"DEN Networks Limited Q2 FY16 Earnings Conference Call"

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Moderator: Ladies and gentlemen, Good Day and Welcome to DEN Networks Limited Q2 FY16 Earnings Conference Call. This conference call may contain certain forward-looking statements about the company which are based on the beliefs, opinions, and expectations of the company as on the date of this call. These statements are not the guarantees of future performance and involve risks and uncertainties that are difficult to predict. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference call please signal an operator by entering '*' then '0' on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Pradeep Parameswaran. Thank you and over to you, sir.

Pradeep Parameswaran: Thank you so much. Welcome to all the analysts on the call. Thanks so much for being part of 2Q'FY16 Results. I will start with a very brief overview of our numbers for the quarter and spend a bit of time on the strategic side and then Manish will walk through the details of the results.

In line with some of the discussions from the last few calls, I will keep the same order of discussion. To start with, we have had a flat quarter on the cable side, on the revenue standpoint. Our DAS 1 and DAS 2 ARPUs, net of taxes and LCO share is continuing to be at Rs.93 level for DAS 1 and Rs.66 for DAS 2 respectively on a per month, per box basis.

Secondly on broadband, our growth continues to be on track with our aspirations, I am pleased to report that our subscriber base has grown up by about 60% this quarter, so we now are at 57,000 subscribers versus 35,000 subscribers in the previous quarter. We have also achieved a 25% growth roughly over last quarter on the homes passed basis. Our business today covers an additional 115,000 homes versus 486,000 homes the last quarter, most of that continues to be in Delhi.

The third lever that I talked about in the past was around footprint expansion of DAS 3, as can be expected with the deadline drawing closer we are beginning to see more momentum. In this quarter we have added 350,000 boxes of which 330,000 are in Phase-III markets, this compared to a total of 185,000 boxes added in the last quarter. As we stand today, we have a total of 2.6 million boxes in the DAS 3 markets and our aspiration is to monetize that at the earliest given opportunity post DAS 3 deadline.

On DEN-Snapdeal, that JV continues to make very strong progress. In the past quarter we added a major distribution platform in the form of Videocon D2H. As of September 30 we were available in about 38 million homes. We also have made substantial progress on negotiations with other platforms and you will see those being introduced in the coming days.

Our conversion ratio has improved from 32% to 33% and more than 20% of our business is coming from repeat customers. The margins of these business continue to hold and consequently the financials are very much on track.

And at this time I would like to hand over to Manish to walk us through some of the salient numbers.

Manish Dawar: Thanks Pradeep. Ladies and Gentlemen, Good afternoon. I am sure you would have seen the presentation that we circulated this morning on our H1 and Q2 performance. Please refer to the file that was loaded about an hour back, we just noticed a small error in the previous year numbers on one of our discontinued distribution businesses, my apologies for the same.

In summary, on a consolidated basis we had a flattish quarter, as Pradeep mentioned. We achieved a consolidated revenue including activation income of INR271 crores versus Rs.266 crores in the previous quarter, a marginal improvement of 2%. Cable revenues including activation income accounted for INR259 crores compared to INR256 crores in the previous quarter including activation income.

Cable subscription revenues were lower by 3% on a quarter-to-quarter basis to INR115 crores from the previous quarter of 119 crores. This resulted in an average revenue on per box per month basis in DAS markets of about INR77 versus INR78 a quarter ago on 3.9 million paying subs. ARPU for DAS 1 and DAS 2 markets as mentioned by Pradeep stood at 93 and 66 respectively. These ARPUs are average for the quarter rather than the exit numbers and are net of taxes and net of LCO share on per box per month basis.

The collections efficiency continues to be strong during the quarter. The placement income was lower by 6% on a quarter-on-quarter basis at 111 crores, this is due to lower placement deal with one of the broadcaster and some small placement deals getting expired and not renewed yet.

Revenues for broadband business stood at INR8 crores, a 58% increase on a quarter-to-quarter basis, this is in line with the drive on the subscriber additions that we have and there is a small improvement in ARPU also alongside the increase in the number of subscribers. As Pradeep has talked about, we have grown almost 60% on our number of subscribers' gross additions during the quarter. TV shop gained traction and the share in the Snapdeal-JV revenue improved to about INR3.3 crores which is approximately 84% improvement versus what was booked in the first quarter of current financial year.

