Company Focus

13 March 2009 | 10 pages

UTV Software Communications (UTVS.BO)

Sell: Tough Times, Reducing Target Price to Rs190

Target price change ☑
Estimate change ☑

- **Revising earnings** — We pare our EBIT estimates by ~15-66% over FY09-11E, driven by cuts in TV content and movie verticals. We reduce our EPS estimates by ~12-15% over FY10/11E, but increase FY09E EPS by ~41% due to the increase in other income and interest income from the last quarter. Our SOTP based TP comes to Rs190 (Rs250 earlier), with the revised earnings and EV/EBIT multiples. Post a disappointing FY09 YTD, we maintain Sell/High Risk (3H) as subdued return ratios should prevent re-rating in the near term.
- **Movies segment key to profitability** — Filmed entertainment is inherently volatile; but remains key driver of earnings. FY09 has been below expectations – release of some movies (including 2 large budget films) slated this year were delayed. We take a more conservative stance for FY10E from management guidance, factoring release of 4 big films and take 14 movies overall. Upside potential from *The Happening* would be captured in next year's estimate.
- **TV to remain lackluster** — TV margins declined drastically, from ~18% in FY08 to 3-5.5% this year. Management cautioned that EBIT margins would remain in the sub 6% range. We expect muted revenue and profit growth from this segment, going forward - trim TV segment EBIT by ~50-60% over FY09-11E.
- **Gaming has a high return potential; but only from FY11E** — We view gaming vertical as a 'High Risk - High Return' segment. The three Ignition IPs - *Reich, Wardevil,* and *Angelic* - are expected to be released in Jul/Aug 2010, Dec 2010 and Jan 2011 respectively, and thus any uptick in margins from these would only be visible from FY11E. There is an exposure of US$15-20m on each game and break even would occur with 0.8-1m units, according to management.

Sell/High Risk	**3H**
Price (13 Mar 09)	Rs195.80
Target price	Rs190.00
from Rs250.00	
Expected share price return	-3.0%
Expected dividend yield	0.8%
Expected total return	**-2.2%**
Market Cap	Rs6,695M
	US$130M

Price Performance (RIC: UTVS.BO, BB: UTV IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2007A	463	22.34	375.7	8.8	2.5	29.4	1.3
2008A	577	24.68	10.5	7.9	1.1	18.1	0.5
2009E	1,027	26.52	7.5	7.4	0.5	11.1	0.8
2010E	1,024	25.77	-2.8	7.6	0.4	6.3	1.0
2011E	1,165	29.31	13.7	6.7	0.4	6.1	1.3

