

Company In-Depth

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Zee Telefilms (ZEE.BO)

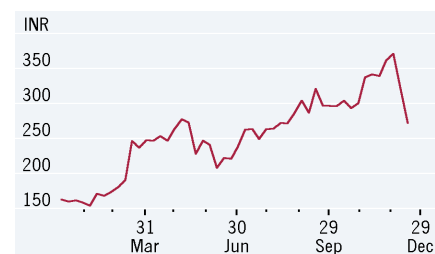
Buy: Management Turns More Aggressive on Growth Guidance

 Rating change
 Target price change
 Estimate change

- Management gung-ho about growth** — Zee management stated at its analyst meet that it needs to revise growth estimates upwards for the recently spun off cable business, WWIL. WWIL's subscriber base has increased from 6.8m to 9m, driven by MSO acquisitions. Of these, we estimate that 1m are paid customers
- HITS to be implemented by Mar'07** — WWIL is likely to implement HITS (head end in the sky) platform by Mar '07, which will allow it to significantly enhance its digital footprint across the country. WWIL management has guided at overall revenues of Rs35bn by FY12 and EBITDA margin of 25%. WWIL has earmarked a capital expenditure of about Rs7bn over the next three years.
- Zee News margins are healthy** – ZNL management guided at 35% EBITDA margins for the ongoing business, although new business losses have pared overall margins to about 20%. ZNL expects revenues of about Rs9bn and EBOTDA margin of 35% by FY11.
- CAS takes off, finally!** — After a hiatus of over 5 years, conditional access has finally taken off. According to Zee, 300,000 set-top boxes have been seeded over the last 2 months in CAS designated areas. These areas can incrementally add Rs250m-Rs300m to revenues (flowing through to PBT) for Zee Entertainment.
- WWIL and ZNL to list on 10th January** — Given that WWIL and ZNL have been spun off, we adjust our SOTP-based target price for ZEE to Rs313 (Rs253 for Zee Entertainment and Rs60 for DISH TV). We expect WWIL to list at Rs138 per share and ZNL to list at Rs52 per share. Zee will go ex-DISH TV in 2nd/3rd week of January and DISH will likely list in 1st/2nd week of February.

Buy/Low Risk	1L
Price (08 Jan 07)	Rs274.50
Target price	Rs313.00
	<i>from Rs406.00</i>
Expected share price return	14.0%
Expected dividend yield	1.2%
Expected total return	15.3%
Market Cap	Rs117,624M
	US\$2,662M

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



See page 5 for Analyst Certification and important disclosures.

Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2005A	3,173	7.69	1.3	35.7	8.5	26.2	0.4
2006A	1,996	4.83	-37.2	56.8	11.1	17.0	0.3
2007E	2,262	5.20	7.7	52.7	9.8	20.2	0.2
2008E	3,526	8.11	55.9	33.8	8.5	26.9	1.2
2009E	4,581	10.54	29.9	26.0	7.4	30.4	2.0

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	35.7	56.8	52.7	33.8	26.0
EV/EBITDA adjusted (x)	27.6	48.7	42.3	25.6	18.5
P/BV (x)	8.5	11.1	9.8	8.5	7.4
Dividend yield (%)	0.4	0.3	0.2	1.2	2.0
Per Share Data (Rs)					
EPS adjusted	7.69	4.83	5.20	8.11	10.54
EPS reported	7.69	4.83	5.20	8.11	10.54
BVPS	32.16	24.64	28.00	32.40	36.95
DPS	1.14	0.71	0.54	3.38	5.51
Profit & Loss (RsM)					
Net sales	13,079	10,511	13,650	16,645	19,056
Operating expenses	-9,057	-8,309	-11,135	-12,416	-13,272
EBIT	4,022	2,202	2,514	4,229	5,784
Net interest expense	-207	-222	-155	-109	-76
Non-operating/exceptionals	521	457	400	400	400
Pre-tax profit	4,336	2,437	2,759	4,521	6,108
Tax	-1,023	-460	-497	-995	-1,527
Extraord./Min.Int./Pref.div.	-140	19	0	0	0
Reported net income	3,173	1,996	2,262	3,526	4,581
Adjusted earnings	3,173	1,996	2,262	3,526	4,581
Adjusted EBITDA	4,351	2,412	2,764	4,509	6,104
Growth Rates (%)					
Sales	-4.5	-19.6	29.9	21.9	14.5
EBIT adjusted	0.8	-45.3	14.2	68.2	36.8
EBITDA adjusted	1.0	-44.6	14.6	63.1	35.4
EPS adjusted	1.3	-37.2	7.7	55.9	29.9
Cash Flow (RsM)					
Operating cash flow	4,790	3,169	2,613	1,964	2,899
Depreciation/amortization	329	210	250	280	320
Net working capital	1,288	963	100	-1,842	-2,001
Investing cash flow	-45	-250	-250	-250	-250
Capital expenditure	-45	-250	-250	-250	-250
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	27	-1,201	-137	-1,723	-2,560
Borrowings	555	-868	114	-150	0
Dividends paid	-529	-332	-251	-1,573	-2,560
Change in cash	4,771	1,719	2,226	-9	90
Balance Sheet (RsM)					
Total assets	23,388	18,477	21,086	25,095	29,197
Cash & cash equivalent	1,571	2,665	26	2,989	4,935
Accounts receivable	5,344	3,987	4,814	5,442	6,356
Net fixed assets	4,101	1,626	1,376	1,346	1,276
Total liabilities	9,727	7,866	8,431	10,478	12,549
Accounts payable	3,206	2,575	3,064	3,434	3,979
Total Debt	5,304	4,436	4,550	4,400	4,400
Shareholders' funds	13,661	10,611	12,655	14,617	16,648
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	33.3	22.9	20.3	27.1	32.0
ROE adjusted	26.2	17.0	20.2	26.9	30.4
ROIC adjusted	20.6	15.2	19.4	29.5	41.0
Net debt to equity	27.3	16.7	35.8	9.7	-3.2
Total debt to capital	28.0	29.5	26.4	23.1	20.9

