DishTV (DITV)

Media

ADD

MARCH 10, 2010

CHANGE IN RECO.

Coverage view: Neutral

Price (Rs): 39

Target price (Rs): 45

BSE-30: 17,053

Indian C&S distribution—Part 3: Carriage and placement fees. We discuss the debate over carriage and placement (C&P) fees being a legitimate business cost (distributor view) versus a tax on broadcasting (broadcaster view). We believe C&P fees (1) are here to stay given persistent demand-supply gap on C&S distribution but (2) will likely stabilize given rapid spread of digital platforms. We upgrade Dish TV to ADD (REDUCE previously) with a 12-month DCF-based TP of Rs45 (Rs38 previously).

Company data and valuation summary

DishTV

Stock data			
52-week range (Rs) (high,low)			60-22
Market Cap. (Rs bn)			41.4
Shareholding pattern (%)			
Promoters			64.8
FIIs			15.4
MFs			5.4
Price performance (%)	1M	3M	12M
Absolute	(5.6)	(9.6)	71.7
Rel. to BSE-30	(11.2)	(9.2)	(17.8)

Forecasts/Valuations	2010	2011E	2012E
EPS (Rs)	(2.5)	(1.2)	0.6
EPS growth (%)	(61.6)	(52.4)	(146.5)
P/E (X)	(15.4)	(32.4)	69.7
Sales (Rs bn)	10.8	14.5	17.9
Net profits (Rs bn)	(2.7)	(1.3)	0.6
EBITDA (Rs bn)	0.7	2.4	4.5
EV/EBITDA (X)	60.5	19.7	10.7
ROE (%)	248.6	(37.1)	19.1
Div. Yield (%)	0.0	0.0	0.0

C&P fees here to stay given large (and rising) demand-supply gap in C&S distribution

We examine the long running debate between broadcasters and distributors over carriage and placement fees—the former terms it as a non-government tax on broadcasting while the latter claims the same to be a legitimate business cost. We view the debate as one on the quantum of C&P fees charged, which is a high share (around 15%) of industry ad revenues. For some broadcasters (news channels), this constitutes the highest line item in their cost structure (higher than content costs—production and employee). However, distributors view this from the point of pure demand and supply—the dominant analog cable system in India can support only 106 channels versus over 450 channels vying for carriage and placement (even limited 25-30 channel capacity on Prime/Color band) in India.

The emergence and rapid spread of digital platforms (DTH and cable) are a positive step in bridging the demand-supply gap. We believe the strong growth of digital platforms (cable and DTH) will reduce the share of C&P fees to 7-8% of industry ad revenues over the long term given higher capacity on digital (200-250 channels) platforms. However, C&P fees are here to stay given (1) time taken to transition from analog to digital, (2) demand-supply gap even in digital (can only increase given new channel launches lined up for FY2010) and (3) international experience (barter system with distributors getting FCT in return).

Revised carriage revenue expectations; relatively fair valuations

We upgrade Dish TV stock to ADD (REDUCE previously) with a 2-month DCF-based target price of Rs45 (Rs38 previously) on account of (1) a new (though relatively simple, we admit) carriage and placement fee model, which allocates higher carriage revenues to digital platforms like DTH given their rapid penetration in the Indian C&S landscape, (2) modest reduction in capital expenditure (on account of reduced set-top box prices and revised exchange rate assumptions) and (3) modest changes to our content cost estimates for Dish TV (we continue to model above-consensus 20% CAGR in content costs over FY2010E-12E). We highlight that our revised carriage fee revenues for Dish TV have the most significant impact on valuations given the almost complete pass-through to EBITDA (conversely, nil incremental cost).

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We believe Dish TV stock is an attractive long-term play on the historically unorganized, fragmented C&S distribution sector in India, which is rapidly getting consolidated in the hands of a few digital platform (cable and DTH) operators. Dish TV has (1) successfully maintained its first-mover advantage with around 5.5 mn subscribers (versus around 1.5-4.5 mn for competition) and also leads in (2) resource mobilization (Rs8.3 bn from rights issue, Rs4.7 bn from Apollo Management) over the past 12 months. We would highlight limited valuation risk (see Exhibit below for comparative telecom valuation; Bharti Airtel stock has an overhang of around 8-10% on account of its impending Zain transaction, as per our Telecom analyst Rohit Chordia) as well as our relatively conservative operating and financial assumptions for Dish TV (see Exhibit below).

