

## Company Results Review

29 January 2007 | 7 pages

### MTNL (MTNL.BO)

#### Sell: 3QFY07 - Stability Yes, but Where Will Growth Come From?

- **Results slightly above expectations** — MTNL's EBITDA at Rs2.3m was broadly in-line with expectations, aided by stable fixed line subs and some help from new businesses. Recurring earnings at Rs1.7bn (37% qoq) were, however, materially aided by higher other income accrued on IT refunds.
- **Core business witnessed some stability, opex steady** — Fixed line business stemmed line losses (after two quarters of line losses) as subscriber base remained stable. Staff cost increased slightly due to the implementation of VRS schemes while admin expenditure remained steady. On the whole, operating costs remained stable qoq.
- **New businesses grow but grow too slowly** — Wireless revenue growth at 8%qoq is much slower than peers (15-20% qoq) and much smaller (~17% of MTNL's revenues) to be able to drive earnings growth. Broadband is doing relatively better. Additions continue to be robust (75k) but contribution from this business (Rs533m in 3Q and Rs1352m in 9M-FY07) is still not meaningful.
- **Maintain Sell/Low Risk** — Though cash + potential IT refunds equal ~Rs65-70/share, continued capex depresses free cash yield. Monetization of land is proceeding slowly and is fraught with execution risks.

<b>Sell/Low Risk</b>	<b>3L</b>
Price (29 Jan 07)	Rs168.95
Target price	Rs97.00
Expected share price return	-42.6%
Expected dividend yield	2.7%
<b>Expected total return</b>	<b>-39.9%</b>
Market Cap	Rs106,439M US\$2,410M

Price Performance (RIC: MTNL.BO, BB: MTNL IN)



Figure 1. Results Summary

	3Q06	2Q07	3Q07	Q/Q Growth %	Y/Y Growth %
Income from services	12,669	12,204	12,603	3.3	(0.5)
Staff cost	(4,871)	(4,596)	(4,799)	4.4	(1.5)
Interconnect costs	(2,205)	(2,256)	(2,069)	(8.3)	(6.2)
License Fee	(1,085)	(1,097)	(1,216)	10.8	12.0
Administrative / operative expenditure	(2,213)	(2,327)	(2,212)	(5.0)	(0.1)
EBITDA	2,295	1,928	2,308	19.7	0.5
PBT	1,482	1,839	2,511	36.6	69.4
PAT	1,175	1,210	1,661	37.3	41.4

Source: Citigroup Investment Research

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Fiscal year end 31-Mar	2004	2005	2006E	2007E	2008E
<b>Valuation Ratios</b>					
P/E adjusted (x)	9.3	11.3	15.7	21.2	26.3
EV/EBITDA adjusted (x)	5.8	7.2	8.1	9.2	10.2
P/BV (x)	1.0	1.0	0.9	0.9	0.9
Dividend yield (%)	2.7	2.7	2.7	2.7	2.4
<b>Per Share Data (Rs)</b>					
EPS adjusted	18.26	14.90	10.75	7.97	6.42
EPS reported	18.26	14.90	10.75	7.97	6.42
BVPS	164.13	173.71	179.40	182.31	184.23
DPS	4.50	4.50	4.50	4.50	4.00
<b>Profit &amp; Loss (RsM)</b>					
Net sales	63,696	55,924	52,889	51,031	49,390
Operating expenses	-46,493	-43,409	-43,433	-44,151	-43,854
<b>EBIT</b>	<b>17,203</b>	<b>12,515</b>	<b>9,456</b>	<b>6,880</b>	<b>5,536</b>
Net interest expense	-346	-358	-200	0	0
Non-operating/exceptionals	0	0	0	0	0
<b>Pre-tax profit</b>	<b>16,856</b>	<b>12,157</b>	<b>9,256</b>	<b>6,880</b>	<b>5,536</b>
Tax	-4,514	-2,672	-2,480	-1,858	-1,495
Extraord./Min.Int./Pref.div.	-841	-94	0	0	0
<b>Reported net income</b>	<b>11,501</b>	<b>9,390</b>	<b>6,775</b>	<b>5,023</b>	<b>4,042</b>
Adjusted earnings	11,501	9,390	6,775	5,023	4,042
Adjusted EBITDA	22,641	18,395	15,941	13,613	12,614
<b>Growth Rates (%)</b>					
Sales	9.6	-12.2	-5.4	-3.5	-3.2
EBIT adjusted	33.0	-27.3	-24.4	-27.2	-19.5
EBITDA adjusted	4.8	-18.8	-13.3	-14.6	-7.3
EPS adjusted	31.0	-18.4	-27.8	-25.9	-19.5
<b>Cash Flow (RsM)</b>					
<b>Operating cash flow</b>	<b>18,290</b>	<b>12,090</b>	<b>22,773</b>	<b>9,030</b>	<b>7,037</b>
Depreciation/amortization	5,438	5,880	6,485	6,732	7,078
Net working capital	7,824	1,117	9,313	-2,725	-4,082
<b>Investing cash flow</b>	<b>-7,681</b>	<b>-7,850</b>	<b>-9,948</b>	<b>-8,597</b>	<b>-7,456</b>
Capital expenditure	-9,337	-10,277	-9,748	-8,597	-7,456
Acquisitions/disposals	58	79	0	0	0
<b>Financing cash flow</b>	<b>-3,204</b>	<b>-4,634</b>	<b>-3,189</b>	<b>-3,189</b>	<b>-2,835</b>
Borrowings	-5	-4	0	0	0
Dividends paid	-3,198	-4,630	-3,189	-3,189	-2,835
<b>Change in cash</b>	<b>7,405</b>	<b>-394</b>	<b>9,636</b>	<b>-2,757</b>	<b>-3,254</b>
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>210,411</b>	<b>221,890</b>	<b>224,269</b>	<b>221,329</b>	<b>217,924</b>
Cash & cash equivalent	25,568	25,174	34,810	32,053	28,799
Accounts receivable	16,506	17,611	15,939	13,981	13,532
Net fixed assets	67,407	70,957	74,220	76,084	76,463
<b>Total liabilities</b>	<b>107,011</b>	<b>112,452</b>	<b>111,245</b>	<b>106,471</b>	<b>101,860</b>
Accounts payable	47,436	50,676	49,469	44,695	40,084
Total Debt	169	0	0	0	0
<b>Shareholders' funds</b>	<b>103,401</b>	<b>109,438</b>	<b>113,024</b>	<b>114,857</b>	<b>116,064</b>
<b>Profitability/Solvency Ratios (%)</b>					
EBITDA margin adjusted	35.5	32.9	30.1	26.7	25.5
ROE adjusted	11.6	8.8	6.1	4.4	3.5
ROIC adjusted	9.9	7.1	5.0	3.6	2.8
Net debt to equity	-24.6	-23.0	-30.8	-27.9	-24.8
Total debt to capital	0.2	0.0	0.0	0.0	0.0

