

FPO proceeds to ease working capital debt burden



- ITI, a PSU under DoT, offers a wide array of information and communications technology (ICT)-related products and services and caters to an extensive customer base across industry segments such as Telecom, Defence, IT, Financial Institutions and Solar Energy.
- The company has strong visibility in its order book worth Rs110.5bn, which mainly comprises government projects such as ASCON, BharatNet, Network for Spectrum, Smart Energy Meters, Space programs and e-governance projects.
- In FY15-19, ITI recorded 30% revenue CAGR. With the backing of the GoI, management has been able to turn around its financials after being labeled as a “sick company” in 2004. The company has already logged 36% yoy revenue growth YTD FY20.
- ITI is raising Rs16bn (according to media reports) through a follow-on public offer (FPO). The proceeds of the issue will be utilized for meeting working capital requirements, repayment of loans and general corporate purposes.

ITI offers a variety of products and services such as defense security encryption products, optical and data network products and other IT products. The company also provides an extensive collection of services, ranging from operation and maintenance of BTS systems to data center solutions and to citizen-centric services such as National Population Register (NPR). With the transfer of technology agreements with various partners, the company has access to new technology and products, thereby expanding its offerings to customers while boosting innovation as well. ITI undertakes major GoI projects which has helped it build healthy relationships with various PSUs and governmental agencies. In fact, the company has been able to retain its key PSU customers and derives a significant percentage of its revenues from such customers.

Currently, ITI's order book comprises several large turnkey projects (29.1%), AMC orders (57.9%), and other products and services (13%). In addition, it has been selected as the lowest bidder by the Ministry of Defence for the ASCON Phase IV project.

Object of the issue

The FPO involves raising Rs16bn (as per news reports) in fresh equity, with up to 180mn shares being issued. An additional issue of up to 1.8mn shares are reserved for allocation to eligible employees. The company intends to decide the price band for this FPO at its board meeting which is scheduled to take place today. The proceeds from this offering will be used for the repayment of borrowings (Rs6.1bn), funding working capital needs (Rs6.4bn), and for general business purposes. The issue opens on 24th January and closes on 28th.

Key risks include: 1) reliance on grants from the GoI; 2) no assurance in advance orders being converted into confirmed orders; and 3) high working capital needs.

Financial snapshot

Rs Mn	FY15	FY16	FY17	FY18	FY19
Total Revenue	5,791	11,933	15,481	14,842	16,684
EBITDA	-2,103	-1,897	-1,046	814	-1,004
EBITDA Margin (%)	-36.3	-15.9	-6.8	5.5	-6.0
Net Profit	-2,971	2,372	2,664	2,306	925
EPS (Rs)	-10.3	8.2	4.8	3.0	1.0
ROE (%)	-48.5	43.9	30.7	17.2	5.4
P/E (x)	-9.6	12.0	20.9	32.7	96.2
EV/EBITDA (x)	-30.9	-34.7	-62.8	79.4	-65.9
P/B (x)	7.1	4.2	5.2	4.6	5.0

Source: Company, Emkay Research

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Company background

ITI Ltd, a PSU under the Department of Telecommunications (DoT), was established in 1950 and became a deemed public limited company from July 1, 1975. It serves customers across several industry segments such as Telecommunications, Defence, Information Technology, Banks, Financial Institutions and Solar Energy. With more than seven decades of experience, the company offers an extensive collection of products, solutions and services across various segments.

The wide assortment of products include defence communication and security encryption products, optical and data network products and passive infrastructure products, IT products, Internet-of-Things and other diverse products. ITI also purchases traded products that are subsequently installed as part of its projects.

