

VIDESH SANCHAR NIGAM LIMITED (VSNL)

“Significant discount to sum-of-parts”

January 08, 2007

VALUE BUY

INVESTMENT THESIS REVISITED

We are revisiting the investment thesis based on the following :

(A) Demerger of Surplus Land (773 acres)

By Feb 12, 2007 indications are that the Tatas will exercise their call option on the government holding of 51% as per their original shareholding; concurrently a solution is envisaged for the defined surplus real estate assets of VSNL.

At the time of the disinvestment, it was explicitly agreed that land (clearly identified as “surplus land”) owned by VSNL would be demerged into a separate company. It was further agreed that if for any reason VSNL could not hive-off/demerge the land, an alternative course of action (as stipulated in the share purchase and shareholders agreement) would be explored. A number of options have been presented to the VSNL board—including a demerger—to “monetize” this real estate pot of gold. The beneficiaries of this action would be three sets of shareholders: The GOI (as per its 51% original shareholding), the shareholders (20%) who tendered in the open offer in 2001 and the rest (29% - partly held by Tatas, institutions and current public shareholders). (*Appendix IV*)

Properties identified (as “surplus land”) include some of the finest & most upmarket areas like Greater Kailash (70 acres) in New Delhi.

Valuation of VSNL’s surplus land (*Appendix II*) is Rs 243 per share, being a 20% discount on the calculated value per share of Rs303, based on prevailing property prices.

(B) Undersea Cable Assets

FLAG Telecom, a subsidiary of Reliance Communications Ltd., has just announced an expansion to the extent of 50,000 KM of undersea optic fibre for Rs70 Bn. This effectively puts a valuation of Rs1.4 MM/KM of undersea cable. While being simplistic in its approach, the 60,000 KM (approx.) of Tyco Global Network’s undersea cable could potentially be valued at Rs84 Bn, assigning a value per share of over Rs295 to Tyco’s assets. However, given the age of the assets etc., the value will be a lot lesser. ***But the mere fact that Reliance (through FLAG Telecom) is committing cash investment to what has been universally seen as a ‘boring’ business by the world at large, implies that these carrier type/backbone assets are actually now appreciating in value and are clearly more valuable than has been traditionally accepted.***

Taking a valuation of 60% of FLAG’s valuation of undersea cable assets we get a value of Rs177 per share for Tyco’s undersea cable assets. (*Appendix III*)

(C) VSNL's stake in Tata Teleservices

VSNL has a 16.57% holding in the equity of Tata Teleservices Ltd. with which it has technical and operational synergies. As per reported discussions with private equity players, the equity valuation of Tata Teleservices is estimated to be Rs129 Bn. Accordingly, **VSNL's stake in Tata Teleservices is valued at about Rs75 per share.**

VSNL'S VALUATION

MODEL I :Based on Revaluation of Real Estate and Consolidated Earnings	
Category	Value per share Rs
(i) Surplus Real Estate	243
(ii) Stake in Tata Teleservices	75
(iii) Consolidated Operations	288
(iv) Real estate assets integral to the business in the past, now considered redundant, (i.e. like their buildings in Fort and Prabhadevi in Mumbai) and not part of the surplus real estate as above	100-150
(v) Balance Business (Voice/ Enterprise Data/ Retail)	No Value Assigned
Value Range per share: 706-756	
MODEL II :Based on Revaluation of Real Estate & Tyco's Undersea Cable Assets	
Category	Value per share Rs
(i) Surplus Real Estate	243
(ii) Stake in Tata Teleservices	75
(iii) Indian operations	316
(iv) Tyco's Valuation	177
(v) Teleglobe	57
(vi) Less: Consolidated debt per share	57
(vii) Real estate assets integral to the business in the past, now considered redundant, (i.e. like their buildings in Fort and Prabhadevi in Mumbai) and not part of the surplus real estate as above	100-150
(viii) Balance Business (Voice/ Enterprise Data/ Retail)	No Value Assigned
Value Range per share: 911-961	

In addition, the following are add-ons:

- **Cash /cash equivalents**

We are not taking this into account for value per share as this money would have to be used for funding VSNL's acquisition(s) / enhanced CAPEX needs.

- **Company's South Africa Venture**

On the basis of the above two models there is a significant discount to the sum-of-the parts valuation of VSNL at the current price. Taking a conservative measure we believe VSNL should be priced at a minimum of Rs706 per share.

