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Stock Rating
Overweight

Industry View
In-Line

Mahanagar Telephone Nigam

A Turnaround Story

What's Changed

Rating	Underweight to Overweight
Price Target	Rs121.00 to Rs206.00

We are raising earnings, upgrading to Overweight.

Higher subscribers and higher revenues from cellular & broadband businesses have led us to revise earnings upwards by 10.4% and 25.7% for F2007 and F2008 respectively. MTNL's net cash equates to Rs87/share, i.e. **55% of its current market capitalization**. Stripping off the cash, MTNL trades at 6.2x F2008e core earnings, a 50% discount to its Asian peers, making its valuation look attractive, we believe.

Turnaround in core business. MTNL has arrested the fall in wireline subscribers in the last two months by providing broadband services at attractive rates and offering innovative voice packages. On the **wireless front**, MTNL has surpassed our expectations, increasing market share from 5.6% and 6.4% in Delhi and Mumbai in March 04 to 11.4% and 13.3% currently, despite the stiff competition.

Cost control measures. MTNL has successfully reduced its staff numbers by 5% in the last two years and plans to reduce this by another 2.5% in F2007, which should enable it to curtail staff costs in the future. MTNL has also recently leased out long distance infrastructure to reduce its interconnect costs. We estimate MTNL's EBITDA margins should increase from 22.5% in F2006 to 29.6% in F2008.

Key triggers: a) MTNL receiving Rs25 bn cash from income tax authorities in relation to license fees; b) strong F1Q07 results; c) moves from management that indicate it is taking action on MTNL's game plan to sweat its real estate assets; d) positive outcome on its Rs40 bn income tax litigation relating to Section 80-IA.

Key Ratios and Statistics

Reuters: MTNL.BO Bloomberg: MTNL IN ADR: MTE.N

India Telecommunications

Price target	Rs206.00
Shr price, close (May 24, 2006)	Rs157.85
Mkt cap, curr (mn)	Rs99,446
52-Week Range	Rs225.75-108.00
Sh out, basic, curr (mn)	630
ROE (06e) (%)	6.1
S'hldr eqty (06e) (mn)	Rs113,200

Fiscal Year (Mar)	2005e	2006e	2007e	2008e
ModelWare EPS (Rs)*	15.05	10.63	14.23	15.45
Prior ModelWare EPS (Rs)	17.59	13.82	12.89	12.29
Rev, net (Rs mn)	55,924	51,245	55,155	58,077
ModelWare net inc (Rs mn)	9,484	6,697	8,965	9,732
P/E	10.5	14.8	11.1	10.2
Div yld (%)	2.9	1.8	2.8	3.0
P/BV	0.9	0.9	0.8	0.8

* = Please see explanation of Morgan Stanley ModelWare later in this note.
e = Morgan Stanley Research estimates

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Financial Summary

Income Statement

(Rs Million)	F2004	F2005E	F2006E	F2007E	F2008E
Wireline Revenues	47,318	43,589	39,139	40,370	40,515
Wireless Revenues	2,275	3,858	6,355	9,091	11,642
Interconnect Revenues	13,105	7,345	4,053	3,910	4,110
VAS & Others	998	1,132	1,698	1,785	1,811
Operating Revenues	63,696	55,924	51,245	55,155	58,077
Interconnect / Network Ch.	12,286	9,279	8,220	8,254	8,495
License Fees	6,430	4,972	4,471	4,818	5,079
Employee Costs	16,194	18,359	17,366	16,464	16,913
Other Operating Cost	9,265	9,837	9,665	10,322	10,404
Total Operating costs	44,174	42,446	39,722	39,858	40,891
Operating Profit	19,523	13,478	11,522	15,297	17,186
Interest	346	358	250	-	-
Depreciation	5,438	5,880	6,377	6,926	7,395
Non Operating Income	3,143	4,917	3,421	4,436	4,112
Profit before Tax	16,882	12,157	8,317	12,807	13,903
Income Tax	4,513	2,672	1,620	3,842	4,171
Net Profit	12,369	9,484	6,697	8,965	9,732
Prior Period / Extraordinary	(841)	(94)	(910)	-	-
Reported PAT	11,528	9,390	5,787	8,965	9,732

Balance Sheet

(Rs Million)	F2004	F2005E	F2006E	F2007E	F2008E
SOURCES OF FUNDS					
Share Capital	6,300	6,300	6,300	6,300	6,300
Share Premium	6,650	6,650	6,650	6,650	6,650
Reserves & Surplus	90,326	96,488	100,250	106,077	112,403
Shareholders' Funds	103,276	109,438	113,200	119,027	125,353
Deferred Tax Liability	5,635	5,740	4,842	6,100	7,030
Loan Funds	-	-	-	-	-
Total	108,911	115,178	118,041	125,128	132,383
APPLICATION OF FUNDS					
Net Block	62,103	64,686	71,208	77,017	78,796
Capital Work in Progress	4,818	6,271	3,225	3,184	2,294
Net Fixed Assets	66,921	70,957	74,433	80,200	81,090
Investments	3,807	3,975	3,975	3,975	3,975
Cash & Cash Equivalents	25,531	25,174	25,613	50,722	55,066
Current Assets (Ex Cash)	113,755	121,785	98,736	78,379	83,052
Current Liabilities	101,095	106,712	84,715	88,149	90,798
Net Current Assets	38,191	40,247	39,634	40,953	47,319
Total Assets	108,918	115,178	118,041	125,127	132,383

