Company Focus

25 October 2007 | 10 pages

UTV Software Communications (UTVS.BO)

Buy: 1H Strong, 2H Stronger

- **Robust 2QFY08** – UTV reported a net profit growth of 221% in 2QFY08 to Rs130mn, which albeit on a low base, was way ahead of our estimates. Sales grew by 84% driven primarily by movie revenues. EBITDA margin expanded by 955bps as high margin revenue streams from movie content kicked in.
- **Movies lead the way –** Movie revenues grew 663% in 2QFY08 on the back of ancillary revenues. Interactive revenue growth, however, was subdued at 17.5% as (1) there were no game releases this quarter and (2) Indiagames was not consolidated pending closure of the deal. TV content revenues declined 5% due to high base of last year, which included syndication revenues.
- **Blockbuster 2H –** We expect UTV to report a stronger 2HFY08 on the back of (1) strong movie pipeline of eight releases, (2) monetization of past Hollywood movies, (3) new game launches in 4Q, (4) consolidation of Indiagames and (5) stronger TV content revenues as the impact of new programs and UTV's own broadcasting initiatives sets in.
- **Strong guidance** – Management has reiterated its FY08 guidance; revenues of Rs4b and net profit of Rs800mn. While there is upside to our FY08 PAT forecast (Rs323m), we maintain our estimates due to risk associated with box office revenues.
- **Reiterate Buy (1H)** – UTV is a strong integrated play on the high-growth segments of movies, gaming & broadcasting offering 55%, 3-year earnings CAGR. Buy (1H).

Buy/High Risk	**1H**
Price (25 Oct 07)	Rs680.90
Target price	Rs887.00
Expected share price return	30.3%
Expected dividend yield	0.3%
Expected total return	**30.5%**
Market Cap	Rs15,588M
	US$394M

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 (%)
2006A	91	4.69	-43.8	145.1	9.9	6.8	0.0
2007A	198	8.66	84.5	78.7	8.6	12.6	0.4
2008E	323	13.01	50.3	52.3	6.8	15.1	0.3
2009E	629	25.31	94.5	26.9	5.6	22.9	0.5
2010E	807	32.48	28.3	21.0	4.6	24.0	0.7

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	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	147.8	80.1	53.3	27.4	21.3
EV/EBITDA adjusted (x)	140.0	nm	22.9	12.8	10.2
P/BV (x)	10.1	8.8	6.9	5.7	4.6
Dividend yield (%)	0.0	0.4	0.3	0.5	0.7
Per Share Data (Rs)					
EPS adjusted	4.69	8.66	13.01	25.31	32.48
EPS reported	7.29	20.24	13.01	25.31	32.48
BVPS	68.64	79.20	99.78	121.51	149.39
DPS	0.00	2.85	1.84	3.58	4.59
Profit & Loss (RsM)					
Net sales	2,084	1,749	3,882	6,246	8,038
Operating expenses	-2,016	-1,709	-3,269	-5,155	-6,677
EBIT	**68**	**40**	**612**	**1,091**	**1,361**
Net interest expense	0	-16	-143	-116	-81
Non-operating/exceptionals	48	18	57	62	69
Pre-tax profit	**116**	**42**	**526**	**1,038**	**1,349**
Tax	-25	163	-128	-247	-323
Extraord./Min.Int./Pref.div.	51	258	-74	-162	-218
Reported net income	**142**	**463**	**323**	**629**	**807**
Adjusted earnings	91	198	323	629	807
Adjusted EBITDA	116	71	703	1,190	1,469
Growth Rates (%)					
Sales	17.9	-16.1	121.9	60.9	28.7
EBIT adjusted	-65.0	-41.7	nm	78.2	24.7
EBITDA adjusted	-53.4	-38.4	887.1	69.2	23.4
EPS adjusted	-43.8	84.5	50.3	94.5	28.3
Cash Flow (RsM)					
Operating cash flow	**-503**	**390**	**1,073**	**671**	**841**
Depreciation/amortization	47	31	91	99	108
Net working capital	-711	49	450	-218	-292
Investing cash flow	**-194**	**-472**	**-1,683**	**-100**	**-100**
Capital expenditure	-159	-501	-54	-100	-100
Acquisitions/disposals	-35	29	-1,629	0	0
Financing cash flow	**630**	**708**	**11**	**-412**	**-514**
Borrowings	830	622	-257	-323	-400
Dividends paid	0	-65	-46	-89	-114
Change in cash	**-67**	**626**	**-599**	**159**	**227**
Balance Sheet (RsM)					
Total assets	**2,933**	**4,469**	**6,083**	**7,654**	**8,974**
Cash & cash equivalent	66	685	12	9	17
Accounts receivable	582	465	872	1,403	1,806
Net fixed assets	407	877	840	842	834
Total liabilities	**1,595**	**2,581**	**3,604**	**4,636**	**5,263**
Accounts payable	484	939	2,212	3,560	4,582
Total Debt	1,015	1,637	1,380	1,057	657
Shareholders' funds	**1,338**	**1,887**	**2,479**	**3,019**	**3,711**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	5.6	4.1	18.1	19.1	18.3
ROE adjusted	6.8	12.6	15.1	22.9	24.0
ROIC adjusted	2.4	8.4	20.5	39.0	42.9
Net debt to equity	70.9	50.5	55.2	34.7	17.2
Total debt to capital	43.1	46.5	35.8	25.9	15.0

