Elara Capital

Entertainment Network India

Global Markets Research

Phase III: Music to ears

Cabinet approves radio phase III licensing policy

The Union Cabinet has approved the I&B ministry's proposal of the FM Radio's Phase III licensing policy, which will allow private radio players to expand footprints across the country. The radio Phase III policy will open FM radio services to about 227 new cities, in addition to the present 86 cities, with a total of 839 new FM radio channels. The government expects to raise about INR17.3bn from the auction working out to about INR21mn per channel. The ministry raised INR1.5bn from Phase-I licensing, while it raised over INR9bn from Phase II round of licensing.

Capex within limits

The 15% limit, at the national level ownership of channels, will allow ENIL to buy a maximum of 131 channels of the total 1,087 channels (existing 248 channels and new phase III licenses 839). A ball park addition of 100 channels at an average licensing cost of INR21mn would entail a license acquisition cost of INR2.1bn. Further a set up cost of INR15mn per channel could lead to INR1.5bn. Thus the company could require a capital of maximum INR3.6bn for capex. With a cash balance of INR1bn and debt free status, we believe the company is well placed to raise capital from multiple sources and limited equity dilution.

Key catalysts in favor of strong earning opportunity

Factors like content diversification, multiple frequencies will offer higher inventories and allow radio players to play different genre of content and tap wider gamut of advertisers. Further networking and resolution of royalty issues will contain costs and allow radio players to tap smaller ad markets with profitable avenues. The I&B ministry has also reduced the lock-in period from five to three years, which will provide good acquisition opportunities to stronger players and reduce competition. We believe, phase III will drive the next leg of growth for radio companies and ENIL, being the sole PAT profitable player will gain significantly.

Valuation

At CMP of 278, ENIL is trading at an implied EV/EBITDA of 10.6x and 8,7x on FY12E and FY13E respectively. The stock provides 12% from our target price of INR310. We remain bullish on the stock and will revise out estimates as more clarity emerges on the phase III licensing costs.

Rating : Accumulate

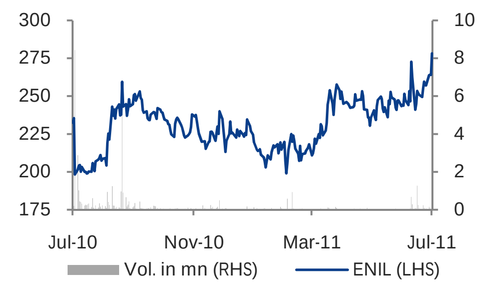
Target Price : INR310
Upside : 12%
CMP : INR278 (as on 7 July 2011)

Key data*

Bloomberg /Reuters Code	ENIL IN/ ENIL.BO
Current /Dil. Shares O/S (mn)	47.7/47.7
Mkt Cap (INRbn/US$mn)	13/ 298
Daily Vol. (3M NSE Avg.)	69,776
Face Value (INR)	10
1 US$= INR44.5	

Source: Bloomberg ; * As on 7 July 2011

Price & volume



Source: Bloomberg

Share holding (%)	Q1FY11	Q2FY11	Q3FY11	Q4FY11
Promoter	71.2	71.2	71.2	71.2
Institutional Investors	10.9	13.5	14.6	16.7
Other Investors	6.9	7.7	6.9	5.9
General Public	11.0	7.6	7.4	6.3

Source: BSE

Price performance (%)	3M	6M	12M
Sensex	(2.6)	(3.1)	9.2
ENIL	11.6	26.7	19.6
Reliance Media Works	(27.2)	(36.7)	(40.2)

Source: Bloomberg

Key Financials

Y/E Mar (INR mn)	Rev	YoY (%)	EBITDA	EBITDA (%)	Adj PAT	YoY (%)	Fully DEPS	RoE (%)	RoCE (%)	P/E (x)	EV/EBITDA (x)
FY09	4,293	3.0	(61)	(1.4)	(603)	NA	(12.6)	(14.5)	(10.4)	NA	NA
FY10	4,228	(1.5)	445	10.5	(154)	NA	(3.4)	(3.7)	(1.7)	NA	29.3
FY11E	4,635	9.6	1,016	21.9	380	NA	7.1	4.6	15.2	39.3	12.8
FY12E	3,664	(21.0)	1,227	33.5	646	276.1	13.5	14.5	19.8	20.5	10.6
FY13E	4,113	12.3	1,493	36.3	847	31.2	17.8	15.9	21.8	15.6	8.7

