

## Company Flash

23 October 2007 | 8 pages

# Zee Entertainment (ZEE.BO)

## 2QFY08: Solid Earnings, But Subscription Revenues Disappoint

- Solid 2Q earnings** — Zee's 2QFY08 net profits grew solid 362% yoy to Rs970m, ahead of our estimate of Rs895m. 2QFY08 growth should be viewed in the context of the depressed earnings base of 2Q last year on account of heavy losses in cricket matches broadcast by Zee Sports. However, profit growth is still strong, notwithstanding the low base of last year.
- Ad revenues strong as ratings improve** — Zee's reported advertising revenues in 2Q grew 27.8% yoy, though if discounted for the incremental revenues from cricket matches in 2Q last year, underlying growth is close to 50%. Zee's viewer ratings continue to pick up, which will continue to drive strong growth for ad revenues; management has guided at 25% growth.
- Subscription revenues disappoint** — We are disappointed by the sequential decline in Zee's subscription revenues. Management has attributed the decline entirely to lower international pay revenues, adversely affected due to a stronger rupee. However, we expected strong DTH revenues and increasing payout from CAS designated areas to drive strong overall growth, despite lower international growth, and this slowdown worries us.
- Solid margin expansion** — EBITDA margin expansion of 27% is exaggerated on account of a low base due to losses in cricket last year; however, the absolute level of 33.1% is encouraging and demonstrates the strength of Zee's renewed programming and ratings driving higher advertising revenues. Margins are likely to pick up further, as incremental subscription revenues kick in.

<b>Buy/Low Risk</b>	<b>1L</b>
Price (23 Oct 07)	Rs338.75
Target price	Rs354.00
Expected share price return	4.5%
Expected dividend yield	1.1%
<b>Expected total return</b>	<b>5.6%</b>
Market Cap	Rs146,871M US\$3,700M

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



### Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2006A	2,142	5.19	-32.5	65.2	13.3	17.9	0.2
2007A	2,411	5.55	6.8	61.1	8.7	17.6	0.2
2008E	3,987	9.17	65.4	36.9	7.8	22.2	1.1
2009E	5,130	11.80	28.7	28.7	7.0	25.6	1.7
2010E	6,232	14.34	21.5	23.6	6.2	27.8	2.1

