

## Media

Sector coverage view

Neutral

Company	Rating	Price, Rs	
		14-Jun	Target
ZEEL	U	284	215
SunTV	U	1,457	1,200

## CAS or no CAS, time to do a reality check on earnings expectations

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- **First came CAS; this will take time and the faster the investors realize this, the better**
- **Second came advertisement revenues; fragmentation will take care of it**
- **What next? Nothing**

We suggest investors do a reality check on earnings growth expectations of ZEEL and Sun TV in light of (1) less-than-stellar progress of a CAS and potential risks to domestic pay-TV revenues and (2) increased fragmentation in the broadcasting sector and potential risks to advertisement revenues. We do not set much store by the recent recommendations of The Group on Digitalization and Introduction of Voluntary CAS. The group has recommended introduction of a CAS in 55 cities in phases starting from October 2008. However, we doubt the government has any keenness to pass legislation for a mandatory CAS in other parts of the country; note its extreme reluctance to do so, even in the notified cities of Delhi, Kolkata and Mumbai. Also, we are getting increasingly concerned by the incessant launch of channels and the impact of increasing market fragmentation on a channel's advertisement revenues and cost of programming. We retain our U rating on ZEEL and Sun TV stocks and 12-month DCF-based target price of Rs215 and Rs1,200 respectively. Key upside risks stem from higher-than-expected advertisement and subscription revenues.

**The government may have no plans for a CAS (Cannot Act Somehow); does not bode well ZEEL's domestic pay-TV revenues.** We believe our domestic pay-TV revenue forecasts for ZEEL may have downside risk given (1) likely slow pace of adoption of a CAS on cable systems (mandatory or voluntary) and (2) slower-than-expected off-take in DTH subscribers. We model ZEEL's FY2008E, FY2009E and FY2010E domestic pay-TV revenues to increase to Rs3.8 bn, Rs4.9 bn and Rs6.1 bn, respectively from Rs3.1 bn in FY2007 (Rs854 mn in 4QFY07). Similarly, we model Sun TV's FY2008E, FY2009E and FY2010E domestic pay-TV revenues to increase to Rs1.8 bn, Rs2.7 bn and Rs3.2 bn, respectively from Rs0.7 bn in FY2007E. We do not doubt the need for a proper conditional access system (along with digitalization), which will result in increased consumer choice, enhanced competition and a coherent cable industry. However, we have been long skeptical about the government's intention to introduce a system, which will increase viewing costs for the consumer (cost of a set top box and likely higher monthly subscription fees). The government has introduced a CAS in the three remaining metros only after the intervention of the judiciary. However, there is no legislation for the introduction of a CAS beyond the original four metros and we doubt the government will issue a notification for a mandatory CAS in other metros/parts of the country.

**CAS—Call After Sometime or tell me when it happens.** We find the recommendations of the above-mentioned group academic. The government's notification is critical and the government has shown little interest in even implementing a CAS in the notified areas of the three metros as discussed above. The group has recommended that the government notify a CAS on cable systems in 55 cities (18.1mn TV households, 13.4 mn cable households) from an "effective date" (in phases from October 2008 to September 2011). The group has recommended mandatory CAS for the 55 cities for a period of one year followed by continuation of a CAS on a voluntary basis.

### Kotak Institutional Equities Research

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We believe a better approach to a voluntary CAS would be run a parallel digital system (but no CAS; a household will receive all channels to start with) along with the current analog system. We expect a number of households in top-tier cities to voluntarily opt for a digital system (even though there may not be a choice of channels) simply due to enhanced viewing quality and the current low cost of set-top boxes. MSOs can introduce conditional access after a period of time within a regulatory framework decided by the TRAI covering (1) interconnection between broadcaster, MSO and LCO, (2) must-carry and must-provide elements and (3) penalties for disruption of service by any service provider.

**Advertisement revenues—watch out because there are too many channels to watch.** We are getting increasingly concerned about the proliferation of channels in India driven by (1) easy funding and (2) even easier market capitalization creation. We have a laundry list of 82 channels, which will start operations over the next few months but a few more have been announced over the last few days.