Comparative valuation of Dish TV, March fiscal year-ends, 2010E

	09-Mar-10		Wireless	
Company	Mcap (US$ bn)	EV (US$ bn)	Mcap (US$ bn)	EV (US$ bn)
Bharti Airtel	24.2	25.5	16.9	17.9
Reliance Comm	7.3	14.7	5.5	11.0
Idea Cellular	**4.2**	**4.9**	**3.4**	**3.9**

	2010E				
Company	Subscribers (mn)	ARPU (Rs/month)	EBITDA margin (%)	EBITDA (Rs/sub)	EV/sub (US$)
Bharti Airtel	127	243	31	901	140
Reliance Comm	101	161	33	645	109
Idea Cellular	**63**	**206**	**26**	**654**	**62**

Dish TV comparative valuation		Comments
Dish TV paying subs base (mn, end-FY2015E)	10.3	
Dish TV ARPU (Rs/sub/month, FY2015E)	194	ARPUs 15% lower but rising trend
Dish TV EBITDA margin (%, FY2015E)	32	EBITDA margin in line with Bharti Airtel
EV/subscriber (US$, end-FY2015E)	**154**	**10% premium to Bharti Airtel**
Enterprise Value (US$ bn, end-FY2015E)	1.59	
Enterprise Value (US$ bn, end-FY2010E)	0.88	
Enterprise Value (Rs bn, end-FY2010E)	**41.5**	
Net debt/(cash) (Rs bn, end-FY2010E)	**0.2**	**Dish TV rights issue/GDR in FY2010E**
Equity value (Rs bn, end-FY2010E)	41.2	
Shares outstanding (mn, end-FY2010E)	1,063	Conversion of Dish TV rights issue
Equity value (Rs/share, end-FY2010E)	**39**	

Source: Bloomberg data, Kotak Institutional Equities estimates

Key operating assumptions of Dish TV, March fiscal year-ends, 2008-2015E

	2008	2009	2010E	2011E	2012E	2013E	2014E	2015E
Gross subscriber addition (mn)	1.0	2.1	1.9	2.0	1.8	1.6	1.40	1.30
Net subscriber addition (mn)	0.9	1.8	1.5	1.5	1.2	0.9	0.61	0.46
Gross subscriber base (mn)	3.0	5.1	7.0	9.0	10.8	12.4	13.8	15.1
Net paying subs base (mn)	**2.5**	**4.3**	**5.8**	**7.2**	**8.4**	**9.2**	**9.8**	**10.3**
growth (%)		***71***	***35***	***25***	***16***	***10***	***7***	***5***
Net paying ARPUs (Rs)	**130**	**143**	**140**	**147**	**159**	**171**	**182**	**194**
growth (%)		***10***	***(2)***	***5***	***8***	***7***	***7***	***6***
Income growth (%)			***9***	***11***	***11***	***11***	***11***	***11***
Real GDP growth (%)			7	8	8	8	8	8
Inflation (%)			4	5	5	5	5	5
Population growth (%)			2	2	2	2	2	2
Revenues (Rs bn)	4.1	7.4	10.8	14.5	17.9	20.4	23.3	25.8
Content costs (Rs bn)	**2.5**	**3.8**	**4.6**	**5.5**	**6.6**	**7.5**	**8.4**	**9.3**
Gross margin (%)	***39***	***49***	***58***	***62***	***63***	***63***	***64***	***64***
EBITDA (Rs bn)	**(2.2)**	**(1.4)**	**0.7**	**2.4**	**4.5**	**5.9**	**7.3**	**8.4**
EBITDA margin (%)	***(52)***	***(18)***	***7***	***16***	***25***	***29***	***31***	***32***

Source: Company data, Kotak Institutional Equities estimates

However, we also highlight the inflection point for the stock, which may be when Dish TV becomes free cash flow positive (or EBIT positive) and can sustain future expansion on the strength of its core operations and balance sheet, may still be some time away (likely FY2012E). In the interim, the nascent stage of the industry implies that it will continue to face operational risks. We highlight (1) competition risk—entry of new players and existing competition (cable as well as DTH) becoming aggressive, (2) resultant impact on ARPUs and subscriber churn (see Exhibit below), (3) taxation risk—rising incidence of entertainment tax on DTH (though likely to be subsumed within GST by FY2012E) and (4) regulatory risk—related to cost of content (wholesale pricing) and prices of services offered to consumers (retail pricing).