Exhibit 1: Diversified offerings of the company

Defence Communication & Security Encryption Products & Services	Optical and Data Network Products & Services and Passive Infrastructure Products	IT Products and Services	Internet of Things (IoT)
<p><i>Communication network projects for India's defence forces</i></p> <ul style="list-style-type: none"> ▪ Communication Projects <ul style="list-style-type: none"> - Designed, manufactured, installed & maintained all three phases of ASCON for the Indian Army - Selected as L-1 by MoD for ASCON Phase IV project – the project is valued at Rs7,700crs - Order for laying OFC under the NFS project for the Indian defence forces in the Eastern and North- Eastern region ▪ Defence Security Encryption <ul style="list-style-type: none"> - BEU encryptors to encrypt and decrypt Internet Protocol (IP) data; - PCM encryptors to encrypt and decrypt various types of data in PCM format. 	<p><i>End to end portfolio of optical & data networking products</i></p> <ul style="list-style-type: none"> ▪ Broadband Products & Services <ul style="list-style-type: none"> - Turnkey solutions for supply, installation, commissioning, O&M of GPON & associated equipment - Raebareli Unit → Introduced machines for manufacturing GPON equipment viz. 3D automatic optical, X-ray & solder paste inspection - Bengaluru Unit → Upgraded for manufacturing GPON equipment, also provide testing services for GPON cards & equipment as part of AMC with BSNL & BBNL - GPON OLT units & ONTs →Phase I of "Bharat Net" ▪ Passive infrastructure products <ul style="list-style-type: none"> - Optical network, data & voice traffic equipment - HDPE pipes & OFC ▪ MLLN Products and Services <ul style="list-style-type: none"> - Including turnkey solutions for supply, installation, O&M of network equipment to BSNL & MTNL 	<p><i>Hosting services along with a suite of IT & software services</i></p> <ul style="list-style-type: none"> ▪ Data Centre <ul style="list-style-type: none"> - Tier 3 data centre in Bengaluru set up in collaboration with Trimax Data Centre Services - Hosting & managed services to Govt organizations & private companies → currently has 96% occupancy - Expanding data centre operations by building a Tier 3 plus data centre with 1,000 rack capacity; ITI plans to expand its offering to include end-to-end hosting & managed services ▪ Software as a service (SaaS) <ul style="list-style-type: none"> - Suite of SaaS for financial & banking solutions – Aadhaar authentication & digital wallet services ▪ IT Support Services <ul style="list-style-type: none"> - ITI's SaaS packages are backed by active customer support services 	<p><i>State of the art infrastructure to manufacture IoT Products</i></p> <p>Partner with technology cos & start ups to offer various IoT products & solutions. It focuses on products including smart metering, smart health, smart environment, smart surveillance, smart agriculture, intelligent transport, smart e-governance, other similar smart products and solutions</p> <p>Annual Maintenance Contracts (AMC) and Operation & Maintenance Contracts (O&M)</p> <p><i>AMCs for telecommunications and defence networks.</i></p> <ul style="list-style-type: none"> - First three phases of ASCON - OCB exchanges, MLLN & signalling transfer point network of BSNL & MTNL - BTS for GSM network of BSNL in Tamil Nadu, Uttar Pradesh & Uttarkhand for next ten years

Source: Company, Emkay Research

In addition to the above, ITI provides a range of services, including operation and maintenance of base transceiver stations, IT and software services such as optical fiber cable-laying services, telecom product testing services, start-up hub services, skill development services, and citizen-centric services such as the National Population Register and Socio Economic and Caste Census, and annual maintenance contracts for the products supplied.

The company has five manufacturing facilities across India and is primarily engaged in projects for the Government of India. It has manufacturing facilities in Bengaluru, Mankapur, Naini, Palakkad and Rae Bareli.

Investment Rationale & Key strengths

Strong relationship with Government Agencies

A differentiated product, service and solution offering has helped ITI build beneficial relationships with PSUs such as BSNL, BBNL, MTNL and EESL. In addition, it has a strong association with the Ministry of Defence, Ministry of Rural Development, Ministry of Urban development, the Registrar General of India and other such governmental agencies.

The company benefits from the GoI's preferential market access policy. According to this policy, local manufacturers are given preference in procurement by government agencies. The policy states that domestic producers who have a defined value addition shall receive preference over foreign or domestic manufacturers that do not meet the value addition criteria.

Backing of Government of India

ITI has the backing of the GoI. In fact, when the company was classified as a "sick company", the GoI approved grants in aid to settle part of its statutory dues. To meet its operational requirements, it received grants in aid worth Rs5bn and Rs1.3bn in FY17 and FY18, respectively.