We are not sure whether the market can support so many players especially if there is limited progress in the subscription market. Just to put things in perspective, the total size of the Hindi general entertainment market is about Rs18 bn, there are four new channels starting operations in the next 9-12 months and the annual operating cost of a channel is about Rs4 bn. At this point of time, we do not think even the number three player among the extant Hindi General Entertainment channels is profitable. We would also focus on the increased cost of programming; as can be seen in Exhibit 4 and 5, Balaji Telefilms' realization has increased steeply over the past few years and quarters.

#### 24 new channels will start operations in the most common genres

List of extant and proposed channels in the general entertainment, news, cinema, sports genres

	Hindi - GE	English - GE	Hindi - News	English - News	Cinema	Music	Sports	Niche
<b>Existing</b>								
	Channel Siti	AXN	Aaj Tak	BBC	B4U Movies	ATN Music	DD Sports	Animal Planet
	DD1	Star World	Awaaz	CNBC TV18	CVO	B4U Music	ESPN	Animax
	DD2	Zee Cafe	DD News	CNN	FILMY	Channel V	Neo Sports	Cartoon Network
	SAB		Dilli Aaj Tak	CNN IBN	Hallmark	Enter10	Neo Sports Plus	Discovery
	Sahara One		IBN 7	Headlines Today	HBO	ETC	Star Sports	Disney Channel
	Sony TV		India TV	NDTV 24x7	Jhankarr Movies	ITV	Ten Sports	Fashion TV
	Star One		Janmat	NDTV Profit	MAX	MH1	Zee Sports	History
	Star Plus		NDTV India	Times Now	PIX	MTV		Hungama TV
	Star Utsav		Sahara Samay		Star Gold	Music India		Kermit
	Zee Smile		Star News		Star Movies	Siti Music		National Geographic
	Zee TV		TEZ		Zee Action	SS Music		Nickelodeon
	Zoom		Zee Business		Zee Cinema	VH1		POGO
			Zee News		Zee Classic	YO Music		Reality TV
					Zee Premier	Zee Music		TMG
					Zee Studio	Sur Sangeet		Toon Disney
								Travel & Living
								Zee Education
								Zee Trendz
								Zone Reality
								Play TV
								Voyager TV
<b>Total existing channels</b>	<b>12</b>	<b>3</b>	<b>13</b>	<b>8</b>	<b>15</b>	<b>15</b>	<b>7</b>	<b>21</b>
<b>Proposed</b>								
	INX Group	BBC World India	MH1 News	INX News X	NDTV Imagine	9X	Star Cricket	13th Street
	NDTV Imagine	NDTV Imagine	NCR9		Olive TV	9X Music		CBeebies
	UTV Bindass		Triveni News			RK Music		MarineBiz TV
	Viacom-18		TV9 Mumbai					Sahara Real Estate
								Sanskriti
								Universal Channel
								Weather Channel
<b>Total proposed channels</b>	<b>4</b>	<b>2</b>	<b>4</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>1</b>	<b>7</b>
<b>Total existing and proposed</b>	<b>16</b>	<b>5</b>	<b>17</b>	<b>9</b>	<b>17</b>	<b>18</b>	<b>8</b>	<b>28</b>

Source: Industry data, Kotak Institutional Equities estimates.

