TeleNav

TNAV : NASDAQ : US$8.44

BUY

Target: US$14.00

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COMPANY STATISTICS:

52-week Range:	7.80 - 11.48
Avg. Daily Vol. (000s):	164
Market Cap (M):	US$321
Shares Out basic (M):	38
LT Debt (M):	0.0
Net Cash /shr:	1.21
Bk Value/Sh:	US$2.72
FYE:	June
Website:	http://www.telenav.com/

EARNINGS SUMMARY:

FYE Jun		2009A	2010E	2011E
Revenue (M):		110.9	168.7	215.5
EBITDA (M):		44.7	73.0	76.8
Net income (M):		29.6	41.0	40.3
EPS:		0.57	1.05	0.87
EPS:	Q1	-	0.21A	0.22
	Q2	-	0.27A	0.21
	Q3	-	0.33A	0.22
	Q4	-	0.24	0.22
Total		0.57	1.05	0.87

SHARE PRICE PERFORMANCE:

COMPANY SUMMARY:
Incorporated in 1999 and headquartered in Sunnyvale, CA, TeleNav is a location-based services (LBS) and Mobile Internet company. Its core product is voice-guided navigation on mobile phones, but the company also develops solutions that support a broad range of location-enhanced applications, such as mobile advertising, commerce and social networking. TeleNav provides its solutions through a network of wireless carriers and under its own brand.

All amounts in US$ unless otherwise noted.

Technology -- Industrial -- Location Technology

A LEADING MOBILE INTERNET COMPANY, POWERING MOBILE NAVIGATION AND RELATED SERVICES; INITIATING COVERAGE WITH BUY, $14 TARGET

Investment recommendation

We are initiating coverage of TeleNav with a $14 target price and BUY recommendation. We feel that the current share price creates an attractive entry point/opportunity for investors, as we believe that many additional upside opportunities are not included in management's financial projections.

Investment highlights

- Leader in large under-penetrated market for mobile navigation
- Closely aligned with wireless carriers
- Revenue model provides excellent visibility into the company's future financial health
- Ad model holds promise; telematics offerings are a bonus
- Solid balance sheet, highlighted by no debt and low working capital requirements

Valuation

Our $14 target price is based on 7x our 2011 EV/EBITDA estimate. We believe this represents a very conservative view of what the shares are worth. From a relative valuation standpoint, we think the stock can trade into the high teens with strong execution in the coming quarters.

INVESTMENT THESIS

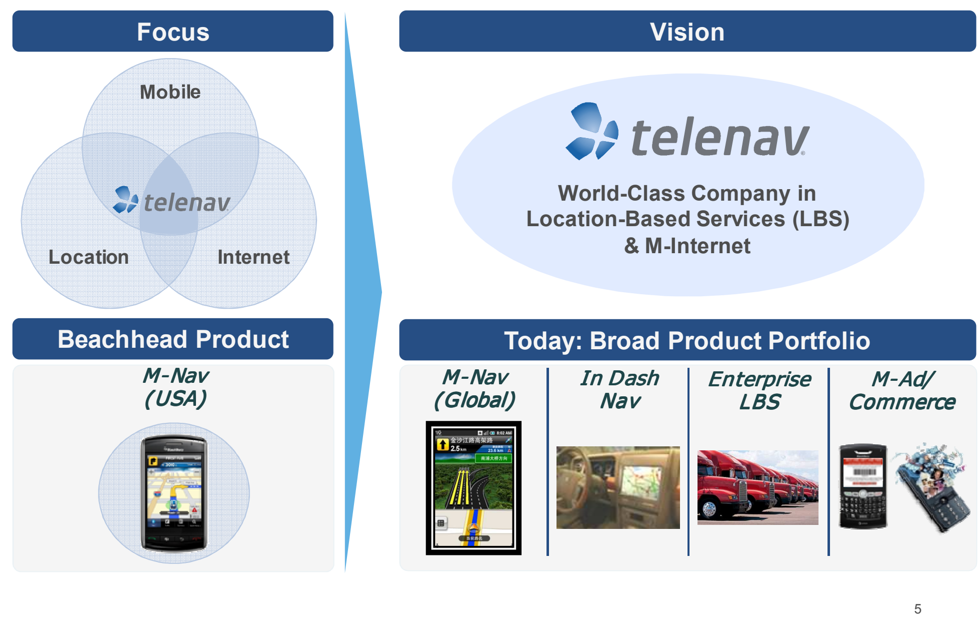
TeleNav is the largest Mobile Internet company providing navigation-related services into the rapidly growing wireless applications marketplace. It is the largest provider of primarily wireless carrier “branded” turn-by-turn navigation services in the world, with 14.5M+ paying subscribers via 15 separate wireless carrier partners in 29 different countries. Despite its rapid growth, TeleNav’s US penetration rate within its wireless subscriber base is still less than 7%, with most international markets remaining essentially virgin territories. As companies such as Google, Nokia, Microsoft and others begin to enter/offer “free” turn-by-turn services, overall consumer awareness will grow, along with TeleNav’s carrier partners’ interests in maintaining a strong menu of competitive offerings. TeleNav’s business model is closely aligned with its carrier partners’ desire to stay relevant in the expanding marketplace for wireless applications. Beyond continued strong subscriber growth within an under-penetrated marketplace, TeleNav also has strong offerings in both fleet telematics and in-vehicle automotive navigation.

