10 November 2010

BSE Sensex: 20876

IDFC INSTITUTIONAL SECURITIES

India Research

Hathway Cable

Rs199

OUTPERFORMER

RESULT NOTE

Mkt Cap: Rs28.4bn; US$632m

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Result: **Q2FY11**

Comment: **Need for acceleration...**

Key financials

Year	Net Sales	yoy chg (%)	Net profit	EPS (Rs)	yoy chg (%)	EV / E (x)	PER (x)
FY09	6,634	60.0	(623)	(1.1)	NA	176.1	(187.6)
FY10	7,361	11.0	(580)	(4.1)	263	24.3	(51.7)
FY11E	8,879	20.6	278	1.9	(148)	13.4	107.9
FY12E	11,960	34.7	833	5.8	199	8.5	36.0
FY13E	17,285	44.5	2,165	15.2	160	4.8	13.9

Key highlights of Q2FY11 results and our interaction with the management

- Hathway Cable and Datacom (Hathway) reported its Q2FY11 results. On a consolidated basis, Hathway has reported a QoQ revenue growth of 17% at Rs2.28bn (estimates of Rs2.1bn), EBITDA growth of 34% at Rs502m (estimates of Rs480m) and PBT of Rs118m (estimates of Rs95m).
- On a standalone basis, Hathway has reported revenue growth of 30% QoQ at Rs1.3bn, EBITDA growth of 152% at Rs356m and net profit of Rs41m (loss of Rs139m in Q1FY11).
- Of the consolidated revenues, carriage revenues are estimated to contribute ~Rs1bn and subscription and advertising the remaining Rs1.28bn.
- With respect to digitization, delay of delivery of lower cost STBs has led to slow digital subscriber addition during H1FY11. Hathway has added 165,000 digital subscribers in H1FY11 taking the total digital subscriber base to 1.2m. With delivery of new STBs now in process, we expect the pace of digitization to pick up pace as demand remains robust.
- With respect to the paying subscriber base, Hathway has added 99,366 subscribers in H1FY11 on the back of acquisitions. Total paying subscriber base for Hathway now stands at 1.74m, of which primary subscriber base stands at 0.5m.
- Of the total IPO proceeds of Rs4.8bn, Hathway has used Rs1.9bn so far. Of this, Rs405m has been deployed towards digital capex and STBs, Rs304m towards broadband infrastructure and Rs967m in debt repayment. Hathway has used only Rs64m so far on acquisition. While allocation for acquisition related funds stands at Rs2.4bn, our sense is that with the recent TRAI recommendations expected to be implemented in the next few months, Hathway would utilize capital for digitization rather than aggressive acquisitions.

- In July 2010, TRAI announced key recommendations for the cable distribution industry which includes a sunset date of 31st December 2013 for complete migration from analogue to digital cable services. We view the TRAI recommendations as being extremely positive for the industry as a whole and Hathway in particular. Prior to this announcement, in our report "Television Distribution" dated 30th June 2010, we initiated coverage on the sector with a strong positive bias. As outlined in the report, we expect India to reach 86m digital homes by 2015 as against 22m currently. Against this backdrop, we believe the current recommendations by TRAI could potentially underpin faster growth in the overall industry. However, implementation of these recommendations require approval of the I&B ministry, the timeline for which remains uncertain.
- On account of the slower than anticipated pace of digitization in H1FY11 on the back of delayed delivery of STBs, we have downgraded our digital subscriber estimates to 1.63m (from 1.77m earlier) for FY11 and 3.11m (from 3.14m earlier) for FY12. This has resulted in an EPS downgrade of 4% each for FY11E and FY12E.

Hathway is the largest MSO in India with ~15% share of the paying subscriber base and 30%+ share of the digital base. With Concept (last mile consolidation), Capital (USD60m of initial funding and Rs4.8bn from IPO) and Credibility (management bandwidth) in place, we expect Hathway to capitalize on the ongoing digital boom in India and accrete its digital base to 4.7m subscribers by FY13E. This, coupled with sustained customer additions (by way of acquisitions and improved declaration), would help Hathway attain a 3.9m paying subscriber base (1.6m in FY10) and 32% revenue CAGR to Rs17.1bn by FY13E. As Hathway retains the gains of improving declarations in the initial round and higher-margin broadband business registers a strong 45% CAGR over FY10-13E, we see operating profit growing by 5x and PAT of Rs2.1bn by FY13. Maintain Outperformer with a price target of Rs264 (valuation methodology explained below).

Valuations

We have valued Hathway's business on the basis of EV/ subscriber and arrive at an EV/ subscriber target on the basis of per subscriber economics. While attaching 32 months of ARPU to arrive at EV/ primary point subscriber, secondary point subscriber has been valued at 29 months ARPU and broadband subscriber at 36 months ARPU. Using this methodology, we have arrived at a fair price of Rs264 per share for Hathway.

Fair price of Rs264

	Secondary pt	Primary Pt	Broadband	Total
Number of subs in FY13E (m)	2.1	1.8	1.42	
ARPU (Rs / month)	325	300	315	
Month of ARPU	29	32	36	
EV / subscriber (Rs)	9,440	9,530	11,474	
Enterprise value (Rs m)	19,823	17,155	16,265	53,243
Less: Debt (Rs m)				3,000
Equity Value (Rs m)	19,823	17,155	16,265	50,243
Number of shares (m)				143
Per share value (Rs)				352
Less: Minority interest				25
Target price				**264**

Subscriber base

(no in '000s)	Q1FY11	Q2FY11
Analog subscribers	532	535
Secondary subscribers	1,194	1,205
Paying subscribers	**1,727**	**1,740**
Digital subscribers	1,140	1,198
Broadband subscribers	344	355

Quarterly results

(Rs m)	Q4FY10	FY10E	Q1FY11	Q2FY11	FY11E	FY12E	FY13E
Revenues	**987**	**7,361**	**998**	**1,299**	**8,879**	**11,960**	**17,285**
yoy growth (%)		*11*			*21*	*35*	*45*
Expenses	789	6,049	857	943	6,552	8,186	10,786
EBITDA	**198**	**1,312**	**141**	**356**	**2,327**	**3,774**	**6,499**
OPM (%)	*20.1*	*17.8*	*14.2*	*27.4*	*26.2*	*31.6*	*37.6*
Other Income	24	15	43	50	60	66	73
Interest	122	550	97	95	419	364	364
Depreciation	142	1,245	227	239	1,373	1,889	2,359
PBT	(42)	(468)	(140)	72	595	1,586	3,848
Tax	-	84	-	-	89	397	962
PAT	**(42)**	**(552)**	**(140)**	**72**	**506**	**1,190**	**2,886**
Exceptional items	57	28	(1)	31	228	357	722
PAT post exceptional	(99)	(580)	(139)	41	278	833	2,165

Quarter numbers are for standalone entity, while annual numbers are for consolidated entity

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Explanation of Ratings:

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

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