Source: Company, Elara Securities Estimate

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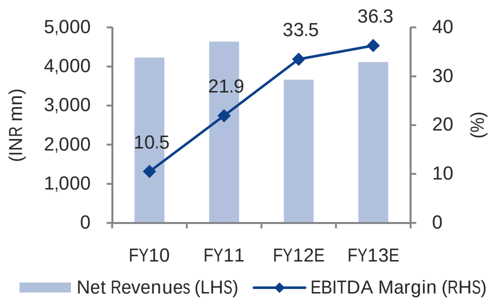
Consolidated Financials (Y/E Mar)

Income Statement (INR mn)	FY10	FY11	FY12E	FY13E
Net Revenues	4,228	4,635	3,664	4,113
EBITDA	**445**	**1,016**	**1,227**	**1,493**
Less :- Depreciation & Amortization	526	423	326	316
EBIT	**(81)**	**594**	**901**	**1,177**
Less:- Interest Expenses	121	22	-	-
Add:- Non operating Income	7	16	-	-
PBT	**(195)**	**587**	**901**	**1,177**
Less :- Taxes	23	214	255	329
Reported PAT	**(218)**	**372**	**646**	**847**
Minority Interest (16.5%)	(65)	(7)	-	-
Adjusted PAT	**(154)**	**380**	**646**	**847**
Balance Sheet (INR mn)	**FY10**	**FY11**	**FY12E**	**FY12E**
Share Capital	477	477	477	477
Reserves	3,490	3,347	3,993	4,840
Borrowings	574	-	-	-
Minority Interest	134	-	-	-
Deferred Tax Liability		89	89	89
Total Liabilities	**4,675**	**3,912**	**4,558**	**5,405**
Gross Block	4,501	3,781	3,780	3,878
Less:- Accumulated Depreciation	1,822	1,967	2,293	2,609
Net Block	2,678	1,814	1,488	1,269
Add:- Capital work in progress	39	-	-	-
Deferred Tax (Net)	69			
Investments	17	873	873	873
Net Working Capital	1,557	1,224	2,197	3,262
Other Assets	315	-	-	-
Total Assets	**4,675**	**3,912**	**4,558**	**5,405**
Cash Flow Statement (INR mn)	**FY10**	**FY11**	**FY12E**	**FY12E**
Cash profit adjusted for non cash items	331	1,009	1,227	1,493
Add/Less : Working Capital Changes	574	287	183	(50)
Operating Cash Flow	1,265	998	1,155	1,113
Less:- Capex	(71)	407	1	(98)
Free Cash Flow	1,193	1,405	1,156	1,015
Financing Cash Flow	(1,041)	(597)	-	-
Investing Cash Flow	(71)	(450)	1	(98)
Net change in Cash	**153**	**(48)**	**1,156**	**1,015**
Ratio Analysis	**FY10**	**FY11**	**FY12E**	**FY12E**
Income Statement Ratios (%)				
Revenue Growth	(1.5)	9.6	(21.0)	12.3
EBITDA Growth		128.5	20.7	21.7
PAT Growth	NA	NA	276.1	31.2
EBITDA Margin	10.5	21.9	33.5	36.3
Net Margin	(3.6)	3.7	17.6	20.6
Return & Liquidity Ratios (%)				
Net Debt/Equity (x)	0.1	(0.1)	(0.3)	(0.5)
ROE (%)	(3.7)	4.6	14.5	15.9
ROCE (%)	(1.7)	15.2	19.8	21.8
Per Share data & Valuation Ratios				
Diluted EPS (INR/Share)	(3.4)	7.1	13.5	17.8
EPS Growth (%)	NA	NA	91.6	31.2
DPS (INR/Share)	-	-	-	-
P/E Ratio (x)	NA	39.3	20.5	15.6
EV/EBITDA (x)	29.3	12.8	10.6	8.7
EV/Sales (x)	3.1	2.8	3.6	3.2
Price/Book (x)	3.2	3.5	3.0	2.5
Dividend Yield (%)	NA	NA	NA	NA