TeleNav’s recurring subscription-based and ARPU (average revenue per user)-driven revenue model provides excellent visibility into the company’s future financial health, while a solid balance sheet, highlighted by no debt and low working capital requirements, allows the company to generate substantial cash flow with very strong financial flexibility to extend its leadership opportunities via acquisitions . We are initiating coverage of TeleNav (TNAV : NASDAQ) with a $14 target price and BUY recommendation. Our target price is based on 7x our 2011 EV/EBITDA estimate of $77M, well supported by both comparable and DCF analysis.

COMPANY OVERVIEW

Incorporated in 1999 and headquartered in Sunnyvale, California, TeleNav is a location-based services (LBS) and Mobile Internet company. Its core product is voice-guided turn-by-turn navigation on mobile phones, but the company also develops solutions that support a broad range of location-enhanced applications, such as mobile advertising, commerce and social networking. The company’s LBS solutions, delivered through a hosted service business model, provide consumers and enterprises with convenient and easy-to-use location-specific, real-time and personalized features and functions. TeleNav provides its solutions through a network of wireless carriers in the US, as well as through certain carriers in other countries. Most carrier partners choose to preload TeleNav’s solutions on their new phones. Sprint and AT&T are its largest customers and represented 61% and 29% of consolidated revenue in fiscal 2009, respectively. Although the company does offer its solutions under the TeleNav brand, it is more commonly delivered as a white label solution through its 15 wireless network carrier partners in 29 countries. Wireless carrier partners offer TeleNav’s services on either a standalone basis (AT&T Navigator) or bundled with other voice and data services (Sprint “Simply Everything” plan). As of March 31, 2010, TeleNav had 14.5M paid subscribers across more than 500 types of mobile phones, all major mobile phone operating systems and a broad range of wireless network protocols. This subscriber base represents less than 7% of its US wireless carrier partners’ total subscribers today. Other major partners include Ford (SYNC platform), HP, LG, Motorola, NAVTEQ, Nokia, Palm, Qualcomm, RIM, Samsung and TeleAtlas. The company employees roughly 800 engineers (50 in China), has eight US patents and 10 foreign patents (with 51 US patent applications pending) and contributes roughly 50% of sales to operating costs and R&D.

Figure 1: Company focus and vision



Source: Company reports

COMPANY SEGMENTS

The large majority of TeleNav's revenue comes from its voice-guided, real-time, turn-by-turn mobile navigation service. The service offers real-time traffic alerts, route planning and updated points of interest (POI) among other features. The company offers its solutions to a lesser extent under the TeleNav brand through its two-way, Internet connected PND call TeleNav Shotgun. However, its offering is more commonly delivered as a while label solution through its wireless network carrier partners, with the most recognizable applications being AT&T Navigator and Sprint Navigation.