Cash Flow Statement

(Rs Million)	F2005E	F2006E	F2007E	F2008E
Cash Flows from Operations				
Profit/(Loss) before tax	12,157	8,317	12,807	13,903
Depreciation	5,880	6,377	6,926	7,395
Interest	358	250	-	-
Direct Taxes Paid	(2,567)	(2,518)	(2,584)	(3,241)
Changes in Working Capital	(2,413)	1,052	23,791	(2,023)
Prior period adjustments	(94)	(910)	-	-
Total	13,321	12,567	40,940	16,034
Cash Flows from Investing Activities				
Purchase of Fixed Assets	(9,916)	(9,853)	(12,693)	(8,284)
Purchases of Investments	(168)	-	-	-
Total	(10,084)	(9,853)	(12,693)	(8,284)
Cash Flows from Financing Activities				
Repayment of L.T. Debt	-	-	-	-
Interest Expense	(358)	(250)	-	-
Dividends	(2,835)	(1,800)	(2,789)	(3,028)
Dividend Tax	(393)	(225)	(349)	(378)
Total	(3,586)	(2,275)	(3,138)	(3,406)
Net change in Cash & Cash Eq.	(349)	439	25,110	4,343

Ratio Analysis

(Rs Million)	F2004	F2005E	F2006E	F2007E	F2008E
Valuation					
EPS	19.63	15.05	10.63	14.23	15.45
P/E	8.0	10.5	14.8	11.1	10.2
P/BV	1.0	0.9	0.9	0.8	0.8
Yield (%)	2.9	2.9	1.8	2.8	3.0
EV/EBITDA	3.8	5.2	6.1	2.9	2.4
Profitability					
EBITDA Margin (%)	30.6	24.1	22.5	27.7	29.6
Net Profit Margin(%)	19.4	17.0	13.1	16.3	16.8
ROE (%)	12.5	8.9	6.0	7.7	8.0
ROCE (%)	16.5	11.2	7.3	10.5	10.8

Source: Company data, Morgan Stanley Research
E = Morgan Stanley Research Estimates

Investment Case

Summary & Conclusions

We are raising earnings upwards by 10.4% and 25.7% for F2007 and F2008 respectively and upgrading MTNL to Overweight for the following key reasons.

1) **Turnaround in the wireline business** – MTNL has started focusing on providing its **wireline** subscribers with broadband services at attractive rates and offering innovative voice packages; this has led to a small growth in its subscriber in the months of March and April 2006. We estimate the company would gain from **higher broadband revenues** as well.

2) On the **wireless front** the company has increased its market share from 5.6% and 6.4% in Delhi and Mumbai in March 04 to 11.4% and 13.3% respectively in April 06, despite stiff competition from Bharti and Reliance; **surpassing our revenue and subscriber estimates**. During that period, the EBITDA contribution from wireless increased from 1.2% of EBITDA to 24.6%, a more than ten-fold absolute increase. We expect MTNL to sustain its strong wireless performance in the next two years and have revised our subscriber and revenue estimates from this business upward, as shown in Exhibit 1.

3) MTNL has successfully implemented two Voluntary Retirement Schemes (VRS) in the last two years and has lowered its staff numbers by 2,598; It is implementing a third VRS that should reduce its strength by another 1,400 in F2007, getting its overall number down to 49,226, a 7.5% fall in a three-year time frame. We **estimate that staff costs as a percentage of sales will decline** from 33.9% in F2006 to 29.1% in F2008E.

4) MTNL has acquired a **National Long Distance (NLD)** license and has started leasing out infrastructure from VSNL in the Mumbai-Delhi route to lower its interconnect charges, at significantly lower rates than it paid BSNL in F2006. The company has also **come out with tenders** inviting bids from various operators for carrying its traffic across the country at competitive carriage tariffs. We **estimate the interconnect costs as a percentage of sales to decline** from 16% in F2006 to 14.6% in F2008.

To summarize, higher subscribers and higher revenues from cellular and broadband have led us to revise our revenue forecasts upwards by 9.35% and 14.5% for F2007 and F2008 respectively. We estimate MTNL's EBITDA margins should increase from 22.5% in F2006 to 29.6% in F2008 due to cost cutting relating to staff and interconnect costs. Overall, we are raising earnings by 10.4% and 25.7% for F2007 and F2008; key changes are shown in Exhibit 1. In line with our earnings revisions, we have increased our target price to Rs206/share, implying upside potential of 30% from current levels

MTNL has fallen 26% in absolute terms in the last month, underperforming the market by 17% over the period, and 16% in the last year. The company's cash and cash equivalents equal Rs54.6 bn, or Rs87/share, i.e. **over 50% of its current market capitalization**. Stripping off cash, MTNL trades at 6.2x F2008 earnings, on our numbers, making the valuation look attractive, we believe.

Company Description

MTNL is the premier wireline service provider in Delhi and Mumbai, where it launched its wireless services in February 2001. The Government of India holds a 56.25% stake.

Industry View: In-Line

Progress on deregulation and low tele-density are industry positives. Intense competition and low incremental ARPU's are industry negatives.

