

Company Results Review

23 April 2007 | 8 pages

Zee Telefilms (ZEE.BO)

Buy: Ad Revenue Slowdown a One-off; Results In Line

- 4Q FY07 results in line** — Net profits grew 3% yoy, driven by operating leverage on an improving pay revenue profile.
- Ad revenue slowdown a one-off** — Ad revenue declined 5.5% yoy in 4Q, impacted by a high base last year, as well as lower yields due to Cricket World Cup and KBC. However, Zee's ratings continue to improve, and we expect ad-revenue growth to bounce back in the coming quarters.
- Pay revenues improving** — Zee's pay revenue growth is accelerating, a trend that should further intensify as DTH and set-top-box penetration pick up. 4Q FY07 pay revenues grew 5% yoy, driving an EBITDA margin expansion of 555 bps.
- Our best play on Indian broadcasting** — Zee, in our view, is the best play on structural changes driven by increasing digitization of TV broadcasting and improving addressability. Its pay revenue and margin profiles look set to improve dramatically, driving a 38%EPS CAGR over FY07-09E. We maintain our Buy/Low Risk (1L) rating.

Buy/Low Risk	1L
Price (20 Apr 07)	Rs266.90
Target price	Rs277.00
Expected share price return	3.8%
Expected dividend yield	1.4%
Expected total return	5.2%
Market Cap	Rs115,684M US\$2,781M

Price Performance (RIC: ZEE.BO, BB: Z IN)



Figure 1. Statistical Abstract

Year to 31-Mar	Net Profit (Rs Mils.)	FD EPS (Rs)	EPS Growth (%)	P/E (x)	DPS (Rs)	Yield (%)	RoE (%)
2005	3,123.2	7.6	6.2	35.2	1.1	0.4	26.2
2006	1,962.6	4.8	(36.2)	55.2	0.7	0.3	17.0
2007E	2,604.6	6.1	25.7	43.9	0.6	0.2	23.3
2008E	3,971.3	9.2	51.9	28.9	3.9	1.4	29.5
2009E	4,977.5	11.6	25.2	23.1	6.0	2.3	31.8

Source: Company Reports and Citigroup Investment Research estimates

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Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	34.7	55.2	43.9	28.9	23.1
EV/EBITDA adjusted (x)	27.2	47.9	36.7	22.5	16.7
P/BV (x)	8.3	10.8	9.3	7.9	6.9
Dividend yield (%)	0.4	0.3	0.2	1.4	2.3
Per Share Data (Rs)					
EPS adjusted	7.69	4.83	6.08	9.23	11.55
EPS reported	7.69	4.83	6.08	9.23	11.55
BVPS	32.16	24.64	28.77	33.78	38.77
DPS	1.14	0.71	0.63	3.86	6.04
Profit & Loss (RsM)					
Net sales	13,079	10,511	13,802	17,121	19,756
Operating expenses	-9,057	-8,309	-10,926	-12,369	-13,484
EBIT	4,022	2,202	2,876	4,752	6,272
Net interest expense	-207	-222	-155	-109	-76
Non-operating/exceptionals	521	457	500	500	500
Pre-tax profit	4,336	2,437	3,221	5,143	6,696
Tax	-1,023	-460	-580	-1,131	-1,674
Extraord./Min.Int./Pref.div.	-140	19	0	0	0
Reported net income	3,173	1,996	2,641	4,012	5,022
Adjusted earnings	3,173	1,996	2,641	4,012	5,022
Adjusted EBITDA	4,351	2,412	3,126	5,032	6,592
Growth Rates (%)					
Sales	-4.5	-19.6	31.3	24.0	15.4
EBIT adjusted	0.8	-45.3	30.6	65.2	32.0
EBITDA adjusted	1.0	-44.6	29.6	60.9	31.0
EPS adjusted	1.3	-37.2	25.7	51.9	25.2
Cash Flow (RsM)					
Operating cash flow	3,855	-1,519	-16	5,137	5,084
Depreciation/amortization	329	210	250	280	320
Net working capital	1,733	2,058	-2,485	1,052	-180
Investing cash flow	-3,461	3,944	-2,508	-250	-350
Capital expenditure	-45	-400	0	-250	-250
Acquisitions/disposals	0	3,734	0	0	0
Financing cash flow	51	-1,330	243	-1,736	-2,731
Borrowings	555	-868	114	-150	0
Dividends paid	-529	-332	-294	-1,793	-2,809
Change in cash	445	1,094	-2,282	3,151	2,003
Balance Sheet (RsM)					
Total assets	23,388	18,477	21,583	26,163	30,549
Cash & cash equivalent	1,571	2,665	416	3,576	5,590
Accounts receivable	5,344	3,987	4,872	5,622	6,622
Net fixed assets	4,101	1,626	1,376	1,346	1,276
Total liabilities	9,727	7,866	8,592	10,943	13,106
Accounts payable	3,206	2,575	3,099	3,543	4,140
Total Debt	5,304	4,436	4,550	4,400	4,400
Shareholders' funds	13,661	10,611	12,991	15,219	17,443
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	33.3	22.9	22.7	29.4	33.4
ROE adjusted	26.2	17.0	23.3	29.5	31.8
ROIC adjusted	20.6	15.2	22.2	33.1	44.0
Net debt to equity	27.3	16.7	31.8	5.4	-6.8
Total debt to capital	28.0	29.5	25.9	22.4	20.1

