

IPO NOTE
DQ Entertainment (International) Limited Subscribe
IPO Details

Face Value	Rs. 10
Price Band (Rs.)	Rs. 75 - 80
Issue Opens	08-Mar-10
Issue Closes	10-Mar-10
BRLM	SBI Capital Markets Limited
Registrar to issue	Karvy Comp. Pvt. Ltd.
Issue Size	16 million equity shares

Pre issue shareholding pattern

Shareholders	% Stake
Promoter and Promoter Group	94.0%
Non-Promoter Group	6.0%

Post issue shareholding pattern

Shareholders	% Stake
Promoter and Promoter Group	75.0%
Non-Promoter Group	25.0%

Allocation (not less than)	No. of shares
Employee	321,011
QIBs	9,436,200
Non-Institutional	1,572,700
Retail	4,718,100

IPO Details	Lower End	Upper End
Price Band	Rs. 75	Rs. 80
Equity Shares prior to issue (mn)	63.2	63.2
Fresh Issue of shares (mn)	16.0	16.0
Total Equity Shares (mn)	79.3	79.3
Share Capital (mn)	Rs. 792.8	Rs. 792.8
Implied market cap (mn)	Rs. 5,946.2	Rs. 6,342.6
Debt (mn) (30/09/09)	Rs. 378.1	Rs. 378.1
Cash (mn) (30/09/09)	Rs. 76.4	Rs. 76.4
Implied EV (mn)	Rs. 6,248.0	Rs. 6,644.4

DQ Entertainment (International) Limited (DQE) is an animation services and production company focused on both the Indian and international markets. It carries out production, co-production and global distribution of TV series, direct-to-home videos and feature films. It also creates game art for online, mobile and next-generation consoles. It has an asset base of over 350 hours of animation content from which it earns revenues through licensing and distribution activities. DQE intends to raise in excess of Rs. 1.2 bn by issuing 16 million equity shares of face value Rs. 10 each, out of which 15.73 million shares would be issued to the public and the rest would be reserved for eligible employees. The funds raised from the issue will be used for investment in co-production deals, development of production and office facilities, and investment in its Ireland unit and for general corporate purposes.

We see the issue as a good investment opportunity as:

- The Company is focused on acquiring high-margin Intellectual Property (IP) rights, and getting into low-risk co-production arrangement to diversify from a pure outsourcing service model.
- The Company has exhibited a strong financial performance with impressive EBITDA margin of over 35% and comfortable leverage position with debt/net worth ratio of 0.25x and healthy interest coverage ratio of over 5x in FY09.
- It has a strong order book of ~USD 95.07 mn (Rs. 4.56 bn), providing high revenue visibility. Over 40% of the order book is already in various stages of production.
- DQE has a diversified client base of over 90 companies which include internationally recognized brands such as the Disney Group, Nickelodeon, American Greetings, BBC, etc.

Valuation and Recommendation

According to our valuation, at a price band of Rs. 75-80, the Company proposes a EV/EBITDA of 8.6x-9.1x for FY11E, which is at a discount to the peer group (UTV Software Communications, Balaji Telefilms, Prime Focus) average of 11.5x. DQE also has better EBITDA margin at over 35% and ROE at 10.5% for FY11E in comparison to the peer set average of 17% and 7%, respectively. So, keeping in mind these numbers along with DQE's strong fundamentals, we recommend investors to Subscriber to the issue.

Year to March	FY08	FY09	H110	FY10E	FY11E	CAGR (%)
(Figures in Rs. mn, except per share data)						
Net Sales	946	1,509	690	1,647	1,958	13.9%
EBITDA	252	537	256	586	729	16.5%
Adj. Net Profit	70	162	103	194	259	26.7%
Margins (%)						
EBITDA	26.6%	35.6%	37.0%	35.5%	37.2%	
NPM	7.4%	10.7%	15.0%	11.8%	13.2%	
Per Share Data						
Adjusted EPS (Rs.)	1.2	2.7	1.8	3.1	3.3	
PER (x) @ Rs 75		27.3x		24.6x	22.9x	
PER (x) @ Rs 80		29.1x		26.2x	24.5x	

IPO

Issue details

DQ Entertainment (International) Limited is making an Initial Public Offer (IPO) of 16,048,011 equity shares of Rs. 10 each (face value). Of this, up to 321,011 shares would be reserved for subscription by eligible employees. The issue less the portion reserved for employee constitutes 15,727,000 shares of Rs. 10 each. The issue would constitute 20.24% of the post issue paid-up capital of the Company. The price band is Rs. 75-80 per share and the issue will be open for subscription from March 8-10, 2010. Prior to issue the Company has completed a Pre-IPO Placement of 3,772,771 Equity Shares to certain selected investors (including 2,936,427 to IDFC Investment Advisors Limited) at a price of Rs. 68.11 per share raising aggregate Rs. 257 mn.