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
<b>Valuation Ratios</b>					
P/E adjusted (x)	65.2	61.1	36.9	28.7	23.6
EV/EBITDA adjusted (x)	59.7	45.8	26.4	20.3	16.6
P/BV (x)	13.3	8.7	7.8	7.0	6.2
Dividend yield (%)	0.2	0.2	1.1	1.7	2.1
<b>Per Share Data (Rs)</b>					
EPS adjusted	5.19	5.55	9.17	11.80	14.34
EPS reported	5.19	5.55	9.17	11.80	14.34
BVPS	25.48	38.87	43.62	48.51	54.49
DPS	0.74	0.54	3.65	5.93	7.24
<b>Profit &amp; Loss (RsM)</b>					
Net sales	11,042	14,416	17,215	20,343	24,036
Operating expenses	-8,728	-11,451	-12,023	-13,610	-15,805
<b>EBIT</b>	<b>2,314</b>	<b>2,965</b>	<b>5,192</b>	<b>6,733</b>	<b>8,231</b>
Net interest expense	-131	-220	-154	-108	-75
Non-operating/exceptionals	562	630	500	500	500
<b>Pre-tax profit</b>	<b>2,745</b>	<b>3,375</b>	<b>5,538</b>	<b>7,125</b>	<b>8,656</b>
Tax	-603	-964	-1,551	-1,995	-2,424
Extraord./Min.Int./Pref.div.	0	0	0	0	0
<b>Reported net income</b>	<b>2,142</b>	<b>2,411</b>	<b>3,987</b>	<b>5,130</b>	<b>6,232</b>
Adjusted earnings	2,142	2,411	3,987	5,130	6,232
Adjusted EBITDA	2,474	3,192	5,452	7,033	8,571
<b>Growth Rates (%)</b>					
Sales	-15.6	30.6	19.4	18.2	18.2
EBIT adjusted	-42.5	28.1	75.1	29.7	22.3
EBITDA adjusted	-43.1	29.0	70.8	29.0	21.9
EPS adjusted	-32.5	6.8	65.4	28.7	21.5
<b>Cash Flow (RsM)</b>					
<b>Operating cash flow</b>	<b>2,400</b>	<b>-265</b>	<b>3,710</b>	<b>3,940</b>	<b>4,009</b>
Depreciation/amortization	160	228	260	300	340
Net working capital	98	-2,904	-538	-1,491	-2,563
<b>Investing cash flow</b>	<b>6,272</b>	<b>-186</b>	<b>-400</b>	<b>-500</b>	<b>-500</b>
Capital expenditure	0	-186	-400	-400	-400
Acquisitions/disposals	2,917	0	0	0	0
<b>Financing cash flow</b>	<b>-683</b>	<b>-4,830</b>	<b>-1,979</b>	<b>-2,756</b>	<b>-3,364</b>
Borrowings	-449	-4,622	-280	0	0
Dividends paid	-344	-249	-1,699	-2,756	-3,364
<b>Change in cash</b>	<b>7,989</b>	<b>-5,281</b>	<b>1,331</b>	<b>684</b>	<b>145</b>
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>20,215</b>	<b>23,054</b>	<b>27,709</b>	<b>32,270</b>	<b>36,936</b>
Cash & cash equivalent	1,286	255	1,412	1,905	1,779
Accounts receivable	4,855	5,848	7,250	8,824	10,695
Net fixed assets	2,171	2,129	2,269	2,369	2,429
<b>Total liabilities</b>	<b>9,247</b>	<b>5,674</b>	<b>8,215</b>	<b>10,592</b>	<b>12,661</b>
Accounts payable	3,108	4,130	4,909	5,780	6,806
Total Debt	4,901	280	0	0	0
<b>Shareholders' funds</b>	<b>10,967</b>	<b>17,380</b>	<b>19,494</b>	<b>21,678</b>	<b>24,275</b>
<b>Profitability/Solvency Ratios (%)</b>					
EBITDA margin adjusted	22.4	22.1	31.7	34.6	35.7
ROE adjusted	17.9	17.6	22.2	25.6	27.8
ROIC adjusted	13.5	15.4	24.7	29.9	32.3
Net debt to equity	33.0	0.1	-7.2	-8.8	-7.3
Total debt to capital	30.9	1.6	0.0	0.0	0.0

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## 2QFY08 Results Tables

Figure 1. Zee Entertainment – 2QFY07 Results Summary (Rupees in Million, Percent)

	2QFY07	2QFY08	% YoY
Advertising Revenues	1717.1	2195	27.8
Subscription Revenues	1473.9	1624.6	10.2
Other Revenues	305.4	166.4	-45.5
<b>Total Revenues</b>	<b>3496.4</b>	<b>3986</b>	<b>14.0</b>
Operating Expenses	-3279.0	-2665.2	-18.7
<b>EBITDA</b>	<b>217.4</b>	<b>1320.8</b>	<b>507.5</b>
<i>EBITDA Margin (%)</i>	<i>6.22</i>	<i>33.14</i>	<i>2692 bps</i>
Interest & Other Income	151.5	224.7	48.3
Finance Cost	-34.3	-85	147.8
Depreciation	-50.9	-55.4	8.8
<b>PBT</b>	<b>283.7</b>	<b>1405.1</b>	<b>395.3</b>
Tax	-73.6	-434.5	490.4
<i>Tax Rate (%)</i>	<i>25.9</i>	<i>30.9</i>	<i>498 bps</i>
<b>PAT</b>	<b>210.1</b>	<b>970.6</b>	<b>362.0</b>
Minority Interest	12.2	-45.6	
<b>PAT after Minority Interest</b>	<b>222.3</b>	<b>925</b>	<b>316.1</b>