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4Q FY07 Results

Figure 2. Zee — 4Q FY07 Results Summary

	4Q FY06	4Q FY07	% Change
Advertising Revenues	1,956.0	1,848.9	-5.5
Subscription Revenues	1,757.0	1,848.6	5.2
Other Sales and Services	253.4	146.4	-42.2
Total Revenues	3,966.4	3,843.9	-3.1
Operating Expenses	-3,204.9	-2,892.5	-9.7
EBITDA	761.5	951.4	24.9
<i>EBITDA Margin (%)</i>	<i>19.2</i>	<i>24.8</i>	<i>555 bps</i>
Other Income	125.4	176.6	40.8
Interest	-20.5	-8.4	-59.0
Depreciation	-101.6	-55.8	-45.1
PBT	764.8	1,063.8	39.1
Tax	-88.5	-364.6	312.0
<i>Tax Rate (%)</i>	<i>11.6</i>	<i>34.3</i>	<i>2270 bps</i>
Exceptional Item	0.0	0.0	Nm
Profit After Tax	676.3	699.2	3.4
Less: Minority Interest	-7.7	95.4	nm
Profit After Tax and Minority Interest	668.6	794.6	18.8

Source: Company and Citigroup Investment Research

Figure 3. Zee — 4Q FY07 Cost Details

	4Q FY06	4Q FY07	% Change
Net Sales	3,966.4	3,843.9	-3.1
Programming & Operating Cost	2,098.5	1,631.5	-22.3
<i>% of sales</i>	<i>52.9</i>	<i>42.4</i>	<i>-1046 bps</i>
Staff Cost	259.1	291.9	12.7
<i>% of sales</i>	<i>6.5</i>	<i>7.6</i>	<i>106 bps</i>
Selling & Other Expenses	847.3	969.1	14.4
<i>% of sales</i>	<i>21.4</i>	<i>25.2</i>	<i>385 bps</i>

Source: Company and Citigroup Investment Research

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Figure 4. Zee — 4Q FY07 Segmental Results

Revenues	4Q FY06	4Q FY07	% Change
Content & Broadcasting	3,456.3	3,747.5	8.4
Access	618.1	0.0	-100.0
Education	69.6	96.4	38.5
Total Revenues	4,144.0	3,843.9	-7.2
Less: Inter-segment Revenues	177.6	0.0	nm
Net Revenues	3,966.4	3,843.9	-3.1
Segmental EBIT			
Content & Broadcasting	604.3	888.1	47.0
Access	46.4	0.0	-100.0
Education	9.2	7.5	-18.5
Total EBIT	659.9	895.6	35.7
Segmental EBIT (%)			
Content & Broadcasting	17.5	23.7	621 bps
Access	7.5	nm	nm
Education	13.2	7.8	-544 bps
Total EBIT	15.9	23.3	738 bps

Source: Company and Citigroup Investment Research

Zee Telefilms

Company description

Zee Telefilms Limited (Zee) is India's largest vertically integrated media and entertainment company. It has an integrated range of businesses, encompassing the content-to-consumer value chain of media and entertainment business. Zee has been investing heavily in new businesses, including new channels and content.