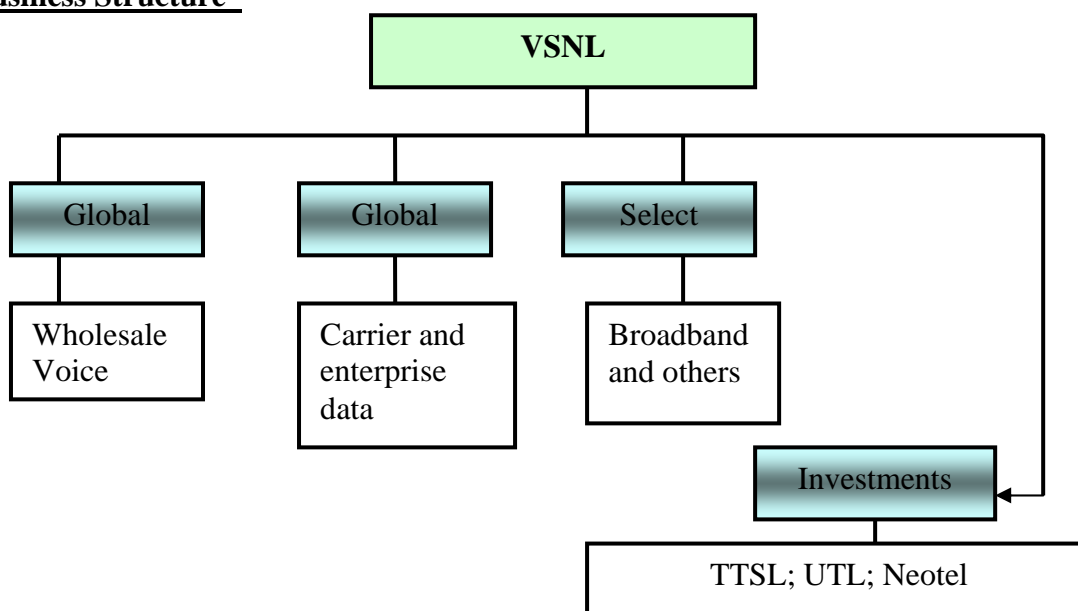
POTENTIAL TRIGGERS

We see VSNL as an integral part of the portfolio with multiple triggers:

- **A rapidly globalizing corporate with a powerful change in business dynamics (voice to data, national to international, growth through inorganic and organic components)**
- **Real Estate spin-off**
- **Monetizing the Tata Tele stake**
- **Significant synergies in marketing its products/services with other Tata group companies (Tata Tele, TCS?!)**
- **Tatas exercising their option to acquire the balance 26% of the GOI stake in VSNL (Feb 12, 2007)**
- **An institutionally underowned stock—having the potential to be an institutional favourite**

APPENDIX I VSNL — RECAST BUSINESS

Business Structure



Networks, International Facility, Customer Svs, IT, HR, Finance, Legal

Source: VSNL

▪ **Global Wholesale Voice**

With the acquisition of Teleglobe in Feb 2006, VSNL has become #1 global international wholesale voice player. It has a 16% (18 Bn min.) market share of the total 110.3 Bn minutes of the international wholesale voice market. VSNL's latest venture in this area is its investment in South Africa's second fixed line operator Neotel.

Targeting greater than market volume growth, it is offering aggressive rates to major carriers and is also focusing on newer, emerging segments like VoIP (Voice over Internet Protocol) and Mobile to Mobile services. With 16.57% share in Tata Teleservices, it is also likely to benefit from its 7-8% growth in subscribers.

▪ **Carrier and Enterprise Data Services**

From being an enterprise data service provider to-and-from India, VSNL has increased its reach using Global Business Pathway. Its products range has also expanded from just IPLC in 2005-06 to a host of services including ethernet, voice & security services, managed messaging & collaboration, IP Contact Centre & Call Centre Marketplace etc. in 2006-07. Its area of coverage has also spread from 7 cities and 15 account managers to over 23 cities, 30 account managers, solution architects and professional service providers. It aims at having a base of 20 MM broadband subscribers by 2007-08.

▪ **Retail Broadband**

On the retail front it is taking initiatives to set up access management team and has developed significant relationship with cable operator community currently having over 2,000 access partners. VSNL has the largest Wi-Fi deployment in telco space in India with blanket airport

coverage of 19 terminals and is the first one to provide Wi-Fi at stadiums like Eden Gardens, Wankhede and Ferozeshah Kotla. It has also been contracted 300 hotspots at major hotels, Pizza Hut, Coffee World, McDonalds and Crossword for the same.

▪ ***Investments***

VSNL continues to reap the benefits from its numerous Indian as well as global investments. Significant amongst these are its 16.57% stake in Tata Teleservices, its 26% stake along with Tata Africa in Neotel and United Telecom Limited, which is a joint venture amongst VSNL, MTNL, Nepal Ventures Pvt. Ltd. and Telecommunications Consultants India Ltd. offering telecom services in Nepal.