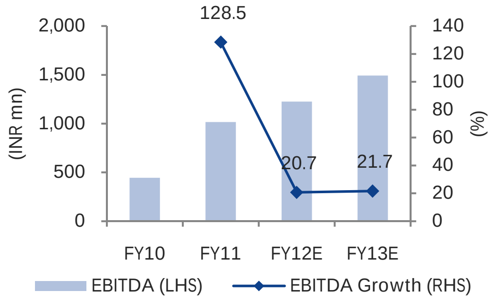
Source: Company, Elara Securities Estimates

Revenue & margins growth trend



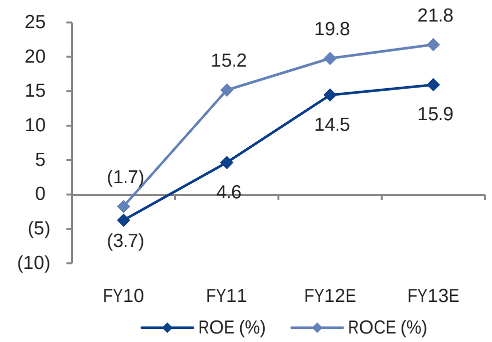
Source: Company, Elara Securities Estimates

EBITDA margin trend



Source: Company, Elara Securities Estimates

Return ratios

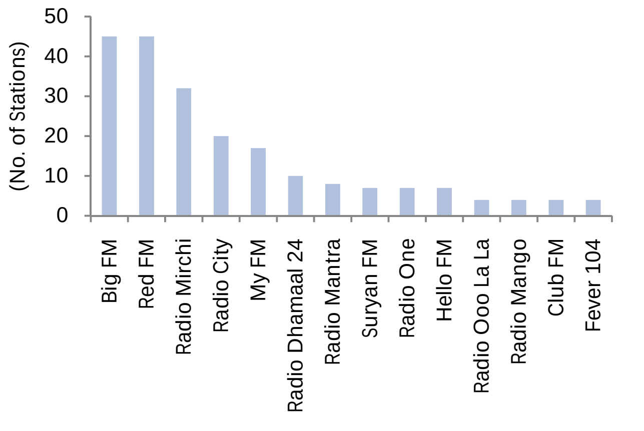


Source: Company, Elara Securities Estimates

Cabinet approves radio phase III licensing policy

The Union Cabinet has approved licensing of third phase of FM radio which will allow private radio players to expand footprints across the country. The radio Phase III policy will open FM radio services to about 227 new cities, in addition to the present 86 cities, with a total of 839 new FM radio Channels. The government expects to raise about INR17.3bn from the auction working out to be about INR21mn per channel. The ministry raised INR 1.5bn from Phase-I licensing, while it raised over INR9bn from Phase II round of licensing.

Exhibit 1: Private Players - No of stations



Source: India Media and Entertainment report, PWC

Exhibit 2: ENIL's categorywise presence

Categories	Total cities	ENIL's Presence
A+	4	4
A	9	9
B	17	11
C	47	7
D	13	1
	90	32

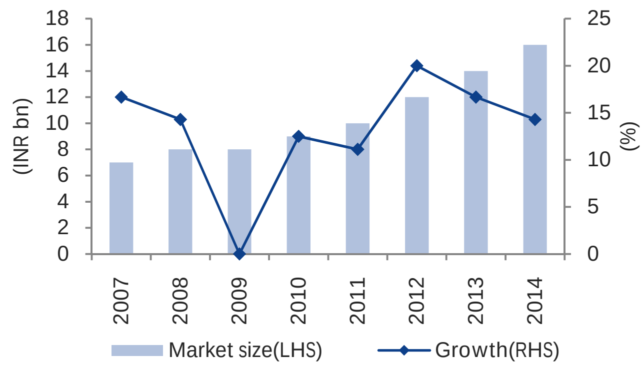
Source: Company

The I&B ministry announced that the E-auction will be conducted in batches and number of batches will be decided by the Ministry of I&B, depending upon the response from the bidders after auction of first batch. Earlier the ministry had indicated it will be in three batches, grouped as existing and new cities. It will come out with information memorandum indicating the cities, reserve prices city-wise, number of channels to be taken up in each batch and other procedures for e-auction