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2QFY08 Result Review

Figure 1. UTV – 2QFY08 Results Summary (Rupees in Million, Percent)

	2QFY07	2QFY08	% Change
Revenues from operations	**387.6**	**712.7**	**83.9**
Expenditure	-328.8	-536.5	63.2
Operating Profit	58.8	176.2	199.6
Operating Margin (%)	*15.2*	*24.7*	*955 bps*
Other Income	0.7	22.5	3026.3
Interest	0.0	-20.6	nm
Depreciation	-15.2	-10.1	-33.6
Profit before Tax	**44.4**	**168.0**	**278.8**
Tax	-4.0	7.6	nm
Tax Rate (%)	9.0	-4.5	nm
Profit after Tax	**40.4**	**175.6**	**335.0**
Minority interest	0.0	-46.1	nm
PAT after Minority Interest	**40.4**	**129.5**	**220.8**
Cost Details			
Direct Costs	264.1	429.6	62.7
% of sales	*68.1*	*60.3*	*-784 bps*
Personnel Costs	37.5	44.4	18.4
% of sales	*9.7*	*6.2*	*-345 bps*
Other Expenditure	27.2	62.4	129.2
% of sales	*7.0*	*8.8*	*173 bps*

Source: Company Reports

Figure 2. UTV – 2QFY08 Segmental Results (Rupees in Millions, Percent)

Revenues (Rsm)	2QFY07	2QFY08	% Change
Television	217.9	206.8	-5.1
Films	87.3	406.6	365.5
Interactive/Allied Services	85.5	100.5	17.5
Less: Inter segment revenues	-3.1	-1.1	-63.0
Total Revenues	**387.6**	**712.7**	**83.9**

EBIT (Rsm)	2QFY07	2QFY08	% Change
Television	20.6	18.7	-9.1
Films	23.1	176.1	663.6
Interactive/Allied Services	37.5	5.4	-85.5
Total segment results before interest, depreciation, tax	**81.2**	**200.2**	**146.6**
Less: Interest(net)	0.0	-20.6	nm
Less: Other un-allocable exp (net of other inc)	-36.8	-11.6	-68.5
Total PBT	**44.4**	**168.0**	**278.8**

Segment EBIT (%)	2QFY07	2QFY08	% Change
Television	9.5	9.1	-40 bps
Films	26.4	43.3	1691 bps
Interactive/Allied Services	43.9	5.4	-3849 bps
Total	**20.8**	**28.0**	**727 bps**

Source: Company Reports

Figure 3. UTV IOM 1HFY08 Profit and Loss Summary (US$ Mn)

	US$m
Revenue	**10.02**
Cost of sales	-4.63
Gross profit	**5.39**
Administrative expenses	-0.36
Profit from operations	5.03
Investment income	0.45
Negative goodwill on Consolidation	2.87
PBT	**8.35**
Taxation	-0.17
Net Profit before Minority Interest	**8.18**
Minority interest	-0.01
Profit After Minority Interest	**8.17**

Source: Company Reports

Figure 4. 2HFY08 Movies Releases

Movie Name	Language
Atidhi	Telugu
Kennamoochi Yennada	Tamil
Dhan Dhanadhan Goal	Hindi
Welcome	Hindi
Taare Zameen Par	Hindi
Jodhaa Akbar	Hindi
Bombay Meri Jaan	Hindi
Wednesday	Hindi

Source: Company

UTV Software Communications

Company description

UTV is an integrated media and entertainment company with presence in Indian and international film production and distribution business, television content and interactive media such as animation, VFX and online and mobile gaming. UTV started off by producing ad-films and then TV content in 1990 for state-owned Doordarshan and consequently for Zee TV. It ventured in movie production and distribution in 1998. In 2005, it launched the kids channel Hungama, which became the top kids' channel within a year. UTV sold off Hungama to the Walt Disney Co. UTV recently 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 add the final dots in its presence across the integrated media value-chain. UTV has also re-entered the broadcasting space by the launch of 'Bindaas' a youth-centric general entertainment channel. It is planning to roll out nine channels before mid-2008