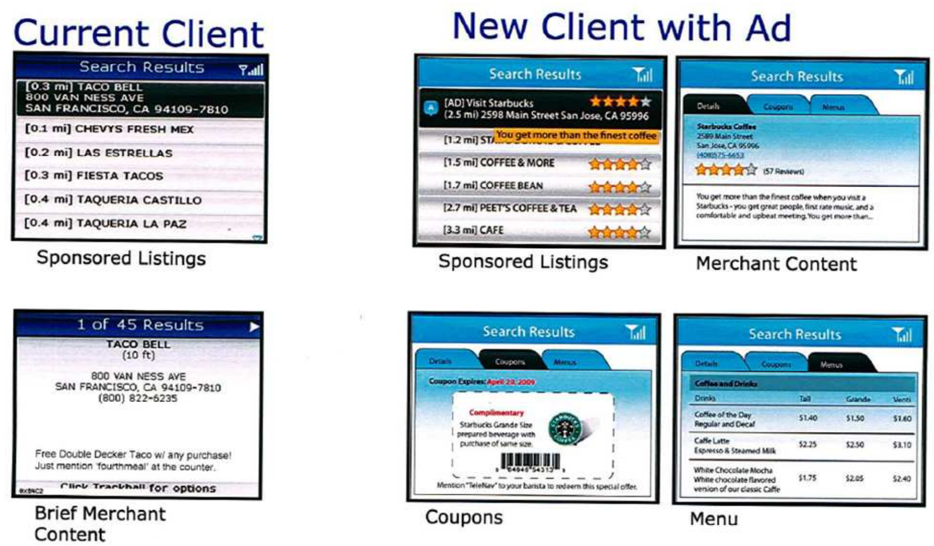
In addition to its core product, TeleNav offers Mobile Resource Management (MRM) solutions for enterprises, in-dash navigation solutions for automotive users and solutions that support a broad range of location-enhanced applications, such as mobile advertising, commerce and social networking. These offerings contribute relatively little to the top line today, but are expected to increasingly gain traction in coming years.

MRM. Management expects this segment to contribute 5% of revenue by 2012. Frost and Sullivan estimated that the US MRM market would grow from $86M in 2008 to $744M in 2013, representing a CAGR of 54%.

In-dash navigation. Management expects this segment to contribute 10% of revenue by 2012. IDC estimated that the worldwide OEM in-dash navigation market would grow from 7.7M units in 2008 to 12.2M units in 2012, representing a CAGR of 12%.

Mobile advertising, commerce, social networking. Management expects these solutions to contribute 5% of revenue by 2012. eMarketer estimated that US mobile advertising would grow from $320M in 2008 to $1.6B in 2013, representing a CAGR of 37%. We believe that this segment has the potential to generate substantial revenue in the long term and contribute to continued growth. TeleNav recently deployed a limited release of it mobile location-based advertising services to a limited number of users which delivers personalized, location-based and time-sensitive mobile advertising and includes features such as sponsored listings, content, coupons and dining menus.

Figure 2: Mobile advertising offering



Source: Company reports

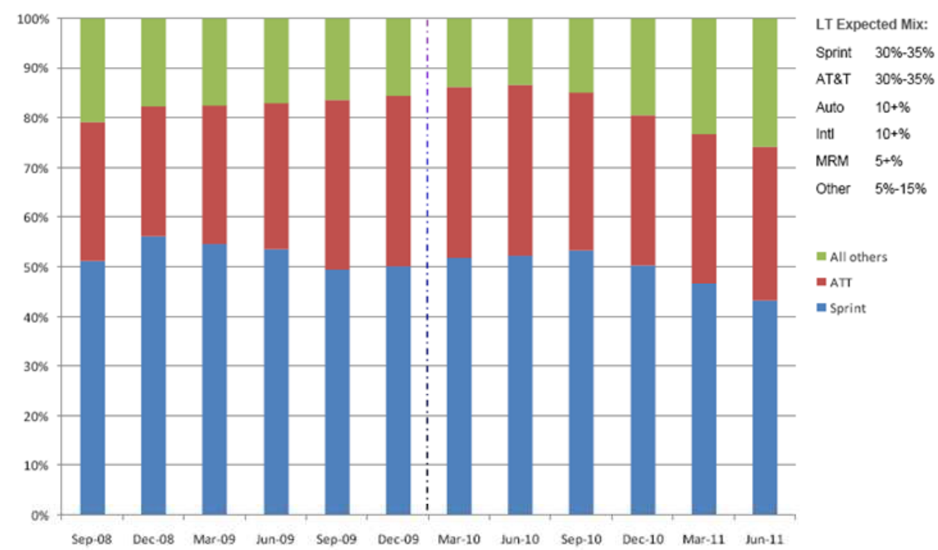
In March 2010, TeleNav released usage data that show consumers use GPS navigation devices for more than just directions. The data show that users also rely on these devices for finding nearby businesses and searching for local hotspots. The most searched for businesses by TeleNav users were Wal-Mart, Starbucks, Target, Best Buy and Bank of America. Pizza, Chinese food, burgers, American food and Mexican food topped the list of food searches. Also, the data revealed that more searches occurred in Los Angeles than in any other city and that more residents of Phoenix searched for gas prices than in any other city.