Offers scalability proposition to radio players

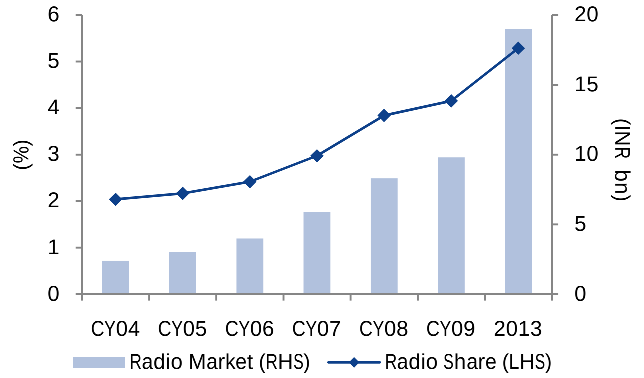
The radio industry currently standing at about INR10bn is left with limited free capacity in the system. In order to grow further the industry requires a wider target market and a higher operating scale. We believe, offering of new channels in existing as well as new cities will allow the radio industry to cater to larger audience and thus expand operations.

Exhibit 3: Radio ad market



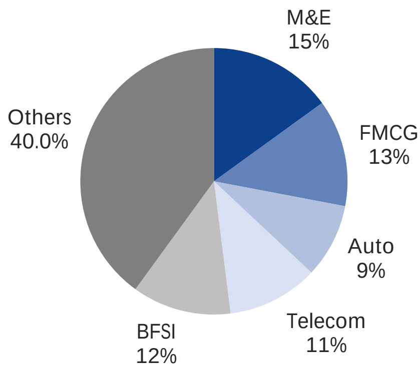
Source: KPMG report

Exhibit 4: Radio ad market



Source: KPMG report

Exhibit 5: Advertisement mix



Source: KPMG report

Currently radio ad market contributes about 5% of the overall ad pie, in comparison to world average of about 8%, and over 12% in US and UK. Phase II allowed radio industry to take the leap from about 1.5% of overall ad pie to 4%. We believe, phase III will enable the company to take the next leap from current level of about 5% to nearly 7%-8% of the ad pie.

The industry is expected to grow about 16%-18% as per KPMG's report. We believe, phase III would allow the industry to grow at a higher rate of about 25%-30%, led by higher inventory availability and listenership base.

Capex within limits

The limit on the ownership of channels, at the national level, allocated to an entity has been retained at 15%. Thus with an addition of 839 channel to the current about 238 channels, the overall channels work out to be about 1,087.

The limit on ownership of 15% channels allows any broadcaster to own maximum of about 163 channels. With the current operation of 32 channels, ENIL can add a maximum of another 131 channels. A ball park addition of 100 channels in its kitty and an average licensing cost of INR21mn would entail a license acquisition cost of INR2.1bn for the company. Further a capex cost of INR15mn per channel to set up the station could lead to INR1.5bn. Thus the company could require a capital of maximum INR3.6bn to undergo the capex. ENIL has a cash balance of INR1bn, an expected operating cashflow of INR1.1bn in FY12E. and is completely debt free. Thus, we believe the company is well placed to raise capital from multiple sources with limited equity dilution.

Key catalyst

Content diversification

Radio operators have been permitted to carry news bulletins of All India Radio and are also permitted to broadcast current affairs content. We believe this will act as a key catalyst in increasing the radio listenership base, thus expanding the target market. Until now, radio companies were restricted to broadcasting only music on radio and thus could only attract music listeners on radio. Further since all radio companies were playing the same content, there was limited content differentiation among players. We believe, the advent of different genre of content will enable radio players to tap a wider advertising market and thus expand the market size.