Sensitivity of Dish TV's valuation to subscribers, ARPUs and content costs

	DCF value (Rs/share)	Change from base case (%)
Change in monthly subscription fees (%)		
10%	62	37
5%	53	18
Base case	**45**	
-5%	37	(18)
Change in average content costs (%)		
-10%	52	15
-5%	**48**	**8**
Base case	**45**	
5%	41	(8)
10%	38	(15)
Change in # of paying subscribers (%)		
20%	52	16
10%	48	8
Base case	**45**	
-10%	41	(8)
-20%	38	(16)

Source: Kotak Institutional Equities estimates

Carriage and placement fees: the argument continues

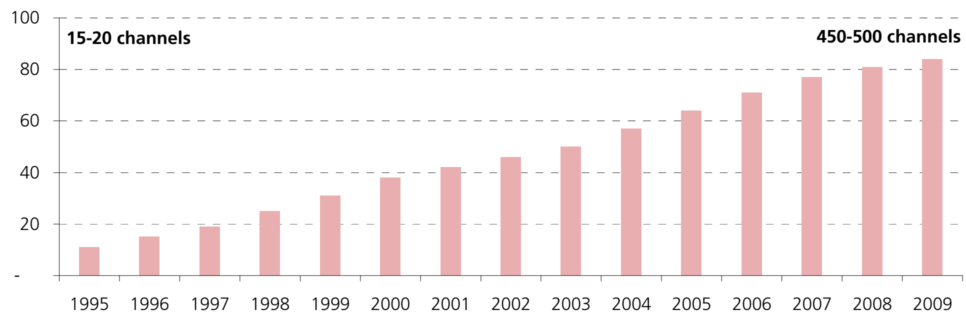
The legacy of carriage and placement (C&P) fees for C&S distribution dates almost as far back as the legacy analog cable networks in India. However, the debate over C&P fees may be more contentious than some of the more fundamental issues in C&S distribution in India (under-declaration of the actual subscriber base by unorganized, fragmented local cable operators (LCOs), consequent mark-up of price of channels/bouquets by large broadcasters). Given there is no standard international terminology for carriage and placement fees, we briefly discuss the same.

- **Carriage fees**. Carriage revenue of a distributor is the fee paid by the broadcaster to carry its channel on the distributor's network. An analog cable network can carry a maximum of 106 channels (theoretical limit, typical analog networks in India carry between 50-100 channels) of various genres.

- **Placement fees**. Placement revenue is the fee paid by the broadcaster to carry its channel **on a preferred analog signal or frequency band on the distributor's network**. The preferred band usually consists of around 25-30 channels in the Prime/Color band on the analog cable network, which offers superior signal/channel quality versus other available frequency bands.

The fundamental driver of C&P revenues is the stupendous growth of C&S broadcasting in India in the last 15-20 years (see Exhibit below); the number of C&S households (or subscribers) grew to over 100 mn in 2010 (including digital) from around 10 mn in 1995. If the 10X growth in number of subscribers was not surprising given C&S TV was the most attractive entertainment avenue (variety of content on offer, cost of pay-TV versus other media), the number of channels increased over 20X (over 450 C&S channels on-air in India currently versus only around 15-20 channels in 1995). The growth in channels was also not surprisingly given (1) the proliferation of regional entertainment underpinned by linguistic fragmentation and (2) the specialized needs of a growing urban population with demand for niche channels.

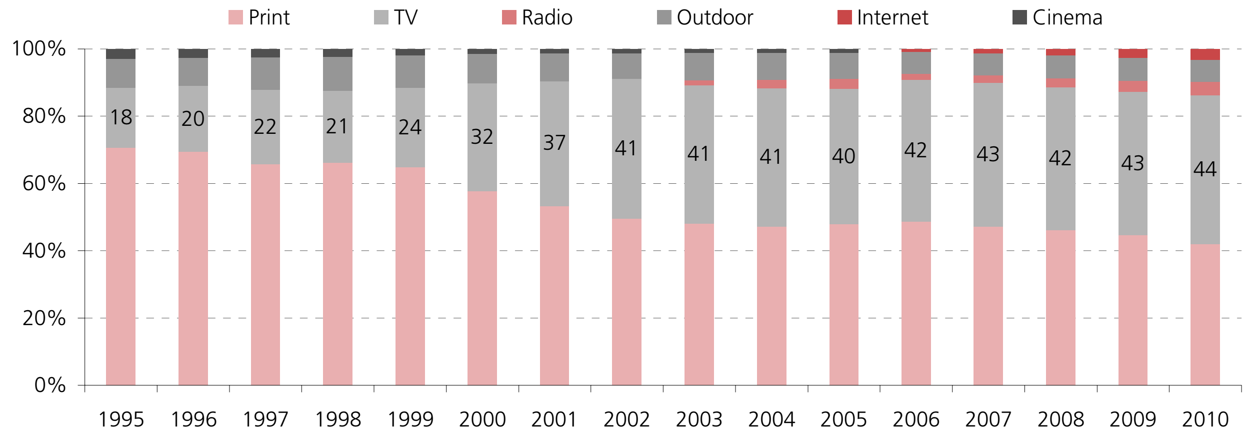
Trends in cable HHs in India, calendar year-ends, 1995-2009 (mn)



Source: Media Partners Asia, Kotak Institutional Equities

The analog cable network with limited capacity could not handle the significant increase number of channels, notably in urban areas where a mix of urban and migrant constituents demanded the complete variety of entertainment available on C&S broadcasting. The resultant demand-supply gap led to channels (new launches) vying for viewer attention and paying carriage fees to increase their household reach (with increased probability of the viewers sampling the channel and converting to repeat audience). The channel benefited from likely increased popularity, which could be monetized through advertising sales; we note that TV likely replaced print as the largest advertising medium in India in FY2010E (see Exhibit below).