MSCI Country: India

Asia Strategist's Recommended Weight: 1.5%
MSCI Asia/Pac All Country Ex Jp Weight: 6.0%

We have four key triggers for the stock:

- a) MTNL receiving Rs25 bn (Rs40/share) cash from income tax authorities relating to the license fee;
- b) We are 30.1% and 43.7% above consensus for F2007/08 results and expect analysts to revise earnings **post MTNL reporting strong F1Q07 results**;
- c) MTNL is planning to sweat its real estate assets and any positive directional move could lead to a re-rating;
- d) Positive outcome on its Rs40 bn (Rs63.5/share) income tax litigation relating to Section 80-IA.

Exhibit 1

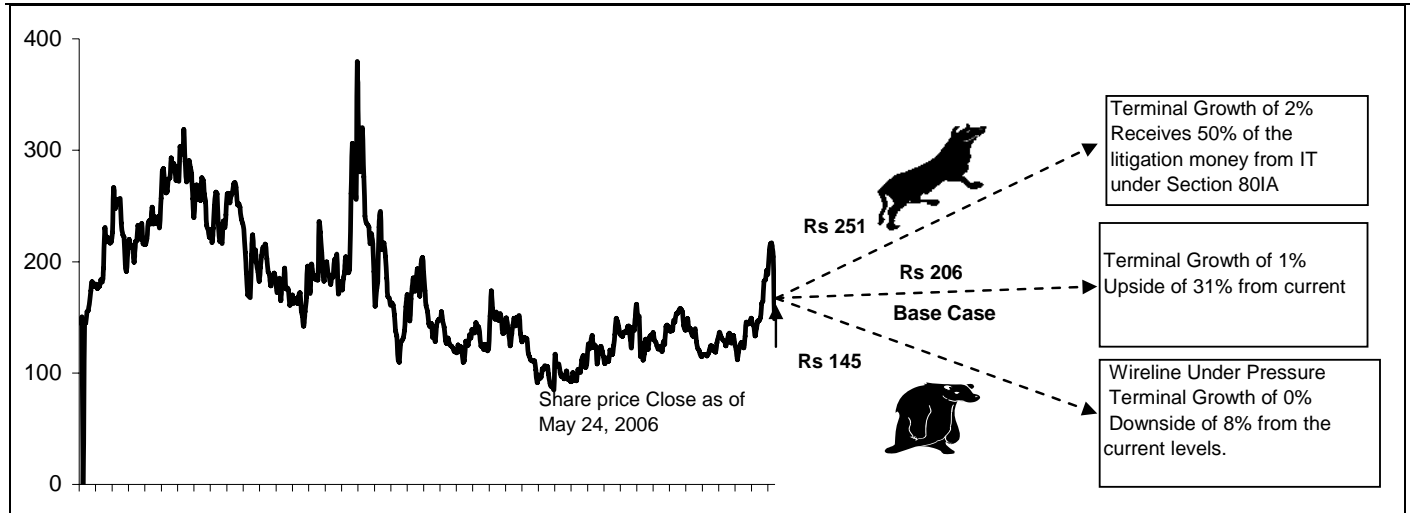
MTNL- What's Changed in our Assumptions

Old-New	F2006E	F2007E	F2008E
Net Income (Rs)			
Old	8,709	8,121	7,741
New	6,697	8,965	9,732
Change (%)	-23.1	10.4	25.7
Total Revenues (Rs Million)			
Old	50,852	50,479	50,735
New	51,245	55,155	58,077
Change (%)	0.8	9.3	14.5
Cellular Revenue(Rs Million)			
Old	3,902	4,609	4,921
New	6,355	9,091	11,642
Change (%)	62.9	97.2	136.6
Broadband (Rs Million)			
Old	0	0	0
New	966	2,418	3,511
Change	NM	NM	NM
EBITDA (Rs million)			
Old	14,822	14,702	14,776
New	11,522	15,297	17,186
Change (%)	-22.3	4.1	16.3
Yr. End Wireline Subs ('000)			
Old	3,606	3,642	3,678
New	3,878	3,874	3,872
Change (%)	7.5	6.4	5.3
Yr. End Wireless Subs ('000)			
Old	1,842	3,097	3,860
New	2,047	3,480	4,265
Change (%)	11.1	12.4	10.5
Total Subscribers('000)			
Old	5,448	6,739	7,538
New	5,924	7,354	8,137
Change (%)	8.7	9.1	7.9
EPS (Rs)			
Old	13.8	12.9	12.3
New	10.6	14.2	15.4
Change (%)	-23.1	10.4	25.7
Net Profit (Rs Million)			
Morgan Stanley		8,965	9,732
Consensus		6,889	6,771
MS vs Consensus (%)		30.1	43.7

Source: Morgan Stanley Research

Exhibit 2

Bull vs Bear vs Base Case



Source: Company data, Morgan Stanley Research

We show our base, bear and bull case assumptions in Exhibit 2 above.

Our base case assumptions are shown in Exhibit 1. To arrive at our new price target of Rs206 we use our DCF, based on a cost of capital of 12.1% and a terminal growth of 1%.

For the bull case scenario, we arrive at a value of Rs251/share based on three assumptions:

- a) long-term growth of 2%,
- b) MTNL receives 50% of its litigation money with the income tax authority pertaining to Section 80-IA
- c) MTNL receives Rs375 mn per annum as rentals on its surplus real assets and we expect this to happen by the end of F2007.