Allowance of Multiple Frequencies

Private operators have been allowed to own more than one channel but not more than 40% of the total channels in a city subject to a minimum of three different operators in the city. Operating multiple frequencies in one city could be a key positive for a player like ENIL, which being the market leader with 35% market share has exhausted free capacity in Tier I cities and thus would have limited volume growth opportunities. Further owning multiple frequencies in an environment of content differentiation will allow the company to operate different genres of content like English music, news, current affair, and others. Since this may not be mass attraction, the broadcaster may not employ the primary channel for such content. However, with lower opex and capex for second channel in the same city, the broadcaster would be willing to tap the niche through multiple frequencies.

Networking allowed

Networking of channels will be permissible within a broadcaster's own network across the country. With networking allowed, radio companies can operate a hub and spoke model with one major base in a large city operating all the smaller stations around the city. Typically, the capex to set up a station would be about INR30-40mn. With the networking in place, ENIL management expects to save about 50%-60% capex and reducing the capex to INR10-20mn per station.

With most of the stations likely to come in smaller towns, with low ad market of about less than INR50mn, a lower capex would allow the radio companies to have better payback period.

Reduction in the locking period

Promoters/majority shareholders are allowed to sell their stake after three years of operation from the present 5 years. This leaves all broadcasters open for acquisition, as the existing channels have completed over four years of operation, starting in FY06-07 at the time of phase II. The overall radio market has accumulated losses of over INR20bn, thus we believe, smaller player that are bleeding and have weak balance sheetswould be on sale. ENIL has been eying acquisitions, and this could provide good opportunity for inorganicgrow.

Limited players in small cities

FM Phase-III proposes a maximum of 3 channels in D category cities. (Population of 0.1-0.3mn). Small cities have ad pie of less than about INR50mn, thus, a player with 30%-40% market share operating with about 25% EBITDA margin should have a payback of about four years. Anything lower than this would not provide sufficient incentive to bidders in smaller cities.

