MTNL (MTNL.BO)

Sell: 3QFY08 – Mobile Joins Fixed on Revenue Decline

- **EBITDA slightly below expectations** — MTNL's EBITDA at Rs1.8bn was only slightly below expectations despite a qoq decline in revenues due to a surprising dip in interconnect costs. Even net profit increased qoq (3%) for the first time in 3 quarters helped by lower tax and depreciation charge. The results on the whole were disappointing though.
- **Mobile contributes to revenue decline** — While stable/declining fixed line revenue on account of steady line loss and traffic migration to wireless was expected, what was surprising was the 9.3% qoq decline in mobile revenues as a result of a sharp decline in post-paid ARPU, which contributed to the 4%yoy decline in overall revenues. While broadband additions and continued rise in broadband ARPUs (>Rs600 now) continues to impress, it is still too small to drive revenues.
- **Cost declines may not be sustainable –** Interconnect costs decreased 15%qoq inexplicably aiding the operating performance somewhat. Other costs remained broadly in-line and helped in moderate EBITDA margin expansion (15.3% vs. 14.8% in 2Q).
- **Maintain Sell (3L)** — Though a favorable ruling in the pending 80IA case (worth Rs16-20bn) could be a potential positive, the eventual outcome and timing remains highly uncertain. Monetization of land is proceeding slowly and is fraught with execution risks.

Sell/Low Risk	3L
Price (30 Jan 08)	Rs123.40
Target price	Rs125.00
Expected share price return	1.3%
Expected dividend yield	4.1%
Expected total return	**5.3%**
Market Cap	Rs77,742M US$1,978M

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

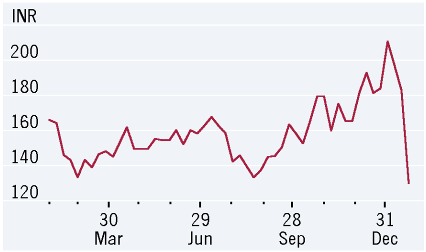

Figure 1. Statistical Abstract

Rs m	3QFY07	2Q08	3Q08	Q/Q Growth	Y/Y Growth
Income from services	12,319	11,985	11,897	(0.7)	(3.4)
Staff cost	(4,799)	(4,285)	(4,330)	1.1	(9.8)
Interconnect costs	(2,069)	(2,315)	(1,982)	(14.4)	(4.2)
License Fee	(1,216)	(1,074)	(1,145)	6.6	(5.8)
Administrative / operative expenditure	(2,212)	(2,537)	(2,623)	3.4	18.6
EBITDA	2,024	1,775	1,818	2.4	(10.2)
PBT	2,228	1,453	1,480	1.9	(33.6)
PAT	1,378	948	976	3.0	(29.2)

Source: Citi Investment Research

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

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Figure 2. Revenue Break-up

Rs m	2QFY06	3QFY07	4QFY07	1QFY08	2QFY08	3QFY08	Q/Q Growth %	Y/Y Growth %	Comments
Basic Telephone	10,336	9,376	9,039	8,714	8,329	8,330	0.0	(11.2)	
Rentals	2,670	2,892	2,720	2,619	2,627	2,641	0.5	(8.7)	Impacted by continued line losses
Call Charges & Other Revenue	6,549	5,822	5,758	5,172	4,782	4,582	(4.2)	(21.3)	Usage revenue impacted by traffic migration as wireless tariff dips
Interconnection	1,118	663	561	923	920	1,107	20.3	67.0	
Cellular	1,364	1,960	1,769	2,028	2,294	2,080	(9.3)	6.1	The QoQ decline in cellular revenues due to drop in ARPU
WLL	214	230	205	213	229	249	8.7	8.2	
Other Services	854	753	987	1,002	1,133	1,238	9.3	64.4	
Income from Services	12,768	12,319	12,000	11,957	11,985	11,897	(0.7)	(3.4)	
Other Income	1,673	1,961	1,861	843	1,468	1,372	(6.5)	(30.0)	
Total Income	14,441	14,280	13,861	12,800	13,453	13,269	(1.4)	(7.1)	

Source: Citi Investment Research

Figure 3. Subscriber Base

	2QFY06	3QFY07	4QFY07	1QFY08	2QFY08	3QFY08	Q/Q Growth %	Y/Y Growth %	Comments
Basic Wireline (incl. WLL-F)	3,892,270	3,764,212	3,801,510	3,750,499	3,718,362	3,710,295	(0.2)	(1.4)	Steady loss in fixed line due to fixed-mobile substitution
WLL-M	154,301	113,108	118,648	121,867	137,154	141,741	3.3	25.3	
GSM	1,282,808	2,424,533	2,746,814	2,608,811	2,772,120	2,954,880	6.6	21.9	
- Pre paid	896,618	1,852,624	2,113,755	1,943,723	2,087,694	2,257,692	8.1	21.9	
- Post paid	386,190	571,909	633,059	665,088	684,426	697,188	1.9	21.9	
Total Wireless	1,437,109	2,537,641	2,865,462	2,730,678	2,909,274	3,096,621	6.4	22.0	
Total Connections	5,329,379	6,301,853	6,666,972	6,481,177	6,627,636	6,806,916	2.7	8.0	
Broadband	82,534	397,885	469,446	499,707	483,257	511,968	5.9	28.7	Up tick in broadband additions the only +ve
Dial Up Connections	1,115,434	1,265,067	1,293,119	1,313,670	1,331,809	1,344,675	1.0	6.3	
Total	1,197,968	1,662,952	1,762,565	1,813,377	1,815,066	1,856,643	2.3	11.6	

Source: Citi Investment Research

Figure 4. ARPU (Rs)

	3QFY07	4QFY07	1QFY08	2QFY08	3QFY08
Fixed line	800	721	687	697	691
GSM - Pre-paid	203	174	184	180	178
- Post-paid	303	303	276	281	256
Broadband	407	442	490	521	608

Source: Citi Investment Research

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 strategy

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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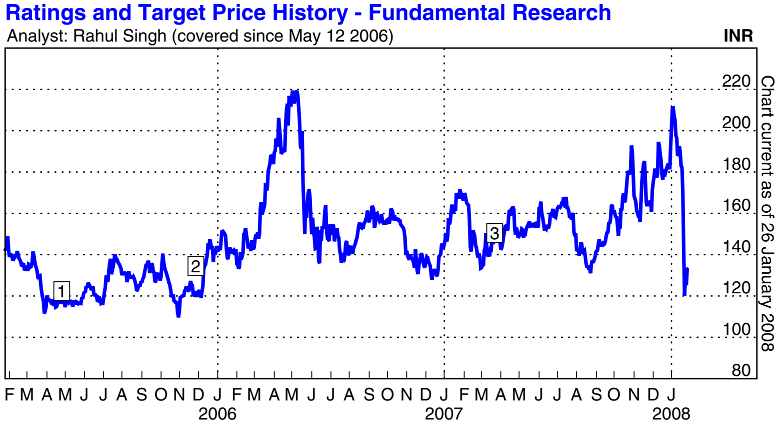
MTNL (MTNL.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Rahul Singh (covered since May 12 2006)



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

*Indicates change.

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