Moving to the bottom-line, consolidated EBITDA post activation income stood at a loss of INR 11 crores, with cable EBITDA at 22 crores positive versus 18 crores positive in the previous quarter. There was a loss in the broadband business of 20 crores, football 9 crores and TV shop at 4 crores during the quarter. Football, as you know, the season has just kicked in and therefore most of the revenues and expenses will come in quarter three which is October to December quarter, but we started to incur the expenses in quarter two ahead of the season.

Consolidated EBITDA pre-activation stood at a loss of 39 crores versus 20 crores in the previous quarter, this is mainly on account of football season kicking in and higher losses in cable and broadband business.

As discussed during our previous call, our intent remains that we will divest out of the soccer business and we continue to scout for the opportunities available in this space. Off the 27 DAS cities where DEN is present, 14 cities have moved to a billing rate net of taxes of INR80 plus compared to 13 in the previous quarter, and 58% of paying DAS subscribers are now in the bracket of INR80 plus.

With that I would like to open the floor for Q&A. Thanks a lot.

Moderator: Thank you. Ladies and Gentlemen, we will now begin with the question-and-answer session. We have the first question from the line of Vivekanand Subbaraman from Ambit Capital. Please go ahead.

Vivekanand Subbaraman: I have two questions. One is on the placement side of the business, so this quarter we saw a dip and you explained two reasons. So my first question with respect to placement is that the lower placement income that we received from one broadcaster, is it a sign that placement income is likely to dip or remain flat despite our digitizing Phase-III and IV subscribers? That is one. And secondly, in terms of the subscription revenue I can see that there is some progress that has been made with respect to billing improving to greater than 80 in one more city and also remaining stable in the 65 to 80 region. So just wanted to understand what is the reason for QoQ stability of subscription revenue? And lastly on the content side we saw that you and Star had some bit of standoff so to say wherein Star had published ads exerting customers to look at alternate platforms. So what is the pace of the renewal deal with Star? Thanks.

Pradeep Parameswaran: Just on a lighter note, I am sure DEN has never advertized on the front page of Economic Times in our lives, so thanks to Star at least a lot more people know about our company. On a serious note, let me spend a minute on the content and carriage issue because the question that you asked on carriage and content are related, while you asked those were separate questions.

See as you all know a part of the reason why our P&L is materially worse as what it used to be in the previous years' is because obviously the content cost increase has been dramatically higher than our ability to monetize those subscribers, I think that story is well understood by everybody. And consequently we have taken at least at DEN a very deep look at what can we afford to actually pay especially as we look forward towards the monetization of Phase-III for our content. And our conclusion is that, learning from our lessons of the last cycle, we are definitely not going to sign up for content deals that fundamentally will not allow us to improve our profitability, right. Number two, as you know there was also an experiment in my mind, I will call that experiment of moving to this construct of the RIO or a modified RIO approach and I think we have lived through a year of that now, and having the lessons of that it is also clear to us that that is definitely neither in the favor of the broadcaster nor in the favor of the platform that is carrying it. And consequently I would say we deliberated and developed in our minds a strategy that allows DEN to have a more sustainable trajectory on net content and carriage. So as I explained in my previous calls we do not look at the lines of placement and content independently, we always focus on the net content minus carriage line.

And part of what you saw play out with Star was definitely a reflection of our belief around what cost structure we can afford and what the broadcaster would have expected and given that there was a substantive gap in those two numbers the battle was a reflection of that. Having said that, I am happy to report I think that we have a notional agreement in place while lots of the final details are being worked out, we have a high level agreement in place which will secure, I think, a content position for us over the next two years that will be quite good in allowing us to win as well as providing Star the benefits around extended reach. Just on that, out of the four major broadcasters, we have long term deals now done with two of them and one is in active negotiation. So my hope is in the course of this quarter or early next quarter we will have a very high degree of visibility on content and placement over the next two years that allows us to very confidently plan in the Phase-III digitized space.