Key Challenges

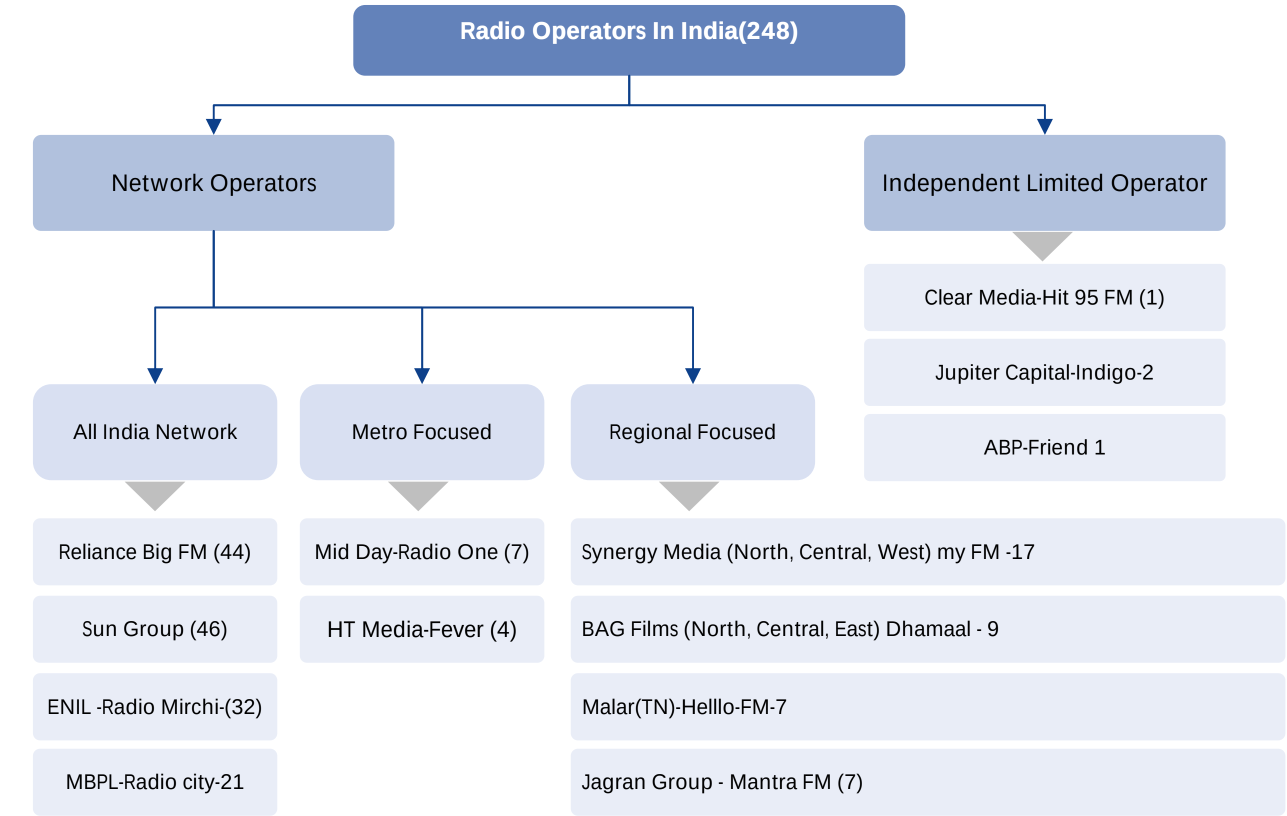
Aggressive bidding

Aggressive bidding could lead to high break even and payback period, making it a loss making proposition.

Slowdown in ad market

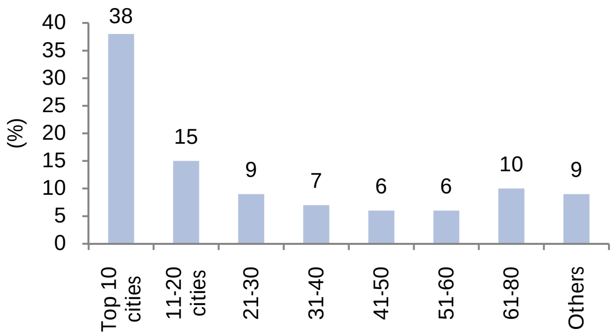
Any slowdown in ad market may increase ad inventories subsequently impacting ad rates.

Exhibit 6: Total Radio Operators in India



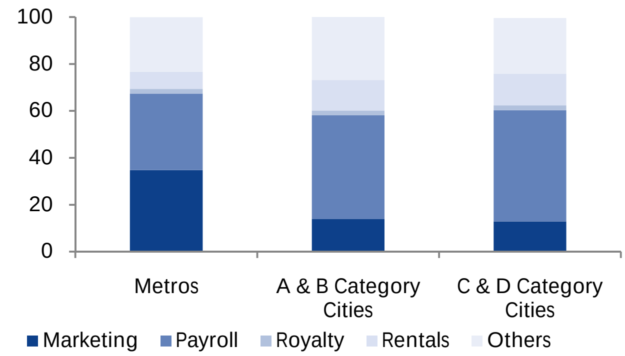
Source: KPMG report

Exhibit 7: Listenership Share



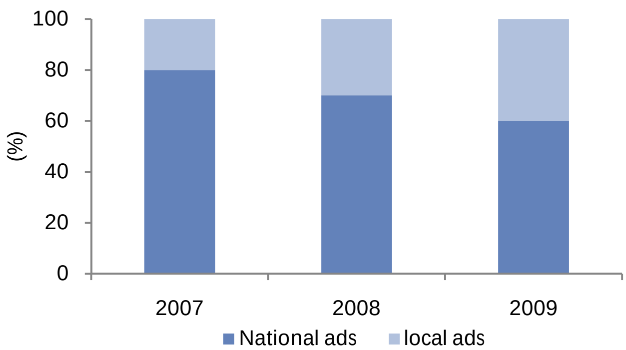
Source: KPMG report

Exhibit 9: Station wise cost structure (%)