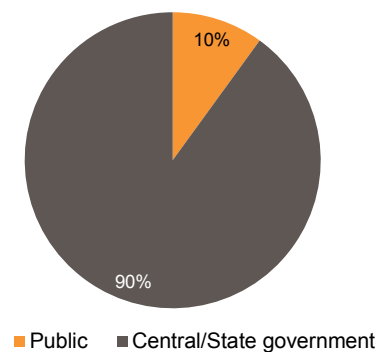
It was also the recipient of capital grants in the form of equity for capex worth Rs0.8bn, Rs3.4bn and Rs0.6bn in FY17, FY18 and FY19, respectively. For the half year ended Sep'19, it further received a grant of Rs1.1bn for capex.

In Dec'19, the GoI earmarked another Rs854mn as a grant in aid (funds have not been received yet) to settle partial statutory dues and for meeting general operational requirements.

In the past, ITI has used grants from the government to modernize and upgrade its manufacturing infrastructure. Further, the grant was used to develop capabilities in manufacturing a diverse range of ICT products, defence security encryption products and electronic products.

The President of India is the primary shareholder of the company, holding an 89.97% stake, while the Governor of Karnataka holds 0.03%. The public shareholding is 10%.

Exhibit 2: Shareholding pattern



Source: RHP, Emkay Research

Diversification in offerings

ITI caters to a varied customer base across several industry segments such as Telecommunications, Defense, Information Technology, Banks and Financial Institutions, and Solar Energy. The company has a wide range of products such as:

- Defense security encryption products
- Optical and data network products and passive infrastructure products such as GPON, Wi-Fi products, MLLN and signaling transfer point solutions
- Multi-capacity encryption units, electrical products such as smart energy meters, smart cards, solar panels, set-top boxes and mini personal computers
- Internet-of-Things (IoT) products
- Other diverse products such as HDPE ducts, 3D printing and sanitary napkin vending machines

Order book

The company has a healthy order book worth Rs110.5bn. As of December 31, 2019, the order book, including advance purchase orders, net of GST, comprised the following:

Exhibit 3: Breakdown of order book

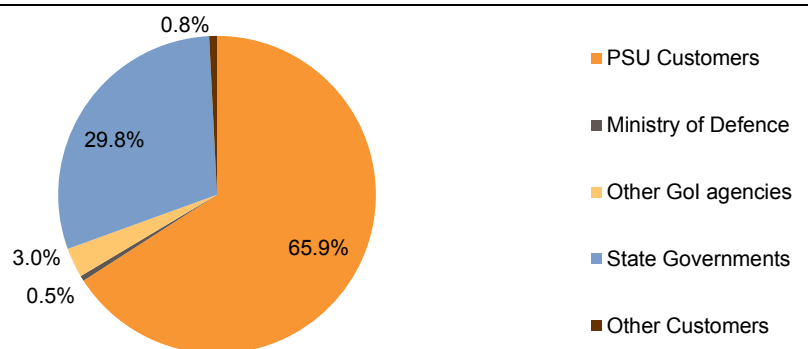
Project	Amount (in Rs mn)	% of total order book
BTS O&M*	56,217	50.9%
MahaNet	19,890	18.0%
ROs/CCOs/IT/ITI/Misc. products	10,462	9.5%
Smart energy meters	6,582	6.0%
GujaratNet	5,359	4.9%
Rajnet	2,836	2.6%
WBNet	1,978	1.8%
NFS project	1,665	1.5%
GPON	1,550	1.4%
GSM SZ AMC	668	0.6%
Defence business/AMC	810	0.7%
HDPE Duct	538	0.5%
AMC for ASCON	508	0.5%
AMC for OCB	38	0.0%
MLLN/SSTP AMC	17	0.0%
Others	1,394	1.3%
Total	1,10,511	100.0%

Source: RHP, Emkay Research, Note: Order relating to BTSO&M includes 2 advance work orders

The order book includes expected revenues from the unexecuted segments of existing contracts (including signed contracts for which all pre-conditions have been met). It also includes advance purchase orders and advance work orders for which final orders have not been given.

In addition to the already strong order book, ITI was selected as the lowest bidder by the Ministry of Defence for the ASCON Phase IV Project. This project entails establishing an extensive optical fibre network for the Indian army, inclusive of supply, installation, and maintenance of the optical fibre network and telecom equipment, mobile terminals and other infrastructure. Following a three-year execution period, the project also involves two years of warranty support and eight years of AMC. The approximate value of the project is Rs77bn.