Share of advertising revenues across media platforms, March fiscal year-ends, 1995-2010E (%)



Source: Industry data, Kotak Institutional Equities estimates

The analog state and unorganized nature of last-mile cable TV distribution in India resulted in problems for broadcasters, notably significant 'leakage' of revenues with LCOs under-reporting their subscriber base; this resulted in their high dependence on advertising revenues to sustain operations. Additionally, the poor quality of signal/channels beyond the Prime/Color band of frequencies, which could carry on 25-30 channels, resulted in broadcasters paying even higher amounts (placement fees) to be placed by the distributors (MSOs) in the Prime/Color band. The distributors, also financially impacted due to the subscriber under-declaration by the LCOs, found a steady revenue stream in C&P fees paid by the broadcasters.

The emergence and rapid spread of digital platforms (DTH and cable) in India is a positive step given its dual-advantage over analog cable—(1) the large channel capacity (theoretical capacity is as high as 1,000 channels) and (2) the quality of signals is consistent and thus, channel placement is not really an issue. However, we believe C&P fees are here to stay given (1) analog cable remains the dominant platform in India and the transition to digital will take time and (2) the supply-demand gap remains even in digital (current capacity of 200-250 channels versus over 450 channels currently on-air). The renewed growth in new channel launches in FY2011E will likely again pressure distribution capacity unless digital capacity is augmented.

The international experience is also instructive. As per Media Partners Asia, cable MSOs in the US received significant fees from broadcasters given scarcity of space on the analog network. This continued even after the growth of cable digitalization in the 1990s as competition for eyeballs and advertising increased with the growth of mainstream and niche channels. The quantum of carriage fee declined as adoption of digital (also DTH) improved. However, the reality (also in other markets) is that new channels without significant brand recognition (FOX News being the most notable recent example) typically pay carriage fees to C&S operators (including digital). Some barter systems (FCTs in exchange for distribution) have also evolved over time.

Carriage and placement revenue model—DTH to benefit

The Exhibit below presents our carriage placement revenue/fees model. We briefly discuss the key features (and risks) of the model. We expect Dish TV (as also other DTH operators) to start receiving higher carriage fees (no placement fees) given its rapid spread and rising penetration across India and as their weight in the TAM Media Research (the leading TV ratings agency in India) coverage increases over time (lagged impact).

Estimation of carriage and placements fees across various distribution platforms, March fiscal year-ends, 2008-2020E

	2008	2015E	
Ad-spend-to-GDP ratio (%)			
China	0.56		
Brazil	0.86		
Russia	0.75		
India	**0.45**	**0.56**	**Assuming India lags China by about 7-8 years; India has greater domestic-market orientation**

	2008-2015E
India economic data (%)	
Real GDP growth	7.5
Inflation	4.5
Nominal GDP growth	12.0
Ad revenue growth	**15.1**
Ad-to-GDP growth (X)	**1.3**

