Zee Entertainment Enterprise – BUY

Z IN	Rs273	31 March 2010	Company update

A regional flavour

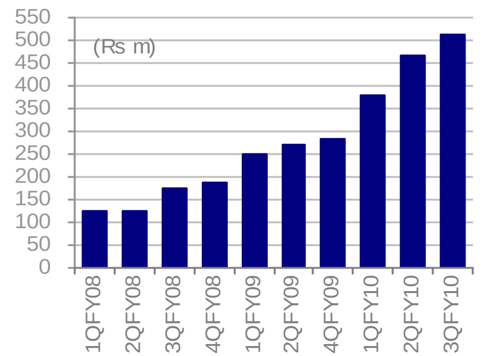
Zee Entertainment's 4QFY10 numbers will reflect for the first time the effect of the merger of Zee News's six regional channels into ZEEL. In numbers, this translates to only a minor 3-4% upgrade to our EPS estimates, but we feel the merger is a structural positive. It will help Zee diversify its Zee's business profile, reducing its dependence on Zee TV's advertisement revenues. It will also allow the company to tap into the regional advertisement space, where growth is likely to outpace that in an already buoyant national ad market. We retain BUY.

Regional channels add some diversity; no longer a one-GEC show: The addition of six new channels brings some much-needed diversity to Zee's business profile, reducing the dependence on Zee TV. We expect these channels to contribute as much as 14% to Zee Entertainment's revenues and 18% of EBIDTA for FY11. Going forward, we reckon Zee TV's ad revenue will contribute less than 20% of its total revenues, thereby sheltering the company somewhat from the volatility of GRPs in the Hindi GEC space.

Strength in regional ad-spend a positive; regional channel ratings showing resilience: Among regional GECs, Zee Marathi continues to be the market leader, while Zee Bangla has stabilised its market share somewhat. Zee Telegu and Zee Kannada are close to the second spot in their respective markets. This augurs well for Zee, as the overall ad market remains buoyant. Regional ad spends are likely to tend higher, so regional GECs will likely outpace the national GEC ad-revenue growth.

Marginal upgrade in earnings post-dilution: The merger of the six regional channels and also ETC Network into ZEEL would lead to a dilution of ~12.5%. In addition, Rs1.2bn of debt pertaining to the regional channels would be transferred to ZEEL. Factoring these in and the earnings of the new channels leads to a 2.2% and 4.4% upgrade in our EPS estimates for FY11 and FY12. The company is yet to disclose detailed earnings for these new channels, which when it happens would likely lead to a minor tweaking of our numbers.

DTH revenue growth remains strong



Source: Company, IIFL Research

Financial Summary

Y/e 31 Mar	FY08A	FY09A	FY10ii	FY11ii	FY12ii
Revenues (Rs m)	18,354	21,773	22,814	29,470	33,940
EBITDA Margins (%)	29.6	25.2	27.0	28.9	29.7
Pre-Exceptional PAT (Rs m)	3,885	3,673	4,524	6,244	7,399
Reported PAT (Rs m)	3,859	5,124	4,524	6,244	7,399
EPS (Rs)	9.0	8.5	10.1	12.8	15.1
Growth (%)	63.6	-5.6	19.4	26.4	18.5
PER (x)	**30.7**	**32.5**	**27.2**	**21.5**	**18.2**
ROE (%)	13.5	15.1	11.0	13.5	14.1
Debt/Equity (x)	0.1	0.2	0.1	0.1	0.1
EV/EBITDA (x)	**22.4**	**22.5**	**19.9**	**15.1**	**12.3**
Price/Book (x)	4.2	3.5	3.0	2.9	2.6

Price as at close of business on 30 March 2010

12-mth TP	*(Rs) 297 (9%)*
Market cap (US$ m)	**2,622**
52Wk High/Low (Rs)	303/102
Diluted o/s shares (m)	434
Daily volume (US$ m)	6
Dividend yield FY10ii (%)	0.9
Free float (%)	58.5

Shareholding pattern (%)

Promoters	41.5
FIIs	28.1
Domestic MFs	23.0
Others	7.4

Price performance (%)

	1M	3M	1Y
Zee	10.4	4.7	157.2
Rel. to Sensex	3.3	3.3	73.4
UTV Software	-0.8	-4.6	128.4
Sun TV	14.0	24.4	153.6
NDTV	-2.8	-15.5	49.1