Exhibit 4: Customer-wise breakdown of order book



Source: RHP, Emkay Research

A brief overview of the key orders

- **BTS O&M:** The company has advance purchase orders for operation and maintenance of BTS for the GSM network of BSNL in Tamil Nadu, UP and Uttarakhand for a duration of 10 years.
- **MahaNet:** This assignment involves laying of Optical Fiber Cables (OFC), supply of access equipment and maintenance services.
- **RO/CCOs/Misc. Products:** It comprises supply and installation of CCTV surveillance systems, Wi-Fi systems, video conferencing solutions, etc.
- **Smart Energy Meters:** ITI has a contract to manufacture and supply 2.5mn smart energy meters for EESL.
- **GujaratNet:** This assignment involves establishing a broadband network between various gram panchayats. It also encompasses laying of underground OFC across 16,800kms and setting up of a network operations center to manage the network.
- **Rajnet:** Project includes supply, installation and maintenance of RF links and 40,000 outdoor Wi-Fi access points across the state of Rajasthan under the BharatNet Phase II.
- **WBNet Project:** Order encompasses supply of 1,560km of (OFC) and broadband connectivity to 183 Gram Panchayats in West Bengal.
- **NFS Project:** Includes laying of OFC under the NFS (Network for Spectrum) project for Indian defence forces in the Eastern and North-Eastern regions.
- **GPON Equipment:** Contracts from BSNL and BBNL for a turnkey project to supply and install GPON technology equipment for “BharatNet.”
- **GSM SZ:** Project comprises AMC of GSM equipment previously supplied to BSNL South Zone circles, including Karnataka, Tamil Nadu, Kerala, Andhra Pradesh, and Chennai.
- **AMC for ASCON:** Assignment includes AMC for maintaining the nodes, OFC and optical terminal and secrecy equipment for the Ministry of Defence’s ASCON Phase I, II and III projects.

Modern manufacturing facilities

ITI has upgraded and modernized its manufacturing plants, infrastructure, machines, equipment and technology. The annual capex of the company in FY19, FY18 and FY17 stood at Rs1.3bn, Rs1.9bn and Rs0.8bn, respectively. The capex for the half year ended Sep’19 was Rs489mn.

To meet the requirements, the company has added manufacturing capability of GPON products, including optical line terminals and optical network terminals, OFC and an HDPE manufacturing line in its Rae Bareli plant. Further, it has established HDPE duct manufacturing lines at its Palakkad unit.

Moreover, the electronic manufacturing facilities in Bengaluru, Rae Bareli, Palakkad and Mankapur have been enhanced so that they can produce optical and data network products, defence security encryption products and so on.

ITI also has a network system unit headquartered in Bengaluru that executes turnkey projects for the installation and commissioning of telecommunication networks. A research and development centre has also been established in Bengaluru.

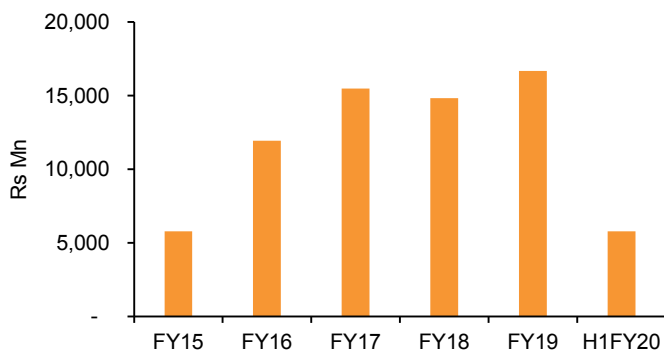
Financial performance

During FY15-19, the company recorded 30.3% revenue CAGR. During the same period, the company has turned profitable, thanks to managerial expertise and grants given by the government. In the nine months ended Dec'19, ITI has already logged a 36% revenue growth yoy as well as 380% yoy growth in profits, which can be primarily attributable to its low base, along with grants from the government. In the current fiscal year, the company had already managed to post 84% of its entire FY19 revenue, thereby showcasing its growth potential.