For the bear case analysis we make four

- a) terminal growth rate = 0%
- b) fall in wireline ARPU by 5% pa as against our base case assumption of 2.5%
- c) fall in public telephone revenue by 8.6% p.a. as against 3.5% in our base case.
- d) increase in salaries per employee by 10% in F2008 as against 5% assumption base case.

Based on these assumptions we would expect MTNL's EPS to stagnate at Rs13/share over the longer term and arrive at a DCF based bear case fair value of Rs145/share.

Turnaround in the Wireline Business

MTNL has been focusing on a two-pronged strategy to arrest its fall in wireline subscribers. First, for its voice centric customer base MTNL has come out with **innovative tariff plans**, which include a) zero monthly rental for consumers already having a single MTNL connection and wanting to opt for a second wireline connection, and b) charging lower long distance tariffs, as shown in Exhibit 6.

For its **data centric subscribers**, MTNL provides the cheapest broadband services available and has managed to lure 500 k of its existing wireline subscriber into using its broadband services. MTNL has been able to generate Rs500/month of additional monthly ARPU from its customers. The company will soon be launching triple play services including IPTV to lure more broadband consumers.

This **two-pronged strategy** has enabled MTNL actually to grow its wireline subscriber base in March as well as April 2006 as against a stagnant subscriber base historically; and an expected decline due to higher competition.

MTNL has to spend relatively less than its peers on its broadband network, since it already has an existing copper and fiber centric wireline network in the metro. We estimate incremental capex of US\$100/subscriber for its broadband consumer, which enables MTNL to have an edge over its competition.

Our estimates for MTNL's wireline and broadband business model are shown in Exhibit 3 and Exhibit 4, respectively.

Exhibit 3

MTNL: Wireline Business Model

	F2005	F2006	F2007	F2008
Call Rev Rs mn	19,396	17,052	16,205	15,788
ARPU/sub (Rs.)	383	357	348	340
Rental Rev (Rs mn)	11308	11538	11246	11237
Monthly Rental/sub (Rs.)	223	242	242	242
Public Phone Rev (Rs. Mn)	10198	8877	8636	8120
Average Rev/Public Phone (Rs)	3,272	2,553	2361	2184
Y-E Public Phones in Service	279,776	299,776	304,776	309,776

Source: Morgan Stanley Research

Exhibit 4

MTNL: Broadband Business Model

Broadband Services	F2006E	F2007E	F2008E
Broadband Subscribers	458	750	1,050
ARPU's (Rs.)	351	333	325
Revenues (Rs million)	966	2,418	3,511
% of Total Revenues	1.9	4.4	6.0

Source: Company data, Morgan Stanley Research

Exhibit 5

Broadband Tariff Comparisons

Operator	Download Speed (KBPS)	Free Data Download (MB)	Monthly Charge (Rs/Month)	Additional Usage Charge (Rs/MB)
MTNL Triband	256	400	199	1.00
MTNL Triband	512	1028	599	1.00
Bharti	256	1028	599	1.20
Reliance	600	350	300	1.25

Source: Morgan Stanley Research

Exhibit 6

Tariff Comparisons

Wireline	MTNL	Bharti	Reliance
Domestic Long Distance(DLD) (Rs/min)			
Mumbai Delhi	1.20	2.40	2.40
Others	2.40	2.40	2.40
International Long Distance(ILD)*(Rs/min)	6.00	7.20	7.00

Wireless	MTNL	Bharti	Reliance
Local(Rs/min)	1.50	2.25	1.20
DLD(Rs/min)	2.40	2.65	2.50
ILD*(Rs/min)	12.00	7.20	7.20

Micro-Prepaid

Recharge Voucher(Rs.)	175.00	200.00	200.00
Calling Value(Rs.)	55.00	50.00	50.00
Local(Rs/min)	1.50	2.25	1.20
DLD(Rs/min)	2.40	2.65	2.50
ILD*(Rs/min)	12.00	7.20	7.20

Prepaid

Recharge Voucher(Rs.)	330	330	330
Calling Value(Rs.)	220	125	125.00
Local(Rs/min)	1.50	2.25	1.20
DLD(Rs/min)	2.40	2.65	2.50
ILD*(Rs/min)	12.00	7.20	7.20

Source: Company data, Morgan Stanley Research. *ISD charges are per minute charges to Unites States

The Wireless Business – An Impressive Performer

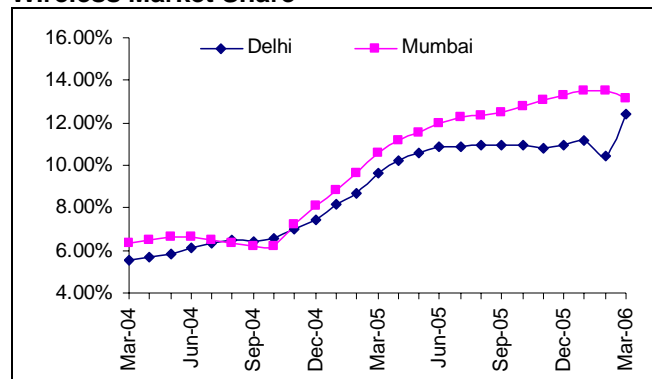
In the past two years, MTNL's wireless business, especially its GSM operations, has outperformed the Indian wireless market in terms of growth rate, quadrupling from a subscriber base of 470 k in March 04 to over 2 mn currently. The company has increased its market share from 5.6% and 6.4% in Delhi and Mumbai in March 04 to 11.4% and 13.3% respectively in April, despite stiff competition from Bharti and Reliance; **surpassing our revenue and subscriber estimates**. During the same period the EBITDA contribution from the wireless business increased from 1.2% of EBITDA to 24.6%, an more than ten-fold absolute increase.