The specific question that you asked around whether the 6 crores dip that we are saying in placement is indication of long-term reduction and placement, we will stick to our guidance that we have provided earlier part of the year which is that we expect our placement revenues to be roughly flattish. You should recognize that there is always a bit of timing issue because some deals that are in negotiation may not get renewed on time, so something that should have shown up in the last quarter may show up in the next quarter. You should also recognize that we make some assumptions around new channel introductions that are to happen, some of which get deferred. So there was a bit of a timing issue on that but we maintain our guidance that our content cost is likely to be in the 10% to 15% increase range for this year and placement is likely to be flat.

Now on your question around subscription, one thing that I will readily acknowledge is that the progress on that has been slower than what the management team expected. While directionally I think we have done many things that should show result, unfortunately it is not yet reflecting in the number and we are concerned about the fact that we have only grown very marginally on that in some geography. So having said that, I think some of the toughest things that we need to do on the content side will now allow us to actually play a lot more freely on the revenue side of the equation and my hope is that we will see material progress on that in the second half of the year.

Vivekanand Subbaraman: Okay. Sir I have a couple of follow-ups. On the Star deal, so are we also signing a Phase-III and IV agreement simultaneously with them or is it just renewal of Phase-I and II deals?

Manish Dawar: We are looking at Phase-III option simultaneously but we are not going to commit unless and until we have a clear visibility on what is happening on Phase-III digitization. So we are lining up the contracts on both basis which is excluding Phase-III and including Phase-III but we will firmly sign it off once we get the full visibility.

Vivekanand Subbaraman: And sir with respect to visibility of Phase-III, is there any update that you can provide on whether it is likely to happen if at all or by this yearend or will there be a meaningful delay?

Pradeep Parameswaran: So all the indications that we get from the various bodies that are related to this decision continues to be that the deadline is likely to stick, having said that, it is impossible for us to predict with any amount of certainty. We are planning our seeding activities on the basis that there will be digitization on December 31st and so we are making plans accordingly.

Vivekanand Subbaraman: And sir on the subscription front, since we are now so close to Phase-III digitization, isn’t there bandwidth constraint with respect to monetization, on the one hand we would have our task cut out in digitizing the subscribers in Phase-III and IV and on the other hand we would want to get more juice from Phase-II and probably Phase-I as well. So I am just trying to understand, when you said second half will be stronger are you trying to say that in the second half or particularly in the last quarter you are likely to get money from DAS 3, is that going to drive the subscription income or do you also expect any progress in better collections in Phases I and III?

Pradeep Parameswaran: So while we would not be able to give you the segregated position on Phase-I, Phase-II versus Phase-III, Phase-IV, but actually what I will tell you is that we are very keen to drive Phase-I, Phase-II collections to higher levels and we will be putting great deal of focus on that. And of course in addition to that, as you know with analog markets you are not allowed to connect so we virtually had no subscription from Phase-III markets. And relative to many other players we have a very large footprint in Phase-III and so while most of the seeding the deadline remains the same, most of the seeding will happen over the course of the next two or three months. Of course we do have expectations that we will start to monetize that base in some shape and form.

Moderator: Thank you. Our next question is from the line of Rohit Dokania from IDFC Securities. Please go ahead.

Rohit Dokania: One, if you could talk about your set-top box inventory and the amount of set-top boxes that we have ordered given it's already November?

Pradeep Parameswaran: So while we would not get into specifics of the inventory levels, what we will say is that our total footprint that we expect to digitize over Phase-III and Phase-IV is about 8 million, of which obviously good majority are in Phase-III markets. As we disclosed during this call we have 2.6 million digital subscribers already in Phase-III and we very much plan to cover the rest of the available Phase-III footprint in our current analog markets over the course of the digitization deadline time period.

Manish Dawar: Rohit, you would have also noticed that in the current quarter we have added almost 350,000 boxes of which 330,000 boxes are in Phase-III markets and this is almost double compared to the previous quarter.