In addition, ITI is in process of repaying its loan obligations, which is also evident by its half-yearly balance sheet filing according to which borrowings decreased by Rs600mn. In fact, this FPO issue is also targeted at reducing debt, showing the company's commitment to debt reduction.

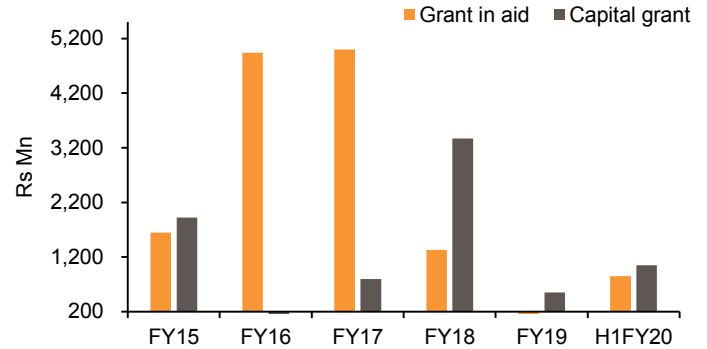
Grants from the government have helped the company in turning its financials around. This can be clearly observed from the number of grants in terms of capital grants and grants in aids given by the GoI. In fact, in Dec'19, the GoI earmarked Rs854mn as a grant in aid (funds have not been received yet) to settle partial statutory dues and to meet general operational requirements of the company.

Exhibit 5: Revenue growth



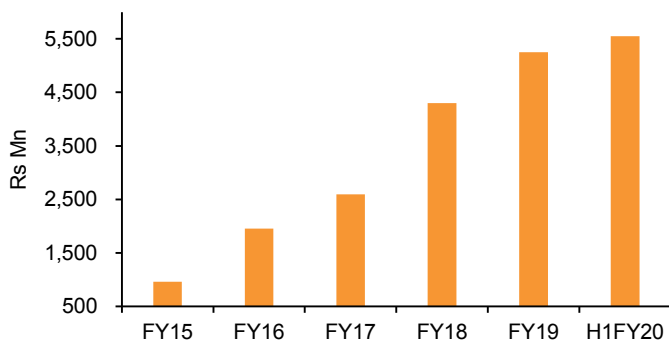
Source: RHP, Emkay Research

Exhibit 6: GoI grants to meet operational and capex needs



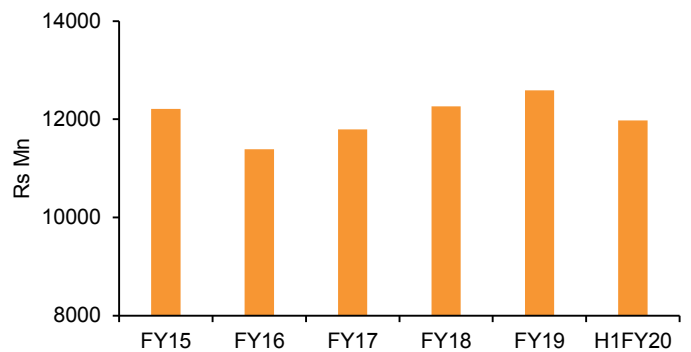
Source: RHP, Emkay Research

Exhibit 7: Net block



Source: RHP, Emkay Research

Exhibit 8: Debt including working capital



Source: RHP, Emkay Research

Key risks

Reliance on grants from Government of India

In 2004, ITI was declared a “sick company.” The company posted an operating profit in FY18. However, there have been operating losses in every financial year from FY03 to FY17.

The Government of India has approved a revival plan in 2014 and since then it has been providing relief to the company in the form of grant in aid as well as capital grants.

Gol grants are approved and released as per its own internal framework. There can be no guarantee that funds will be given at the exact time that the company desires or needs. It is important to mention that any delay in release of grants could result in an adverse effect on the business.

Given the fact that the company is still nursing its balance sheet, its future operating results are quite difficult to predict. They may be volatile in nature and may differ substantially from the recent results of operations.