**58 new regional language channels will start operations over the next few months**

List of extant and proposed regional language channels

	Tamil	Telugu	Marathi	Kannada	Malayalam	Punjabi	Bengali	Gujarati	Others
<b>Existing</b>	Chutti TV	DD8 Telugu	DD10 Sahyadri	DD9 Chandana	Amrita TV	Balle Balle	24 Ghanta TV	DD11 Gujarati	Aastha
	DD5 Podhigai	Eenadu TV	ETV Marathi	ETV Kannada	Asianet	DD Punjabi	Aakaash Bangla	ETV Gujarati	C Channel
	Jaya TV	ETV2 Telugu News	Mi Marathi	Suprabhata	Asianet News	ETC Punjabi	DD7 Bangla	Gurjari	CCC
	KTV	Gemini Music	Prabhat TV	TV9 Karnataka	Asianet Plus	Lashkara	ETV Bangla	Zee Gujarati	CMM
	Makkal TV	Gemini News	Zee Marathi	U2	DD4 Malayalam	Punjab Today	Kolkata TV		CTVN AKD Plus
	Raj Digital Plus		Zee Talkies	Udaya Movies	Indiavision	Zee Punjabi	Sangeet Bangla		DD Delhi
	Raj Musix	Maa Telugu		Udaya TV	Kairali		Star Ananda		DD India
	Raj TV	Siti Telugu		Udaya Varthegalu	Kiran TV		Tara Muzik		DD International
	Sun Music	Teja TV		Ushe	Manorama News		Tara Newz		DD6 Oriya
	SUN News	TV9 Telugu News		Zee Kannada	Surya TV		Zee Bangla		ETV Bihar
	Sun TV	Vissa							ETV Oriya
	Vijay TV	Zee Telugu							ETV Uttar Pradesh
	Zee News (Tamil)								IN Mumbai
									OTV
									QTV
									Sadhna
									Sanskar
									Siti Cable
									Siti Cinema
									Taaza TV
									Zee Jagran
									Zee Jagran
<b>Total existing channels</b>	<b>13</b>	<b>12</b>	<b>6</b>	<b>10</b>	<b>10</b>	<b>6</b>	<b>10</b>	<b>4</b>	<b>22</b>
<b>Proposed</b>	Asianet	Bhakti	NDTV Mumbai	Asianet		INX Group	INX Group	INX Group	BAG Films (4 channels)
	Kalaighar TV	N TV		Kasturi			NDTV Calcutta	TV9 Gujarat	INX Group (5 regional channels)
	NDTV Chennai	STAR - Balaji		NDTV Bangalore					Raj TV (11 channels)
	Raj Youth	TV1							STAR - Balaji (regional channels)
									Triveni Media (17 regional news channels)
									TV-18 (3 regional news channels)
<b>Total proposed channels</b>	<b>4</b>	<b>4</b>	<b>1</b>	<b>3</b>	<b>0</b>	<b>1</b>	<b>2</b>	<b>2</b>	<b>41</b>
<b>Total existing and proposed</b>	<b>17</b>	<b>16</b>	<b>7</b>	<b>13</b>	<b>10</b>	<b>7</b>	<b>12</b>	<b>6</b>	<b>63</b>

**A new channel will require plentiful ad revenues to recoup its costs; may be difficult in the initial years**

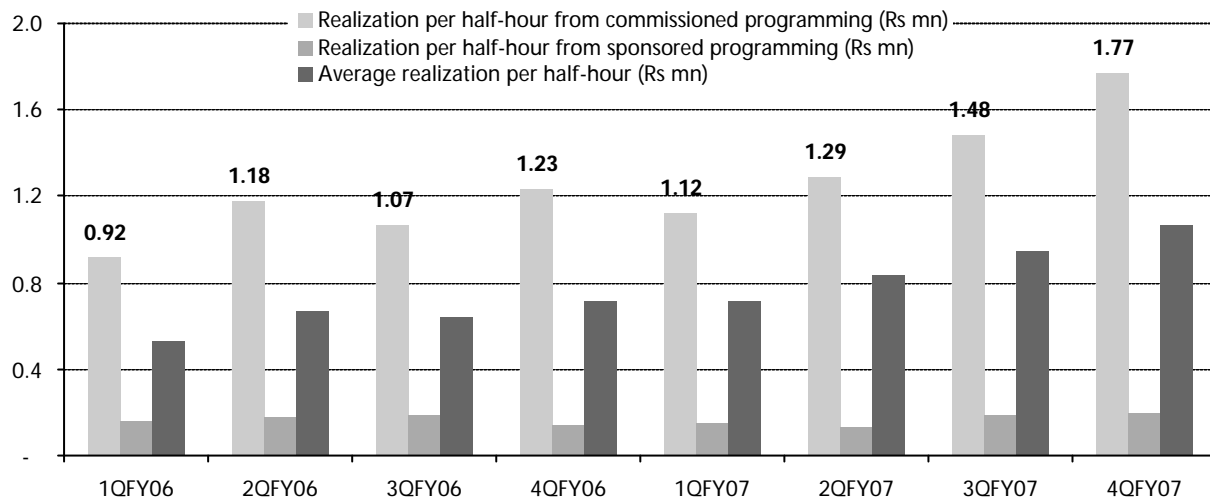
Economics of a new hindi general entertainment channel (Rs mn)

