

YOU Broadband & Cable India Limited

CRISIL IPO Grade 2/5 (Below average)

September 01, 2010

Grading summary

CRISIL has assigned a CRISIL IPO grade of '2/5' (pronounced "two on five") to the proposed IPO of YOU Broadband & Cable India Limited (YOU Broadband). This grade indicates that the fundamentals of the IPO are **below 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 grade is not a recommendation to buy, sell or hold the graded instrument, its future market price or suitability for a particular investor.

The assigned grade reflects the company's presence in growing sectors – broadband and cable television distribution (YOU Broadband is present in the cable television distribution business through its associate company – Digital Outsourcing Private Ltd). The company has been able to sustain its market share of internet subscribers in the past four years. The company has also grown in the cable television business through the acquisition of various multi-service operators (MSOs). The company stands to benefit from the synergies of bundling broadband and television to its subscribers, resulting in higher revenues and economies of scale.

However, the assigned grade is tempered by the high degree of competition in the broadband industry which has led to a fall in average revenue per subscriber (ARPU), resulting in low margins for players. YOU Broadband has a relatively weaker competitive positioning in the broadband industry which is dominated by the telecom behemoths. The future growth of YOU Broadband, to a large extent, depends on the company's ability to successfully acquire local cable operators (LCOs), thereby increasing primary subscribers, and enabling cross-selling of internet offering. However, the strategy to acquire and integrate LCOs faces execution challenges. The grading is also constrained by the high degree of competition in cable television from direct-to-home (DTH) operators, many of whom have strong parentage and financial muscle. The company is also highly dependent on the IPO proceeds to fund its growth plans and any delay in fund raising would adversely affect these plans.

In FY09, YOU Broadband reported a net loss of Rs 151 mn on a top line of Rs 739 mn, translating into a net margin of -20.3%. It posted an EPS of Rs -0.7, while its book value per share was Rs 10.1. For the half-year ended September 2009, the company posted a net loss of Rs 91 mn on a top line of Rs 356 mn.

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About the company

YOU Broadband & Cable India Limited was originally incorporated as NetShastr Facilities India Private Limited in November 2000. The company was originally promoted by BG India Telecom (Mauritius) Limited (BGITML), which in turn was controlled by British Gas Asia Pacific Holdings Pte Limited. In June 2006, the entire shareholding of British Gas Asia Pacific Holding in the issued share capital of BGITML was transferred to Citigroup Venture Capital International Growth Partnership Mauritius Limited (CVCI). In FY08, YOU Broadband acquired a strategic stake in Digital Outsourcing Private Limited (DOPL), its associate company which is in the business of cable television distribution. As on March 31, 2010, YOU Broadband held a 36.24% stake in DOPL.

YOU Broadband holds a pan-India category "A" ISP licence for the broadband internet services, as well as an infrastructure provider category – I (IP-I) licence, which permits it to lease the passive networking infrastructure to other service providers. As on March 31, 2010, YOU Broadband had operations in 11 cities across India. YOU Broadband's associate company DOPL was incorporated in February 2007 and has since grown substantially in size primarily through acquisition of MSOs and LCOs in various cities across India. As on March 31, 2010, DOPL had cable television operations in 10 cities across India.

Issue details

Shares offered to public	Not available at the time of grading
As per cent of post issue equity	Not available at the time of grading
Object of the issue	<ul style="list-style-type: none"> • Incur capital expenditure with respect to broadband business • Acquisition of additional shares in DOPL • Further investment in DOPL for incurring capital expenditure with respect to cable television business • Meet working capital requirements • Pre-payment of an outstanding loan • Finance general corporate expenses
Amount proposed to be raised	Rs 3,600 Mn
Price band	Not available at the time of grading
Lead manager	Edelweiss Capital Limited

Source: DRHP

Detailed Grading Rationale

A. Business Prospects

- ***Good growth prospects in the broadband industry***

According to CRISIL Research, only about 4.5% of total households in India had internet access in March 2010. The number of households with internet access is expected to double from about 10 mn in March 2010 to around 19 mn by March 2013, registering a three-year CAGR of about 22%. Despite a healthy growth in internet households, internet penetration in households is expected to be a meager 8% in March 2013, indicating a potential for significant growth in the long term. Uptake of internet services would be supported by proliferation of computers and higher availability of online content. YOU Broadband is expected to benefit from the robust growth in the broadband industry.

- ***Cable television distribution industry in consolidation phase***

The cable television distribution industry is in a consolidation phase with larger MSOs acquiring smaller ones. MSOs are also increasingly digitizing so as to combat competition from DTH players and reduce under-reporting of subscribers by LCOs. The focus is to finally buy-out the LCOs operating in the MSO's network to eliminate under-reporting. Thus, although higher growth rate is expected in satellite television (DTH), there is tremendous scope for large MSOs such as DOPL for inclusive growth through consolidation.