Issue objectives

- Investment in co-production agreements, focusing on Intellectual Property content creation
- Development of office premises & production facilities, and development of infrastructure and additional facilities at the SEZ Unit, Kokapet Village, Rangareddy District, Andhra Pradesh
- Investment in its subsidiary, DQ Entertainment (Ireland) Limited
- General Corporate Purposes

Promoters

The promoters of the Company are Mr. Tapaas Chakravarti and DQ Entertainment (Mauritius) Limited. DQ Entertainment (Mauritius) Limited is wholly owned by DQE plc, a publicly listed company on the Alternative Investment Market (AIM) of the London Stock Exchange. As DQE plc is ultimately promoted by Mr. Tapaas Chakravarti, he is the ultimate promoter of the Company. Mr. Chakravarti has over 23 years of experience across various industries and has previously worked with Sandoz India Limited, STP Limited, Coats of India and the Sriram Group.

Investment Rationale

Low-risk business model

The Company has moved from a pure outsourcing service model to one where it does most of its projects on a co-production model along with large animation studios, as well as developing their own Intellectual property (IP) content. The Company's strategy of acquiring IP rights has helped in reducing customer attrition, and increasing the volume of higher-end outsourcing work, leading to better margins. Its low-risk approach of entering into co-production arrangements has enabled it to receive production revenues generating its usual production margin, and also acquire rights to earn license revenues. Subsequently,

the Company has strategically moved up the animation value chain, gaining greater exposure to intellectual property ownership and distribution through international co-partnerships, while securing large projects.

Strong Financial Performance

DQE's total income increased by 60% to Rs. 1.5 bn in FY09. Additionally its EBITDA margins improved tremendously to 35.6% in FY09 from 26.6% in FY08 due to a combination of manpower cost reduction and more revenue from high-end animation. In future, the Company is likely to maintain high EBITDA margin supported by increased operational efficiency and expected reduction in average manpower cost per head as it meets most of its manpower requirement by using in-house trained staff.

On the other hand, the Company has a comfortable leverage and interest coverage ratio. As on FY09, its debt to net worth ratio stood at 0.25x, while it enjoyed a healthy interest cover of over 5x in FY09.

Robust Order Book and Diversified Client Base

DQE has a strong order book of ~USD 95.07 mn (Rs. 4.56 bn), providing high revenue visibility. Over 40% of the order book is already in various stages of production & balance will commence during the year. Orders worth USD 28 mn (Rs. 1.35 bn) are to be executed in FY10 and the balance to be executed beyond FY10. Thus, the momentum of revenue growth is likely to be maintained over next 2-3 years.

Moreover, DQE has a diversified client base of over 90 companies, which offers better business stability. Its clients include internationally recognized brands such as, the Disney Group, Nickelodeon, American Greetings, BBC, Moonscoop Group, ZDF-Germany, Australian Broadcasting Corporation and NBC Universal.

Operational Strengths and High Quality Standards

DQE draws strength from its investments in creating robust IT, technology and management infrastructure, including its proprietary ERP solution, which it has continuously developed over the past years. It has developed several in-house animation techniques and technologies, which gives it an advantage over its competitors. It's been awarded ISO 9001:2000 certification by M/s. Det Norske Veritas, Netherlands, which endorses the high working practices within the organization and is recognition that DQE can consistently deliver products or services that meet stringent quality requirements.

Risks and concerns

Revenue concentration from US and Europe

DQE currently derives over 90% of its revenues from clients located in the US (41.6% in FY09) and the European nations (51.2% in FY09). Any adverse economic impact in such regions could have an unfavorable effect on DQE's business, results of operations and financial condition.

Rupee Fluctuations may adversely affect Business

Most of DQE's revenues are currently denominated in foreign currencies, especially in USD and Euros and accordingly, any appreciation of the Rupee against these currencies will result in lower realization in Rupees. It has raised debt in foreign currencies, especially in USD, to finance its business operations and subsequently bears the exchange rate risk for payments of principal and interest. Accordingly, any depreciation of the Rupee against such currencies will increase the debt servicing cost for the Company.

Company Background

Incorporated in 2007, DQ Entertainment (International) Limited is one of the leading producers of animation, visual effects, game art and entertainment content for the Indian as well as global media and entertainment industry. They are a producer, co-producer and global distributor of TV series, direct-to-home videos and feature films. DQ Entertainment is also creators of game art for online, mobile and next-generation consoles. They have forayed into production and distribution of live action television and feature films.

DQ Entertainment has its Production, Sales, Licensing and Distribution centers in Hyderabad, Chennai, Mumbai, Kolkata, Manila, Ireland, Paris, Los Angeles and Japan with work force of 3500+.

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