July 2018

Cable TV’s Amazon Day!

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The competitive intensity in one space of our holding has caused a bit of a heartburn, and depreciation of the values of these businesses is steep. Hathway Cables, Den Networks and GTPL Hathway have all given up nearly 50% of their values in the last three months. While this has shaken up a bit of confidence in this space, the prices now represent just an option value on the businesses.

Cumulatively these companies address 20mn customers on their TV network and 1.3mn customers on their broadband network. All of this has been put together in the last two decades.

The disruptor with a magnitude of capital available at its disposal has spooked the stocks of the incumbents with its announcement of expansion. **The sentiment towards these companies seems to have completely changed, like in the USA, wherever Amazon enters a space, the terminal value of the business seems to just vanish.** None the same, it needs a revisit to the actual reasons on our bias to these companies.

Idea Initiated

As a strategy we tend to look for companies in categories where the competitive intensity had ebbed, categories where companies would not have access to external investors (fresh fund raising) to drive growth. This leaves these businesses to look internally to establish cash flows. Cost rationalization and lower intensity of competition is the hallmark of such situations, the former comes from inability to grow revenues – the latter is the unavailability of external capital.

We saw the beginning of this in the MSO/ Cable companies with the added advantage, a new stream of revenue in broadband subscriptions beginning to contribute to the profitability. Capex in the sector was past its prime. Regulatory hurdles were behind the sector and Phase 3 and Phase 4 of the roll out of the cable TV networks were beginning to contribute to the numbers. There appeared to be a secular growth in ARPUs at least for the next couple of years. We did see a new participant but given the logistics of setting up the network – it didn't look likely that any kind of machinery would be able to profitably cover all parts of India.

The initiation of the idea started then. Consolidation of markets across four national players and profitability was to be led by improved pricing. Well most of this still holds true except for the last one – a new participant has indicated his intention to dominate this space.

Now if we have to even approach this space in retrospect, it is unlikely we would have acted differently.

How do we react to this?

In a normal process, we would either add to this in the portfolio or review or sell what we have. Numerically, the market caps of the current listed MSOs/ Cable TV companies is less than INR 5000cr. Basic logic, excel sheet indicate a much higher number, suggest that even if there is a dominant player in this business, even price takers should be able to justify the value they trade at. We don't know the bottom but do numerically believe that this value should hold through the next couple of years.

If our first premise holds true – consolidation, pricing power and companies' concentration of cash flows, we would be on better footing. One positive that emerges from this event is the business will be pushed from a B2B format (Businesses to Business) to a B2C (Business to Consumer) at a much faster pace. If so, the MSO will get a higher share of the revenue, which is being charged from the consumers.

Not to say that the negatives are not many. Few businesses do well when there is a wall of money unleashed in a sector. This seems to have happened out here. We would need to have patience out here on many counts. First wait for the companies to execute and their deliverables are high, second consolidate and exercise pricing power and finally monitor the roll out of the broadband network across the many players including the new entrant. If all emerges right the new entrant may just about expand the market – and not be predatory.

For this time has to elapse.

Cumulatively across portfolios, these companies account for 5%-10% at the exit quarter. This part of the portfolio accounted for 20% - 50% of the total losses on individual portfolios. Most of it happened in the last two days. We did not see this coming but in relation to where the prices are, the stocks now retain even more value than what they had three months ago.

Numbers and All!

INR Mn	**Revenue/Sub INR***	**EBITDA /Sub INR**	**EV/Sub INR Mn**	**EV/EBITDA (x)**
Hathway	2434	576	5711	8.7
GTPL Hathway	1421	409	1620	3.8
Den Networks	1736	382	1889	4.8
Average	1829	449	2836	5.9

**Annual subscribers (Sub) as of FY18 end; Revenue and EBITDA are as of FY18*

In summary, our conversations with the incumbents' in the Industry does not point to any stress scenario on the business front. Companies will continue to execute as per plan as they still see a business case.
For instance, the business case for Hathway, from present levels of 0.8mn subscribers, reaching 3mn broadband subscribers @INR 500 monthly per sub should get to revenues of INR 1800cr, equivalent to INR 700cr of EBIDTA. This is on a current EV of INR 3150cr. (EV/ EBIDTA of 4.5x).

Now to track this from here.