- ***Increased digitisation to lead to increase in ARPU from cable television subscribers***

Post IPO, the company plans to aggressively digitize its television subscriber base. Digitising enables the company to offer value added services and augment ARPU. DOPL has initiated sale of content on digital set top boxes (STB) to customers. Groups of channels are clubbed together and sold directly to some of the digitised customers who are availing such service. The revenue for providing such service is directly received by the company on a prepaid basis, thus eliminating under declaration for such sales. Going forward the company plans to increase the content available through such packaging which is expected to expand its APRU leading to higher revenues.

- ***Synergy between cable television distribution and broadband business to drive growth***

As on March 31, 2010, the company had broadband operations in 11 cities and cable television operations in 10 cities. The company offers both broadband and cable television services in four out of the 11 cities. The number of cities in which the company provides both broadband and cable television services is expected to increase further as the company expands its broadband operations. The strategy going forward is to acquire LCOs in the company's cable television network which will give access to the customer's household. Besides increasing cable television revenues, acquisition of primary subscribers in the cable television business will present an avenue to the company for cross-selling its broadband service. This is expected to increase the value proposition to subscribers leading to increase in revenues. Using the same cable network to provide both television and broadband service is also expected to reduce the company's operating costs over the medium term leading to higher profitability.

- ***YOU Broadband is a small-sized player in the highly competitive broadband industry***

The broadband services industry is dominated by government-owned companies BSNL and MTNL who own a lion's share of about 65-70% as of March 2010. We believe that this can be attributed to the fact that these players largely own the last mile. Also, integrated private telecom players are increasingly focusing on the broadband market due to significant pressure on their voice ARPU. With about 16 mn internet subscribers as

of March 2010, YOU Broadband holds a sheer 1.5% market share. The company has successfully sustained its market share in the face of stiff competition from larger peers but the intensifying competition in the broadband industry has led to downward pressure on YOU Broadband's ARPU. Moreover, with mass rollout of 3G and Wimax services in 2010-11, we expect the broadband services industry to become hypercompetitive just like the stage in which the mobile services industry currently stands. While the company proposes to offer a dual play (broadband and cable TV) to its customers to counter the competition, it remains vulnerable to ARPU erosion and losing customers to telecom companies who can bundle mobile, land line, broadband and DTH.

- ***Strategy to acquire and integrate LCOs faces execution challenges***

Future growth in revenues and profits, to a large extent, would depend on the management's capability to acquire MSOs/LCOs, where it can face execution challenges. LCOs are typically local businessmen who have a strong adage in their geographies, which could lead to delay in acquiring them. Also, there could be possibilities of acquiring LCOs at higher valuations, as the long-term success of the business depends on increasing primary subscribers. The company has been able to successfully acquire MSO's in the past to augment its television subscriber base. However, the company currently has only 8,000 primary subscribers and does not have a significant operating history in acquiring LCOs.

- ***Company faces risk of losing its subscribers to DTH players if digitization is slow***

The cable television industry faces stiff competition from DTH service providers who are expected to get the lion's share of the incremental penetration of cable and satellite (C&S) in the country. As discussed earlier, the company has good growth prospects in its cable television business through consolidation and digitization. From the IPO proceeds, the company plans to purchase about 0.4 mn set-up boxes (STBs), which is adequate to digitize about 30% of their homes reached. The company is dependent on the LCO for digitization, as the last mile is owned by the LCO. Thus, if the company is not able to digitize demanding subscribers in time, it may lose them to DTH providers.

- ***Timely availability of funds is critical for growth***

YOU Broadband's business of broadband internet access started generating cash profits in FY09 and H1FY10 and can now sustain its operations. However, the company's plan of expanding broadband services to newer cities would require huge amount of capital expenditure. The company's strategy of digitizing and acquiring primary subscribers is also expected to require huge amount of cash.

YOU Broadband has very little debt in its balance sheet and is therefore very lowly levered. This has the effect of very low interest and principal repayment burden at its growth stage. However, to fuel its growth plans, the company is critically dependent on the IPO proceeds. Any delay in fund raising can adversely affect the company's plans.

- ***Regulatory changes could affect the industry***

The cable television 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.

B. Financial Performance

YOU Broadband & Cable India Limited

YOU Broadband's revenues grew at a two-year CAGR of 29% to Rs 739 mn in FY09 driven by increasing number of subscribers and increase in revenues from the enterprise segment. Operating margin improved from -18.7% in FY08 to 13.4% in FY09 and 11.0% in H1FY10 due to revenue growth and decreases in advertisement and sales promotion expenses, and other expenditure. EBITDA for FY09 turned positive and stood at Rs 99 mn compared to EBITDA loss of Rs 128 mn in FY08 and Rs 84 mn in FY07.