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Figure 2. Revenue Breakdown

Revenue Break Up (Rs m)	1QFY06	2QFY06	3QFY06	4QFY06	1QFY07	2QFY07	3QFY07	Q/Q Growth %	Y/Y Growth %	Comments
Basic Telephone	10,455	10,336	10,968	12,028	9,950	9,284	9,407	1.3	(14.2)	Marginal increase in fixed line subs reflected in increased rental income
Rentals	2,658	2,670	3,382	2,827	2,903	2,714	2,893	6.6	(14.5)	
Call Charges & Other Revenue	7,090	6,549	6,730	7,827	6,100	5,962	5,825	(2.3)	(13.4)	Tariff cut in long distance (esp. Mumbai-Delhi segment) affects the usage revenue
Interconnection	707	1,118	855	1,374	947	608	689	13.3	(19.4)	Steadily improving cellular revenues with sub adds; could slow down in 4Q due to capacity constraints
Cellular	1,152	1,364	1,529	1,566	1,795	1,872	1,989	6.3	30.1	
WLL	273	214	109	149	236	175	225	28.6	107.0	
Other Services	724	854	64	710	743	873	982	12.5	1,426.3	
Income from Services	12,605	12,768	12,670	14,453	12,724	12,204	12,603	3.3	(0.5)	
Other Income	1,348	1,673	848	1,492	789	1,564	1,890	20.9	123.0	Interest accrued on IT refunds included
Total Income	13,953	14,441	13,517	15,945	13,513	13,768	14,493	5.3	7.2	

Source: Company Reports

Figure 3. Subscriber Base

Subscriber Base	1QFY06	2QFY06	3QFY06	4QFY06	1QFY07	2QFY07	3QFY07	Q/Q Growth %	Y/Y Growth %	Comments
Basic Wireline (incl. WLL-F)	3,962,663	3,892,270	3,856,868	3,877,608	3,851,665	3,761,334	3,764,212	0.1	(2.4)	Fixed line connections remained stable after two quarters of decline
WLL-M	179,468	154,301	126,022	105,665	80,090	80,355	113,108	40.8	(10.2)	MTNL's wireless additions steady but constrained by capacity
GSM	1,112,980	1,282,808	1,526,422	1,941,155	2,169,661	2,290,255	2,424,533	5.9	58.8	
- Pre paid	760,112	896,618	1,136,301	1,457,462	1,640,763	1,728,484	1,852,624	7.2	63.0	
- Post paid	352,868	386,190	390,121	483,693	528,898	561,771	571,909	1.8	46.6	
Total Wireless	1,292,448	1,437,109	1,652,444	2,046,820	2,249,751	2,370,610	2,537,641	7.0	53.6	
Total Connections	5,255,111	5,329,379	5,509,312	5,924,428	6,101,416	6,131,944	6,301,853	2.8	14.4	
Internet connections										
Broadband	43,070	82,534	144,983	211,935	266,632	323,329	397,885	23.1	174.4	Broadband additions continue to be impressive
Dial Up Connections	1,062,397	1,115,434	1,153,479	1,188,204	1,221,429	1,247,988	1,265,067	1.4	9.7	
Total	1,105,467	1,197,968	1,298,462	1,400,139	1,488,061	1,571,317	1,662,952	5.8	28.1	