Stock movement

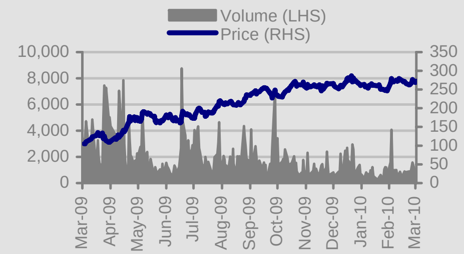


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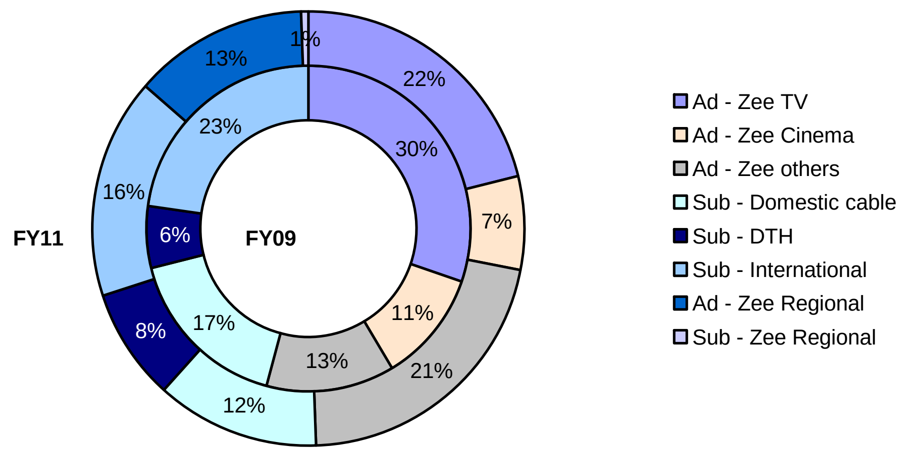
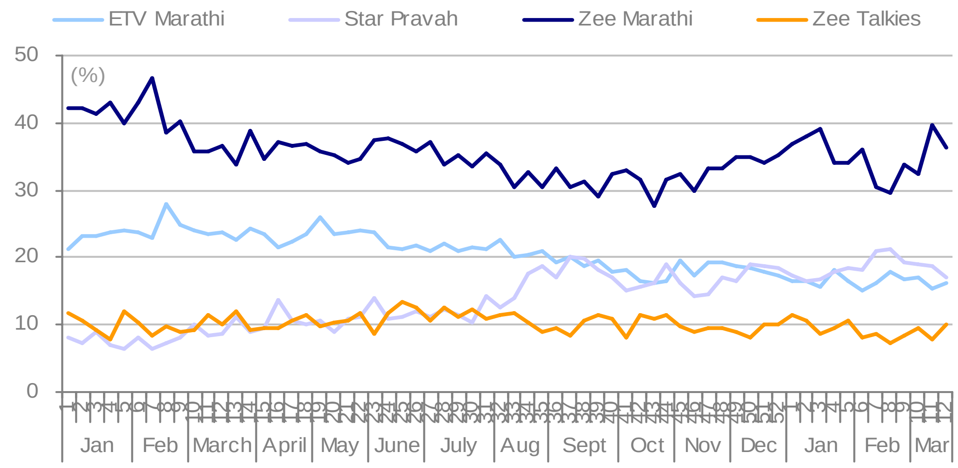
Figure 1: Reduced dependency on Zee TV's ad revenues