		Comments
<b>1. Programming</b>		
Total no. of 1/2 hr prime-time slots available per week (#)	36	8:00-11:00 PM on weekdays and Saturday
Cost of prime-time slot program	0.88	50% discount to 4QFY07 prime-time realization of Balaji Telefilms
<b>Total cost of prime time programming per week</b>	<b>31.8</b>	
Total no. of 1/2 hr afternoon slots available per week (#)	36	1-4 PM on weekdays and Saturday
Total no. of 1/2 hr original afternoon slots available per week (#)	18	Excluding 50% repeat of prime-time programming content
Cost of afternoon slot program	0.35	60% discount to prime-time programming cost
<b>Total cost of afternoon programming per week</b>	<b>6.4</b>	
Total no. of 1/2 hr non-prime slots available per week (#)	264	
Total no. of 1/2 hr original slots available per week (#)	48	Two hours of original programming in evening (children) and morning
Cost of non-prime slot program	0.05	Repeats, low cost content
<b>Total cost of non-prime programming per week</b>	<b>2.4</b>	
<b>Total cost of programming per annum</b>	<b>2,110</b>	
<b>2. Distribution</b>		
Total no. of primary MSOs in India (#)	10	For the initial launch of the program
Average carriage charges by MSO per year	25.0	
<b>Total carriage charges per annum</b>	<b>250.0</b>	
Total carriage charges per week	4.8	
<b>3. Employees</b>		
Total no. of employees	600	Assuming the broadcaster does it own distribution
Cost per employee (Rs mn/annum)	1.5	
<b>Total employee cost per annum</b>	<b>900</b>	
<b>4. SG&amp;A</b>		
<b>Total SG&amp;A costs per annum</b>	<b>900</b>	
<b>Total direct operating costs (Rs mn/annum)</b>	<b>4,160</b>	

Source: Industry, Kotak Institutional Equities estimates.

**Balaji Telefilms' realization has increased steeply over the past few quarters despite a decline in ratings**

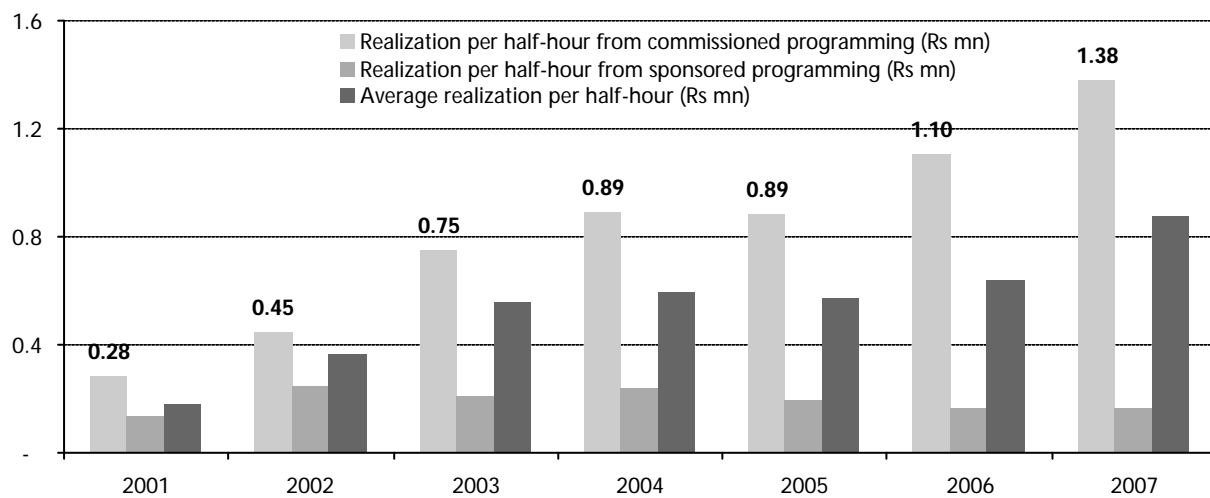
Realization for Balaji's programming costs, March fiscal year-ends, 2006-2007 (Rs mn)



Source: Kotak Institutional Equities estimates.