Specific to social networking, TeleNav released a beta version of Whereboutz in 2008 that allows end users to share their location and status with friends on-line or via mobile phones. In the fourth calendar quarter of 2009, TeleNav launched a social networking application that connects end users based upon their locations and interests.

CUSTOMERS AND PENETRATION RATES

Though TeleNav currently has 15 wireless network carrier partners in 29 countries, revenue from Sprint and AT&T make up the large majority of the company's revenues today. In fiscal 2009, Sprint and AT&T represented 61% and 29% of consolidated revenue, respectively. As a result, there remain plenty of opportunities to grow the business through not only expansion of existing carrier relationships, but also through the addition of new carriers.

Figure 3: Revenue mix by main carriers and products (as % of quarter)

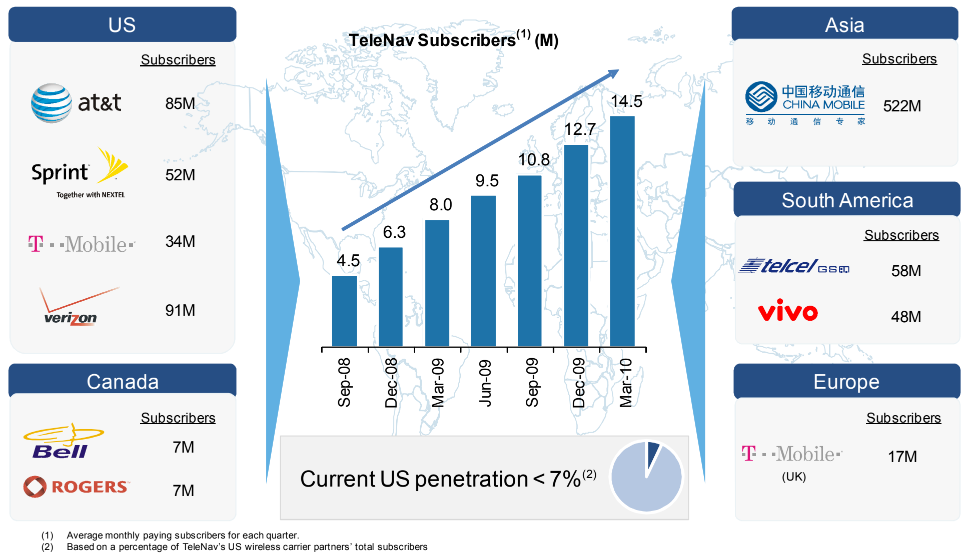


Source: Company reports

TeleNav's current agreement with Sprint expires on December 31, 2011, but the company's right to be Sprint's exclusive provider expires on December 31, 2010. The current agreement with AT&T expires on March 19, 2011, and TeleNav is the exclusive provider of white-label GPS navigation services to AT&T Navigator during this time. Neither Sprint nor AT&T is required to offer TeleNav's LBS, but the loss of either, or a change in pricing strategy, could be material.

At the current 14.5M subscriber level, TeleNav's US penetration rate is less than 7%. Management expects to announce the launch of one new domestic partner in 2010 and sees the international market representing approximately 10% of consolidated revenue by 2012 (currently ~3%). The biggest opportunity here is China Mobile, which has 500M+ subscribers. Roughly 450K subscribers are paying for mobile maps and 50K subscribers have adopted turn-by-turn navigation, meaning that TeleNav has the potential to add meaningful subscribers to its base with the signing of China Mobile (expected next year).