	2008	2009	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
Indian media C&P model													
Real GDP growth (%)		6.5	6.5	7.5	9.0	9.0	7.5	6.5	7.0	7.0	7.0	7.0	7.0
Inflation (%)		7.5	2.5	4.5	5.0	5.0	4.5	2.5	4.0	4.0	4.0	4.0	4.0
Nominal GDP growth (%)		14.0	9.0	12.0	14.0	14.0	12.0	9.0	11.0	11.0	11.0	11.0	11.0
Ad revenue growth (%)		**14.0**	**9.0**	**15.0**	**21.0**	**21.0**	**15.0**	**9.0**	**14.5**	**14.5**	**14.5**	**14.5**	**14.5**
Ad-to-GDP growth (X)		**1.0**	**1.0**	**1.3**	**1.5**	**1.5**	**1.3**	**1.0**	**1.3**	**1.3**	**1.3**	**1.3**	**1.3**
Industry advertising													
Industry ad revenues (Rs bn)	184	210	229	263	318	385	443	483	553	633	724	829	950
Television ad revenues (Rs bn)	78	90	100	115	141	172	199	221	255	293	337	387	445
Television ad growth (%)		**15.0**	**11.0**	**16.0**	**22.0**	**22.0**	**16.0**	**11.0**	**15.0**	**15.0**	**15.0**	**15.0**	**15.0**
differential (%)		**1.0**	**2.0**	**1.0**	**1.0**	**1.0**	**1.0**	**2.0**	**0.5**	**0.5**	**0.5**	**0.5**	**0.5**
Carriage and placement revenues													
Television C&P revenues (Rs bn)	**8**	**14**	**13**	**14**	**17**	**21**	**24**	**26**	**26**	**26**	**29**	**31**	**34**
C&P-to-ad share (%)		**15.1**	**13.6**	**12.6**	**12.1**	**12.1**	**12.1**	**11.6**	**10.1**	**9.1**	**8.6**	**8.1**	**7.6**
differential (%)			**(1.5)**	**(1.0)**	**(0.5)**	**-**	**-**	**(0.5)**	**(1.5)**	**(1.0)**	**(0.5)**	**(0.5)**	**(0.5)**
Television C&P growth (%)		**68.8**	**(0.1)**	**7.4**	**17.1**	**22.0**	**16.0**	**6.4**	**0.1**	**3.6**	**8.6**	**8.3**	**7.9**
Number of C&S HHs (mn)													
Direct-to-home (DTH)	**6**	**12**	**19**	**26**	**32**	**37**	**41**	**44**	**47**	**49**	**51**	**53**	**55**
Digital cable	1	2	3	5	8	11	14	17	19	21	23	25	27
Analog cable	75	76	78	77	76	75	74	73	72	71	70	69	68
Total C&S HHs	**82**	**90**	**100**	**108**	**116**	**123**	**129**	**134**	**138**	**141**	**144**	**147**	**150**
Carriage and placement multiples (X)													
Carriage - DTH	**2**												
Carriage - Digital cable	**2**												
Carriage - Analog cable	**1**												
Placement - Analog cable	**4**												
Carriage and placement share (%)													
Carriage - DTH		3.1	5.9	8.8	11.6	13.9	15.7	17.1	18.1	19.1	19.8	20.5	21.2
Carriage - Digital cable		0.5	1.0	1.4	2.2	3.5	4.7	5.8	7.0	7.7	8.5	9.2	10.0
Carriage - Analog cable		19.3	18.6	18.0	17.2	16.5	15.9	15.4	15.0	14.6	14.3	14.1	13.8
Total carriage		**22.9**	**25.5**	**28.1**	**31.1**	**33.9**	**36.3**	**38.3**	**40.0**	**41.5**	**42.6**	**43.8**	**44.9**
Placement - Analog cable		77.1	74.5	71.9	68.9	66.1	63.7	61.7	60.0	58.5	57.4	56.2	55.1
Total placement		**77.1**	**74.5**	**71.9**	**68.9**	**66.1**	**63.7**	**61.7**	**60.0**	**58.5**	**57.4**	**56.2**	**55.1**
Carriage and placement revenues (Rs bn)													
Carriage - DTH		**0.4**	**0.8**	**1.3**	**2.0**	**2.9**	**3.8**	**4.4**	**4.6**	**5.1**	**5.7**	**6.4**	**7.1**
Carriage - Digital cable		0.1	0.1	0.2	0.4	0.7	1.1	1.5	1.8	2.0	2.4	2.9	3.4
Carriage - Analog cable		2.6	2.5	2.6	2.9	3.4	3.8	3.9	3.8	3.9	4.1	4.4	4.6
Placement - Analog cable		10.4	10.1	10.4	11.7	13.7	15.3	15.8	15.3	15.5	16.5	17.5	18.5
Total C&P revenues (Rs bn)		**14**	**13**	**14**	**17**	**21**	**24**	**26**	**26**	**26**	**29**	**31**	**34**

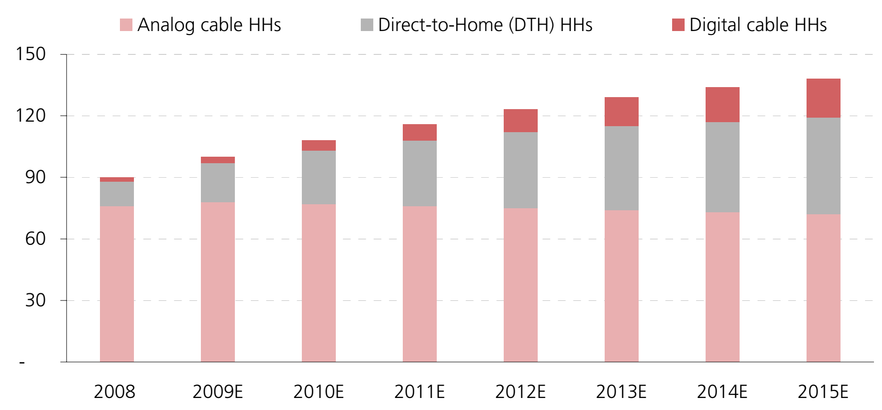
Source: Industry data, Kotak Institutional Equities estimates