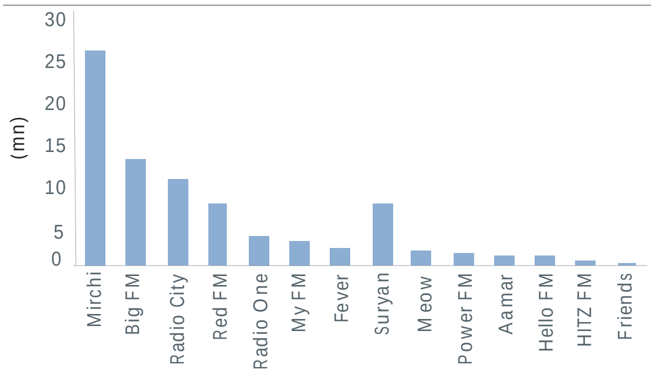
Source: Report - FM Radio and Broadcasting Industry India report

Exhibit 8: Share of radio ad revenues



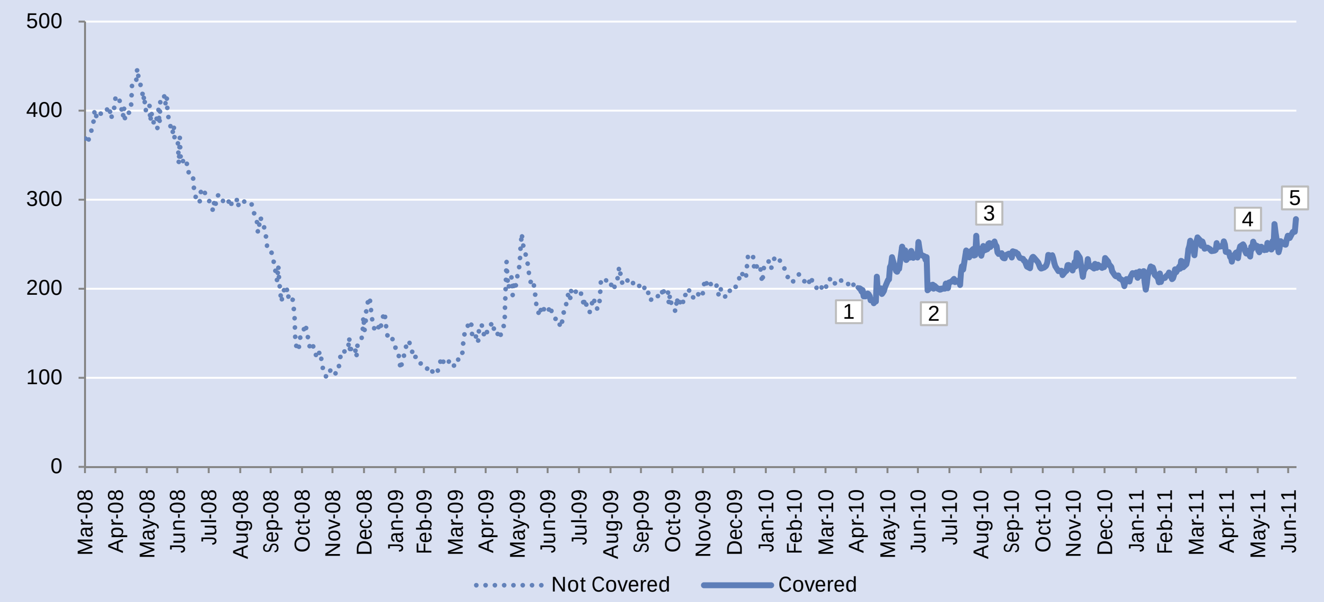
Source: KPMG report

Exhibit 10: Listenership of radio operators



Source: IRS

Coverage History



	Date	Rating	Target Price	Closing Price
1	7-May-2010	Buy	INR272	INR192
2	12-Jul-2010	Buy	INR253	INR202
3	25-Aug-2010	Buy	INR290	INR238
4	24-May-2011	Buy	INR310	INR247
5	8-July-2011	Accumulate	INR310	INR278

Guide to Research Rating

BUY	Absolute Return >+20%
ACCUMULATE	Absolute Return +5% to +20%
REDUCE	Absolute Return -5% to +5%
SELL	Absolute Return < -5%

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