Figure 4: Customers and penetration rates



Source: Company reports

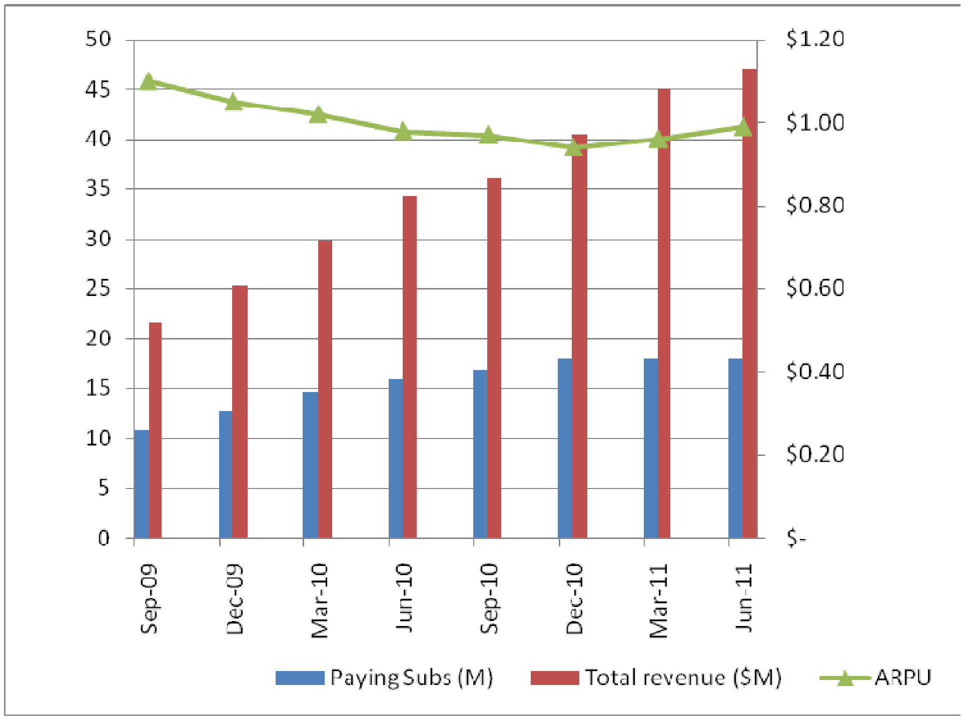
REVENUE MODEL

TeleNav's services are offered by its wireless carrier partners on either a standalone basis or bundled with other voice and data services. The standalone service is provided via a monthly recurring charge (MRC), and although it drives a higher ARPU ($9.99/month; we estimate TeleNav gets approximately 50% revenue share per month from the carrier), it carries a lower gross margin than the bundled offering and overall MRC subscriber growth is much lower. In the bundled offering (i.e., bundled for free with a monthly data plan commitment), TeleNav gets slightly less than $1 per month per subscriber from the carrier. This lower ARPU is offset by much faster subscriber growth. This "white-labeled" strategy results in deeper integration with the carrier, an expanded subscriber base and higher revenues. Of its two largest customers, AT&T (29% of revenues) uses the MRC model today while Sprint (61% of revenue) typically bundles the service. We believe expanded consumer awareness of "free navigation" will drive more carriers to pursue a data plan bundled strategy, including AT&T. Management expects MRC price reductions in 2010 (baked into expectations), which should impact revenue in the near term but result in both higher subscribers and revenue in the long term.

Average revenue per user (ARPU). As of March 31, 2010 (FQ3/10), TeleNav had 14.5M paying subscribers and an ARPU of $1.02. ARPU has trended lower as a result of the shift in end-user growth to bundled offerings and the company's wireless partners' white label offerings, both of which constitute lower monthly fees per end user. Despite the declines, ARPU is projected to grow higher starting by June 2011 from a changing user mix, an increase in AT&T MRC pricing and growing advertising revenue.

Subscribers. Paying subscriber growth has been strong, but is expected to moderate in December 2010 at around 18M subscribers as a result of other free navigation applications in the market. This is still 43% y/y growth, though. Long term, management expects an expanded availability of voice bundles to drive growth in the subscriber install base. The company is projecting 26M users by December 2012, which represents 40%+ growth y/y. As can be seen in the below chart, as usage increases, ARPU decreases but revenue grows.

