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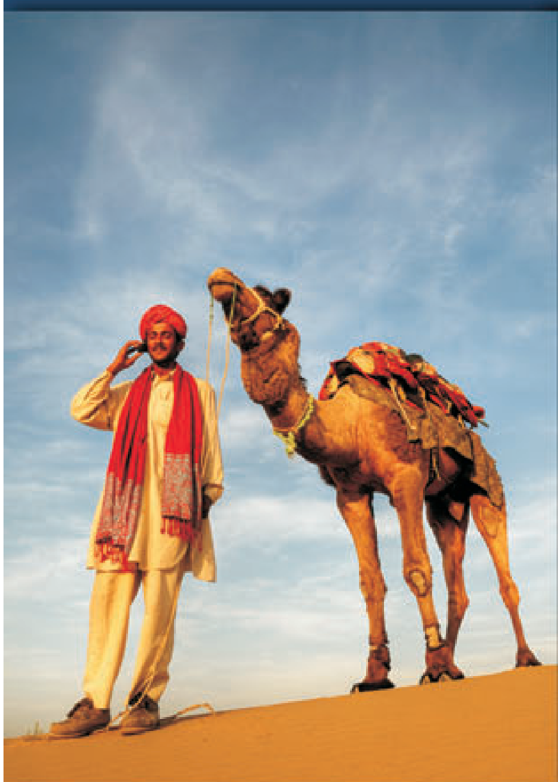

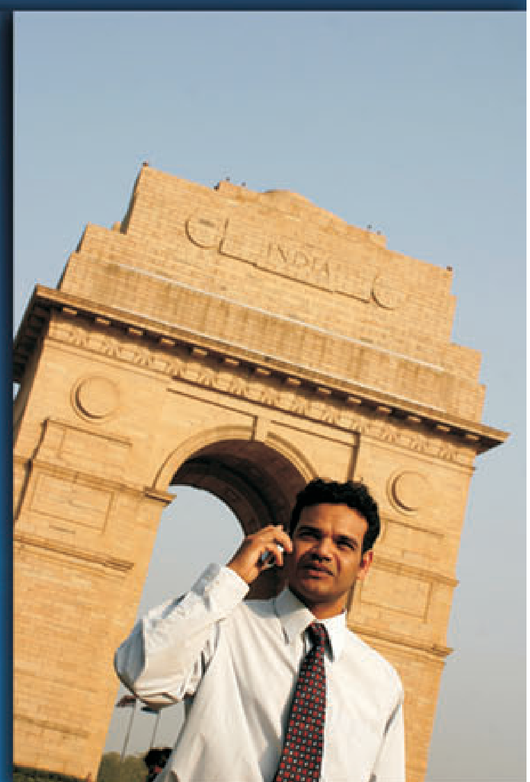

November 2009

Cable TV - The Money's in the Last Mile.

by
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Indian Cable TV subscribers are estimated to have paid approximately Rs. 13,000 crores (USD 2.8 billion) in subscription charges in 2008. Over 80% of this is estimated to have been pocketed by the local cable operator (LCO). The economics for the average LCO are compelling:

- The LCO uses differential pricing to capture 70-80% of TV households in his locality (have you ever asked your cook/maid how much she pays for cable-note that she gets the same product/service as you)
- His subscriber base is a black box – there is no formal record of who his customers are or how many there are. Consequently, programming cost payouts are low; with even more upside if multiple MSOs (Multi System Operators) are vying for the LCOs loyalty in his market
- Minimal operating costs due to absence of basic customer service features like call centers, bills etc.
- Low corporate overheads and a cash business with minimal taxes.
- Capex is a fraction of what a top quality network would require with little adherence to standards or licenses for legal Rights of Way.
- Good understanding of his local area coupled with quick service; in many cases ready to resort to muscle power and other unethical practices to defend his territory.

Needless to say, his P&L would show a very fat profit margin and this explains the presence of an estimated 60,000 LCOs in the country. Though derided by everyone, he has proven to be a tough competitor on his own turf. It explains why MSOs with ample PE funds have shied away from building a local organization to compete with the LCO. Instead, most MSOs have tried to co-exist, in an uneasy marriage with their LCOs. With an increasing number of suitors, LCOs have been switching from one MSO to another, depending upon the bait offered. Clearly, the large number of secondary subs that are claimed by major MSOs in India are broad estimates and could prove to be ephemeral. A LCO could easily take his network of thousands of subscribers to another MSO, almost overnight.

