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INDIA RESEARCH | MEDIA | RESULT NOTE: Q4FY11 | BSE SENSEX: 15345 | MAY 17, 2011

OUTPERFORMER

DEN Networks

Regulatory trigger critical!

Rs106

Mkt Cap: Rs13.8bn; US$306m

Key financials

(Rs m)	Net Sales	yoy chg (%)	Net profit	EPS (Rs)	yoy chg (%)	EV / E (x)	PER (x)
FY09	7,122	762.6	(151)	(8.3)	NA	91.5	NA
FY10	9,191	29.1	303	2.3	NA	14.5	45.5
FY11	10,462	13.8	379	2.9	25	12.2	36.3
FY12E	12,423	18.7	591	4.5	56	9.5	23.3
FY13E	15,569	25.3	1,276	9.8	116	5.3	10.8

Source: Company, IDFC Securities Research

Key highlights of Q4FY11 results and our interaction with the management

- DEN Networks (DEN) reported its Q4FY11 results. DEN has reported a revenue growth of 15% at Rs2.82bn (estimates of Rs2.8bn), EBITDA of Rs231m (estimates of Rs325m) and PAT of Rs81m (estimates of Rs98m) for the quarter.
- Scale up of cable distribution players, both DEN and Hathway, over the last six months has clearly been below expectations. While the regulatory environment towards digitization now looks optimistic, our sense is that financial deliverance for cable players will play out only over the longer term. Operational deliverance over the next 6-12months will be critical.
- During the quarter, DEN has garnered cable revenues of Rs1.6bn, of which carriage revenues are estimated to be at ~Rs820m. Star-DEN (a 50:50 JV with Star Network) has contributed revenues of Rs1.22bn.
- DEN has seen a ~2% improvement in declaration levels, taking the total number of paying subscribers to 1.5m. With regards digital subscribers, the pace of digitization picked during the quarter with DEN having added 95,000 digital subscribers (against 43,000 in Q3FY11). Total number of digital subscribers for DEN now stands at 540,000. The pace of digitization is expected to remain strong in FY12.
- Operating expenditure during the quarter increased by 9% QoQ at Rs2.6bn. This was primarily on account of higher content costs as also incentive payouts. EBITDA margins for the quarter stood at 8.2%.
- As on 31st March 2011, consolidated gross debt stands at Rs1.55bn and cash on books at Rs2.27bn.

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- In a positive development for the Indian TV distribution space, the Information and Broadcasting (I&B) Ministry has announced the final schedule for mandatory digitization in the country. The final schedule sets 31st March 2012 as the sunset date for analog cable TV in services in the four metros and 31st December 2014 as sunset date for the entire country. Analog cable services will be completely switched off on the respective dates, ensuring compliance by all industry participants. The TRAI recommendations have been pending final ministry approval since Aug 2010. We see the finalization of the digitization process with deadlines, by the I&B Ministry, as a crucial step forward for the industry. The Cabinet approval is the final step for these proposals to get implemented, which is likely to come by the Monsoon session of the Parliament. Once approved by the Cabinet, it would become a law, which we believe will change the face of the cable distribution space in the country.
- Operational deliverance by DEN has been below expectations, with the pace of digitization yet to gather the anticipated momentum. Further, with the regulatory mandate on digitization likely in the next 2-3 months, cable players have slowed down pace of acquisition significantly. The regulatory trigger will be critical to add momentum to the overall cable distribution industry.
- While the regulatory environment is conducive, our sense is that DEN would need to significantly up their scale of operations on ground to improve their financial performance. Factoring in the lower than anticipated pace of digitization, higher content costs as also slower pace of acquisitions, we have downgraded our EPS estimates for DEN by 18% for FY12 and 23% for FY13. Correspondingly, our target price for the stock stands revised to Rs172 per share (from Rs207 earlier).

