DEN Networks Limited

October 25, 2018

Summary of Rated Instruments

Instrument	Rated Amount (Rs. crore)	Rating Action
Fund-based Term Loans	525.62	[ICRA]A %; placed on Watch with Positive Implications
Fund-based Working Capital Facilities	105.00	[ICRA]A %; placed on Watch with Positive Implications
Non-fund Based Working Capital Facilities	15.00	[ICRA]A1 %; placed on Watch with Positive Implications
Unallocated Limits	3.58	[ICRA]A1%/[ICRA]A%; placed on Watch with Positive Implications
Total	**649.20**	

Material Event

Reliance Industries Limited (RIL, rated [ICRA]AAA(Stable)/[ICRA]A1+), on October 17, 2018, announced plans to acquire a 66.5% stake in DEN Networks Limited (DEN). RIL, through its step-down subsidiaries (together referred to as the RIL Group), proposes to make a primary investment of Rs. 2,045 crore[1] in the company through a preferential issue besides a secondary purchase of Rs. 245 crore from existing promoters for the 66.5% stake. In addition, the RIL Group has made an open offer to the other shareholders of DEN to acquire 12.22-crore equity shares, representing 25.58% of the company's expanded voting share capital for a consideration of up to Rs. 887.8 crore. Following these transactions, assuming full acceptance of the open offer, the RIL Group would hold 92.1% voting rights and sole control of DEN. The investments are subject to shareholder and other regulatory approvals.

Impact of the Material Event

ICRA has placed the long-term rating of [ICRA]A (pronounced ICRA A) and the short-term rating of [ICRA]A1 (pronounced ICRA A one)[2] outstanding on DEN's Rs. 649.2-crore bank facilities on Rating Watch with Positive Implications.

The previous detailed rating rationale is available on the following link: Click here

Rationale

The rating action follows the strategic investments announced by the RIL Group in DEN. With a total investment outlay of ~Rs. 3,180 crore (including the open offer), RIL will get a controlling stake of up to 92.1% in the company. The significant fresh equity infusion would strengthen DEN's credit profile as its balance sheet could be partly (or entirely) deleveraged, with surplus available for deployment towards expansion in poorly penetrated or new geographies. Given the presence of a strong and resourceful promoter Group, ICRA expects DEN to enjoy synergistic benefits from a diversified geographical presence, large scale of operations[3] and a presence across the media value chain[4]. This would enable it to

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[1] *100 lakh= 1 crore= 10 million*

[2] *For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications*

[3] *In terms of subscriber base, DEN has a billed cable subscriber base of ~8.2 million and broadband homes passed of 0.93 million (as of June 2018). The RIL Group is also acquiring a controlling stake in Hathway Cable and Datacom Limited (seeded STBs of 7.2 million and broadband homes passed of 5.5 million as of June 2018) and GTPL Hathway Limited (seeded STBs of 8.9 million and broadband homes passed of 1.53 million as of June 2018). With Reliance Jio's 250+ million subscribers and given its plans to foray into wired broadband, the combined entity will benefit from a large subscriber base with a pan-India presence and ability to bundle services (cable, fast-speed*

navigate the competitive pressure from other multiple system operators (MSOs), direct-to-home (DTH) and telecom players through access to funds for rapid expansion, latest technology and improved bargaining power against content providers. Pending the completion of the proposed transaction as well as the availability of further clarity on the business plans, the ratings have been placed on Watch with Positive Implications.

The ratings continue to favourably factor in the improvement in DEN's operating and financial performance over the past few quarters, barring Q1 FY2019, which witnessed some moderation due to some delay in package rate hikes. The improvement was backed by healthy collection efficiency and better average revenue per user (ARPU) in the phase III and IV digital subscriber base. This supported an improvement in profitability till FY2018. Additionally, as a significant part of the investment phase, pertaining to the digitisation of the subscriber base has been completed, the debt levels have started to reduce. ICRA continues to take cognisance of the extensive experience of the promoter and the management team in the cable television distribution industry as well as DEN's status as one of the largest MSOs in India, in terms of an active cable subscriber base (~8.2 million as of June 2018). ICRA also notes the high growth potential of digital cable in the country, following the completion of the cable TV digitisation exercise in the next few quarters.

The ratings are, however, constrained by the subdued profitability and return indicators owing to the highly capital-intensive nature of the industry (requiring seeding of set-top boxes (STBs) and placing of a fibre cable network). The delayed monetisation of investments made in Phase III and IV, coupled with intense competition among MSOs and alternative technology platforms like DTH and internet-based over-the-top (OTT) services for acquiring a subscriber base at the cost of ARPUs, poses a challenge for DEN. This, along with large repayment obligations and incremental funding requirement for expanding the broadband business, has led to muted debt protection metrics so far. However, the proposed infusion of long-term funds by the RIL Group will provide significant upside to DEN by deleveraging its balance sheet, increasing its financial flexibility (for undertaking incremental capex and/or raising debt) and will also provide synergistic benefits of scale vis-à-vis its peers and content providers.