Net profit margin for FY09 also improved over FY08 but continued to be in the red at -20.3% primarily because of high depreciation cost. In FY09, return on net worth was -6.8%, a stark improvement from -15.6% in FY08 and -19.5% in FY07. Debt equity level was very low at 0.05 times in FY09.

Financial performance snapshot

		FY07 Actual	FY08 Actual	FY09 Actual	Sep-09 Actual
Sales	Rs mn	444	681	739	356
Operating margin	%	(18.8)	(18.7)	13.4	11.0
Net profit	Rs mn	(266)	(372)	(151)	(91)
Net margin	%	(59.7)	(54.5)	(20.3)	(25.4)
ROCE	%	(19.5)	(15.6)	(6.8)	(3.9)
RONW	%	(18.8)	(16.4)	(6.3)	(4.0)
Basic EPS	Rs	(3.2)	(1.0)	(0.7)	(0.4)
Net worth	Rs	2,108	2,430	2,328	2,247
No. of eq. shares	mn	83	389	231	231
Book value per share	Rs	25.5	6.2	10.1	9.7
Dividend per share	Rs	-	-	-	-
Debt/equity	Times	0.11	0.06	0.05	0.15

*Note: Numbers have been reclassified as per CRISIL standards and may differ from DRHP

Source: DRHP

Digital Outsourcing Private Limited (DOPL)

DOPL commenced operations in FY08 and has grown in size through acquisitions of MSOs and LCOs. DOPL clocked revenues of Rs 336 mn in FY09 and Rs 296 mn in H1FY10. Operating margins were at -111.9% in FY09 and -40.6% in H1FY10. The company posted a net loss of Rs 420 mn in FY09 and Rs 178 mn in H1FY10.

Financial performance snapshot

		FY09 Actual	Sep-09 Actual
Sales	Rs mn	336	296
Operating margin	%	(111.9)	(40.6)
Net profit	Rs mn	(420)	(178)
Net margin	%	(124.8)	(60.2)
ROCE	%	(62.9)	(27.5)
RONW	%	(91.2)	(114.2)
Basic EPS	Rs	(128.7)	(54.6)
Net worth	Rs	229	83
No. of eq. shares	Mn	3	3
Book value per share	Rs	70	26
Dividend per share	Rs	-	-
Debt/equity	Times	1.92	5.64

*Note: Numbers have been reclassified as per CRISIL standards and may differ from DRHP

Source: DRHP

C. Management Capabilities and Corporate Governance

YOU Broadband's board comprises five directors of whom one is an executive director, two are non-executive directors and two are independent directors. Both non-executive directors are nominee directors on the board nominated by YOU Broadband's parent company – Citigroup Venture Capital International Growth Partnership Mauritius Limited (CVCI).

The company has an experienced and professional management in place. The Managing Director and CEO of the company, Mr Eyyuni Venkat Srinivas Chakravarthy, has been with company since its inception in 2001 and has been able to successfully expand the company's broadband operations in 11 cities as on March 31, 2010. Prior to joining YOU Broadband, Mr Chakravarthy was with Hathway Cable as head of southern zone, cable business. The management has been able to sustain its market share in the internet industry while combating stiff competition from larger peers. Foray into cable television distribution and offering dual play to subscribers is also a step in the right direction. The top management is ably supported by a second line, which has good experience in the cable broadband and television industry.

YOU Broadband's board comprises two independent directors. Mr. Girish Kasthuri Rangan joined as an independent director in May 2007; he chairs the board. Mr. Sean George Cronin Sutcliffe joined as independent director in March 2010. Based on our discussion with independent directors, we believe that they have a fair understanding of the overall business of the company and are well-equipped to provide guidance and exercise oversight over the management.

Annexure I Business Profile

YOU Broadband along with its associate company DOPL is in the business of cable broadband and television distribution service.

YOU Broadband provides broadband service in 11 cities across India through a network of over 990 kms of fibre optic cable and over 4,100 kms of trunk coaxial cable network. As on March 31, 2010, the company's residential broadband internet service subscriber base aggregated approximately 209,520 customers. Based on the company's estimates, YOU Broadband has a network area coverage of approximately 1.5 mn homes and its residential broadband internet service subscriber base represented an estimated penetration of 13.4% of two-way broadband-enabled homes as on September 30, 2009.

DOPL offers cable television distribution services in 10 cities including Mumbai, Navi Mumbai, Bangalore, Vizag and Nagpur. As on February 28, 2010, DOPL offered its services to an estimated 1.5 mn homes through cable operators and approximately 8,000 direct residential subscribers. About 100,000 customers of DOPL are provided with digital cable television services.

