

Hathway Cable & Datacom Ltd

CRISIL IPO Grade 3/5 (average)

December 23, 2009

IPO Grade

CRISIL IPO Grade '3/5': The grade indicates that the fundamentals of the issue are average relative to other listed equity securities in India. However, this grade is not an opinion on whether the issue price is appropriate in relation to the issue fundamentals.

Issue Details

Shares offered to public	27.75 million
As per cent of post issue equity	19.4 per cent
Object of the issue	Acquisition of subscribers, capital expenditure for set-top boxes and upgradation of network
Amount proposed to be raised	Rs 8,000 million (approximate)
Price band	Not available at the time of grading
Lead managers	Morgan Stanley India Co Pvt Ltd, UBS Securities India Pvt Ltd and Kotak Mahindra Capital Co Ltd

Company Background

Hathway Cable & Datacom Ltd, which was incorporated in 1959, was acquired by the Rajan Raheja Group in 1998. It offers cable television (TV) services in both analog and digital modes along with cable broadband. News Corp, owner of the Star TV Group, is an investor in the company since 2000, holding a 20.1 per cent stake as of August 2009.

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The grading analysis of Hathway Cable & Datacom Ltd is largely based on the information provided in the Draft Red Herring Prospectus (DRHP) and interaction with the management.

Grading Highlights

Business prospects

- Hathway is one of the leading multi service operators (MSOs) in the country, having a household reach of more than 8 million homes.
- The industry is plagued by under-reporting of subscribers by local cable operators (LCOs), estimated to be at 80-85 per cent.
- 'Paying subscriber' base stood at 1.6 million as of March 2009
- Digital subscriber base stood at 1.0 million, out of total paying subscriber
- Given the size, the company is well-placed to capitalise the opportunities from consolidation and digitisation in the cable industry.
- The growth strategy involves acquiring more LCOs for increasing last mile presence and converting analog subscribers to digital.
- The ability to manage the growth strategy at a faster pace, thereby reducing under-reporting, is critical for the company's growth.
- Broadband contributed 16 per cent to the company's topline in 2008-09.
- Hathway is looking at increasing broadband subscribers through the roll out of more broadband services.
- A large size gives the company relatively superior bargaining power with broadcasters for carriage and placement fees.
- The company is likely to face stiff competition from direct-to-home (DTH) players for cable TV distribution.

Financial performance

- Hathway's revenues grew at a CAGR of 48.4 per cent during 2006-07 to 2008-09. The growth was mainly because of the acquisition of MSOs and LCOs during this period.
- The company posted positive operating margins of 15.5 per cent in 2008-09 against negligible operating margins in the previous year.
- In 2008-09, the company realised a cash profit of Rs 335.6 million, though it continued to incur losses at the net level.
- Access to funds is critical for Hathway to continue to pursue its growth strategy of subscriber acquisition and digitisation.

Management capabilities

- Hathway is a professionally run company. The top management has adequate industry experience, and has been associated with the company for a considerable period of time.
- The top management is well supported by a capable second line of management.
- Management has demonstrated a strong track record of handling acquisitions in the past; has acquired and integrated 21 MSOs in the last 2 years.
- However, the large scale of acquisitions envisaged is likely to pose significant management challenges

Corporate governance

- Out of the 12 member board, 4 of them are independent directors. One of the independent directors, Mr Bharat Shah, chairs the board.
- Hathway's board has good experience, with some board members highly experienced in the media

industry.

- Based on our interactions, it appears that the level of engagement of the independent directors in the company's affairs is reasonably good.

Detailed Grading Rationale

Overall grading summary (CRISIL IPO Grade 3/5)

To arrive at the overall grade, CRISIL has considered the following parameters:

- Business prospects and financial performance
- Management capability
- Corporate governance

CRISIL has assigned a CRISIL IPO Grade ‘3/5’ (pronounced ‘three on five’) to the proposed IPO of Hathway Cable & Datacom Ltd. The grade indicates that the fundamentals of the issue are average relative to other listed equity securities in India. However, this grade is not an opinion on whether the issue price is appropriate in relation to the issue fundamentals. The offer price for the issue may be higher or lower than the level justified by its fundamentals. The grade is not a recommendation to buy/sell or hold the graded instrument, the graded instrument’s future market price or its suitability for a particular investor. The analysis related to the grading of Hathway Cable & Datacom Ltd is largely based on the information contained in the Draft Red Herring Prospectus (DRHP) and interaction with the management.