MTNL's strategy for growth has been tapping its existing wireline customer base and providing cheaper tariffs than its competition, as shown in Exhibit 6. The company is now operating at nearly 75% capacity utilization and has placed an order to add capacity by another 1 mn in Mumbai to ITI, which should be commissioned by August 2006. It is currently in the process of tendering an additional 1 mn capacity in Delhi. In the interim, the company plans to increase the impetuosity behind its CDMA services, where it has around 900 k of unutilized CDMA capacity.

We estimate MTNL to sustain its strong wireless performance in the next two years and have raised our subscriber s and revenue estimates from this business, as shown in Exhibit 1.

Exhibit 7

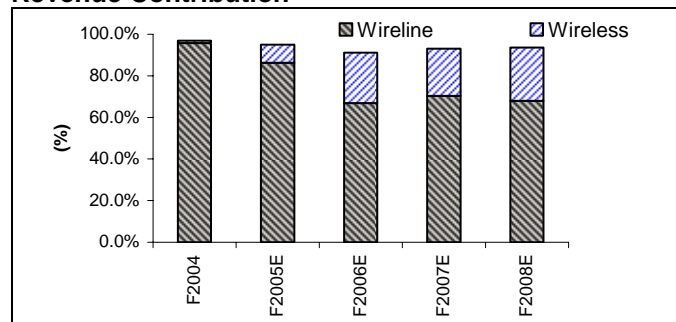
Wireless Market Share



Source: Company data, Morgan Stanley Research

Exhibit 8

Revenue Contribution

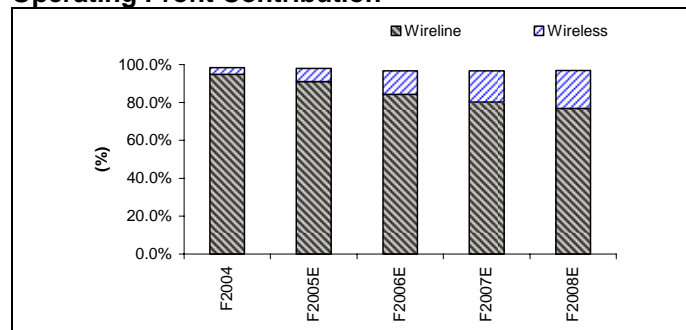


e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

Exhibit 9

Operating Profit Contribution



e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

Exhibit 10

MTNL: GSM Drives Subscriber Growth

('000)	Mar-04	Jun-04	Sep-04	Dec-04	Mar-05	Jun-05	Sep-05	Dec-05	Mar-06
GSM	361	417	440	595	882	1,113	1,283	1,526	1,941
CDMA	107	120	134	182	196	179	154	126	106
Wireline (Including FWT)	3,801	3,800	3,811	3,822	3,825	3,825	3,823	3,820	3,821
Total Subscribers	4,268	4,337	4,385	4,598	4,903	5,117	5,260	5,473	5,868

Source: Company data, Morgan Stanley Research

Employee Costs – Finally Under Control

MTNL's staff costs as a percentage of sales is the highest amongst telecom companies in our universe globally, accounting for 33.9% of sales in F2006. In a bid to control its costs, MTNL has successfully implemented two Voluntary Retirement Schemes (VRS) in the last two years and has lowered its staff numbers by 2,598 to 50,626 employees, a reduction of around 5%. It is implementing a third VRS, which should reduce this number by another 1,400 in F2007.

We understand that the Pay Commission would revise salaries based on inflation, in F2007, a task it does every five years. We have factored this in by assuming a 4% increase in salary per employee for F2008.

The company has virtually stopped any external hiring and is increasing the productivity of its employees by focusing on new business opportunities. **We now estimate that MTNL's staff costs as a percentage of sales will decline** from 33.9% in F2006 to 29.1% in F2008, as shown in Exhibit 11.

Lower Carriage Cost to Boost Operating Margins

The Indian regulators have recently come out with a New Interconnect Usage (IUC) Regime effective March 2006 changing the long distance carriage charges from a flat structure to a ceiling based tariff. TRAI has now fixed a ceiling charge of Rs0.65 per minute irrespective of distance instead of the existing slab system of Rs0.20 to Rs1.1.0/ minute on carrier charges.

Taking advantage of the increased NLD competition, MTNL has **come out with tenders** inviting bids from various operators for carrying its traffic across the country at competitive carriage tariffs.

MTNL has acquired a **National Long Distance (NLD)** license and recently started leasing out infrastructure from VSNL in the Mumbai - Delhi route to lower its interconnect charges. The company also recently announced packages that would enable its consumers to call Mumbai - Delhi at local call rates. **We estimate the interconnect costs as a percentage of sales to decline** from 16% in F2006 to 14.6% in F2008.