Figure 5: Subs, revenue and ARPU



Source: Company reports and Canaccord Genuity

Gross and operating margin. As of March 31, 2010 (FQ3/10), TeleNav had gross and operating margins of 84% and 42%, respectively. Gross margin is expected to decline to around 76% in C2011 due to declining monthly ARPU, increased subscriber usage (which increases COGS), lower margin on the auto business and the addition of a backup data center and other infrastructure investments such as staging servers and IT expansion. Management expects long-term gross margin of 70%. Operating margin is also expected to decline from current levels due to higher operating expenses and increased headcount. Headcount and related costs make up roughly 65-70% of operating expenses. Management expects long-term operating margin of 25%-30%. Though gross and operating margins are expected to decline over the next couple of years, the long-term projections (70%+ GM and 25-30% operating margin) still signal a healthy and stable business.

Figure 6: Select financial metrics outlook

FYE June 30 (US$000s, except per share)	F2009	F2010E	F2011E	F2012E
Revenue	110,880	168,678	215,488	273,645
Paying Subs	9,500	15,900	18,000	22,450
ARPU	$1.11	$1.04	$0.97	$0.92
Gross margin	81.7%	82.2%	77.6%	75.3%
Operating margin	38.1%	40.1%	31.0%	30.9%
EPS	0.57	1.05	0.87	1.09
Shares outstanding	27,648	39,075	46,300	46,600

Source: Company reports and Canaccord Genuity

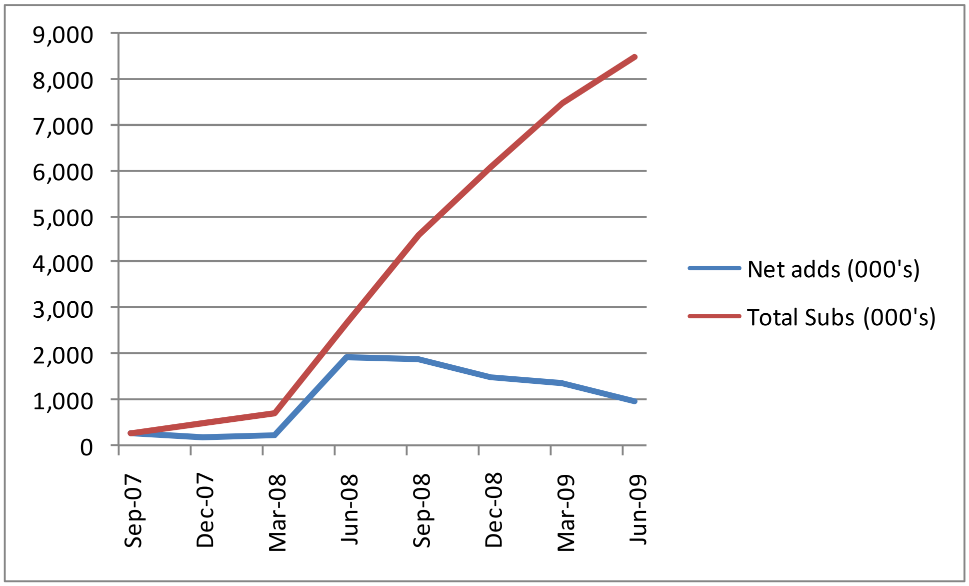
NOTHING IS FREE

In October 2009, the turn-by-turn navigation market was turned on its head when news that the Motorola Droid (launched on Verizon) would launch with free turn-by-turn functionality supplied by Google. Only a few months later, in mid-January 2010, Nokia announced free walk and drive navigation applications, using Ovi Maps, on its smartphones. Initially, the new version of Ovi Maps was available for download on 10 Nokia handsets, with more expected to be added over the ensuing weeks. By March 2010, all new Nokia GPS-enabled smartphones included the new version of Ovi Maps. Since the announcement, the application has been downloaded more than 10 million times.

While free navigation alternatives from Google and Nokia (and most recently Microsoft) are likely to take some market share, it is also expected to stimulate a larger carrier response and drive greater awareness for these applications. As consumers become more aware of the available offerings, we believe that they will see that TeleNav’s solutions compare favorably to the alternatives. Also, keep in mind that Nokia has only about 3% market share in the US, and while Android-based phones are today estimated at about 9% market share and growing, only Android 2.1-powered devices are capable of supporting its navigation application. Additionally, most wireless carriers continue to heavily influence the user experience on both feature phones and smartphones. This trend is not expected to change in the near term.