APPENDIX II: MODEL I Based on Revaluation of Real Estate and Consolidated Earnings		
Valuation of Non-Operational Assets		
a) <u>Surplus Land</u>		(Rs MM)
<u>Location</u>	<u>Acres</u>	<u>Market Value</u>
Dighi-Pune	524	} 3,900
Halishahar-Kolkata	35	
Padianallur-Chennai	86	
Chatturpur-New Delhi	58	27,739
Greater Kailash-New Delhi	70	54,783
Total	773	86,422
		Value per share: 303 (based on prevailing property prices)
		Discounted @20% 243
b) <u>16.57% Stake in Tata Teleservices Ltd.</u>		(Rs Bn)
Equity value of Tata Teleservices		129
16.57% Stake		21
		Value per share: 75
"Non Operational" Value per share		318
Valuation of Operational Assets		
c) <u>Consolidated Operations</u>		(Rs MM)
FY 08 EBIDTA Estimate		13,087
EV/EBIDTA multiple 7.5x		98,153
Per share value		344
d) <u>Less: Consolidated net debt per share</u>		57
"Operational value per share"		288
e) <u>Other real estate</u>		100-150
Sum-of-the parts		706-756

APPENDIX III: MODEL II Based on Revaluation of Real Estate & Tyco's Undersea Cable Assets		
Valuation of Non-Operational Assets		
a) Surplus Land		(Rs MM)
<u>Location</u>	<u>Acres</u>	<u>Market Value</u>
Dighi-Pune	524	} 3,900
Halishahar-Kolkata	35	
Padianallur-Chennai	86	
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16.57% Stake		21
Value per share:		75
"Non Operational" Value per share		318
Valuation of Operational Assets		
c) Indian Operations		Rs MM
FY 08 EBIDTA Estimate		12,000
EV/EBIDTA multiple 7.5x		90,000
Per share value		316
d) Tyco's Valuation		
Total Undersea Cable Length		60,000
(RsMM/KM)		1.4
Total Value		84,000
Valuing at 60% of FLAG's valuation of undersea cables		50,400
Value per share:		177
e) Teleglobe		
Acq. Cost of USD 239 MM at 1.5x		16,133
Value per share:		57
f) Less: Consolidated net debt per share		57
g) Other real estate		100-150
Sum-of -the parts		911-961

APPENDIX IV

News Clipping on 'VSNL' published in The ET Investor's Guide, 1 Jan 2007

LAND OF PROMISES

VSNL is in the news often not only for its business plans or launch of new products, but also for the huge real estate worth thousands of

crores it owns. In the five years since the Tatas acquired the telecom giant from government, its stock price shoots up whenever prospects for unlocking this huge wealth brighten. The saga is now approaching a crucial juncture as the acquisition would complete five years on February 12, '07. Tatas will get a last chance to exercise their call option for acquiring the balance 26% of government stake. With the unprecedented boom in telecom company valuations, it is a chance Tatas would not like to miss, learns **The Insider**.

However, to complete the transaction they will also have to settle the issue of demerger of some key real estate assets into a separate company and distribute the shares of this company to VSNL's shareholders. The shares of the property company would be distributed to three sets of shareholders: the government (as per its 51% original shareholding), those shareholders who offered shares during the open offer (20%) and the rest (29% - partly held by Tatas, institutions and current public shareholders). This arrangement was designed to deny the Tatas any gains from surplus land and make sure that those shareholders who sold shares under the open offer to the strategic partner would be recognised for the sharing of the demerger profits. The demerger was delayed as there was stalemate over issues such as payment of stamp duty on the land to be sold. Moreover, some issues are being explored with the US attorneys since VSNL is a company listed on the New York Stock Exchange. According to sources, the current valuation of the surplus land at Delhi, Pune, Chennai and Kolkata is over Rs 18,000 crore and once Tatas demerge it, the benefits would be distributed by means of dividends or shares. At these valuations, the demerger would mean a value addition of nearly Rs 600 per share to the VSNL valuation from the property company alone. And the government alone would gain value of nearly Rs 9,000 crore. The questionnaire mailed to the company did not get a response.

STOCK OWNERSHIP / CONFLICT DISCLOSURE

<i>Prime / Prime Subsidiaries</i>	<i>No</i>
<i>Key Prime Management &/or Other Employees</i>	<i>Yes</i>
<i>Any Other Corporate Finance Conflict of Interest</i>	<i>No</i>

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