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Digital mandate to bring substantial benefits for industry and consumer

(MUMBAI, December 6, 2011) The government mandate to digitize cable networks across India will bring a significant transformation to the US$7 billion TV industry with a positive impact on the nascent broadband market, says a report published today by Media Partners Asia (MPA).

Vivek Couto, executive director of Media Partners Asia, said: "India's broadcasting and pay-TV market is on the cusp of a high growth *value* phase similar to North America between 1998 and 2003, Korea during 2003-7, and Taiwan during 2005- 10. Valuations of the domestic companies in these markets during the high-growth value stage typically skyrocketed, as networks were upgraded and services to consumers expanded. In India, domestic players and foreign investors will both do well, to the benefit of consumers, when the government's policies take shape"

The report, entitled *Investing in Digital India: The Dynamics of Mandatory Addressable Digitization*, underlines benefits across the value chain:

- **A boost for the government and the economy.** If the current analog cable distribution model remains in place and digital penetration is limited, the cumulative value of the tax receipts lost by the government would reach US$11 billion over the next decade or >US$1 bil. per year. The government therefore has sufficient incentives to push digitization and can also accelerate the process by offering tax incentives to a potential multi-billion-dollar industry. Digitization will also help the government pursue India's broadband goals and thereby help to boost economic growth. Potentially, a 10% increase in broadband penetration would increase India's GDP by ~1.5%. As of September 2011, broadband per capita penetration in India was only 1%. In its National Broadband Plan, the Telecom Regulatory Authority of India sees a pivotal role for cable operators with digital network upgrades paving the way for broadband growth.

- **Consumer choice.** Digital cable TV will improve the consumer experience and resolve legacy issues from analog cable services. Consumers will gain access to (1) More TV channels; 2) Attractive tiering options with differentiated content across local, regional and niche genres; (3) A better viewing experience; and (4) Improved quality of service. Digital cable TV will also be affordable for the consumer. As per international benchmarks, spending on pay-TV typically accounts for ~5% of GDP per capita. In this context, digital cable TV in India will be affordable given heavy subsidies on STBs (currently subsidized at ~60-70% by MSOs), which will ensure that consumer spends fall within the 5% benchmark. Consumers will also benefit from new competition as digitization in metros ensures that seven DTH satellite platforms (including free service DD Direct) compete for customers with digital cable operators.

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- **A cable transformation.** MPA expects a 6x increase in subscriber revenues for cable MSOs though not without at least a 20% churn in the cable subs base to DTH. Subscriber declaration levels will increase from 15% currently to 100%, while the retained ARPU will increase by 6x, after assuming a 30% base case revenue share with the local cable operator (LCO). Additional drivers and differentiators will come from bundled broadband and high-definition (HD) services. Broadband will reduce the payback period on digitization; under a bundled model, the payback period could be reduced by a year to 24 months, as opposed to 36 months under a standalone digital proposition. The main challenges, apart from managing subscriber churn to DTH, are: (1) Carriage and placement (C&P) fees will drop by about 20–50%; and (2) Incentivizing revenue-sharing agreements have to be struck with LCOs in order to drive digital into the home.

- **DTH opportunity.** Phase I digitization in the four key metros offers a good opportunity for DTH operators to grab high-ARPU customers and increase the platform's reach in larger TAM markets. MSOs envisage about 15–20% churn in cable subs to DTH though some suspect this could grow to 30% in the early stages of Phase I deployment. Subsidized HD offerings will also act as a key differentiator for DTH players as few cable operators have rolled out HD services.

- **Broadcasters.** Digitization will help boost subscription revenues and reduce dependence on advertising. Improved economics will also help broadcasters launch niche channels with a premium focus while C&P fees will fall in certain markets and moderate in others. At the same time, consumer adoption of certain programming tiers and specific channels (over others) will ensure healthy competition while broadcasters will also be under pressure to produce content with differentiation, premium quality (potentially advertising-free) and with local relevance.

- **Investors.** Upon successful implementation of the digital mandate, gradual consolidation of LCOs will become inevitable. This will shift industry profits and value to centralized distribution platforms and broadcasters. Valuations for cable / pay-TV operators in the USA, Korea and Taiwan during their high-growth value stage typically averaged 12–16x one year forward EBITDA, versus the current trading average of 9-10x for India's listed cable/pay-TV entities. MPA assumes similar or higher valuations for companies in India subject to successful execution. Most investors, especially strategic companies, will likely take a wait-and-see approach, potentially making their bets after Phase I is completed.

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