The IPO grade assigned to Hathway, with a paying subscriber base of 1.6 million as of March 2009, reflects the current position of the company as one of the leading MSOs in the country. With digital subscribers accounting for around 1 million of the total paying subscribers, the company is well-placed to capitalise on the opportunities stemming from consolidation and digitisation in the cable distribution space. The grading also takes into account the company’s experienced management and its demonstrated ability to acquire LCOs and integrate them. The company’s efforts to consolidate its subscriber base through acquisition of MSOs and LCOs and convert analog subscribers to digital are expected to yield benefits over a period of time. The ability to manage the growth strategy at a faster pace, thereby reducing under-reporting, is critical for the company’s growth. However, the large scale of acquisitions envisaged is likely to pose significant management challenges. The grading is, however, constrained by the high amount of competition the company faces, particularly from DTH operators, many of whom have strong parentage and financial muscle.

Leading MSO player in the country

- Hathway is one of the leading MSOs in the country. The company has an estimated household reach of more than 8.0 million, giving it strong bargaining power with broadcasters for carriage and placement fees. In 2008-09, the total paying subscriber base stood at 1.6 million. Out of these, the digital subscriber base accounted for 1.0 million. The company has the around 40% share in total digital cable subscribers. Its cable broadband subscriber base stood at 341,015, which is also the highest among cable operators. Hathway has a market share of 4.3 per cent among the total broadband subscribers as on 2008-09.

Industry in consolidation phase

- The cable industry in the country is highly fragmented. It is estimated that the industry has around 1,000 MSOs, out of which 10 are major MSOs, and over 50,000 LCOs. However, the threat from DTH and subscriber’s demand for digital quality services is expected to lead to consolidation in the industry, with major MSOs such as Hathway, DEN and Digi Cable acquiring smaller MSOs and LCOs.

Acquisition-led strategy would require high management bandwidth

- Hathway, along with other players in the industry, is facing issues of huge under-reporting by LCOs

(Local Cable Operator). Against the estimated household reach of 8.0 million as of March 2009, the paying subscriber base stands at a mere 1.6 million. To overcome subscriber under-reporting, the company will continue to follow a strategy of acquiring subscribers in the last mile through the acquisition of LCOs. In the last 2 years it has acquired 21 MSOs and integrated them. However, the large scale of acquisitions planned for the future is likely to pose significant management challenges. The company is looking at subsidising the set top boxes to enable conversion of analog subscribers to the digital platform to counter DTH, as well as provide more channels at better transmission quality to subscribers. Further, to optimise its infrastructure capacity, Hathway also plans to increase the roll out of broadband services in its network.

Funds critical for the growth of the company

- The company’s strategy to acquire subscribers, converting subscribers to digital mode and roll out of broadband services is expected to involve considerable capital expenditure. Hence, funds from the IPO are critical for the growth of the company, and any delays in the fund-raising activity could affect its strategy. Out of the expected issue size of Rs 8,000 million, Hathway is expected to get Rs 5,800 million while the balance would go the ChrysCapital (invested in the company through Monet) and MSPI who are selling part of their stake. Following are the proposed objects of the issue:

Proposed use of issue proceeds

Sr no.	Project description	(Rs mn)
1	Acquisition of customers	2,436
2	Digital capital expenditure	1,564
3	Broadband infrastructure	830
4	Repayment of loan	967
Total		5,797

Source: DRHP

Competition from DTH

- The cable industry is expected to face strong competition from DTH players, many of whom have far strong parentage and financial muscle compared to MSOs such as Hathway. Over the last 2 years, DTH has recorded strong growth due to aggressive marketing campaigns and competitive pricing offered by the DTH players. As of March 2009, the DTH subscriber base is estimated at 12 million vis-à-vis 2 million for digital cable. In future also, we expect subscriber additions by DTH operators to be significantly higher than digital cable subscriber additions. However, over 60 per cent of DTH subscriber additions are taking place outside the top 100 cities, and MSOs, currently, are not targeting these markets for offering digital cable services.