No assurance of advance purchase orders being converted into confirmed orders

ITI is involved in bidding for various tenders with several governmental agencies. In accordance with the terms of these tenders, the bidder who is chosen as the lowest bidder (L-1) is called for final negotiations on the project. Post that, the company can commence the project. However, there are no guarantees that projects for which one is the lowest bidder will actually be awarded to them or not.

Furthermore, certain projects that are present in the order book are advanced purchase orders or advance work orders for which confirmed orders or executed contracts have not yet been received. It is noteworthy to mention that there can be no assurance that such projects will be converted to confirmed orders or not.

Negative cash flows in prior periods

The company has experienced negative cash flows in the recent past. Negative investing cash flow amounting to Rs751mn, Rs985mn, Rs1.3bn and Rs414mn (consolidated basis) was reported in FY17, FY18 and FY19 and for the six months ended Sep'19, respectively. This was largely on account of the development of products that are yet to be commercialised. Further, the company has been paying a substantial amount toward borrowings and finance costs.

Need for sizeable amount of working capital

The business is capital-intensive. In fact, large-scale turnkey projects incur substantial working capital costs.

So far, the company has met its working capital requirements from a working capital facility received from a consortium of banks. As on Dec'19, this consortium had sanctioned a total borrowing amount of Rs31.3bn. In addition, Gol loans and grants and cash generated from the company's operations are also utilized for meeting working capital needs. As of Dec'19, ITI's total outstanding working capital loans stood at Rs9.3bn. The proceeds from this issue will in part be used for working capital purposes.

Key Financials (Standalone)

Exhibit 9: Income statement

Rs mn	FY15	FY16	FY17	FY18	FY19	9MFY20
Net Revenue	5,791	11,933	15,481	14,842	16,684	14,084
Cost of materials consumed	430	413	926	3,134	2,837	10,084
Purchase of stock-in-trade	1,421	6,282	5,122	2,320	3,216	1,031
Changes in inventories of finished goods, WIP and stock in trade	21	4	-176	118	-113	-43
Installation and maintenance charges	2,139	3,181	6,421	5,261	7,839	
Employee benefit expenses	3,212	3,325	3,009	2,255	2,042	1,683
Other expenses	672	625	1,227	940	1,865	527
Total Operating Expenses	7,894	13,830	16,528	14,028	17,687	13,282
EBITDA	-2,103	-1,897	-1,046	814	-1,004	802
Depreciation & Amortization	153	129	169	249	371	324
EBIT	-2,257	-2,026	-1,216	565	-1,375	478
Other Income	849	5,970	5,406	3,275	3,365	1,713
Interest	1,573	1,572	1,526	1,534	1,065	1,047
Profit before tax	-2,980	2,372	2,664	2,306	925	1,144
Tax	-	-	-	-	-	-
Exceptional items	-	-	-	-	-	-
Reported Net Income	-2,980	2,372	2,664	2,306	925	1,144

Source: RHP, Emkay Research

Exhibit 10: Balance sheet

Rs Mn	FY15	FY16	FY17	FY18	FY19	H1FY20
Equity Share Capital	2,880	2,880	5,600	7,600	8,970	8,970
Other Equity	-22,431	-19,677	-18,490	-14,712	-14,379	-10,667
Net worth	-19,551	-16,797	-12,890	-7,112	-5,409	-1,697
Borrowings	3,000	3,000	3,000	3,000	3,000	2,400
Non-Current Liabilities	4,023	3,986	4,956	5,052	5,699	5,033
Total Current Liabilities	45,330	47,616	39,578	48,745	45,954	42,896
Total liabilities	29,802	34,804	31,645	46,685	46,244	46,232
Property, Plant & Equipment	619	1,029	1,570	2,795	3,589	3,723
Capital work-in-progress	330	917	1,016	1,493	1,648	1,818
Non-current assets	990	1,964	2,603	4,363	5,266	5,570
Cash and cash equivalents	458	500	244	413	267	200
Bank Balance	2,254	712	1,419	2,835	1,768	2,232
Current assets	28,813	32,841	29,042	42,321	40,978	40,662
Total assets	29,802	34,804	31,645	46,685	46,244	46,232