Investment thesis

We rate Zee as Buy/Low Risk (1L). We view the recent restructuring announcement by Zee's management in which the company is looking to split its business into four entities as positive because this should add focus to the business and unlock value. The restructuring allays our concerns related to Zee's investment in DTH, which we believe would have strained Zee's balance sheet and diverted the focus away from the core broadcasting business. In addition, hiving off of the DTH business would increase transparency pertaining to Zee's funding of ASC enterprises, which is the private holding entity of the DTH business. By separating the broadcasting business from the distribution business, Zee will likely emerge as a more focused entity, in our view.

Valuation

We are valuing Zee on a P/E multiple. We believe that P/E is the appropriate valuation methodology, given Zee's stable earnings stream and low capital intensity of the business. We use a 30x P/E multiple which returns a value of Rs277 per share. Our 30x target multiple is at the higher end of the historical trading average, which we believe is warranted given that fundamentals are looking up as channel ratings are improving. Our target multiple of 30x factors in: a) an improving EPS growth profile due to a pickup in advertising and pay

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revenues; b) higher ROE and free cash flow profile of Zee on account of de-merger of distribution businesses; and c) maintaining a relative premium to the Sensex.

Risks

We believe that with the restructuring, the business will become more transparent and that the execution risk on DTH will be mitigated. As such, our Low Risk rating is consistent with our quantitative risk-rating system, which tracks 260-day historical share price volatility. The following factors could negatively affect earnings and investor sentiment: inability to execute the proposed restructuring (could be on account of regulatory issues); an economic slowdown, which could result in a decline in advertising growth rates; the loss of channel ratings; and an increase in competitive activity resulting in higher costs and margin contraction. Any of these risks could impede the stock from reaching our target price.

Appendix A-1

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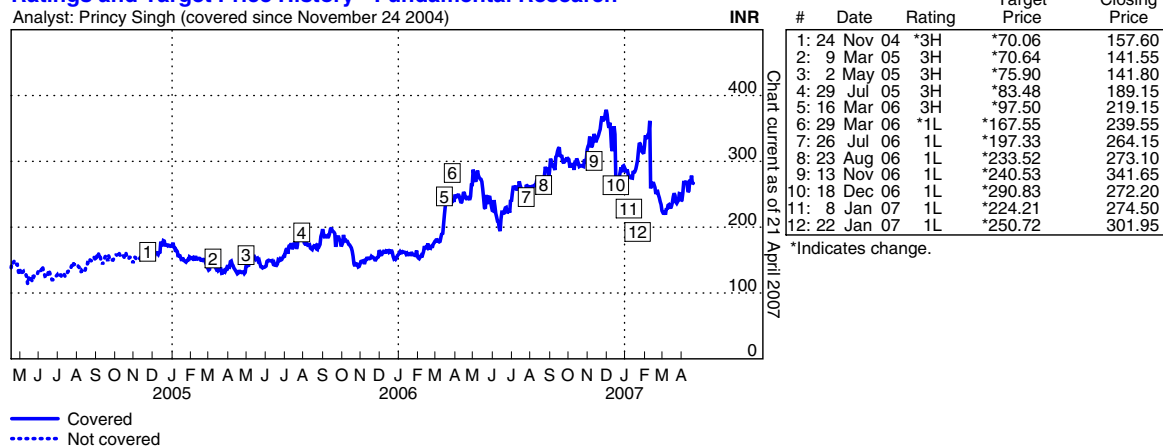
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Ratings and Target Price History - Fundamental Research

Analyst: Princy Singh (covered since November 24 2004)



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