Source: Company Reports

Figure 4. ARPU Trend

Rs	FY05	FY06	1QFY07	2QFY07	3QFY07
Fixed line	819	805	800	784	800
GSM - Pre-paid	358	280	206	230	203
- Post-paid	482	308	350	312	303

Source: Company Reports

## MTNL

### Company description

Mahanagar Telephone Nigam Limited (MTNL) operates a telecommunications company, which provides basic phone, Internet and cellular mobile telephony services in Delhi and Mumbai. The Company establishes, maintains, and manages telecommunication facilities in these cities.

### Investment thesis

We rate MTNL Sell (3L), with a target price of Rs97 based on the average of our DCF estimate and a P/E of 9x FY06E EPS. Our earnings estimates for FY06-08 are now 20-60% below consensus. MTNL's core business decline continues and mobile/broadband is unlikely to compensate for the decline. Private operators continue to cherry-pick the lucrative customers in Mumbai and Delhi. Additionally, the PCO business contributes around 21% of revenue. These revenues still have downside potential. Cost pressure, especially on the employee cost front, will likely continue. The company may be required to absorb 2,000 employees of the DoT, increasing its already bloated 54,000-employee base (vs. Bharti's 9,000 employees). The pension liability could increase according to new accounting norms in Indian GAAP. Cash on the books is unlikely to be paid out in the form of one-time dividends. Capex is high, and the risk is high that cash will be reduced by paying down liabilities and potential acquisitions. The Indian GAAP accounting has potential for downside as it is not conservative — US GAAP numbers are around 60% lower.

### Valuation

We value MTNL using DCF and P/E. We assume a risk-free rate of 7%, risk premium of 7%, beta of 0.93, and terminal growth of 3%. On P/E, we value MTNL at 9x FY06E P/E. MTNL has traded in a band of 6-10x between April 2001 and October 2004, with an average P/E of 8.7x. Our target multiple of 9x is 10% below the median P/E of our regional telecom universe and 30% below the target BSE-Sensex multiple. However, given the continuous decline in profits, we believe that 8x represents a reasonable valuation metric.

### Risk

We rate MTNL Low Risk based on our quantitative risk-rating system. The upside risks that could prevent the stock from achieving our target price include: (1) Merger with BSNL; (2) License fee refund would lead to cash inflow; (3) Refund of 80I(A); and (4) Broadband business related upside.

## Analyst Certification Appendix A-1

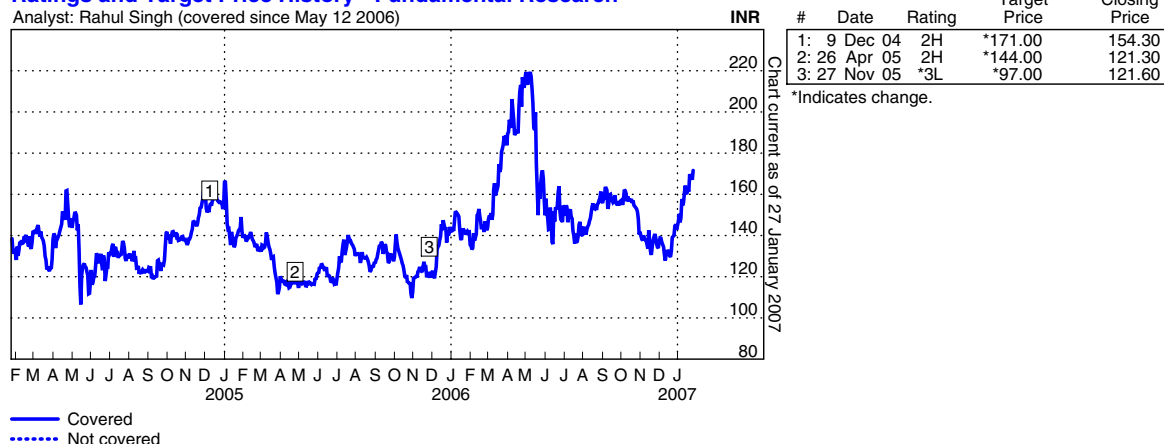
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Analyst: Rahul Singh (covered since May 12 2006)



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