The fragmented India cable industry has tried to take a shortcut to quick profits by large scale acquisition of secondary subscribers and using carriage fees from broadcasters to subsidize the losses incurred in their base cable TV business. However, even in this landscape, there have been a few islands of excellence. A few operators have taken the tougher road of building their own, standards based and fully owned last mile networks. They have made steady progress towards building professional, corporate structures and are trying to emulate world leaders like Comcast in building a world class customer centric communications company (Comcast, incidentally, reported EBITDA margins of 40% in 2008).

In this article, we lay out the expectations of TV households from their cable (or DTH/satellite) operator, compare different models being used to deliver against this expectation, assess cable operators' success in actually delivering against these expectations and showcase a few players who standout from the crowd on these metrics.

Cable TV: The Money's in the Last Mile

What does the average TV household expect from his cable operator?

A scan of various offerings being made to TV households in India reveals the following expectations/needs that a cable operator could fulfill:

Basic customer service: In most cases, customers of the average cable operators have no identity – no customer ID, no bills, and no receipts. Customer service is rudimentary with no easy access to the cable operator's personnel.

Quality signals: No distortions, ghosts etc. while viewing channels he's paying for. And no downtime please.

The customer needs more than plain vanilla analog cable TV: Digital customers make up 70% of Comcast's cable TV customers. It may take a while to reach those levels in India; but there is a clearly a large enough segment of customers that value the benefits of digital TV, and are even willing to pay higher ARPU for this feature (larger bouquet of channels, EPG, DVR facility etc.).

The customer needs more than cable TV: As more cable TV households start to own PCs/laptops, high quality broadband services are becoming an essential need for such households. However, the customer has various options to choose his broadband service provider, and the cable operator's broadband offering would need to be competitive to be considered the default choice.

Customers love local content: Cable TV offers a unique platform for operators to create content tailored for the local population. Low capex/cost content channels can be created catering to the local news, local language music and regional language entertainment space. This not only creates a valuable differentiation versus DTH, but also enables the operator to earn additional advertising income.

Customers will pay for valuable value added services (VAS): The trend towards early monetization of movies through alternate mediums holds significant potential for operators to enter into revenue sharing arrangements with movie production houses. Similar opportunities exist with education.

Who is best positioned to deliver against these expectations?

A comparison of the various business models shows that cable operators with last mile ownership are best positioned to deliver against the chart below **(Exhibit 1)**

However, converting the theoretical superiority of the last mile cable model to a valuable customer proposition is not easy to deliver.

Cable may be best 'positioned', but what does it take for cable operators to 'deliver' against customer expectations?

Any operator who can deliver on the above is well poised to deliver a compelling proposition for his customers, thereby generating significant loyalty and robust revenues and profitability as a reward. However, delivering this would require:

- Ability (and willingness) to commit capital to transition from a low quality analog network to a digital one capable of offering triple play: Operators need to invest in quality equipment for the head-end, network infrastructure all the way to the customer's premises, software for CRM/billing, capex for content creation, EPG etc
- Recruitment of trained and qualified personnel (technical, managerial and administrative)
- Creating a customer centric mindset across the organization: All functions – technology, maintenance, sales, operations etc. – need to be trained to think from the customer's point of view and KPIs need to be framed accordingly
- Visionary and ambitious promoters / entrepreneurs and investors who are prepared to think longer term

Clearly, these have proved to be a steep ask from most cable operators in India.

Exhibit 1: Comparison of alternate business models to deliver content to TV homes

	Cable-Franchise		Cable-Last Mile		DTH	
Customer Service	○	Difficult for MSOs to control LCOs	●	Direct Control over Subscriber	●	Direct Control over Subscriber
Signal Quality	⊙	No control over LCO network quality	●	Direct Control over Network Quality	●	
Digital TV	⊙	Rollout easy, but conflict of interest may exist between MSO and LCO	●		●	
Broadband	○	Most LCO networks not broadband ready. Need to rollout parallel network.	●	Able to provide cable and broadband on a single cable	○	However, can bundle with parallel broadband rollout
Local Content	●		●	Easy to aggregate and provide local content	⊙	Therotically possible, but economically feasibility not clear
VAS	⊙	Can't use LCO network for return path	●	Return path exists	⊙	Complicated, need to use mobile / internet for return path.

