Company Flash

24 April 2007 | 6 pages

MTNL (MTNL.BO)

Sell: 4Q07 - The Downtrend Continues

- Results in-line with expectations — MTNL's EBITDA at Rs2.1bn was broadly in-line with expectations, though it was aided by a qoq decline in staff costs even as revenues continued to be on a downtrend. Net profit at Rs1.5bn (7.7% qoq) remained relatively stagnant.
- Core business declines marginally — Fixed line business stemmed line losses (after two quarters of line losses) as the subscriber base increased marginally (37k). However, fixed line revenues still declined qoq. Surprisingly, wireless revenue declined qoq apparently on the back of a sharp decline in prepaid ARPUs (down 14% qoq).
- Broadband is the only silver lining — Broadband additions continue to remain robust with 18% growth QoQ accompanied by improving ARPU, which improved 9% QoQ to Rs.442. Though this resulted in a steady increase in "Other" revenues, it was not enough to prevent an overall decline in revenues during the quarter.
- Maintain Sell (3L) — Though cash + potential IT refunds equal ~Rs65-70/share, continued decline in core businesses with new business unable to support earnings depresses free cash yield. Monetization of land is proceeding slowly and is fraught with execution risks.

Sell/Low Risk	**3L**
Price (24 Apr 07)	Rs152.35
Target price	Rs125.00
Expected share price return	-18.0%
Expected dividend yield	3.3%
Expected total return	**-14.7%**
Market Cap	Rs95,981M
	US$2,313M

Figure 1. Results summary

	3Q06	2Q07	3Q07	4Q07	Q/Q Growth %
Income from services	12,669	12,204	12,319	12,000	(2.6)
Staff cost	(4,871)	(4,596)	(4,799)	(4,240)	(11.6)
Interconnect costs	(2,205)	(2,256)	(2,069)	(1,992)	(3.7)
License Fee	(1,085)	(1,097)	(1,216)	(1,121)	(7.8)
Administrative / operative expenditure	(2,213)	(2,327)	(2,212)	(2,449)	10.7
EBITDA	2,295	1,928	2,024	2,198	8.5
PBT	1,482	1,839	2,228	2,330	4.6
PAT	1,175	1,210	1,378	1,485	7.7

Source: Citigroup Investment Research

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See Appendix A-1 for Analyst Certification and important disclosures.

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Figure 2. Revenue breakup

(Rs m)	2QFY06	3QFY06	4QFY06	1QFY07	2QFY07	3QFY07	4QFY07	Q/Q Growth %	Y/Y Growth %	Comments
Basic Telephone	10,336	10,968	12,028	10,095	9,497	9,376	9,039	(3.6)	(24.9)	QoQ decline in fixed line revenues inspite of a marginal increase in subscriber base
Rentals	2,670	3,382	2,827	2,903	2,796	2,892	2,720	(5.9)	(3.8)	
Call Charges & Other Revenue	6,549	6,730	7,827	6,437	6,128	5,822	5,758	(1.1)	(26.4)	Continues to be under pressure due to continued traffic migration to wireless
Interconnection	1,118	855	1,374	755	573	663	561	(15.4)	(59.2)	
Cellular	1,364	1,529	1,566	1,780	1,825	1,960	1,769	(9.7)	13.0	The QoQ decline in cellular revenues on account of steep fall in pre-paid ARPU
WLL	214	109	149	236	171	230	205	(10.8)	37.7	
Other Services	854	64	710	613	697	753	987	31.1	39.0	Growth driven by broadband revenues
Income from Services	**12,768**	**12,670**	**14,453**	**12,725**	**12,190**	**12,319**	**12,000**	**(2.6)**	**(17.0)**	
Other Income	1,673	848	1,492	789	1,462	1,961	1,861	(5.1)	24.7	Includes Rs.782.5m on account of int. accrued on refund of Income tax
Total Income	**14,441**	**13,517**	**15,945**	**13,513**	**13,652**	**14,280**	**13,861**	**(2.9)**	**(13.1)**	

