ETFs - CPSE ETF, which focused on the energy sector and Bharat 22 ETF. IPOs of major PSUs like HUDCO, Cochin Shipyards, General Insurance, Bharat Dynamics, and Hindustan Aeronautics were also undertaken in this period. Thus, the achievement of a strong divestment number is dependent on the Government undertaking big-ticket divestments.

Performance of the CPSEs and Divestment Potential

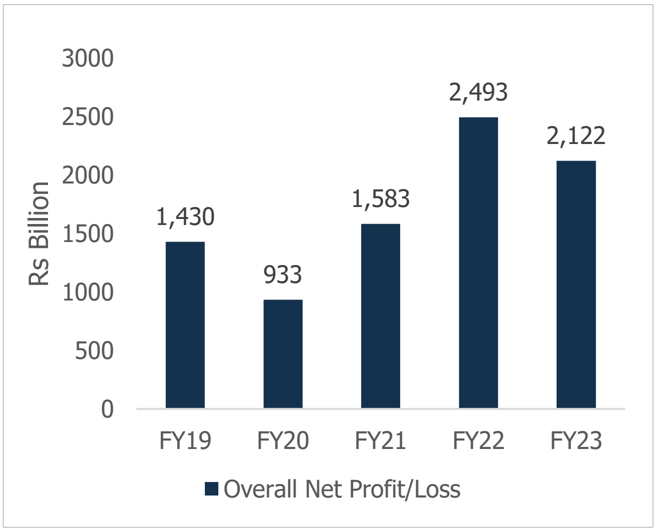
Despite disruptions from the pandemic and subsequent geopolitical and commodity price shocks, Central Public Sector Enterprises (CPSEs) have performed relatively well on an aggregate basis. According to the Public Enterprises Survey, after an initial dip in FY20 due to pandemic-related disruptions, the net profits of CPSEs have rebounded above pre-pandemic levels, touching Rs 2.1 trillion in FY23 growing at a CAGR of 10.4% from FY19 levels (Figure 4). Additionally, the number of loss-making CPSEs decreased from 70 in FY19 to 57 in FY23 (Figure 3). Despite this improvement, 23% of CPSEs continue to incur losses, thereby impacting the exchequer through a potential reduction in dividend transfers and the need for capital infusions. Major CPSEs consistently making losses over the past three years include Bharat Sanchar Nigam Ltd, Mahanagar Telecom Nigam Ltd, and Alliance Air Aviation Ltd. To minimize the impact on the exchequer, the government could consider either liquidating these loss-making CPSEs or transferring their ownership to private players through divestment, thereby ensuring better management.

Figure 3: Loss-Making CPSEs have Reduced



Source: Public Enterprises Survey, CareEdge

Figure 4: Overall Net Profit of CPSEs



Source: Public Enterprises Survey, CareEdge

To calculate the divestment potential at current market capitalization, we analysed the financial data of major listed CPSEs (Annexure 1) and PSBs/Insurance companies (Annexure 2). The analysis is based on 59 major listed CPSEs and 15 listed PSBs and insurance companies where the government holds more than a 51% stake. Assuming the government retains control over the company's governance by maintaining at least a 51% stake in these CPSEs and divests any excess shares, **we estimate a total divestment potential of approximately Rs 11.5 trillion at current market capitalization.**

To put things in perspective, this is a little more than twice the total divestment of Rs 5.2 trillion conducted since 2014. Of this, CPSEs could contribute around Rs 5 trillion, while PSBs and insurance firms could potentially add another Rs 6.5 trillion. This represents the maximum amount that could be raised at current market prices without the government losing governance control of these entities. Indian Railway Finance Corporation Ltd, Hindustan Aeronautics Ltd, Coal India Ltd, and Oil and Natural Gas Corporation are the top firms in terms of divestment potential mathematically. However, the government may not opt to divest all of its potential and the decision to divest these listed firms may be influenced by the industry's strategic nature, the companies' profitability, financial market conditions and welfare/social considerations.

The Way Forward

After missing the divestment target for five consecutive years, taking a fresh look at the divestment strategy is essential. It remains clear that the good divestment performance from FY18-FY19 remained on the back of substantial divestments through public offerings, share buybacks, and strategic divestments. The government over a medium term cannot rely solely on small ticket sales of minority shares by OFS to meet its divestment target and should take a fresh look at big-ticket divestment plans especially if the CPSE has been making losses consistently. The divestment target for FY25 has been set at Rs 500 billion (as miscellaneous capital receipts) and achieving this target hinges on the government's ability to proceed with big-ticket divestments. After the demerger of land assets of the Shipping Corporation of India (SCI), its possible divestment looks likely in FY25, provided favourable market conditions prevail. Media reports suggest that the government intends to invite financial bids for its entire 63.75% stake in the Shipping Corporation. If the government offloads its entire stake in SCI, it could generate ~Rs 125-225 billion as divestment proceeds.

Other plausible divestments include Pawan Hans and CONCOR. However, they continue to remain on the slow burner. The Petroleum and Natural Gas Minister has already shelved divestment plans of BPCL. The sales of minority stakes of government (~45%) in IDBI Bank now appear uncertain. With a bumper dividend from the RBI, the central government's fiscal position remains comfortable, which may limit the urgency to push ahead with big ticket divestments. In case divestment lags going ahead due to headwinds, the government will continue with its focus on asset monetisation. In FY24, the government has monetised assets worth Rs 1.6 trillion under the National Monetisation Pipeline, against the target of Rs 1.8 trillion. We believe the government will stick to the FY25 target of miscellaneous capital receipts (which includes divestment) of Rs 500 billion.