**Balaji Telefilms' realization has increased steeply over the past few years**

Realization for Balaji's programming costs, March fiscal year-ends, 2001-2007 (Rs mn)



Source: Kotak Institutional Equities estimates.

## Consolidated profit model, balance sheet, cash model of Zee Telefilms 2006 and of ZEEL 2007-2012E, March fiscal year-ends (Rs mn)

	2006	2007	2008E	2009E	2010E	2011E	2012E
<b>Profit model (Rs mn)</b>							
<b>Total revenues</b>	<b>16,544</b>	<b>14,412</b>	<b>17,141</b>	<b>19,617</b>	<b>22,363</b>	<b>25,020</b>	<b>27,577</b>
<b>EBITDA</b>	<b>2,695</b>	<b>3,188</b>	<b>5,587</b>	<b>7,212</b>	<b>8,972</b>	<b>10,550</b>	<b>11,957</b>
Other income	639	630	634	716	909	1,185	1,519
Interest	(188)	(219)	(210)	(37)	(2)	—	—
Depreciation	(360)	(228)	(274)	(287)	(299)	(305)	(315)
Amortization	—	—	—	—	—	—	—
<b>Pretax profits</b>	<b>2,787</b>	<b>3,371</b>	<b>5,737</b>	<b>7,605</b>	<b>9,581</b>	<b>11,430</b>	<b>13,161</b>
Extraordinary items	19	—	—	—	—	—	—
Tax	(528)	(984)	(1,814)	(2,480)	(3,296)	(3,956)	(4,552)
Deferred tax	(9)	20	19	19	19	18	18
Minority interest	(117)	(212)	(187)	(223)	(261)	(298)	(333)
<b>Net income</b>	<b>2,153</b>	<b>2,195</b>	<b>3,754</b>	<b>4,921</b>	<b>6,043</b>	<b>7,195</b>	<b>8,294</b>
<b>Recurring net income</b>	<b>2,134</b>	<b>2,195</b>	<b>3,754</b>	<b>4,921</b>	<b>6,043</b>	<b>7,195</b>	<b>8,294</b>
<b>Earnings per share (Rs)</b>	<b>4.9</b>	<b>5.0</b>	<b>8.6</b>	<b>11.3</b>	<b>13.9</b>	<b>16.5</b>	<b>19.1</b>
<b>Balance sheet (Rs mn)</b>							
Total equity	21,286	27,363	30,269	34,079	38,757	44,327	50,748
Deferred tax balance	(148)	(168)	(188)	(207)	(226)	(244)	(262)
Minority interest	458	670	857	1,080	1,342	1,639	1,972
Total borrowings	4,901	3,880	780	40	—	—	—
Current liabilities	4,346	2,628	2,704	2,858	3,045	3,228	3,429
<b>Total capital</b>	<b>30,844</b>	<b>34,373</b>	<b>34,423</b>	<b>37,851</b>	<b>42,918</b>	<b>48,951</b>	<b>55,887</b>
Cash	1,286	1,200	1,584	3,940	8,041	13,131	19,155
Current assets	13,574	14,651	14,392	15,551	16,615	17,664	18,691
Net fixed assets	12,948	12,921	12,846	12,760	12,661	12,555	12,440
Investments	3,024	5,589	5,589	5,589	5,589	5,589	5,589
Deferred expenditure	12	12	12	12	12	12	12
<b>Total assets</b>	<b>30,844</b>	<b>34,373</b>	<b>34,423</b>	<b>37,851</b>	<b>42,918</b>	<b>48,951</b>	<b>55,887</b>
<b>Free cash flow (Rs mn)</b>							
Operating cash flow, excl. working capital	1,931	1,984	3,563	4,696	5,674	6,595	7,405
Working capital	(3,950)	(2,794)	335	(1,005)	(877)	(865)	(827)
Capital expenditure	(383)	(200)	(200)	(200)	(200)	(200)	(200)
Investments	418	(2,565)	—	—	—	—	—
Other income	488	630	634	716	909	1,185	1,519
<b>Free cash flow</b>	<b>(1,496)</b>	<b>(2,945)</b>	<b>4,331</b>	<b>4,207</b>	<b>5,507</b>	<b>6,715</b>	<b>7,896</b>
<b>Revenue model (Rs mn)</b>							
Advertising	6,566	7,062	8,242	9,312	10,616	12,036	13,500
Subscription-domestic	2,742	3,064	3,825	4,916	6,076	7,052	7,878
Subscription-overseas	3,097	3,543	4,296	4,571	4,813	5,032	5,254
Subscription-cable	978	—	—	—	—	—	—
Others	3,160	742	779	817	858	900	944
<b>Total revenues</b>	<b>16,544</b>	<b>14,412</b>	<b>17,141</b>	<b>19,617</b>	<b>22,363</b>	<b>25,020</b>	<b>27,577</b>