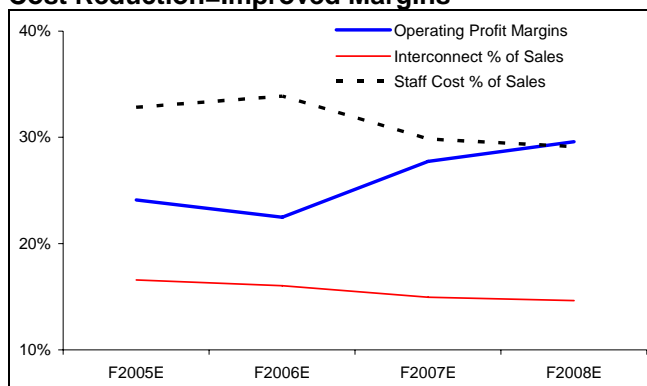
Valuation: Raising Price Target to Rs206

Our price target for MTNL stock remains at the mid-point of the value derived from our DCF calculation, assuming a terminal growth rate of 1% (Exhibit 14). Our new target price of Rs206/share implies an F2008 P/E of 10x of its core

business, which is a 20% discount to our Asian wireline average multiples.

Exhibit 11

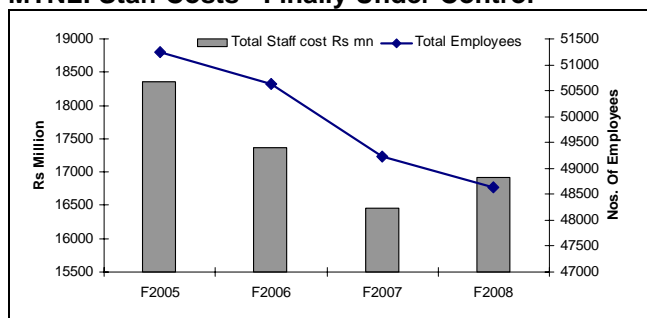
Cost Reduction=Improved Margins



Source: Morgan Stanley Research estimates

Exhibit 12

MTNL: Staff Costs - Finally Under Control



Morgan Stanley Research estimates for 2006 and beyond
Source: Company data, Morgan Stanley Research

Why Buy Now?

MTNL has fallen 26% in absolute terms in the last month, underperforming the market by 17% during the period and 16% in the last year. The company's cash and cash equivalents equal Rs54.6 bn or Rs87/share, i.e. **over 50% of its current market capitalization.**

MTNL has improved its disclosure levels significantly since F4Q06, which we believe will increase investor interest.

Stripping off cash, MTNL trades at 6.2x F2008, i.e. half the valuation of its Asian peers earnings, on our estimates, making its valuation attractive, we believe. Based on our forecast F2008 earnings, the stock trades at an EV/EBITDA of 2.4x as against 4.9x for its Asian peers, and at a P/Book of 0.9 x vs. 2.1x for its Asian peers, again making the valuation look compelling, in our view.

We expect a healthy free cash flow yield of 12.8% in F2008 in the core business and 7.79% yield in overall business (Exhibit 15).

Exhibit 13

MTNL: Long-Term Cost of Capital

Risk Free Return (%)	7.5
Market premium (%)	6.0
Assumed Beta	1.04
Cost of Equity (Re) (%)	13.7
Equity Percentage (%)	80
Cost of Debt (%)	8.0
Tax rate (%)	33.7
After-tax cost of debt (Rd[1-t]) (%)	5.3
Debt	20
WACC (%)	12.1

Source: Company data, Morgan Stanley Research

Exhibit 14

MTNL: DCF Calculation

Net Debt	-29,587
Equity Value (Rs Mn)	129,693
Equity Value (US \$Mn)	2,832
Shares	630
Implies DCF Value/share (Rs)	206

Source: Company data, Morgan Stanley Research

Exhibit 15

MTNL: Free Cash Flow Yield

	F2008E
Free cash Flow (Whole Business)	7,749
FCF yield (%)	7.79
FCF (Core Business)	5,159
FCF yield on Core Business (%)	12.8

Source: Company data, Morgan Stanley Research

Potential hindrances to stock performance and, therefore, to the achievement of our price target are:

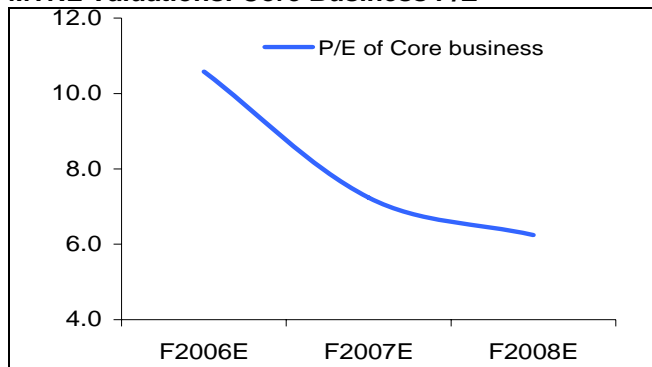
- Competition from private players intensifies, especially in the wireless business.
- The income tax authority delays the payment of Rs25 bn of cash to MTNL on the license fee case indefinitely.
- Fall in the PCO wireline revenues, which account for 18% of F2006 revenues due to higher competition from wireless operators.
- Uncertainty regarding merger with BSNL.6