Rohit Dokania: The other part would be, the blended ARPU, I believe is marginally down sequentially, so if you can talk about what would have lead to the reason why it has fallen, is it because of some content deals not being there because of which the LCOs have not paid out or something of that sort?

Pradeep Parameswaran: Yes, I think I am sure I will hear this question in many different shapes and forms and we addressed in the earlier question also. See, I think I am not going to give excuses because there are always reasons why things do not happen, sometimes that is content issue, sometimes it is a technology issue, sometimes it is a competitive issue, there are many kinds of reasons for it. What I will say and stop is that there are a number of levers that we are putting into place, my hope would have been that some of that would start to play out in this current quarter which we have not seen. But the actions that are required to drive price increases are being taken with reasonable aggression and so hence my expectation that this will start to show in the numbers in the second half of the year.

Rohit Dokania: And the other one would be, I believe that receivable days have actually gone up versus the March quarter or the March end, so is there any specific reason for that?

Manish Dawar: Rohit, the receivables have marginally gone up compared to March end and it is mainly on account of the placement receivables and you have to look at placement receivables along with the payables on the content side, so we saw the content also kind of moving up on the payable side, so therefore directionally it is fine. But as far as the subscription receivables are concerned the last two quarters are absolutely at par, so in the current quarter we have not added anything to our outstanding on subscription receivables.

Rohit Dokania: And just one last question from my side, if you can throw some light, in terms of broadband when do we expect this business to turnaround, would it be let's say later half of FY17 or something of that sort, it will be great if you can throw some light on that.

Pradeep Parameswaran: If you do not mind I will do a little bit of a correction on the word you said, it is not a turnaround, telecom fixed line infrastructure businesses when you are in the investment phase take some time for it to return the money, so it is not definitely a turnaround, in fact most of the metrics are in line with our expectations and we definitely have belief that the business that we have launched in Delhi, let's just take that as an example will be EBITDA positive in FY17 which will be within two years of it's launch which by most metrics is very much ahead of track in terms of profitability. The one thing that I would put in advance is, as you know if we keep adding networks, for example new cities, on an aggregated basis you would not see that in the numbers because the new cities that are launched will then take another two years for it to turnaround in your language, so but on a like-to-like basis we would expect, the business is that we roll out the network through the course of this year to be EBITDA positive in the course of FY17.

Moderator: Thank you. We have the next question from the line of Vivekanand Subbaraman from Ambit Capital. Please go ahead.

Vivekanand Subbaraman: Just persisting with the CAPEX question, so you have mentioned that you are budgeting that Phase-III will get over or you will be able to digitize your subscriber base for Phase-III within this fiscal. And also on the broadband side just wanted an update on the CAPEX, is there any change in the thought process or we are likely to continue with the earlier guidance?

Pradeep Parameswaran: So as far as broadband is concerned, I mean we are continuing with our plans, we talked about a million homes passed in our earlier call and I think we will be quite close there, I mean let's say I would say close to 900 or so. We also talked about crossing 100,000 subscribers in the current year and as you would have seen the numbers from first half we are well on track on that. So we think that we should be able to meet that target of 100,000 subscribers. As far as cable is concerned, yes, our objective is to seed all the boxes in the current year but depending on how the momentum gathers on the ground, what the government reaction is or how well supportive they are of the entire initiative, we think that even if let's say the deadline is maintained as December 31st, there could be a spill over into next year by one quarter or so, because as you know Phase-III is a large territory and it takes time to kind of go and seed box home by home in such a large market

Vivekanand Subbaraman: And sir just to summarize, in H1 what would be the magnitude of the CAPEX that we have done and what are the gross and net debt figures for consolidated balance sheet?

Manish Dawar: Yes, so our first half CAPEX is about 134 crores out of which about 100 crores was spent on cable and the rest is on broadband.

Vivekanand Subbaraman: And sir the gross and net debt?

Manish Dawar: The net debt is 236 crores as of September end and gross debt figure is 1,127 crores

Vivekanand Subbaraman: And sir on this approval that you have taken from the FIPB with respect to increasing the FII limit beyond 49% to 74%, you have taken approval for this, so does this mean that you would be on the lookout for incremental capital or is it just an enabling resolution that you have raised? And what would be the validity of this approval?