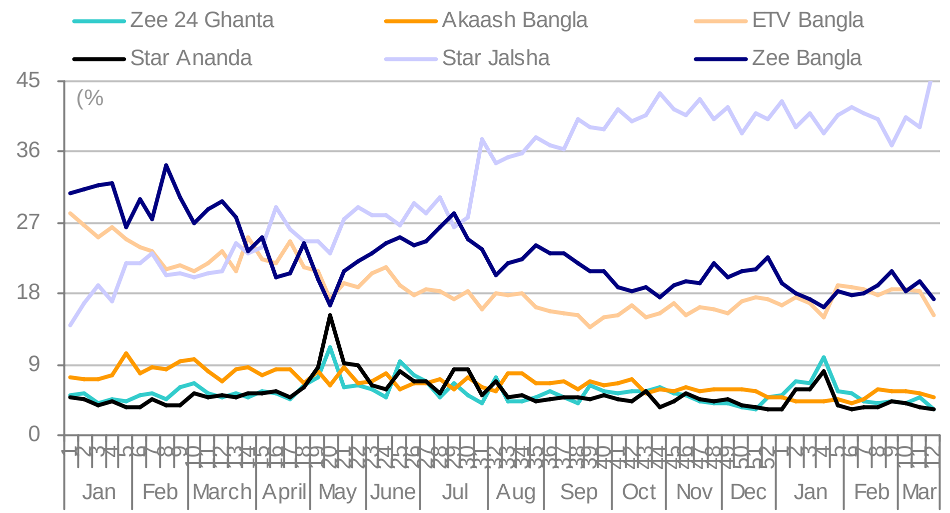
Source: IIFL Research

Figure 3: Marathi GECs: Zee Marathi has widened the gap with its competitors



Source: TAM, IIFL Research

Figure 4: Bengali GECs: Zee Bangla showing signs of arresting decline



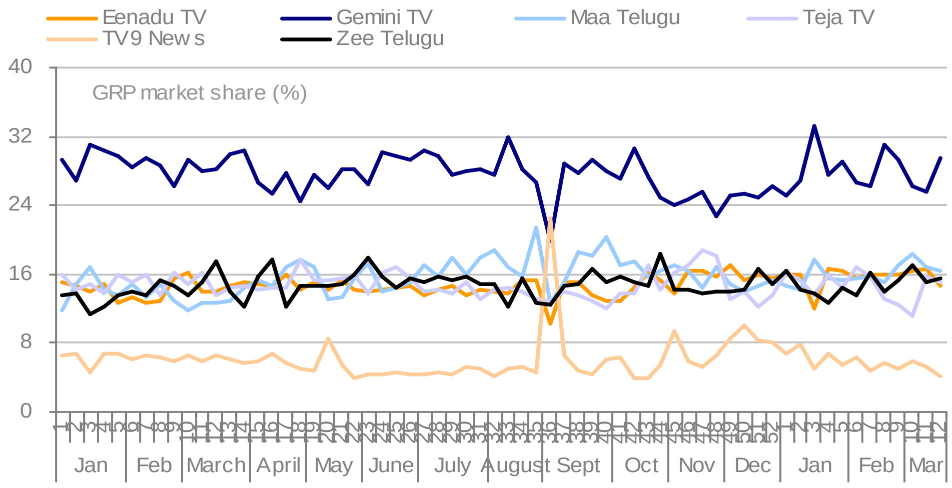
Source: TAM, IIFL Research

Figure 2: Revision in earnings

Rs m	Earlier		Revised		Change (%)	
	FY11	FY12	FY11	FY12	FY11	FY12
Revenues	26,394	30,479	29,470	33,940	11.7	11.4
EBIDTA	7,179	8,321	8,528	10,069	18.8	21.0
PAT	5,442	6,310	6,244	7,399	14.7	17.3
EPS (Rs)	12.5	14.5	12.8	15.1	2.2	4.4

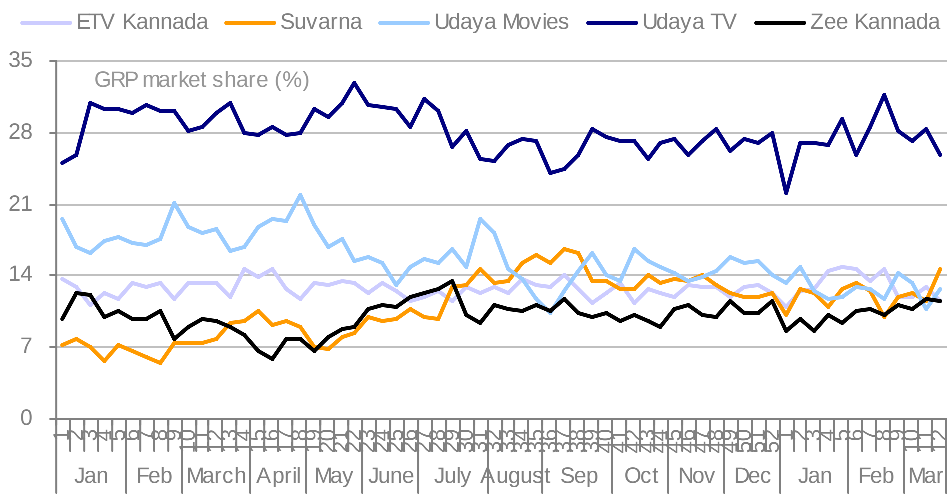
Source: IIFL Research

Figure 5: Telegu GECs: Zee Telegu vying for second spot



Source: TAM, IIFL Research

Figure 6: Kannada GECs: Zee Kannada inching ahead



Source: TAM, IIFL Research

Financial summary

Income statement summary (Rs m)