We see four key potential triggers for the stock:

a) **MTNL receiving Rs25 bn cash from** income tax authorities on license fee, which we expect would be staggered over F2007. MTNL has won **litigation** from the

Exhibit 16

MTNL Valuations: Core Business P/E



Source: Morgan Stanley Research estimates

Income tax authority re license fees for a period of four years amounting to Rs12.5 bn. The company also has prior period cases (not including these four years), amounting to another Rs12.5bn on the same subject.

b) We are 30.1% and 43.7% above consensus for F2007/08 results and **expect analysts to revise earnings post F1Q07 results**; this could be a function of MTNL being under researched, with less than a handful of research analysts actively covering the company as against over 22 analysts covering other Indian telecom stocks like Bharti.

c) **MTNL owns real estate in prime locations** in Mumbai and Delhi and a lot of these assets are under-utilized, according to the management. The company is planning to sweat its real estate assets and any positive directional move by management could lead to a re-rating of the stock. As a start, the company has taken up two initiatives. 1) It has set up a 450 seater State-of-the-Art training institute in Powai in Mumbai, which it is offering on hire to the telecom industry. 2) MTNL is relocating some of its key staff who have been staying in rented apartments and billing MTNL, into MTNL owned houses. This single measure should save the company Rs300 mn per annum as rent charges paid to employees on housing

d) MTNL is also **in litigation with the income tax authority** on cases pertaining to section 80-IA, worth Rs40 bn, and any positive outcome would prove beneficial to the company. Section 80-IA benefits are allowed to be claimed by new telecom undertakings (including Bharti and RCVL), whereby the companies come under Minimum Alternate

Tax (MAT – 10.5% tax liability as against a corporate rate of 33.6%). In the last decade, MTNL has spent over Rs100 bn in digitizing its exchange and setting up its cellular network. MTNL believes revenues from these investments should come under MAT and hence are in litigation with the income tax authority.

APPENDIX – I

Asia/Pacific Telecoms: Key Valuation Metrics

Key Comparables	Price/Earnings			EV/EBITDA				EV/Sub (US\$)				Price/Book		RNOA			
	5/23/2006	2006E	2007E	2004	2005E	2006E	2004-2007E	2004	2005E	2006E	2005E	2006E	2007E	2004	2005E	2006E	
Indian Telecom Service Providers																	
Bharti Tele-Ventures	368.5	20.7	15.8	24.0	16.9	11.4	55.9%	1,382	796	504	7.6	5.6	-	19.0%	24.9%	26.5%	
MTNL	165.0	10.8	10.4	5.8	4.0	3.9	-82.4%	2,022	862	519	0.9	0.9	-	7.2%	6.8%	6.8%	
VSNL	392.9	19.6	16.3	13.1	11.4	9.8	45.6%	NA	NA	NA	1.9	-	-	11.0%	11.7%	9.7%	
Asian Wireline/Integrated																	
China Telecom	2.6	9.5	9.5	4.6	4.2	4.0	114.9%	NA	NA	NA	1.1	1.0	0.9	7.6%	8.1%	7.8%	
China Netcom	12.1	7.7	7.2	4.9	4.1	3.7	31.3%	221	185	166	1.4	1.2	1.0	9.1%	7.7%	8.1%	
Hanaro (%)	6,000.0	NM	32.8	6.5	6.9	5.9		na	NA	NA	NA	na	na	1.5	2.0	4.0	
KT Corp. (%)	40,600.0	9.5	9.4	3.4	3.0	3.1	NM					0.9	0.9	0.8	10.1	10.5	9.8
PLDT (%)	1,960.0	10.9	9.3	6.9	5.6	4.9		435	370	320	5.2	4.3	3.7	18.6	24.2	30.7	
PT Telkom	7,200.0	11.1	10.5	7.4	6.1	4.9	42.9%	706	527	415	5.4	4.6	4.4	33.2%	36.3%	33.9%	
Singapore Telecom (%)	2.6	13.3	12.2	8.1	7.6	7.5		2,874	NA	NA	NA	0.9	0.8	13.7	14.9	15.8	
Telecom Corp. of NZ (%)	4.5	10.7	11.1	5.6	5.7	5.8	NM	1,808	1,681	1,604	3.0	4.2	3.7	0.0	0.0	0.0	
Telekom Malaysia	9.3	13.7	12.0	5.5	6.1	5.3	68.8%	953	914	872	1.6	1.8	1.7	8.8%	9.6%	10.2%	
Telstra (%)	3.8	13.1	15.7	5.7	5.6	6.0	NM	2,496	2,442	2,524	3.1	1.8	1.6	18.1	15.7	13.5	
Average		11.9	12.2	6.0	5.7	5.1	184.1%	1,356	1,020	983	2.5	2.2	2.1	12.2%	13.4%	13.9%	
Asian Wireless																	
Far Eastone (%)	38.9	10.3	10.7	5.3	4.8	4.8	NM	784	773	738	2.1	2.0	1.9	18.1	19.1	19.5	
Wireless	-	-	-	-	-	-	0.0%	na	na	na	-	-	-	na	0.0%	0.0%	
China Mobile (HK)	41.0	12.2	12.3	8.7	6.0	6.0	48.0%	532	414	334	1.5	1.4	1.3	10.3%	11.9%	11.9%	
Advanced Info Service	93.5	12.3	11.6	5.8	6.1	6.1	425.9%	468	433	399	3.6	3.6	3.5	0.0%	0.0%	0.0%	
SK Telecom	218,500.0	9.6	8.9	5.4	4.7	4.7	135.2%	1,229	1,143	1,071	1.7	1.5	1.4	24.9%	23.1%	22.6%	
KTF	31,150.0	10.1	9.6	5.2	3.7	3.7	73.8%	803	651	607	1.3	1.2	1.1	10.3%	10.4%	11.0%	
LG Telecom (%)	12,150.0	6.8	6.7	9.1	5.9	5.9		822	728	618	2.7	1.9	1.5	10.5	16.7	17.7	
PT Indosat	4,900.0	11.7	11.3	5.1	4.8	4.8	40.3%	342	239	198	1.6	1.5	1.4	12.6%	13.0%	11.6%	
Bharti Tele-Ventures	368.5	20.7	15.8	24.0	16.5	16.5	55.9%	1,446	809	510	7.4	5.4	4.2	24.3%	28.3%	26.2%	
China Unicom	6.6	14.0	12.6	5.0	3.9	3.9	60.8%	143	104	91	1.2	1.1	1.1	4.8%	6.6%	7.0%	
Mobile One Limited	2.1	11.7	12.3	7.5	6.4	6.4	132.2%	NA	NA	NA	4.4	5.5	5.3	30.9%	33.4%	32.7%	
Total Access Comm.	4.2	14.9	16.3	7.6	7.1	7.1	113.1%	NA	NA	NA	2.1	1.9	1.8	9.3%	9.9%	8.2%	
Maxis Communications	8.8	11.4	11.5	6.3	5.5	5.5	140.8%	NA	NA	NA	3.5	3.1	2.9	26.6%	43.3%	48.4%	
SmarTone (%)	8.1	NM	52.0	4.5	4.8	4.8	NM	497	491	482	1.4	1.4	1.4	14.4	1.9	4.1	
Average		11.2	13.7	7.1	5.7	5.8	111.5%	707	579	505	2.5	2.3	2.1	15.2%	15.5%	15.8%	