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

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Fiscal year end 31-Mar	2007	2008	2009E	2010E	2011E
Valuation Ratios					
P/E adjusted (x)	8.8	7.9	7.4	7.6	6.7
EV/EBITDA adjusted (x)	104.3	13.0	43.0	6.5	5.2
P/BV (x)	2.5	1.1	0.5	0.4	0.4
Dividend yield (%)	1.3	0.5	0.8	1.0	1.3
Per Share Data (Rs)					
EPS adjusted	22.34	24.68	26.52	25.77	29.31
EPS reported	21.63	25.01	26.52	25.77	29.31
BVPS	79.20	184.04	408.87	475.84	503.07
DPS	2.50	1.00	1.50	2.00	2.50
Profit & Loss (RsM)					
Net sales	1,749	4,342	5,976	10,132	12,665
Operating expenses	-1,709	-3,733	-5,826	-8,967	-10,906
EBIT	**40**	**608**	**151**	**1,164**	**1,760**
Net interest expense	-16	-60	215	-285	-375
Non-operating/exceptionals	283	116	750	300	200
Pre-tax profit	**307**	**664**	**1,116**	**1,179**	**1,585**
Tax	163	113	112	94	-95
Extraord./Min.Int./Pref.div.	-22	-193	-200	-250	-325
Reported net income	**449**	**584**	**1,027**	**1,024**	**1,165**
Adjusted earnings	463	577	1,027	1,024	1,165
Adjusted EBITDA	71	647	199	1,224	1,837
Growth Rates (%)					
Sales	-16.1	148.2	37.7	69.5	25.0
EBIT adjusted	-41.8	nm	-75.2	673.2	51.1
EBITDA adjusted	-38.5	808.3	-69.2	514.2	50.1
EPS adjusted	375.7	10.5	7.5	-2.8	13.7
Cash Flow (RsM)					
Operating cash flow	**375**	**-3,856**	**-6,027**	**-2,947**	**-1,903**
Depreciation/amortization	31	39	49	60	77
Net working capital	49	-4,554	-7,303	-4,281	-3,469
Investing cash flow	**-472**	**-73**	**-456**	**-597**	**-584**
Capital expenditure	-501	-243	-456	-597	-584
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**701**	**3,966**	**8,382**	**3,726**	**1,390**
Borrowings	622	1,060	0	303	1,500
Dividends paid	-65	-40	-58	-88	-110
Change in cash	**604**	**37**	**1,899**	**181**	**-1,097**
Balance Sheet (RsM)					
Total assets	**4,469**	**10,652**	**19,968**	**26,929**	**30,821**
Cash & cash equivalent	685	714	2,613	2,794	1,697
Accounts receivable	465	1,538	2,456	3,609	4,164
Net fixed assets	877	1,081	1,489	2,026	2,533
Total liabilities	**2,581**	**5,082**	**4,789**	**7,053**	**9,566**
Accounts payable	0	0	0	0	0
Total Debt	1,637	2,697	2,697	3,000	4,500
Shareholders' funds	**1,887**	**5,570**	**15,179**	**19,876**	**21,255**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	4.1	14.9	3.3	12.1	14.5
ROE adjusted	29.4	18.1	11.1	6.3	6.1
ROIC adjusted	8.7	14.7	2.4	7.2	7.6
Net debt to equity	50.5	35.6	0.6	1.0	13.2
Total debt to capital	46.5	32.6	15.1	13.1	17.5

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Maintain Sell (3H): Cutting Target Price to Rs190

Our sum-of-the-parts (SOTP) based target price is Rs190, revised from Rs250 earlier:

Figure 1. UTV Software Communications: Sum of the Parts Target Price

	EV/EBIT Multiple	FY10 EBIT	EV adjusted for MI	Fair Value per share
Movies	6.5x	1,329	6,650	167
TV	1.5x	63	94	2
Interactive				27
- Ignition	5.5x	151	583	
- Indiagames	5.5x	44	143	
- Truegames	5.5x	75	330	
Net cash on books			-206	(6)
Equity value			**7,264**	**190**

Source: Citi Investment Research and Analysis estimates

Our valuations to the various businesses are explained below:

1. **Movies:** The movie business is the key driver of profitability, despite its inherent risks. We value the business at an EV/EBIT of 6.5x FY10E EBIT (cut from 7x earlier) to factor in a correction in global comps. We value movies at ~10% premium to the global filmed entertainment universe. The premium is because of the higher growth and scarcity premium applied to UTV – delivering an EBIT CAGR of c66% over FY08-10E. 9mFY09 film business performance was below expectations as the releases of a few films, including large budget films (*Main aur Mrs. Khanna* and *Kaminey*) were delayed.

2. **Television:** We value the TV content business at 1.5x (2x earlier) FY10E EBIT, which is at a ~50% discount to Balaji Telefilms – one of the leaders in TV content space - based on consensus earnings. UTV's operating margins for TV vertical have contracted significantly in FY09E and management expects these to remain at the ~5-6% levels even in FY10E.

3. **Gaming:** We benchmark the gaming vertical with the regional valuations. We increase the multiple on this segment from to 5.5x FY10E v/s. 3.5x FY10E EV/EBIT earlier in line with the increase in regional multiples. We expect a strong operating profit growth of c54% over FY08-10E for this vertical. The real growth could be witnessed only from FY11E onwards, when the upside from the 3 Ignition games could be seen.