Y/e 31 Mar	FY08A	FY09A	FY10ii	FY11ii	FY12ii
Revenue	18,354	21,773	22,814	29,470	33,940
EBITDA	5,424	5,480	6,153	8,528	10,069
EBIT	**5,191**	**5,170**	**5,832**	**8,112**	**9,615**
Interest income	0	0	0	0	0
Interest expense	516	1,339	780	737	763
Exceptional items	-26	1,451	0	0	0
Others items	1,138	1,572	1,443	1,590	1,770
Profit before tax	**5,813**	**6,854**	**6,495**	**8,965**	**10,622**
Tax expense	1,627	1,633	1,884	2,600	3,080
Minorities and others	-328	-98	-87	-121	-143
Net Profit	**3,859**	**5,124**	**4,524**	**6,244**	**7,399**

Balance sheet summary (Rs m)

Y/e 31 Mar	FY08A	FY09A	FY10ii	FY11ii	FY12ii
Cash & cash equivalents	1,652	1,926	2,621	10,078	14,222
Sundry debtors	5,907	6,437	6,744	8,712	10,033
Trade Inventories	2,474	4,576	4,512	5,690	6,454
Other current assets	11,475	14,087	13,087	11,587	11,587
Fixed assets	**15,848**	**18,205**	**22,085**	**22,168**	**22,214**
Other assets	2,515	1,271	1,271	1,271	1,271
Total assets	**39,872**	**46,503**	**50,319**	**59,506**	**65,782**
Sundry creditors	4,152	4,318	4,415	5,549	6,326
Other current liabilities	2,127	1,486	1,586	1,686	1,786
Long-term debt/Convertibles	2,532	5,261	1,836	4,525	3,525
Minorities/other Equity	1,117	948	1,035	1,156	1,298
Networth	**28,611**	**33,995**	**41,147**	**46,290**	**52,547**
Total liabilities & equity	**39,872**	**46,503**	**50,319**	**59,506**	**65,782**

Cashflow summary (Rs m)

Y/e 31 Mar	FY08A	FY09A	FY10ii	FY11ii	FY12ii
Profit before tax	5,813	5,403	6,495	8,965	10,622
Depreciation & Amortization	232	310	321	416	455
Tax paid	-1,794	-1,525	-1,884	-2,600	-3,080
Working capital change	-1,551	-5,719	955	-411	-1,210
Other operating items	-470	961	-2	0	0
Operating Cash-flow	2,231	-570	5,885	6,370	6,786
Capital expenditure	-997	-2,797	-4,200	-500	-500
Free cash flow	**1,234**	**-3,367**	**1,685**	**5,870**	**6,286**
Equity raised	0	68	3,676	41	0
Investments	-185	1,246	0	0	0
Debt financing/disposal	640	1,891	-3,620	2,689	-1,000
Dividends paid	-1,018	-1,013	-1,046	-1,142	-1,142
Other items	26	1,451	0	0	0
Net change in Cash & cash equivalents	**698**	**275**	**694**	**7,457**	**4,144**

Source: Company data, IIFL Research

Ratio Analysis

Y/e 31 Mar	FY08A	FY09A	FY10ii	FY11ii	FY12ii
Sales growth (%)	21.1	18.6	4.8	29.2	15.2
Core EBITDA growth (%)	69.3	1.0	12.3	38.6	18.1
Core EBIT growth (%)	71.9	-0.4	12.8	39.1	18.5
Core EBITDA margin (%)	29.6	25.2	27.0	28.9	29.7
Core EBIT margin (%)	28.3	23.7	25.6	27.5	28.3
Net profit margin (%)	21.2	16.9	19.8	21.2	21.8
Dividend payout ratio (%)	28.0	23.8	29.0	29.0	29.0
Tax rate (%)	7.7	11.3	-1.2	-11.3	-19.8
Net Debt/Equity (%)	0.4	0.7	-0.1	-0.6	-1.0
Return on Equity (%)	13.5	15.1	11.0	13.5	14.1
Return on Assets (%)	9.7	7.9	9.0	10.5	11.2

Source: Company data, IIFL Research

Key to our recommendation structure

BUY - Absolute - Stock expected to give a positive return of over 20% over a 1-year horizon.
SELL - Absolute - Stock expected to fall by more than 10% over a 1-year horizon.

In addition, **Add** and **Reduce** recommendations are based on expected returns relative to a hurdle rate. Investment horizon for **Add** and **Reduce** recommendations is up to a year. We assume the current hurdle rate at 10%, this being the average return on a debt instrument available for investment.

Add - Stock expected to give a return of 0-10% over the hurdle rate, ie a positive return of 10%+.
Reduce - Stock expected to return less than the hurdle rate, ie return of less than 10%.