The conclusion of the election season, combined with key market benchmarks like the NIFTY 50 hovering around all-time highs, provides a perfect opportunity to advance some significant divestment initiatives. However, past issues like procedural delays, litigations by labour unions and other interest groups against divestment, and pricing issues may continue to slow divestment despite favourable market conditions.

Annexure 1: Listed CPSE and Their Divestment Potential

CPSE	Market Capitalisation (Rs Billion)	Potential Divestment* (%)	Potential Revenues (Rs Billion)
Indian Railway Finance Corporation Ltd	2284	35%	807.6
Hindustan Aeronautics Ltd	3477	21%	717.7
Coal India Ltd.	3000	12%	364.0
Oil and Natural Gas Corporation Ltd	3462	8%	273.3
Mazagon Dock Shipbuilders Ltd	781	34%	264.4
Power Finance Corporation Ltd.	1346	19%	255.6
NHPC Ltd	1030	20%	205.5
Fertilizers & Chemicals Travancore Ltd.	504	39%	196.7
Rail Vikas Nigam Ltd	813	22%	177.6
Housing & Urban Development Corporation Ltd	566	24%	136.7
KIOCL Ltd	281	48%	134.8
Bharat Heavy Electricals Ltd.	1064	12%	129.5
Cochin Shipyard Ltd	558	22%	122.0
Indian Renewable Energy Development Agency Ltd	481	24%	115.5
ITI Ltd.	289	39%	113.3
Indian Railway Catering And Tourism Corporation Ltd	814	11%	92.8
Steel Authority Of India Ltd.	634	14%	89.0
NMDC Ltd	784	10%	76.8
Bharat Dynamics Ltd	290	24%	69.4
NLC INDIA Ltd	322	21%	68.2
Hindustan Copper Ltd.	326	15%	49.3
MMTC Ltd	114	39%	44.6
Garden Reach Shipbuilders & Engineers Ltd	186	23%	43.8
Oil India Ltd.	759	6%	42.9
RITES Ltd	169	21%	35.9
IRCON INTERNATIONAL Ltd	253	14%	35.9
NBCC (INDIA) Ltd	287	11%	30.9
HMT Ltd	71	43%	30.2
Railtel Corporation Of India Ltd	135	22%	29.5
Bharat Petroleum Corporation Ltd.	1360	2%	26.9
Container Corporation Of India Ltd.	694	4%	26.4
India Tourism Development Corporation Ltd.	69	36%	24.8
Rashtriya Chemicals & Fertilizers Ltd.	93	24%	22.2
SJVN Ltd	531	4%	21.2
Mishra Dhatu Nigam Ltd	86	23%	19.7
NMDC STEEL Ltd	175	10%	17.1
Shipping Corporation of India Ltd.	126	13%	16.1
National Fertilizers Ltd.	56	24%	13.4
Indian Oil Corporation Ltd.	2405	0%	12.0
MSTC Ltd	63	14%	8.6
Andrew Yule & Company Ltd.	21	38%	7.9
Power Grid Corporation of India Ltd.	2243	0%	7.6
GAIL India Ltd	1458	1%	7.6
BEML Ltd	197	3%	6.0
Shipping Corporation of India Land and Assets Ltd	33	13%	4.2
NTPC Ltd	3572	0%	3.7
State Trading Corporation of India Ltd.	9	39%	3.3
Bharat Electronics Ltd.	2263	0%	3.1
Scooters India Ltd.	7	43%	2.9
MOIL Ltd	108	2%	2.5
Balmer Lawrie Investments Ltd.	19	9%	1.7
Mahanagar Telephone Nigam Ltd.	26	5%	1.4
Madras Fertilizers Ltd	16	8%	1.4
National Aluminium Co.Ltd.	352	0%	1.0
Engineers India Ltd.	149	0%	0.5
BEML Land Assets Ltd	12	3%	0.4
Hindustan Organic Chemicals Ltd.	3	8%	0.2
Bharat Immunologicals & Biologicals Corporation Ltd.	1	8%	0.1
Hemisphere Properties India Ltd	56	0%	0.1

Source: DIPAM, Reuters and CareEdge. Data as of 19th June 2024 *Current shareholding of government minus 51%. Values rounded off.

Annexure 2: Listed Public Sector Banks and Insurance and Their Divestment Potential

PSB Or Insurance Company Name	Market Capitalisation (Rs Billion)	Potential Divestment* (%)	Potential Revenues (Rs Billion)
Bank of Baroda	1480.3	13%	192.0
Bank of India	572.5	22%	128.1
Bank of Maharashtra	469.6	35%	166.5
Canara Bank	219.2	12%	26.1
Central Bank of India	567.8	42%	238.9
General Insurance Corporation of India	690.9	35%	240.3
Indian Bank	727.7	23%	166.2
Indian Overseas Bank	1270.3	45%	576.4
Life Insurance Corporation of India	6748.8	46%	3070.7
Punjab & Sind Bank	427.9	47%	202.2
Punjab National Bank	1419.2	22%	314.4
State Bank of India	7417.5	7%	485.1
The New India Assurance Company Ltd	402.4	34%	138.6
UCO Bank	679.3	44%	301.6
Union Bank of India	1125.9	24%	267.5

Source: DIPAM, Reuters and CareEdge. Data as of 19th June 2024. *Current shareholding of government minus 51%.

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