- **Advertising revenue growth of the Indian C&S broadcasting industry.** The first important point to consider is that carriage and placement fees are strongly linked to advertising revenue growth in the Indian C&S broadcasting industry. As previously discussed, the rationale for the same is that carriage and placement fees are essentially to increase in the viewership of the channel (whether new or legacy), to be reimbursed in terms of higher advertising share for the channel. Additionally, while carriage and placement fees are paid by all channels, the distribution networks have greater leverage over new channels (without any brand recognition in the market). The launch of new channels in the market is also (besides other factors) a function of a buoyant advertising revenue market.

  We highlight that the strong growth in industry advertising revenues (media in general and C&S broadcasting) in India over the next several years led by (1) continued strong (and sustainable) GDP growth (7-9%) in India, (2) rising penetration of all media forms (including C&S broadcasting), (3) rising disposable incomes and discretionary spends attracting more advertisers/categories and (4) low ad-spend-to-GDP ratio in India with sufficient scope for expansion. We highlight that even a moderate increase in ad-spend-to-GDP ratio in India, along with nominal GDP growth of 12-13% over the next several years, will result in advertising revenue CAGR of 15-16% (at a 1.2-1.3X multiple to India's nominal GDP growth).

- **C&P revenues as a percentage of C&S advertising revenue market.** The other important consideration is the share of C&P fees in the advertising revenue market, which has grown to an unsustainable 15% in FY2009 driven by (1) a dominant analog cable network with very limited channel capacity and (2) sharp increase in number of channels driven by new launches chasing strong growth in advertising revenue market. However, the slowdown in the Indian economy in 2HFY09 resulted in a sharp decline in advertising revenue growth in the industry, resulting in limited new launches as well as cost rationalization by broadcasters (with C&P agreements revised downwards). We believe the downtrend is likely to continue given the strong growth in digital platforms (cable and DTH), albeit from a low base (see Exhibit below).

Estimation of TV HHs and C&S HHs in India, March fiscal year-ends, 2008-2015E (mn)



Source: Industry data, Kotak Institutional Equities estimates

- **The split of C&P revenues between analog and digital (also between carriage and placement).** The split of C&P revenues between analog and digital and also carriage and placement revenues is the most challenging part given there is very limited information available on the same. The Exhibit below presents our estimation of the likely split between the relative carriage and placement revenue multiple across platforms (analog versus digital cable versus DTH). The C&P revenue generated is dependent on two key variables—(1) the capacity for carriage, which is greater on digital platforms, and (2) the importance of carriage and placement from a ratings perspective. We believe placement on the Prime/Color band on analog cable is critical for any broadcasters, where capacity is limited (25 channels).

Estimation of C&P revenue per subscriber for various distribution platforms

	Carriage			Placement
	DTH (1)	**Digital cable**	**Analog cable**	**Analog cable**
Available capacity				
Total capacity	200	200	75	NA
Prime/Color band	NA	NA	NA	25
Free capacity (a)	50	50	25	25
Ratings impact				
TAM coverage (1)	partial	partial	yes	yes
Ratings criticality	Limited	Limited	Limited	Significant
Ratings criticality (b)	1	1	1	4
C&P share/revenue multiple				
C&P multiple (a X b)	50	50	25	100
C&P multiple (X)	**2**	**2**	**1**	**4**

Note:
(1) TAM has limited coverage in rural areas, an important market for DTH.

Source: Industry data, Kotak Institutional Equities estimates

- **DTH to be major beneficiary of shift in C&P revenue market.** We believe the rapid penetration of DTH platforms in India will significantly benefit DTH operators not only in terms of improved subscription revenues but also better C&P revenues; this is essentially a corollary to the argument that the bargaining power of the DTH operators versus broadcasters will continue to improve with greater scale. The DTH industry has emerged only in the past few years in India and thus, they were unable to monetize their rising subscriber base—given the legacy strong broadcasters were in a position of strength. The weakness in the advertising revenue market (coupled with limited new channels launches) also resulted in muted C&P revenues. Dish TV, being the market leader, will also be the first to benefit.