Source: RHP, Emkay Research

Exhibit 11: Cash flow

Rs Mn	FY15	FY16	FY17	FY18	FY19	H1FY20
Net Profit before tax	-3,334	2,372	2,664	2,306	925	-544
Depreciation	153	129	178	249	371	208
Financing Charges	1,573	1,572	1,526	1,534	1,065	688
Interest/Dividend Received	-26	-23	-10	-16	-39	-67
Profit On Sale Of Asset	-0	-	-	-921	-	-
Transfer From Grant-In-Aid	-40	-4,987	-3,797	-1,368	-6	-42
Other Comprehensive Income	354	173	387	46	183	90
Non-Cash Expenditure	10	-33	42	34	1,171	11
Total Adjustments	2,023	-3,169	-1,673	-443	2,744	888
Operating cash flow before working capital	-1,311	-797	991	1,863	3,669	344
Changes in Working capital	-175	-2,391	-4,466	-2,957	-3,452	-2,371
Operating cash flow	-1,486	-3,188	-3,474	-1,094	217	-2,027
Capital Work-In-Progress	-127	-1,065	-761	-1,896	-1,278	-489
Sale Of Fixed Assets & Investments	0	-	-	921	-	-
Interest Received	26	23	10	16	39	67
Net Cash flow from Investing Activities	-101	-1,043	-751	-958	-1,239	-422
Proceeds From Short Term Borrowings	3,449	-819	403	472	324	-610
Share Application Money	1,920	-	-	1,370	550	1,050
Issue Of Share Capita	-	-	800	2,000	-	-
Grant-In-Aid Received	179	5,122	5,000	1,330	-	3,093
Financing Expenses	-1,573	-1,572	-1,526	-1,534	-1,065	-688
Net Cash flow from Financing Activities	3,975	2,731	4,676	3,637	-191	2,845
Total Increase / (Decrease) in Cash	2,389	-1,500	451	1,584	-1,212	397
Opening Cash and Bank balance	323	2,712	1,212	1,663	3,247	2,035
Closing Cash and Bank balance	2,712	1,212	1,663	3,247	2,035	2,432

Source: RHP, Emkay Research

Exhibit 12: Key Ratios

Profitability (%)	FY15	FY16	FY17	FY18	FY19
EBITDA Margin	-36.3	-15.9	-6.8	5.5	-6.0
EBIT Margin	-39.0	-17.0	-7.9	3.8	-8.2
Effective tax rate	-	-	-	-	-
Net Margin	-51.3	19.9	17.2	15.5	5.5
ROCE	5.8	-18.2	-58.8	23.8	5.8
ROE	-48.5	43.9	30.7	17.2	5.4
RoIC	27.7	25.8	32.5	51.6	-17.0

Per Share Data (Rs)	FY15	FY16	FY17	FY18	FY19
EPS	-10.3	8.2	4.8	3.0	1.0
CEPS	-9.8	8.7	5.1	3.4	1.4
BVPS	14.1	23.4	18.9	21.4	20.0
DPS	-	-	-	-	-

Valuations (x)	FY15	FY16	FY17	FY18	FY19
PER	-9.6	12.0	20.9	32.7	96.2
P/CEPS	-10.1	11.4	19.6	29.5	68.7
P/BV	7.1	4.2	5.2	4.6	5.0
EV/Sales	11.2	5.5	4.2	4.4	4.0
EV/EBITDA	-30.9	-34.7	-62.8	79.4	-65.9
Dividend Yield (%)	-	-	-	-	-

Gearing Ratio (x)	FY15	FY16	FY17	FY18	FY19
Net Debt/Equity	2.3	1.5	1.0	0.6	0.6
Net Debt/EBITDA	-4.5	-5.4	-9.7	11.1	-10.5
Working capital cycle (days)	-445.8	-210.4	-95.8	13.5	81.5

Growth (%)	FY15	FY16	FY17	FY18	FY19
Revenue	-18.3	106.1	29.7	-4.1	12.4
EBITDA	-13.7	-9.8	-44.8	-177.8	-223.3
EBIT	-13.6	-10.2	-40.0	-146.5	-343.2

Source: RHP, Emkay Research

Emkay Rating Distribution

Ratings	Expected Return within the next 12-18 months.
BUY	Over 15%
HOLD	Between -5% to 15%
SELL	Below -5%

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