Source: Kotak Institutional Equities estimates.

**Consolidated profit model, balance sheet, cash model of Sun TV 2004-2010E, March fiscal year-ends (Rs mn)**

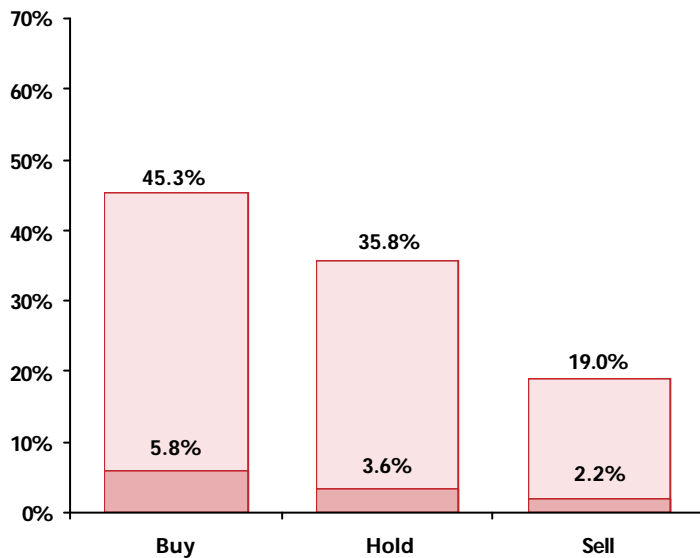
	2004	2005	2006	2007E	2008E	2009E	2010E
<b>Profit model (Rs mn)</b>							
Net sales	2,725	2,903	3,219	4,498	7,181	9,133	10,833
<b>EBITDA</b>	<b>1,293</b>	<b>1,306</b>	<b>2,035</b>	<b>3,009</b>	<b>4,944</b>	<b>6,572</b>	<b>7,999</b>
Other income	67	107	172	439	624	821	1,086
Interest (expense)/income	(9)	(35)	(65)	(16)	—	—	—
Depreciation	(137)	(153)	(147)	(349)	(560)	(459)	(388)
Amortization	—	—	—	(49)	(195)	(195)	(195)
<b>Pretax profits</b>	<b>1,213</b>	<b>1,224</b>	<b>1,995</b>	<b>3,035</b>	<b>4,813</b>	<b>6,739</b>	<b>8,502</b>
Tax-cash	(430)	(454)	(709)	(1,020)	(1,673)	(2,311)	(2,894)
Tax-deferred	(6)	(3)	16	(12)	43	33	23
Minority interest	—	—	—	3	3	(19)	(44)
<b>Net profits after minority interests</b>	<b>777</b>	<b>768</b>	<b>1,302</b>	<b>2,006</b>	<b>3,185</b>	<b>4,442</b>	<b>5,587</b>
<b>Earnings per share (Rs)</b>	<b>17.3</b>	<b>12.4</b>	<b>21.0</b>	<b>29.2</b>	<b>46.2</b>	<b>64.5</b>	<b>81.1</b>
<b>Balance sheet (Rs mn)</b>							
Total equity	3,296	4,063	3,071	10,662	13,062	16,325	20,263
Deferred Tax	45	48	32	43	—	(33)	(55)
Total borrowings	—	424	2,333	—	—	—	—
Current liabilities	287	372	741	753	882	934	979
<b>Total capital</b>	<b>3,627</b>	<b>4,907</b>	<b>6,209</b>	<b>11,488</b>	<b>13,971</b>	<b>17,273</b>	<b>21,276</b>
Cash	1,141	1,853	732	3,378	5,341	8,301	11,969
Current assets	1,538	1,461	2,440	3,120	4,295	5,166	5,934
Total fixed assets	945	1,501	1,027	3,001	2,541	2,207	1,970
Intangible assets	—	88	2,009	1,989	1,794	1,599	1,403
<b>Total assets</b>	<b>3,627</b>	<b>4,907</b>	<b>6,209</b>	<b>11,489</b>	<b>13,972</b>	<b>17,273</b>	<b>21,277</b>
<b>Free cash flow (Rs mn)</b>							
Operating cash flow, excl. working capital	1,152	1,239	1,722	2,321	3,690	4,761	5,655
Working capital	30	26	(251)	(667)	(1,046)	(819)	(723)
Capital expenditure	(219)	(680)	(2,091)	(2,323)	(100)	(125)	(150)
Investments	(335)	(287)	(326)	(348)	(419)	(500)	(550)
Other income	—	(7)	80	439	624	821	1,086
<b>Free cash flow</b>	<b>962</b>	<b>585</b>	<b>(619)</b>	<b>(668)</b>	<b>2,544</b>	<b>3,817</b>	<b>4,781</b>
<b>Ratios (%)</b>							
Debt/equity	—	10.4	76.0	—	—	—	—
Net debt/equity	(34.6)	(35.2)	52.1	(31.7)	(40.9)	(50.8)	(59.1)
RoAE	26.4	20.6	36.1	29.1	26.8	30.3	30.6
<b>RoACE</b>	<b>26.5</b>	<b>20.1</b>	<b>26.6</b>	<b>25.5</b>	<b>27.5</b>	<b>31.0</b>	<b>31.4</b>