- **Cable to lose out relatively but unlikely in terms of absolute C&P revenues.** Cable platforms in India are likely to see modest 5-7% growth in their C&P revenues though fears of declining C&P revenues may be exaggerated given (1) analog cable controls a majority share of subscribers in India (though the trend is increasingly towards digital), (2) a buoyant advertising revenue market will result in new channel launches and even greater competition (is it possible) for limited Prime/Color band capacity and (3) the importance of analog cable for mass entertainment channels even with digital becoming a significant force in the industry. As discussed previously, we also do not anticipate the historical growth pattern of C&P revenues (50% CAGR between FY2007-2009) given (1) analog was usually dominant (90% market share as digital had just emerged) and (2) demand-supply gap was unusually large (450 channels vying for 25 slots, at least in some markets).

Key risks—new channel launches, growth of digital, TAM ratings

We briefly highlight the key risks associated with our model (our expectation of likely trend in C&P revenues and split between digital and cable).

- **New channel launches**. As discussed previously, the pace of new channel launches is an important determinant of the buoyancy in the carriage and placement revenue market. Even though legacy channels also pay for carriage and placement given the need to maintain high reach levels, their C&P fees declines as their brand is established with the viewer base and they become a 'must-carry' channel for the distributor in their target market. We expect the recovery in the advertising revenue market to result in renewed new channel launches; however, the pace of rising new launches and competitive intensity (legacy channels forced to pay to keep new channels at bay) may vary from our expectations.

- **Growth of digital**. The split of C&P revenues between analog and digital as well as between carriage and placement (the latter being an analog cable revenue stream) is dependent on the pace of growth of digital. Stronger-than-expected growth of digital (cable and DTH) will have a negative impact on the carriage and placement revenues of cable distributors (MSOs); we highlight that digital cable does not compensate for the loss of analog cable (likely to be reimbursed through higher subscription revenues). Conversely, it will position DTH (and Dish TV) to benefit from higher subscription as well as carriage revenues; there may also be a scale effect as the bargaining position of DTH improves versus legacy broadcasters.

- **TAM ratings coverage/system**. We highlight that advertising revenues of a channel are contingent upon its ratings (TAM is the leading TV ratings agency in India), which measures its popularity. However, certain shortcomings of the TAM ratings system/coverage may assign less weight to digital/DTH and thus constrain the ability of DTH (and Dish TV) to command its fair share of the C&P revenue market. Our Exhibit below illustrates the coverage of TAM ratings system, which gives significantly lower weight to digital platforms (like DTH) versus their penetration; we believe this is due to the limited coverage of TAM ratings system in rural areas, which are a fertile market for DTH and inaccessible to cable (cable-dark market).

Trends in Indian C&S households (HHs), calendar year-ends, 2008-2009 (mn)

	Total			2009			
	2008	2009	(%)	Urban	(%) (a)	Rural	(%) (a)
India C&S							
Total HHs	213	223	*5*	75	*34*	148	*66*
TV HHs	123	134	*9*	64	*48*	70	*52*
C&S HHs	90	103	*14*	54	*52*	49	*48*
Digital HHs	**15**	**20**	***33***	**6**	***30***	**14**	***70***
Penetration (%)	**17**	**19**					
Analog HHs	**75**	**83**	***11***	**48**	***58***	**35**	***42***
TAM C&S							
Total HHs	51	55	*8*				
TV HHs	43	47	*9*				
C&S HHs	35	39	*11*				
Digital HHs	**3**	**5**	***50***				
Penetration (%)	**9**	**12**					
Analog HHs	**32**	**35**	***8***				

Note:
(a) Urban and rural households as a percentage of total households.

Source: TAM Media Research, Kotak Institutional Equities

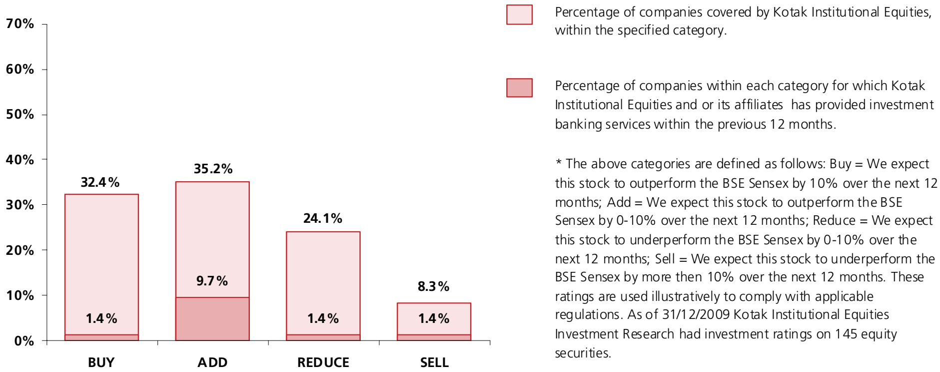
Financial summary of Dish TV, March fiscal year-ends, 2007-2013E (Rs mn)