DTH to lead the growth in Cable and Satellite Households

- At the end of 2008, the TV households were estimated at around 123 million, indicating a penetration level of 57 per cent of total households. CRISIL Research expects penetration to increase to 63 per cent by 2013. There were 86 million cable and satellite (C&S) households as on December 2008, implying 70 per cent penetration amongst TV households. We expect the penetration level to increase to 82 per cent, and the number of C&S households to touch 125 million by December 2013. Most of this growth would come from expansion in the DTH subscriber base.

Regulatory changes could affect the industry

- The cable industry is governed by the Telecom Regulatory Authority of India (TRAI), Ministry of Information and Broadcasting (MIB), Department of Telecommunications (DOT) and other government bodies. The regulations mandate ceiling on subscriber fees for conditional access system (CAS) as well as non-CAS. Any adverse changes in pricing regulation would impact the industry.

Financial Profile

- During 2007-08 to 2008-09, the company's revenues grew at a strong CAGR of 48.1 per cent to Rs 66.3 billion. This growth was driven primarily on the back of acquisition of MSOs and LCOs.
- Of the total revenues, broadband services contributed 16.0 per cent to the topline.
- In 2008-09, the company achieved significant improvement in its financial performance, posting operating margins of 15.5 per cent against negligible operating margins in the previous year.
- Hathway also had a cash profit of Rs 335 million, though it incurred losses at the net level due to higher depreciation charges.
- The debt-to-equity ratio was 0.75 times as on end of 2008-09, as the company raised Fully & Compulsory Convertible Debentures from private equity investors. These got converted into equity shares in August 2009.
- The funds to be raised via the IPO are crucial for the company to continue its growth strategy through the acquisition of customers in the last mile, digitization, and roll out of broadband services.

Financial performance snapshot (consolidated)

Particulars		2004-05	2005-06	2006-07	2007-08	2008-09*
		Actual	Actual	Actual	Actual	Actual
Income from operations	Rs mn	2,032	2,504	3,029	4,166	6,646
Operating margins	Per cent	-3.4	4.2	5.4	0.08	15.5
Net profits	Rs mn	-357	-340	-625	-668	-621
Net margins	Per cent	-17.6	-13.6	-20.6	-16.0	-9.3
RoCE	Per cent	-25.9	-7.9	-15.6	-9.7	0.9
RoNW	Per cent	-30.5	-15.7	-37.0	-28.9	-14.9
No. of equity shares	Mn	31.7	31.7	31.7	111.4	122.9
Net worth	Rs mn	2,339	2,000	1,376	3,248	5,060
Book value (FV Rs 10)	Rs	73.8	63.1	43.4	29.2	41.2
Debt/equity ratio	Times	0.33	0.46	1.23	0.72	0.75
Current ratio	Times	0.8	0.7	0.7	0.6	0.8

Note: Numbers have been reclassified as per CRISIL standards.

*Includes Fully & Compulsorily Convertible Debentures of Rs 2,472 Mn which got converted in August 2009

Source: DRHP

Business Profile

Hathway Cable & Datacom Ltd, which was incorporated in 1959, was acquired by the R Raheja Group in 1998. Currently, the promoter holds a 57.1 per cent stake in the company. News Corp, part of the Star TV Group, is an investor since 2000 and has 20.1 per cent shareholding in the company as of August 2009.

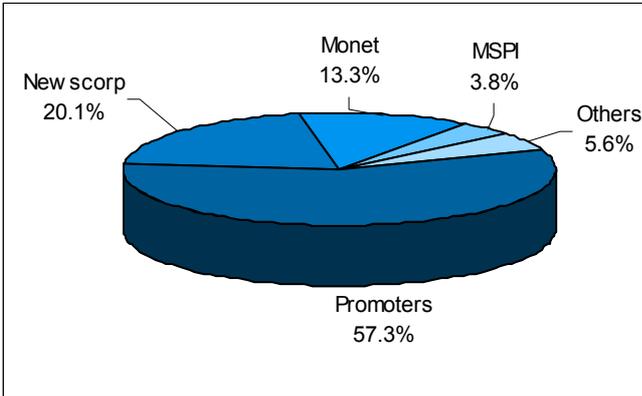
Hathway is one of the leading MSOs in the country, having a household reach of more than 8 million. It also has an all India Internet service provide (ISP) licence. The company offers two services:

- Cable TV distribution through analog and digital modes
- Broadband Internet services

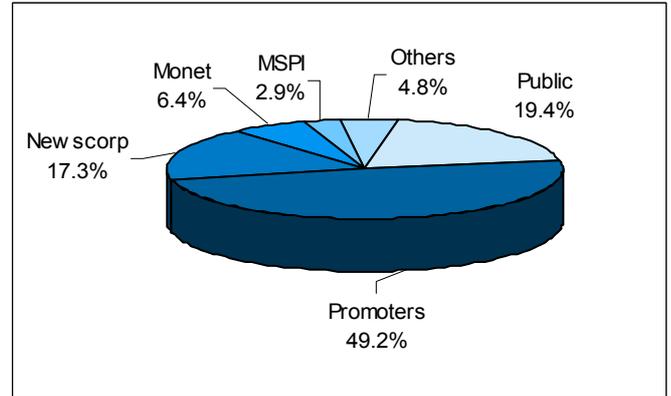
The company provides cable services in 125 cities while broadband services are provided in 20 cities. It has 68 analog head ends, 19 digital head ends and a 15,000-km hybrid fibre co-axial cable network. The total paying subscriber base stands at 1.6 million, out of which 62 per cent are on the digital mode (CAS and non-CAS areas). The company along with other players in the industry is plagued by huge under-reporting of subscribers and revenue by the LCOs who act as “last mile service providers”. To overcome the under-reporting, Hathway is using the strategy of acquiring subscribers through the acquisition of LCOs. Over the last 2 years, the company has primarily grown inorganically, acquiring smaller MSOs and LCOs. Another crucial element of Hathway’s strategy is to convert analog subscribers to digital. The company is expected to continue to pursue this strategy, with the funds raised via the IPO to be used towards subscriber acquisition, digitisation and roll out of broadband services.

Hathway Cable: Shareholding pattern

Pre-IPO



Post-IPO



Source: DRHP

Profile of Management and Board

Hathway is a professionally run company, with the promoters involved only in key decision-making. Mr Jayaraman, who is the CEO, has been associated with the company for the last 9 years, and has extensive experience in the cable industry. Further, the key management personnel of Hathway have more than 15 years of work experience, and all have been with the company for at least 6-7 years. They are supported by a strong second line of management. Hathway's board comprises 12 members out of which four are independent directors. The board has considerable media industry experience. The promoter has four seats on the board, with all acting as non-executive directors. News Corp, which has a 20.1 per cent stake in the company, has two nominee directors on the board. The board is chaired by independent director, Mr Bharat Shah. All the independent directors have extensive knowledge in their relevant fields.

Annexure: Profile of the Directors

Name of directors	Designation	Age (years)	Qualification	Key position held
Mr Rajan Raheja	Non-executive director	56	B.Com	Promoter (nominee)
Mr Vinayak Aggarwal	Promoter (nominee)	40	B.Com, MBA(IIM-B)	CEO of Hathway Investment
Mr Akshay Raheja	Non-executive director	27	MBA, Columbia Business School	Promoter
Mr Viren Raheja	Non-executive director	25	CFA, MBA (London Business School)	Promoter
Mr Brahma Vasudevan	Non-executive director	40	MBA, Harvard Business School	Managing director at Monet Investment Advisors
Mr Jagdish Kumar G Pillai	Non-executive director	47	CA	President-South India, Star TV India
Mr Uday Shankar	Non-executive director	47	M. Phil in Economics	CEO, Star TV India
Mr K Jayaraman	CEO	48	CA	Executive director
Mr Bharat Shah	Independent director & Chairman	62	Diploma in Applied Chemistry	Chairman of HDFC Securities Ltd
Mr Sasha Mirchandani	Independent director	53	Graduate, Mercantile Marine	Managing Director, Blue Run Ventures
Mr Sridhar Gorthi	Independent director	37	B.A. L.L.B (Hons)	Partner at a law firm Trilegal
Mr Devendra Shrotri	Independent director	37	Engineer, Jabalpur Engg. College MBA, Columbia Business School	Founder of Lexvia Inc, a back office administrative service provider

Source: DRHP

Disclaimer

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