Source: Citigroup Investment Research, Company reports

Figure 3. Subscribe base

	2QFY06	3QFY06	4QFY06	1QFY07	2QFY07	3QFY07	4QFY07	Q/Q Growth %	Y/Y Growth %	Comments
Basic Wireline (incl. WLL-F)	3,892,270	3,856,868	3,877,608	3,851,665	3,761,334	3,764,212	3,801,510	1.0	(2.0)	Marginal increase in fixed line subs for the first time in the fiscal year
WLL-M	154,301	126,022	105,665	80,090	80,355	113,108	118,648	4.9	12.3	
GSM	1,282,808	1,526,422	1,941,155	2,169,661	2,290,255	2,424,533	2,746,814	13.3	41.5	Capacity constraints likely to impact growth in Q108 in absence of augmentation
- Pre paid	896,618	1,136,301	1,457,462	1,640,763	1,728,484	1,852,624	2,113,755	14.1	45.0	
- Post paid	386,190	390,121	483,693	528,898	561,771	571,909	633,059	10.7	30.9	
Total Wireless	1,437,109	1,652,444	2,046,820	2,249,751	2,370,610	2,537,641	2,865,462	12.9	40.0	
Total Connections	5,329,379	5,509,312	5,924,428	6,101,416	6,131,944	6,301,853	6,666,972	5.8	12.5	
Internet connections										
Broadband	82,534	144,983	211,935	266,632	323,329	397,885	469,446	18.0	121.5	Broadband additions continue to be robust during the quarter
Dial Up Connections	1,115,434	1,153,479	1,188,204	1,221,429	1,247,988	1,265,067	1,293,119	2.2	8.8	
Total	**1,197,968**	**1,298,462**	**1,400,139**	**1,488,061**	**1,571,317**	**1,662,952**	**1,762,565**	**6.0**	**25.9**	

Source: Citigroup Investment Research, Company reports

Figure 4. ARPU trends

(Rs)	FY05	FY06	1QFY07	2QFY07	3QFY07	4QFY07
Fixed line	819	805	800	784	800	721
GSM - Pre-paid	358	280	206	230	203	174
- Post-paid	482	308	350	312	303	303
Broadband	531	582	452	439	407	442

Source: Citigroup Investment Research, Company reports

MTNL

Company description

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

Investment thesis

We rate MTNL as Sell (3L), with a target price of Rs125 based on our DCF estimate and potential cash tax refunds. 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 even as MTNL's fixed-line traffic faces migration to the wireless networks given the reducing mobile tariffs. Cost pressure, especially on the employee cost front, will likely continue despite natural attrition as pension payouts increase. Cash on the books is unlikely to be paid out in the form of one-time dividends as unproductive capex remains high, and the risk is high that cash will be reduced by paying down liabilities, and potential acquisitions.

Valuation

We value MTNL at Rs125 using DCF for the core business, which gives us Rs102, and potential tax refunds of Rs15bn, or Rs23/share. DCF is a common valuation method for telecoms companies. We assume a risk-free rate of 8%, risk premium of 6%, beta of 0.93, and terminal growth of 3%. Our DCF value of Rs102 is at an imputed EV/EBITDA of 4.5x and PER of 13.0x FY08E, which we believe is fair given the lackluster business outlook and the re-investment risks.

Risks

We rate MTNL as Low Risk based on our quantitative risk-rating system, which tracks 260-day historical share price history. The upside risks that could prevent the stock from achieving our target price include: (1) Merger with BSNL; (2) Refund of 80IA; and (3) Faster than expected crystallization of real estate value.

Appendix A-1

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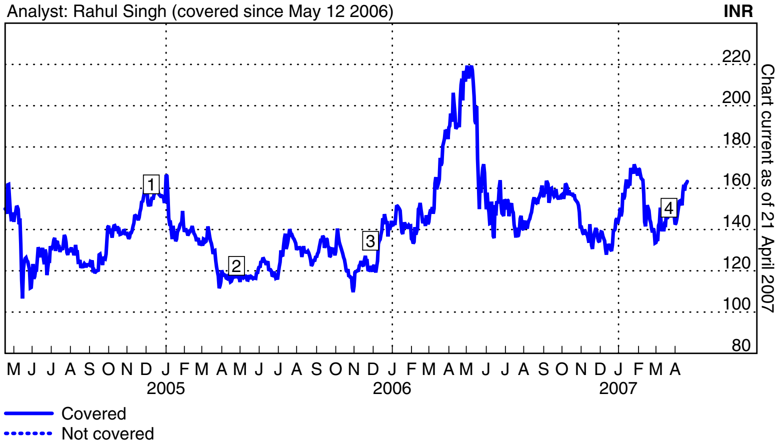
MTNL (MTNL.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Rahul Singh (covered since May 12 2006)



#	Date	Rating	Target Price	Closing Price
1:	9 Dec 04	2H	*171.00	154.30
2:	26 Apr 05	2H	*144.00	121.30
3:	27 Nov 05	*3L	*97.00	121.60
4:	22 Mar 07	3L	*125.00	149.20

*Indicates change.

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