Source: Company Reports

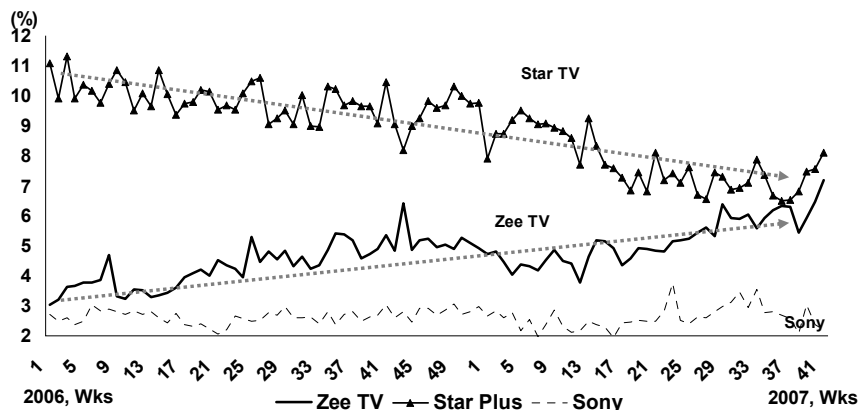
Figure 2. Zee Entertainment – 2QFY07 Key Costs (Rupees in Million, Percent)

Cost Details	2QFY07	2QFY08	% YoY
Net Sales	3,496.4	3,986.0	14.0
Programming & Operating Cost	2403.3	1659.7	-30.9
% of sales	68.7	41.6	-2710 bps
Staff Cost	239.3	337.5	41.0
% of sales	6.8	8.5	162 bps
Selling & Other Expenses	636.4	668	5.0
% of sales	18.2	16.8	-144 bps

Source: Company Reports

## Zee's Viewer Ratings Trend

Figure 3. Viewer Share of Leading General Entertainment Channels (%)



Source: A.C Nielsen; C&S 4+, All India

## Zee Entertainment

### 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. The company owns a bouquet of channels across various genres including general entertainment, cinema, music, news and sports. Zee has been investing heavily in new businesses, including new channels and content.

### Investment strategy

We rate Zee as Buy/Low Risk (1L). We view the recent restructuring by Zee in which the company has split its business into four entities as positive because this has added focus to the business and 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. Additionally, Zee is well positioned to benefit from the rising share of broadcasters in the rapidly increasing pay revenue stream. Zee's viewer ratings are also rising which is expected to drive advertising revenue growth of over 20%. Strong revenues and margin expansion are likely to drive 37% EPS CAGR over the next 3 years.

### 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

Rs354 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 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: an economic slowdown, which could result in a decline in advertising growth rates; the loss of channel ratings; change in regulatory environment curbing pay revenue growth; slower than expected growth of CAS and DTH; 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

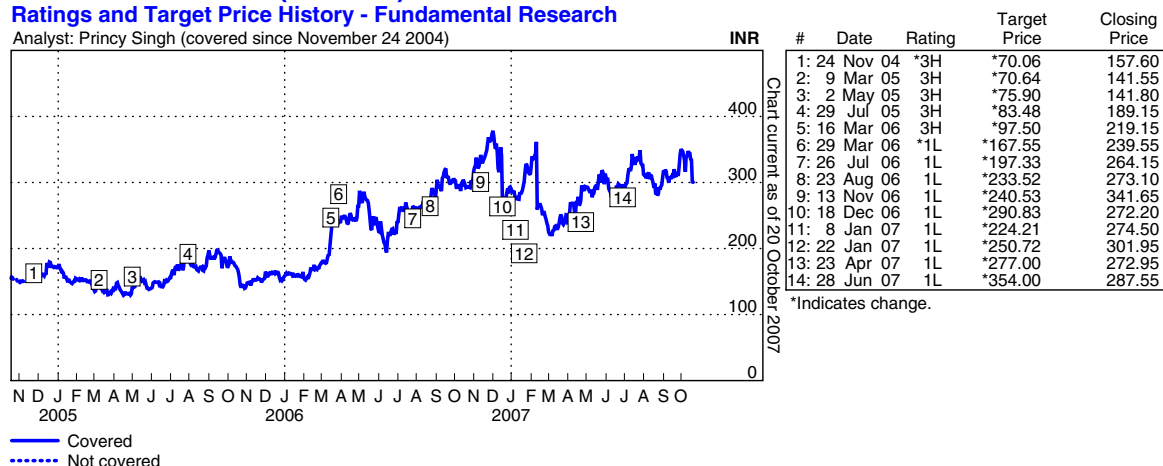
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