Investment strategy

We rate UTV Software Communications (UTV Buy/High Risk (1H) with a target price of Rs887. UTV Software Communications (UTV) is one the few listed integrated media players in India straddling the entire media value chain from Motion Pictures, Broadcasting and TV content to high-growth new media businesses such Animation and Gaming. UTV has broken 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, Overbrook Entertainment have catapulted UTV into the international motion picture space. UTV has a strong slate of 30 movies to be launched in next three years. We forecast revenue CAGR of 78% in the movie business over FY07-FY10E. An US$11m order book and strategic relationships with Walt Disney and other international production houses will drive growth in this business. Gaming revenues will be driven by acquisition of Ignition, UK based console game developer and Indiagames, India's largest online and mobile co. We forecast a CAGR of 113% growth for interactive segment over FY07-10E. After the success of Hungama, UTV is re-entering the broadcasting space by launching nine channels by mid 2008. Besides creating value, in-house channels will also drive UTV's content business. Induction of strategic/ financial partner will unlock value in the broadcasting venture. We forecast revenue CAGR of 66% and earnings CAGR of 40% for UTV over FY07-10E.

Valuation

We use a sum-of-the-parts methodology to value UTV. Given the high earnings trajectory of the movie business at 133% CAGR (FY07-09E), we value it at an EV/EBIT multiple of 23x FY09E EBIT, a premium to the global entertainment universe. We feel this premium is justified given the scarcity premium applied to UTV – it is the only listed motion picture company in India making Hollywood, Bollywood and Indian regional movies – delivering revenue CAGR of 110% over FY07-09E. We value the content business at 18x FY09E EBIT, which is at a premium to the existing listed players. UTV's own broadcasting initiatives will deliver UTV content and will drive EBIT CAGR of 35% over FY07-10E which justifies the premium, in our view. We attribute a premium to global valuations while valuing Ignition as we believe that current earnings do not reflect the potential earnings kick-in from the high-end game Wardevil which will be launched in 2008-09 and which is not factored into our forecasts. We have valued the broadcasting entity at the cost of investment by UTV in this venture as the final shareholding structure and UTV's stake in this business is unclear pending the induction of a financial/strategic partner. We expect significant value-unlocking in this business once a partner is brought in. The valuation multiples we have ascribed to the different businesses may look expensive in the global context, but are at a significant discount compared to the Indian media universe. We thus arrive at a sum-of-the-parts target price of Rs887 for UTV.

Risks

Using our quantitative risk rating system that tracks 260-day historical share price volatility, we rate UTV Software Communications High Risk (H). Key downside risks to our target price are: 1) UTV's business is largely content-driven except its new mobile and online gaming businesses. This aspect induces inherent risks associated with content into its business model. 2) Timing film launches and their success/failure at the box office imparts certain lumpiness into revenues, which we believe will remain. 3) UTV is in a heavy investment phase over the next 2-3 years with investments in the mobile and online gaming businesses, broadcasting initiatives and its movie and television content business. As a result, the return ratios will remain depressed. 4) Broadcasting business in the initial years is expected to make losses. Should UTV consolidate broadcasting accounts with itself, its EPS may be depressed till broadcasting breaks even. 5) Timing the induction would be critical. Any delays on this front may mean more investment from UTV, which may put a strain on its other businesses. Key upside risks to our target price are: 1) Potential content tie-up with Walt Disney for animation motion picture co-production, gaming, TV content etc as management has indicated in the past or outsourcing orders from Walt Disney would lend substantial upsides to our numbers and target price. 2) Induction of a financial/strategic partner at valuations more than that is expected in the market would be positive for the stock price.

Appendix A-1

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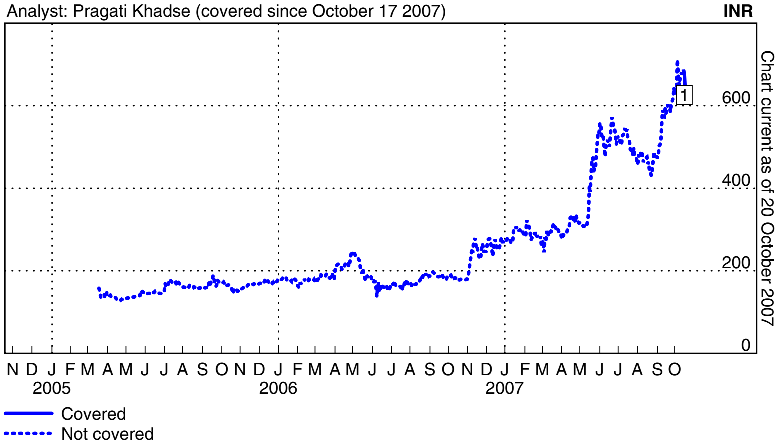
UTV Software Communications (UTVS.BO)
Ratings and Target Price History - Fundamental Research
Analyst: Pragati Khadse (covered since October 17 2007)



#	Date	Rating	Target Price	Closing Price
1:	16 Oct 07	1H	887.00	679.95

*Indicates change.

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