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Zee De-merger Timeline and SOTP Valuation Table

Figure 1. Zee – De-merger Timeline

Timing	Event
Dec 18 2006	Zee share went ex WWIL (Cable business) and Zee News (News and regional channels)
Dec 22-Dec24 2006	Book Closure date for determining eligibility of issuance of equity shares by WWIL and Zee News
10 th Jan 2006	Listing of WWIL and Zee News
2 nd - 3 rd Week Jan 2006	Zee share goes ex-DISH TV (DTH Business)
1 st -2 nd Week of Feb 06	Likely listing of DISH TV

Source: Company Reports and CIR Estimates

Figure 2. Sum-of-the-Parts Valuation and Expected Listing Value per De-merged Business Share

Businesses / Assets Owned	Fully Diluted Shares on listing (Million)	% Ownership of current Zee Shareholders	No of shares awarded for every 100 shares held in Zee before ex-date	CIR Fair value estimate per share post listing for each business	Implied Value for each current Zee share - Sum of parts	Basis of Valuation
Zee Entertainment Broadcasting business including all domestic and international broadcasting. Channels include Zee TV, Zee Cinema, Zee Sports, Zee Music, Zee Smile, Zee Jagaran, Zee Premier, Zee Action, Zee Trendz, Zee Café, Zee Classic, Zee Studio. Also owns investment in Ten Sports, Zee Turner and etc Networks	435.0	100.0	100.0	Rs253	Rs253	Based on 30x FY08E P/E, at a premium to global peer group average
Zee News All news and regional broadcasting channels, including Zee News, Zee Business, Zee Marathi, Zee Bangla, Zee Gujarati, Zee Telegu, Zee Kannada and 24 Ghante	240.4	80.0	45.0	Rs52	Rs24	Based on 30x FY08E P/E, at-par with Indian news channels trading multiples
WWIL Cable MSO (multi system operator) with connectivity to 6.7m households. However, current addressable subscriber base in only 1m	217.8	100.0	50.0	Rs138	Rs69	Based on 20% discount to DCF valuation
DISH TV Satellite TV (DTH) player with 1.6m subscribers	428.9	57.0	57.0	Rs105	Rs60	Based on 20% discount to DCF valuation

Source: Company Reports and Citigroup Investment Research Estimates

Zee Telefilms

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. Zee has been investing heavily in new businesses, including new channels and content.

Investment thesis

We rate Zee as Buy/Low Risk (1L). We view the recent restructuring announcement by Zee's management in which the company is looking to split its business into four entities as positive because this should add focus to the business and unlock value. The restructuring 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. In addition, hiving off of the DTH business would increase transparency pertaining to Zee's funding of ASC enterprises, which is the private holding entity of the DTH business. By separating the broadcasting business from the distribution business, Zee will likely emerge as a more focused entity, in our view.

Valuation

Our target price for Zee of Rs313 is based on a sum-of-parts valuation. Our sum-of-the-parts valuation is based on: 1) Zee Entertainment: We use a 30x P/E multiple which returns a value of Rs253 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. 2) ASCL (DTH Business): We value the DTH business at Rs60 per Zee share based on our DCF methodology. Our primary valuation methodology for valuing the DTH businesses is DCF in view of increased disclosures on the business by Zee management, which has enabled us to model future cash flows. As a secondary methodology, we use Market Cap/Sales multiples, valuing DTH business between 3x-4x FY08E revenues. This is at a premium to global distribution companies, which we believe is warranted given more than 50-65% higher growth rates for these businesses in India compared with the global benchmark. Our market/cap to sales multiple returns a value range of Rs80-Rs90 value range of DTH per share of Zee.

Risk

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: inability to execute the proposed restructuring (could be on account of regulatory issues); an economic slowdown, which could result in a decline in advertising growth rates; the loss of channel ratings; 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.

Analyst Certification Appendix A-1

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Zee Telefilms (ZEE.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Princy Singh (covered since November 24 2004)



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