○ - Poor ⊙ - Mediocre ● - Excellent

Cable TV: The Money's in the Last Mile

Why haven't most cable operators delivered against customer expectations?

Unfortunately for cable TV customers, most LCOs are sub-scale and operate in near monopoly situations. They never felt the need to invest substantial capital and deliver a superior proposition to the customers (existing cash inflows were rich enough).

All national players in the cable industry (Master MSOs or MMSOs) have chosen the (relatively) easy way out and pursued a strategy of acquiring or taking significant stakes in numerous State/District level MSOs. MSOs have got sweet deals as part of this race to acquire such stakes. The battle between MSOs for LCO loyalty has also resulted in 'happy days' for the LCOs – with MSOs offering significant rebates on the amounts due from LCOs. In the meanwhile, MMSOs used carriage/placement fees from broadcasters to keep their ship afloat. In pursuit of immediate valuations, the customer (and thereby the more difficult though profitable route of 'last mile ownership') took a back seat.

The advent of DTH has, however, changed the rules of the game. By providing high quality signals, variety of bouquets tailored to meet different segments, reasonable pricing, exclusive content (education channels) and value added services (movie on demand, temple darshan) along with the trust associated with a national brand, they have been able to wean away 15 million cable subscribers over to their side.

Who are the exceptions and what can other players learn from them?

While there are no national players who have bothered with the 'last mile ownership' model, select regional operators have been successful in rolling out many elements of the above package, albeit in limited geographies. Asianet and Ortel are two examples of such players who have built high quality networks that provide fat pipes to their customer homes and control all elements of their service offering, end to end.

Ortel Communications (a portfolio company of NSR) has successfully made the transition from a single location LCO to an operator with a strong last mile presence in over 15 locations by adhering to the above design principles. Despite the enormous challenges associated with entering new markets with the 'last mile' business model , the Company has stuck to its game plan and used its superior value proposition to customers to secure market share in these locations. This business model has translated into healthy margins, short working capital cycle and low customer churn, thereby providing rapid payback of capital deployed.

Will last mile have the last laugh?

While DTH has gained subscribers on the back of oceans of red ink, it has demonstrated that the Indian customer is looking for a high quality, value added cable service. The technological advantages that the "last mile fat pipe" cable model provides over DTH is well established in several developed markets around the world. Similarly, the performance of Asianet, Ortel and other niche players who have stuck to the 'last mile ownership' model in cable is ample evidence of the economic attractiveness of this model on the back of customer and supplier (broadcaster) satisfaction and goodwill. The next step is for these companies to roll out multiple services like digital TV, broadband and VAS which fully utilize their control of their customer's homes and the lower cost and higher bandwidth that is available to them.

The slowdown over the past 18 months is a warning to MMSOs about the ephemeral nature of carriage fees. They have made progress in deploying digital STBs in parts of their network (albeit at no incremental ARPU). They are also likely to use part of the funds being raised through IPO/private placements to aggressively acquire LCOs across their network. MMSOs need to move rapidly to first match the product/service offering provided by DTH and then upstage them by milking the benefits of the 'fat pipe' entering the customer's premise.

There is no doubt that 'last mile' will have the last laugh – the actions of the cable industry will decide whether the cable or DTH players will laugh louder.

About the Author

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Nithin has been with New Silk Route Advisors for close to two years and focuses on private equity opportunities in the Indian sub-continent out of the Mumbai office. He looks at investment opportunities in the consumer services, financial services and infrastructure verticals and is part of the Ortel deal team.

Nithin was previously an Engagement Manager with McKinsey & Company, Mumbai. During his tenure of five years, he served clients across several industries including infrastructure, oil & gas, power, media, metals & mining, telecom, automotive and food products. Before joining McKinsey, Nithin completed his MBA from the Indian Institute of Management (IIM), Calcutta. Nithin is also a qualified Chartered Accountant from the Institute of Chartered Accountants of India and a Bachelor of Commerce from Mumbai University.

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