Perhaps the most critical point to understand, though, is that despite Google’s and Nokia’s solutions being offered for “free,” consumers will still need a data plan to utilize these services, which could run anywhere from $25-70 per month. Both Google and Nokia will look to monetize their free navigation services through mobile advertising, search subsidization and carrier revenue sharing. TeleNav’s carrier-branded services increasingly come bundled with the data plans (i.e., Sprint’s “Simply Everything” plan), so it is essentially just as free as the Google and Nokia applications.

Figure 7: Growth of Sprint subscribers to TeleNav



Source: Company reports and Canaccord Genuity

CATALYSTS

Numerous opportunities exist for TeleNav to grow its business beyond our current projections:

1. **New carrier partnerships, particularly in North America.** T-Mobile and Verizon are the outstanding US carriers with which TeleNav has only a modest relationship. T-Mobile currently has about 34 million subscribers, while Verizon has about 91M subscribers. Management expects that the carriers will adopt a bundling strategy, which comes at a lower ARPU, but increases both the install base and revenues. TeleNav had a prior agreement with Alltel to be the exclusive white label provider of navigation services, but when Alltel was acquired by Verizon in early 2009 Verizon elected to discontinue selling mobile phones pre-loaded with TeleNav's LBS. Additionally, many Verizon phones come pre-loaded with competitor Network-In-Motion's (NIM) navigation application. NIM was acquired by TeleCommunication Systems in December 2009.
2. **Major ramp at China Mobile.** TeleNav is the exclusive provider of TBT solutions to China Mobile (deal announced late last year), but revenue from the deal is not yet contributing to current growth. China Mobile has 500M+ subscribers, of which roughly 450K are paying for mobile maps and 50K have adopted turn-by-turn navigation. Any material promotion of TeleNav's services by China Mobile has the potential to meaningfully contribute to TeleNav's current growth.
3. **New in-vehicle automotive deals.** The automotive (in-dash) segment is expected to represent less than 10% of total revenue in C2010, but grow to about 10% in C2012 based entirely on existing relationships (the ramp of FORD Sync). The company could benefit from broader expansion of new OEM relationships in this marketplace as well. Typically these solutions would generate a one-time royalty fee per units sold and

revenue recognition would follow that of personal navigation devices (PND), which tends to be unit based, offer a perpetual license to the map and prove discounts based on volume.

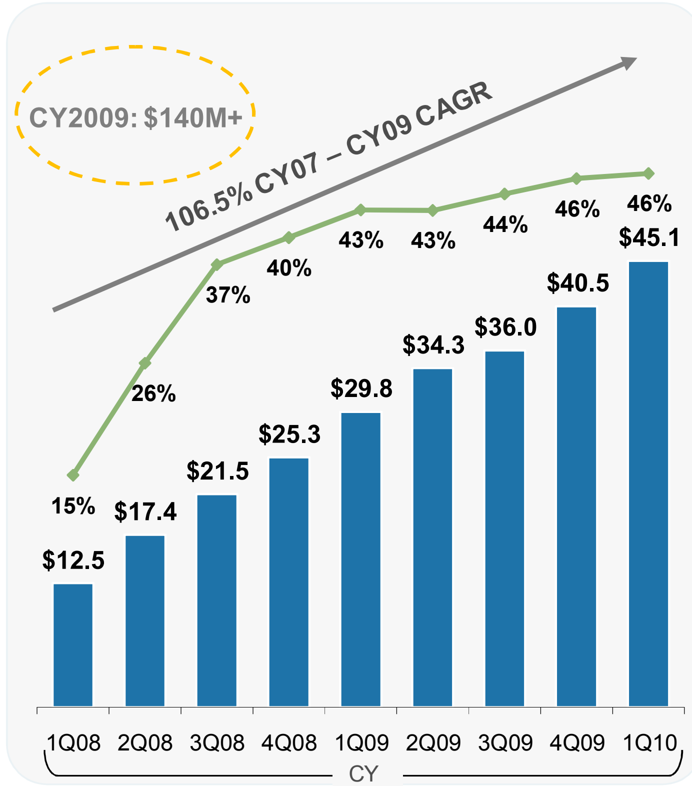
4. **Material advertising revenue contributions.** Management is currently forecasting minimal advertising revenue in the near term, but expects this segment to contribute approximately 5% of total revenue by 2012 from both paying and free subscribers. Should revenue from advertising occur sooner and more broadly than anticipated, TeleNav would likely benefit from the expansion of its advertising ecosystem, the broadening of free navigation and the potential for higher growth aided by mobile social networking.