Source: Kotak Institutional Equities estimates.

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\* The above categories are defined as follows: Buy = OP; Hold = IL; Sell = U. Buy, Hold and Sell are not defined Kotak Institutional Equities ratings and should not be constructed as investment opinions. Rather, these ratings are used illustratively to comply with applicable regulations. As of 03/31/07 Kotak Institutional Equities Investment Research had investment ratings on 137 equity securities.

Source: Kotak Institutional Equities.

As of March 31, 2007

### Ratings and other definitions/identifiers

#### Current rating system

##### Definitions of ratings

- OP = Outperform.** We expect this stock to outperform the BSE Sensex over the next 12 months.
- IL = In-Line.** We expect this stock to perform in line with the BSE Sensex over the next 12 months.
- U = Underperform.** We expect this stock to underperform the BSE Sensex over the next 12 months.

Our target price are also on 12-month horizon basis.

##### Other definitions

**Coverage view.** The coverage view represents each analyst's overall fundamental outlook on the Sector. The coverage view will consist of one of the following designations: Attractive (A), Neutral (N), Cautious (C).

##### Other ratings/identifiers

- NR = Not Rated.** The investment rating and target price, if any, have been suspended temporarily. Such suspension is in compliance with applicable regulation(s) and/or Kotak Securities policies in circumstances when Kotak Securities or its affiliates is acting in an advisory capacity in a merger or strategic transaction involving this company and in certain other circumstances.
- CS = Coverage Suspended.** Kotak Securities has suspended coverage of this company.
- NC = Not Covered.** Kotak Securities does not cover this company.
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- NM = Not Meaningful.** The information is not meaningful and is therefore excluded.

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