NM = Not Meaningful; * Figures for 2004/5/6/7 correspond to the estimates for fiscal year ending March 2005/6/7/8. Figures for 2004-7 correspond to F2005-8: Morgan Stanley Research



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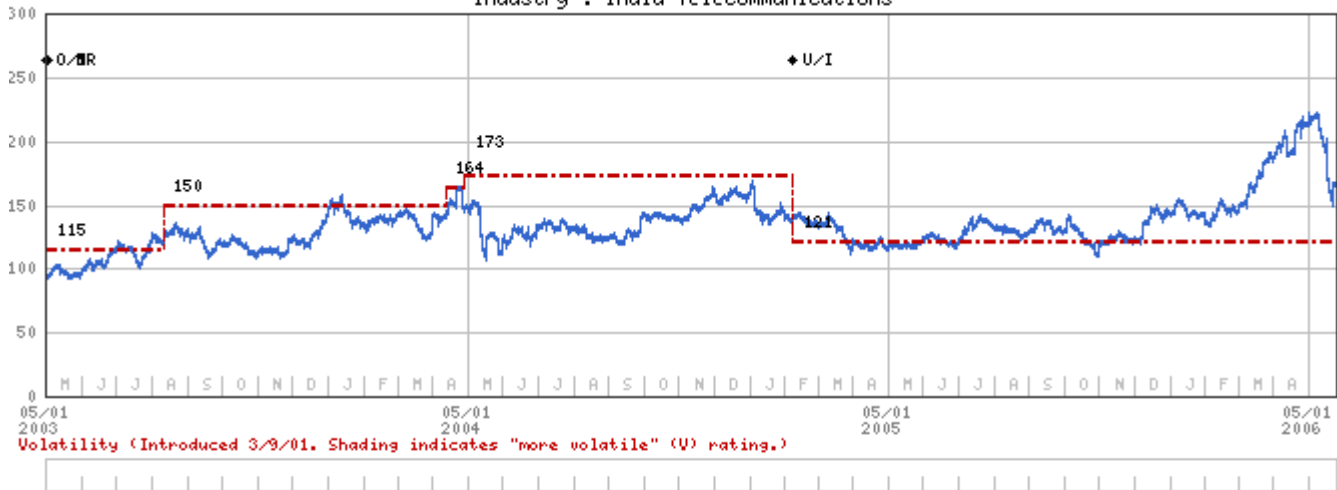
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Mahanagar Telephone Nigam (MTNL.BO) - As of 5/24/06 in INR
 Industry : India Telecommunications



Stock Rating History: 1/28/03 : 0/NR; 5/2/03 : 0/I; 2/7/05 : U/I
 Price Target History: 1/28/03 : 115; 8/11/03 : 150; 4/12/04 : 164; 4/29/04 : 173; 2/7/05 : 121

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Industry Coverage: India Telecommunications

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Mahanagar Telephone Nigam (MTNL.BO)	Overweight (05/25/2006)	Rs157.85
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