5. **AT&T moves to bundle strategy from MRC.** AT&T currently operates under a monthly recurring charge (MRC) model, which drives a higher ARPU ($9.99/month; we estimate TeleNav gets 50% revenue share per month from the carrier), but it carries a lower gross margin and much lower subscriber growth than a bundled offering. In the bundled offering, TeleNav's solution comes free when customers sign up for a data plan and the company gets about $1 per month per subscriber from the carrier. AT&T is expected to remain primarily a MRC strategy, but should it switch to a bundled offering, TeleNav would be expected to benefit from a rapid expansion of subscriber growth rates at AT&T. As an example, we estimate TeleNav subscribers grew from approximately 500K to 8.0M+ in the two years following the bundle strategy launch at Sprint.

FINANCIAL HIGHLIGHTS

TeleNav's recurring subscription-based and ARPU-driven revenue model provides excellent visibility into the company's future financial health, while a solid balance sheet, highlighted by no debt and low working capital requirements, allows the company financial flexibility in what is becoming a more competitive and challenging environment. Additionally, strong cash flow generation and low capital expenditure requirements facilitate growth from within.

Figure 8: Revenue and EBITDA margin performance



Source: Company reports

ESTIMATES

We are presenting our FQ4/10, F2010 and F2011 estimates below.

For FQ4/10, we are forecasting revenue/net income of $47M/$10M. This assumes a paying subscriber count of 15.9M and gross margin of 81%.

For F2011, our estimates are for revenue/net income of $215M/$40M, which assumes gross margin of 78%, operating margin of 31% and paying subscribers of 18M.

Though gross and operating margins are expected to decline over the next couple of years, the long-term projections (70%+ GM and 25%-30% operating margin) still signal a healthy and stable business.

Figure 9: Outlook

FYE June 30 (US$000s, except per share)	FQ4/10E	F2010E	F2011E
Total revenue	47,026	168,678	215,488
y/y growth	37.3%	52.1%	27.8%
Gross Margin	81.2%	82.2%	77.6%
EBITDA	18,840	72,981	76,786
margin	40.1%	43.3%	35.6%
Operating Margin	36.0%	40.1%	31.0%
Net Income	10,208	41,005	40,267
EPS (FD)	0.24	1.05	0.87
y/y growth	-14.0%	84.6%	-17.1%
Paying Subs	15,900	15,900	18,000
ARPU	$0.98	$1.04	$0.97

Source: Canaccord Genuity

VALUATON AND RECOMMENDATION

We are initiating coverage of TeleNav with a $14 target price and BUY recommendation. Our target price is based on 7x our F2011 EV/EBITDA estimate of $77M. We believe this multiple could prove conservative as TeleNav's closest competitor, Network in Motion, was acquired by TeleCommunication Systems in December 2009 for almost 10x EV/EBITDA.

TeleNav's recurring subscription-based and ARPU-driven revenue model provides excellent visibility into the company's future financial health, while a solid balance sheet, highlighted by no debt and low working capital requirements, allows the company financial flexibility in what is becoming a more competitive and challenging environment. Though gross and operating margins are expected to decline over the next couple of years, long-term projections still call for 70%+ and 25-30% levels, respectively, signaling a healthy and stable business. We see several additional upside opportunities (i.e., China Mobile, new Tier 2 North America carrier, material advertising revenue contribution, etc.) that are not included in management's financial projections.

Investment risks

Investment risks include, but are not limited to customer concentration, competition, scalability, intellectual property and regulation.

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Site Visit: An analyst has visited the issuer's material operations in Sunnyvale, California. No payment or reimbursement was received from the issuer for the related travel costs.

Distribution of Ratings:
Global Stock Ratings
(as of 2 July 2010)

	Coverage Universe		IB Clients
Rating	**#**	**%**	**%**
Buy	424	61.0%	36.8%
Speculative Buy	75	10.8%	62.7%
Hold	184	26.5%	20.1%
Sell	12	1.7%	0.0%
	695	100.0%	

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Company	Disclosure
TeleNav	1A, 2, 3, 5, 7

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