	2007	2008	2009	2010E	2011E	2012E	2013E
Profit model							
Net revenues	1,909	4,127	7,377	10,821	14,485	17,932	20,407
EBITDA	**(1,852)**	**(2,152)**	**(1,350)**	**736**	**2,387**	**4,534**	**5,896**
Other income	34	30	13	727	744	696	712
Interest (expense)/income	(118)	(513)	(1,019)	(1,122)	(883)	(970)	(1,003)
Depreciation	(565)	(1,480)	(2,144)	(3,025)	(3,776)	(3,739)	(4,055)
Amortization	(10)	(10)	(10)	—	—	—	—
Pretax profits	**(2,511)**	**(4,126)**	**(4,511)**	**(2,684)**	**(1,528)**	**521**	**1,550**
Extraordinary items	(5)	—	(244)	—	—	—	—
Tax	(3)	(6)	(7)	—	—	(59)	(176)
Deferred taxation	—	—	—	—	251	132	186
Net income	**(2,519)**	**(4,132)**	**(4,763)**	**(2,684)**	**(1,277)**	**594**	**1,560**
Earnings per share (Rs)	**(5.9)**	**(9.6)**	**(6.9)**	**(2.5)**	**(1.2)**	**0.6**	**1.5**
Balance sheet							
Total equity	(395)	(4,527)	(6,241)	4,081	2,804	3,398	4,958
Deferred taxation liability	—	—	—	—	(251)	(382)	(568)
Total borrowings	1,751	5,266	11,311	6,615	7,615	9,115	9,115
Current liabilities	8,596	11,376	15,899	14,249	14,241	13,293	12,302
Total liabilities and equity	**9,952**	**12,116**	**20,969**	**24,945**	**24,409**	**25,424**	**25,808**
Cash	113	199	540	2,502	1,030	1,123	1,477
Other current assets	2,271	3,276	8,297	8,699	9,013	9,308	9,522
Total fixed assets	6,107	7,190	11,187	12,800	13,422	14,048	13,864
Intangible assets	516	506	—	—	—	—	—
Investments	945	945	945	945	945	945	945
Total assets	**9,952**	**12,116**	**20,969**	**24,945**	**24,409**	**25,424**	**25,808**
Free cash flow							
Operating cash flow, excl. working capital	(1,814)	(2,552)	(2,675)	(387)	1,504	3,504	4,718
Working capital changes	3,507	2,129	(883)	(2,052)	(321)	(1,243)	(1,204)
Capital expenditure	(2,921)	(2,579)	(5,102)	(4,637)	(4,398)	(4,364)	(3,872)
Investments	(451)	(293)	14	—	—	—	—
Other income	5	9	11	727	744	696	712
Free cash flow	**(1,674)**	**(3,287)**	**(8,635)**	**(6,348)**	**(2,471)**	**(1,407)**	**354**
Ratios (%)							
Debt/equity	(443.6)	(116.3)	(181.3)	162.1	271.6	268.3	183.9
Net debt/equity	(414.9)	(111.9)	(172.6)	100.8	234.8	235.2	154.1
ROAE (%)	(331.3)	167.9	88.5	248.6	(38.5)	21.3	42.1
ROACE (%)	**(283.2)**	**(345.3)**	**(120.4)**	**(19.8)**	**(5.2)**	**15.2**	**20.0**

Source: Company data, Kotak Institutional Equities estimates

"I, Amit Kumar, hereby certify that all of the views expressed in this report accurately reflect my personal views about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report."

Kotak Institutional Equities Research coverage universe
Distribution of ratings/investment banking relationships



* The above categories are defined as follows: Buy = We expect this stock to outperform the BSE Sensex by 10% over the next 12 months; Add = We expect this stock to outperform the BSE Sensex by 0-10% over the next 12 months; Reduce = We expect this stock to underperform the BSE Sensex by 0-10% over the next 12 months; Sell = We expect this stock to underperform the BSE Sensex by more then 10% over the next 12 months. These ratings are used illustratively to comply with applicable regulations. As of 31/12/2009 Kotak Institutional Equities Investment Research had investment ratings on 145 equity securities.

Source: Kotak Institutional Equities | As of December 31, 2009

Ratings and other definitions/identifiers

Definitions of ratings

BUY. We expect this stock to outperform the BSE Sensex by 10% over the next 12 months.

ADD. We expect this stock to outperform the BSE Sensex by 0-10% over the next 12 months.

REDUCE. We expect this stock to underperform the BSE Sensex by 0-10% over the next 12 months.

SELL. We expect this stock to underperform the BSE Sensex by more than 10% over the next 12 months.

Our target price are also on 12-month horizon basis.

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