Manish Dawar: So Vivek, in the past we received the approval to increase the FDI from 49% to 74%.What we are doing now is trying to modify that secondary approval to include primary as well. There are no immediate plans. It is more of enabling resolution that we are doing.

Vivekanand Subbaraman: And so it is not time window based approval, it is valid perpetually, is it?

Manish Dawar: Yes. Because as you know 49% is under automatic route and with the government approval you can go up to 74% and that is not time bound.

Moderator: Thank you. We have the next question from the line of Gautami Desai from Chanakya Capital Services. Please go ahead.

Gautami Desai: Manish, sorry I missed the gross and net debt figures, can you just come again on that?

Manish Dawar: The gross debt is 1,127 and the net is 236 crores.

Gautami Desai: But you used to have a lot of cash right, so that is how your net used to be always negative, I do not know.

Manish Dawar: Net negative means what?

Gautami Desai: Yes, this net is including the cash, you have considered the cash?

Manish Dawar: Yes, that is what, the gross debt in the books means short-term, long-term everything, then you have cash and cash equivalents and the net of the two is 236, so 236 is not the cash in the books, 236 is the net debt over cash and cash equivalents.

Gautami Desai: Yes, so net debt, you have net debt of 236 crores?

Manish Dawar: Correct. Because as you know, we continue to spend money on CAPEX on both cable and broadband and we are also funding losses on the broadband business, and other smaller businesses..

Gautami Desai: So net debt you have just become positive?

Manish Dawar: Last quarter Gautami it was 183 crores, this quarter it is 236 crores.

Moderator: Thank you. We have the next question from the line of Rohit Dokania from IDFC Securities. Please go ahead.

Rohit Dokania: Pradeep, if you can just address as to what you believe would be the competitive activity or intensity as far as Phase-III is concerned, I mean because Phase-I obviously started with a lot of competition by, amongst MSOs I am saying, so what do you think would Phase-III be any better or you think the number of MSOs itself on a city wide basis is far lower on an average vis-à-vis let's say Phase-I and II?

Pradeep Parameswaran: Rohit, I will avoid forward-looking statements but I will tell you what we are seeing as we do a lot of the work in Phase-III markets over the last few months. What is very obvious is that the level of competitive intensity is I would say a fraction of what we saw in Phase-I and Phase-II as it relates to seeding boxes because that is where you start to see the competition first. We see very-very little of multiple MSOs trying to seed boxes in the same market and some of that is natural, just given that there is not that many overlapping footprints of your analog base, so that is natural. But I also think if I had to guess, I would also assume that the experience of Phase-I and Phase-II has been such that the smaller marginal players have figured out that the business case is not likely to be very attractive and consequently we do not find some of the small independent MSOs doing too much activity in at least the markets that DEN operates in. And one other thing, I mean while we do not do a disclosure on it, directionally what we will tell you is that the level of subsidies around boxes is materially lower than what it used to be Phase-I and Phase-II and that is a real indication of the level of competitive intensity proceeding.

Rohit Dokania: Just one more point, if you can talk about would you feel that the Hits as a technology is a potential in terms of competition not only Phase-III and IV, but some channel checks are also saying that Phase-I and II LCOs are also considering moving to the Hits platform, so I just wanted your thoughts on that.

Pradeep Parameswaran: If you look at Hits globally, the reason you do Hits is because the density of a given market does not support building wired infrastructure, that is the basic logic of that and that logic will apply to I am sure to a fair degree of markets in India particularly in Phase-IV markets and may be some pockets of Phase-III, so I would imagine that there is some place for Hits in that structure. When it comes to the core Phase-I, Phase-II and Phase-III markets at least we do not imagine Hits to be a major player, having said that a good product with compelling economics may always take some share. But structurally Hits everywhere in the world is geared towards cabled carriers.

Moderator: Thank you. Would you like to provide any closing comments?

Pradeep Parameswaran: Thank you everyone for Joining.

Moderator: Thank you. Ladies and Gentlemen, that ends this conference for today. On behalf of DEN networks you may now disconnect your lines. Thank you.