We don't ascribe any value to the broadcasting and new media businesses, as of now, given that these are investment mode and lack of earnings visibility.

Gaming Content - High Return/High Risk

The management is focusing on Ignition's three IPs to drive high growth. The releases of Reich, Wardevil and Angelic have been delayed to Jul/Aug 2010, Dec 2010 and Jan 2011 respectively. The gaming content business has a high return potential - but any meaningful upside would only be visible from FY11E. The exposure per game is US$15-20m (ex marketing budget); break even sales would occur with 0.8-1m units, according to management.

In Figure 2, we have an illustrative example, analysing any Ignition game. The key assumptions are (a) UTV gets ~US$30 per unit out of the ~US$60 ASP per unit; (b) ~US$18m development cost (could be ~US$15-20m as per company estimates); and (c) for the sake of simplicity and illustration, we have assumed marketing and operating cost to be ~15% of revenues although we realize that there is certain amount of spend which will happen irrespective of the success of the game and hence part of this expense is actually fixed in nature.

The key factors which could change the dynamics are (a) Cost overruns which could happen due to the launch getting delayed; and (b) Higher marketing spends that what we have factored in.

Figure 2. Scenario Analysis for an Ignition game

No of units sold (units)	1,500,000	1,000,000	800,000	600,000
Realization (US$/unit)	30	30	30	30
Revenues (US$m)	45	30	24	18
Revenues (Rsm)	**2,160**	**1,440**	**1,152**	**864**
Development Cost Write-off (Rsm)	864	864	864	864
Gross Profit (Rsm)	**1,296**	**576**	**288**	**0**
Other Operating/Marketing Spend (Rsm)	324	216	172.8	129.6
As a % of Sales	*15%*	*15%*	*15%*	*15%*
EBIT (Rsm)	**972**	**360**	**115**	**-130**
EBIT Margin (%)	*45%*	*25%*	*10%*	*-15%*

Source: Company and CIRA

The recently acquired start up, True Games is likely to remain in investment mode for another year. Indiagames growth should continue from both the mobile gaming segment and PC based Games on Demand. We expect ~100% EBIT CAGR over FY08-11E from this segment; large part of the growth should be back ended.

Revising Estimates

Figure 3. UTV Software Communications: Earnings Revision Summary

Year to	Sales			Net Profit (Rs Mils.)			Diluted EPS (Rs)		
31-Mar	Old	New	% Chg	Old	New	% Chg	Old	New	% Chg
2009E	7,433	5,976	-19.6%	729	1,027	40.8%	18.83	26.52	40.8%
2010E	11,174	10,132	-9.3%	1,161	1,024	-11.8%	29.22	25.77	-11.8%
2011E	13,410	12,665	-5.6%	1,365	1,165	-14.7%	34.35	29.31	-14.7%

Source: Citi Investment Research and Analysis estimates

We reduce our EPS estimates by 12-15% over FY10/11E, but increase them by ~41% for FY09E due to the increase in other income and interest income from the last quarter. Revenues have been cut by 6-20% over FY09-11E for the consolidated entity.

However, it would make more sense to view operating profits as reported PAT would include interest incomes, non recurring income and tax write backs. Our EBIT estimates have been cut by 15-66% over FY09-11E, as we reduce estimates for different segments, especially TV and filmed entertainment verticals.

UTV Software Communications

Company description

UTV Software Communications is an integrated media and entertainment company with a presence in Indian and international film production and distribution, television content, broadcasting, gaming and new media. It started by producing ad-films and then TV content in 1990 for state-owned Doordarshan and later Zee TV. UTV ventured into movie production and distribution in 1998. In 2005, it launched Hungama, which became the top kids' channel within a year. UTV sold Hungama to Walt Disney Co. Disney recently raised its stake to 32.1%. Disney and UTV are equal partners with Indian promoters having management control. UTV listed its movie subsidiary UTV Motion Pictures Plc (UTV IOM) on London Stock Exchange's AIM market raising US$70m by offloading a 23% stake. It acquired an online and mobile gaming company, Indiagames, and console game company Ignition, which would give it presence across the integrated media value-chain. UTV has also re-entered the broadcasting space through the launch of four channels.