Of the total cities covered as on March 31, 2010, the company provided both services – broadband and cable television distribution - in four cities namely Mumbai, Navi Mumbai, Bangalore and Vizag.

Sr No.	City	Broadband	Broadband & Cable TV
1	Mumbai	✓	✓
2	Navi Mumbai	✓	✓
3	Bangalore	✓	✓
4	Vizag	✓	✓
5	Surat	✓	
6	Vadodara	✓	
7	Ahmedabad	✓	
8	Gurgaon	✓	
9	Pune	✓	
10	Hyderabad	✓	
11	Chennai	✓	

Source: DRHP

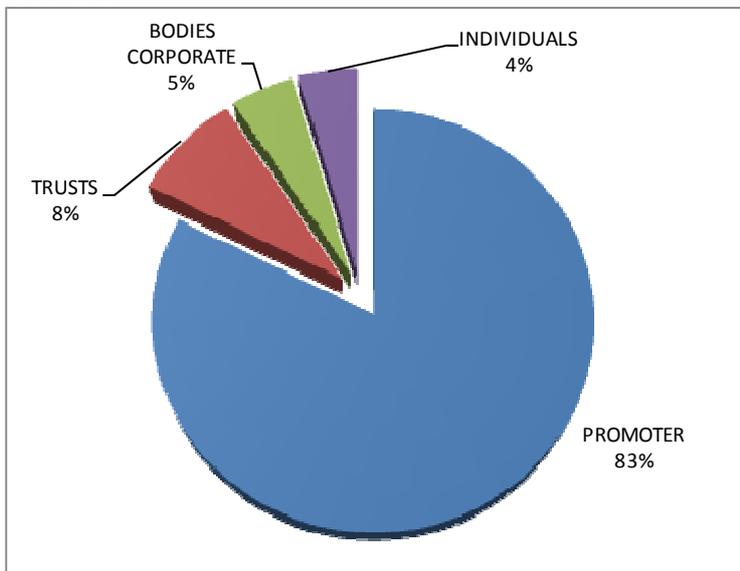
Management and Board Profile

Mr Eyyuni Venkat Srinivas Chakravarthy, the Managing Director and CEO of YOU Broadband, is fairly experienced in the cable broadband and television industry. Under his leadership, the company has successfully expanded its broadband business in 11 cities across India. YOU Broadband also has a strong and experienced second line of management in place. Majority of them have good experience in broadband operations.

YOU Broadband's board comprises five directors, which includes one executive director, two non-executive directors and two independent directors. Mr. Girish Kasthuri Rangan joined as an independent director in May 2007. Mr. Sean George Cronin Sutcliffe joined as independent director in March 2010. Based on interactions with the independent directors, we believe that they have a fair understanding of the overall business of the company and are well-equipped to provide guidance and exercise oversight over the management.

Shareholding Pattern

Pre-IPO



Source: DRHP

Annexure II: Profile of the Directors

Name of Directors	Designation	Age	Qualification	Previous Employment	Directorships / partnership in other entities
Mr. Girish Kasthuri Rangan	Chairman, Independent Non Executive Director	53	M.Sc, M.B.A.	<ul style="list-style-type: none"> Procter & Gamble CEO/ MD, Warner Lambert CEO/ MD, Wockhardt CEO/ MD, BPL Mobile CEO/ MD, Venture Infotech Global Associate Director, Leo Burnett Associate Director/ GM, Lintas India Country Manager- India branch, U21 Global 	NIL
Mr. Eyyuni Venkat Srinivas Chakravarthy	Managing Director and Chief Executive Officer, Executive Non-Independent Director	48	B.Com, C.A., C.S.	<ul style="list-style-type: none"> Mafatlal Industries Limited Head-Southern Zone: Hathway Cable 	YOU Hits Conditional Access Services Private Limited
Mr. Michael David Kazma	Non Independent Non Executive Director	45	B.A., Bradley University	<ul style="list-style-type: none"> Manager: HFC Networks, Central America 	NIL
Mr. Vinayak Shenvi	Non Independent Non Executive Director	40	B.Com, C.A	<ul style="list-style-type: none"> Citicorp Securities and Investments Limited 	<ul style="list-style-type: none"> Orbitech Limited Unimark Remedies Limited Anand Rathi Financial Services Limited JBF Global Pte Limited JBF RAK LLC
Mr. Sean George Cronin Sutcliffe	Independent Non Executive Director	46	Chartered Mechanical Engineer, Cambridge University	<ul style="list-style-type: none"> Chief Executive: Biofuels Corporation Chairman: Tidal Generation Limited Executive Vice President: BG Group plc 	NIL

Source: DRHP

Disclaimer

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