Outlook

ICRA has moved the ratings under Watch with Positive Implications as it expects DEN to derive significant benefits from the proposed transaction, which would make it a part of the financially-strong RIL Group. ICRA would continue to monitor the developments regarding the transaction and will take appropriate rating action after receiving inputs from DEN's management and assessing the overall impact on the company's credit profile.

Key rating drivers

Credit Strengths

Established market position in cable TV industry with sizeable subscriber base - DEN is among the largest MSOs in India with a total active subscriber base of 8.2 million across 250+ cities and 13 states.

Improvement in revenues and operating profits in FY2018 - In FY2018, DEN's consolidated operating revenues grew by 11% YoY to Rs. 1,285 crore, backed by a 15% growth in the cable segment. The OPBITDA increased by 53% to Rs. 282 crore in FY2018 (Previous Year: Rs. 184 crore), driven by the improved profitability of the core business (cable TV) and reduction in losses from the broadband segment. While cable subscription revenues continued on a growth trajectory with 10% growth in Q1 FY2019, the overall financial performance reflected some moderation due to a delay in package

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wired broadband and other services planned by Reliance Jio). A large subscriber base will provide leverage while negotiating the content cost.

[4] *RIL has an extensive media presence in television and broadcasting, internet, filmed entertainment, digital commerce, magazines and allied businesses through Network18 Media and Investments Limited (rated [ICRA]AAA(Stable)/[ICRA]A1+), TV18 Broadcast Limited (a 51.16% subsidiary of Network18 rated [ICRA]AAA(Stable)A1+) and Viacom18 Media Private Limited (rated [ICRA]AAA(Stable)/ [ICRA]A1+)*

rate hikes, on account of one-off instances with certain content providers, and the resultant impact on collection efficiency and ARPUs. The rates and ARPUs are, however, expected to revive over the rest of FY2019.

Completion of digitisation-linked investment cycle allows for reduction in debt levels - With the digitisation cycle coming to an end, incremental capex requirements would be smaller and limited to broadband business expansion/penetration over the medium term. At the same time, improvement in cable subscription revenues and repayment of debt will lead to an improved debt profile. DEN's net debt position has already been improving on a QoQ basis since Q3 FY2017. Its net debt, as on June 30, 2018, was Rs. 190 crore[5] compared to Rs. 335 crore as on September 30, 2016.

Diversification into broadband segment offers healthy business synergies – The company's presence in the broadband segment provides it with the opportunity to offer bundled solutions (cable and broadband) to consumers. Increasing data usage by subscribers and penetration of OTT services augur well for the segment and will drive the revenue in the coming years.

Credit Challenges

Subdued profitability metrics and return indicators, albeit in line with industry peers - The company continues to incur losses at the net level (net margin of -1.3% and -8.9% as on March 31, 2018 and June 30, 2018, respectively; ROCE of 4.3% as on March 31, 2018) due to high content costs (vis-à-vis billable subscriber addition) and interest outgo on account of significant debt-funded capex undertaken for seeding STBs (for increasing market share) and expanding the broadband business. At the same time, the monetisation of investments has remained slow due to several regulatory and competitive reasons, adversely impacting the financial profile of the industry players. Nonetheless, with the phase IV digitisation nearing completion, the cable segment capex cycle is almost at an end and industry-wide traction was witnessed in ARPUs over the past six to eight quarters. DEN reported positive cash accruals for the second consecutive year in FY2018, which also provides comfort.

Muted debt coverage metrics with significant debt repayments over next two years - The company has cumulative debt repayments of nearly Rs. 250 crore over the next two years (FY2019-FY2020). Though its debt-service-coverage ratio (DSCR), as on March 31, 2018, was 1.1 times, witnessing a significant improvement over the FY2017 level backed by improvement in operating profitability, the same remained subdued. Nonetheless, improving cash accruals and earmarked deposits, in the form of margins and debt service reserve account (DSRA balances of approximately Rs. 112.5 crore as on March 31, 2018) against part repayment obligations, provide comfort.

Intense competition in fragmented cable distribution and broadband industry though association with RIL Group to bring synergistic benefits - In addition to the presence of large MSOs and alternative distribution technologies like DTH, the cable distribution industry faces competition from internet-based alternative media platforms like OTT services. Given the technological advantage, DTH players and the state-owned DD Free Dish are likely to offer stiff competition in the Phase III and IV markets, which may limit DEN's ability to monetise these areas which account for more than 50% of its subscriber base. In addition, DEN's presence in the fixed-line broadband segment remains concentrated in Delhi-NCR (although plans to expand to 100 cities were announced) and it faces intense competition from telecom players. However, the proposed association with the RIL Group, which is also acquiring a controlling stake in Hathway Cable and Datacom Limited (a peer MSO), will bring about synergistic benefits of scale (while negotiating content deals), access to the latest technology and funding prowess for expansion.

[5] Net debt is arrived at by reducing the available cash and cash equivalents, including encumbered cash held as margin money or security against borrowings, from the gross debt

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About ICRA Limited:

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Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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