Investment strategy

We rate UTV Sell/High Risk (3H), believing that its current valuations price in our ~53% revenue as well as ~38% EBIT CAGR estimates for FY08-10E. Various businesses are inherently volatile or are at nascent stages, increasing execution risk. That said, UTV is one of few listed integrated media players in India, straddling the media value chain from motion pictures, broadcasting and TV content to high-growth gaming and new media businesses. UTV broke new ground in India's motion picture business by operating a studio-like model. Relationships with international production houses like Walt Disney, 20th Century Fox and Overbrook Entertainment have catapulted UTV into the international motion picture space.

Valuation

Our target price of Rs190 is based on sum of the parts. We use EV/EBIT for most divisions, as this is the most widely used method in the absence of segmental profitability beyond the EBIT level. In nascent segments, where EBIT is negative, we are not ascribing any value. We value the movie business at 6.5x FY10E EV/EBIT. This is at ~10% premium to the global filmed entertainment universe, justified in our view given the growth and scarcity premium applied to UTV. We value the TV content business at a FY10E EV/EBIT of 1.5x, which is at a 50% discount to Balaji Telefilms - one of the segment leaders in India - based on consensus earnings. We benchmark the gaming vertical with the regional valuations and ascribe FY10E EV/EBIT of 5.5x, at par with global peers. We do not ascribe any value to the broadcasting and new media business despite good growth prospects as the business is in its early stages and there is limited clarity on earnings.

Risks

Using our quantitative risk-rating system, which tracks 260-day historical share price volatility, we rate UTV High Risk. Upside risks that could prevent the stock from achieving our target price include: 1) The movie business doing better than expected could result in upside surprises to our estimates; 2) The gaming business could be valued at higher levels. Gaming remains a growth business globally. While we value UTV's gaming business at par with global peers, a higher valuation accorded to UTV's gaming business (on account of higher growth) could result in upside; 3) UTV has talked of more acquisitions in the mobile content aggregation and TV content space. Any value accretive acquisition would pose an upside risk to our target price.

Appendix A-1

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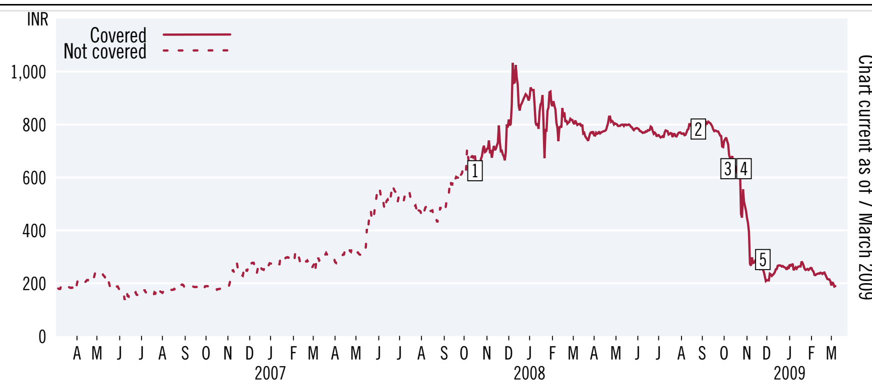
Analyst: Surendra Goyal, CFA
Covered since April 3 2008



Date	Rating	Target Price	Closing Price
1 16-Oct-07	*1H	*887.00	679.95
2 26-Aug-08	*3H	*753.00	790.40
3 7-Oct-08	3H	*662.00	726.05
4 29-Oct-08	3H	*450.00	508.45
5 25-Nov-08	3H	*250.00	251.70

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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