A huge opportunity (70m+ analog homes in the country), strong execution capability (India's 2nd largest MSO within two years of operation) and a favourable regulatory environment – DEN is well placed to capitalize on the digitization wave in the country. However, DEN's performance over the last six months, especially with respect to the pace of digitization, has been clearly below expectations. With the DTH players upping their ante and adding over 1m subscribers per month, we believe it is imperative for DEN to rapidly scale up their on-ground operations and secure its subscriber base. While the regulatory push (cabinet approval for mandatory digitization expected within next three months) will exert pressure on the LCOs and in itself accelerate the pace of digitization for MSOs, we see execution as a critical monitorable over the next 6-12 months. Our sense is that, for operational deliverance to reflect in financial performance for DEN it will be a longer wait. We see merit in investing DEN – to participate in the digitization story backed by a strong business model and lower capital requirement relative to DTH, only with a longer term view. For the near term, our sense is that unless operational deliverance materially improves, value accretion in the stock will be limited. On the back of our longer term structural call on the business, we maintain our Outperformer call on the stock with a target price of Rs172.

Valuations

We have valued the cable business on EV/ subscriber basis, which has been arrived at on the basis of months of ARPU. Economics of individual subscribers suggest that a secondary point can be valued at 25 months, primary point at 31 months and broadband subscriber at 36 months of ARPU. Adopting this valuation methodology on DEN's 2.2m secondary points, 0.5m primary points and 0.4m broadband customers in FY13E, we have arrived at an EV of Rs29bn and equity value of Rs29.8bn for DEN. Our price target for the stock is Rs172.

Fair price of Rs172

	Secondary pt	Primary Pt	Broadband	Star DEN	Total
Number of subs in FY13E (m)	2.2	0.5	0.4		
ARPU (Rs / month)	305	215	250		
Month of ARPU	25.3	31.4	36.4		
EV / subscriber (Rs)	**7,727**	**6,748**	**9,106**		
Enterprise value (Rs m)	17,077	3,644	4,007	4,400	29,127
Less: Debt (Rs m)					(720)
Equity Value (Rs m)	**17,077**	**3,644**	**4,007**	**4,400**	**29,847**
Number of shares (m)					131
Per share value (Rs)					**229**
Less: Minority interest (%)					25
Target price					**172**

Source: IDFC Securities Research

Digitization timelines given by the I&B Ministry

Phase	Areas suggested	TRAI initial recommendation (5th Aug 2010)	I&B Ministry proposed schd (28th Jan 2011)	Revised timelines recommended by TRAI (22nd Feb 2011)	Final schd by I&B Ministry
Phase I	Four Metros of Delhi , Mumbai, Kolkata and Chennai	31st March 2011	31st March 2012	31st Dec 2011	31st March 2012
Phase II	Cities with a Population more than one million	31st Dec 2011	31st March 2013	31st Dec 2012	31st March 2013
Phase III	All Urban areas (Municipal Corp/ Municipalities)	31st Dec 2012	30th November 2014	31st Dec 2013	30th September 2014
Phase IV	Rest of India	31st Dec 2013	31st March 2015	31st Dec 2013	31st Dec 2014

Source: IDFC Securities Research

Quarterly results

(Rs m)	Q4FY10	FY10	Q1FY11	Q2FY11	Q3FY11	Q4FY11	FY11	FY12E	FY13E
Revenues	**2,463**	**9,191**	**2,460**	**2,536**	**2,644**	**2,821**	**10,462**	**12,423**	**15,851**
yoy growth (%)		*29*	*15.1*	*13.3*	*12.4*	*14.6*	*13.8*	*18.7*	*27.6*
Expenses	2,193	8,293	2,154	2,218	2,376	2,591	9,339	10,801	12,836
EBITDA	**270**	**898**	**306**	**318**	**268**	**231**	**1,123**	**1,623**	**3,015**
OPM (%)	*11.0*	*9.8*	*12.4*	*12.5*	*10.1*	*8.2*	*10.7*	*13.1*	*19.0*
Other Income	36	65	33	29	38	49	148	106	111
Interest	48	194	50	45	47	51	191	206	215
Depreciation	104	329	109	116	117	113	455	573	798
PBT	**154**	**440**	**180**	**186**	**142**	**116**	**625**	**949**	**2,112**
Tax	(28)	74	10	17	38	110	174	230	473
PAT	**182**	**366**	**170**	**170**	**104**	**7**	**451**	**719**	**1,640**
Minority Interest	12	63	69	64	12	(79)	67	128	345
PAT post minority interest	170	303	100	105	92	81	379	591	1,294

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Explanation of Ratings:

1. Outperformer: More than 5% upside to Index
2. Neutral: Within 0-5% to Index (upside or downside)
3. Underperformer: More than 5% downside to Index

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