SSKI

INDIA RESEARCH

23 April 2007

BSE Sensex: 13,928

Zee Entertainment

Rs273

OUTPERFORMER

RESULT NOTE

Mkt Cap: Rs118bn; US$2.8bn

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Result: FY07

Comment: Narrowing gap

Last report: 23 January 2007 (Price Rs250*; Recommendation: Outperformer)

**Adjusted to the prices of Dish TV*

Key valuation metrics

Year to March 31 (Rs mn)	Revenues	yoy chg (%)	Net profit	EPS (Rs)	yoy chg (%)	PER (x)	EV/E (x)
2006	11,042	-	2,142*	5.2	-	52.4	43.1
2007E	14,412	30.5	2,195	5.1	2.1	54.0	37.6
2008E	18,701	30.0	3,263	7.5	48.9	36.3	23.9
2009E	22,656	21.0	4,499	10.4	37.9	26.3	17.2

** FY06 - proforma numbers and Net Profit is pre minority*

Zee Entertainment (ZEEL) has reported revenue growth of 31% in FY07 at Rs14.4bn. EBITDA margins are stable at 22% and PAT growth is at 12%. ZEEL's continued journey up the rating chart and acquisition of Ten Sports has helped advertising growth at 32% and subscription revenue growth at 27%. Advertising growth in Q4FY07 has been subdued at 8% on account of shift in viewership towards KBC on Star and Cricket World Cup 2007. High content investments and losses on Zee Sports have restricted the EBITDA margins at FY06 levels of 22%.

ZEEL's continued content investments are paying off as ZEEL now has 17-20 shows consistently featuring amongst Top 50. ZEEL continues to keep its content funnel on launching new shows at regular intervals and has 4-5 different properties featuring into Top 50. We believe that improved rating is now getting reflected in the advertising revenues, as ZEEL takes rack rate hikes and drives revenue growth at 18% CAGR over FY07-10. We also believe that ZEEL, a complete broadcast bouquet, stands to gain due to the changing distribution landscape. As we expect India to have 37m digital C&S households (DTH, CAS, IPTV) by 2010, we expect ZEEL's domestic subscription revenues growing 3x to Rs10.3bn by FY10. We also expect margins to improve from 22% in FY07 to 33.7% in FY10, as yield on advertising revenues improve and subscription revenues start flowing in. We maintain our Out performer call and a price target of Rs315. The only potential risk to ZEEL's growth is increasing competition in the GEC space with launches from NDTV (headed by Sameer Nair); INX Media (Peter Mukherjea) and UTV.

KEY HIGHLIGHTS

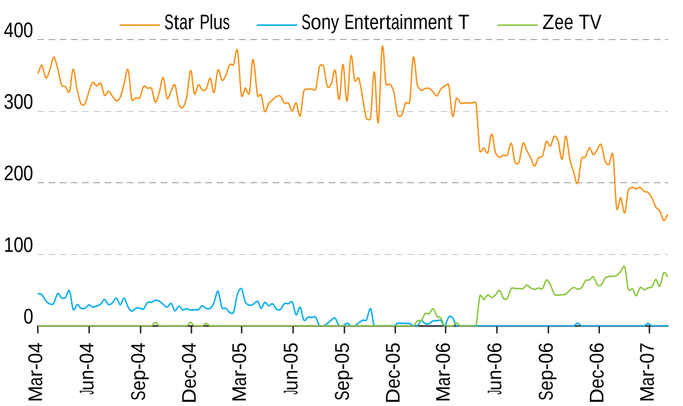
❑ Sustained growth momentum

Zee Entertainment Enterprises Limited has reported revenue growth of 31% in FY07 at Rs14.4bn, however, relatively subdued revenue growth of 11% in Q4FY07. While upward movement on the rating charts and acquisition of Ten Sports has helped advertising revenue growth at 32% during FY07, advertising growth in Q4FY07 is at 8%. This is attributed to launch of Kaun Banega Crorepati on Star Plus as also Cricket World Cup 2007 on SET Max, which had led to substantial advertising budget diversion. However, the impact has been lower than expected as KBC could not garner high TRPs as also India's early exit from World Cup hampered viewership of cricket matches. ZEEL's subscription revenues have grown at 27% in FY07. Ten Sports has added Rs745m to the revenues and Rs220m to the profits during the year. Albeit Zee Sports losses to the tune of over Rs1bn and continued higher investment costs, EBITDA margin has remained steady at 22% on the back of higher subscription revenues and improved advertising yields.

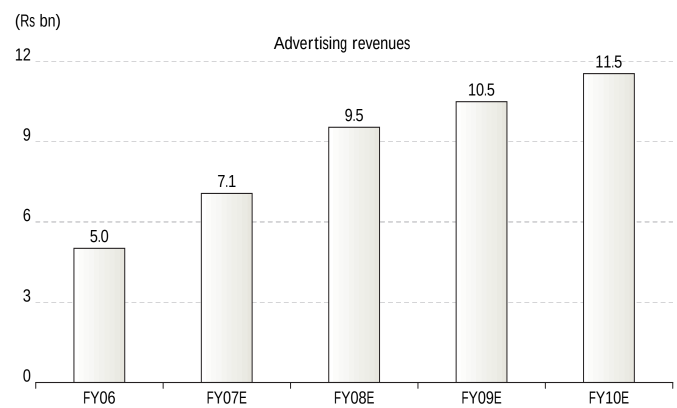
❑ Content enhancement continues – will reflect in advertising revenues

ZEEL's efforts on content enhancement continue and results are also evident, as Zee continues to gain viewership. ZEEL has been consistently having 17-20 slots of the Top 50 TRPs and more importantly has 4-5 different properties (Saath *Phere*, *Kasamh Se*, *Maayka*, *Banoo Mein Teri Dulhan*, *Betiyaan)* featuring in top 50. ZEEL continues to have its content funnel flowing with new shows like *Teen Bahuraniyaan* (competiting for slot with *Kyunki Saas Bhi Kabhi Bahu Thi*), *Titan Antakshari*, etc. ZEEL has upped its programming spend from 35-40% of ad revenues two years back to over 70% now and is expected to move further to 80%, as subscription revenues contribute to profitability. We believe that improved rating has helped ZEEL take rack rate hike ahead of competition and yield improvement will be visible in coming years. We expect ZEEL's advertising growth at 18% CAGR over FY07-10.

Improving TRPs – Top 50…



… will reflect in advertising revenue growth

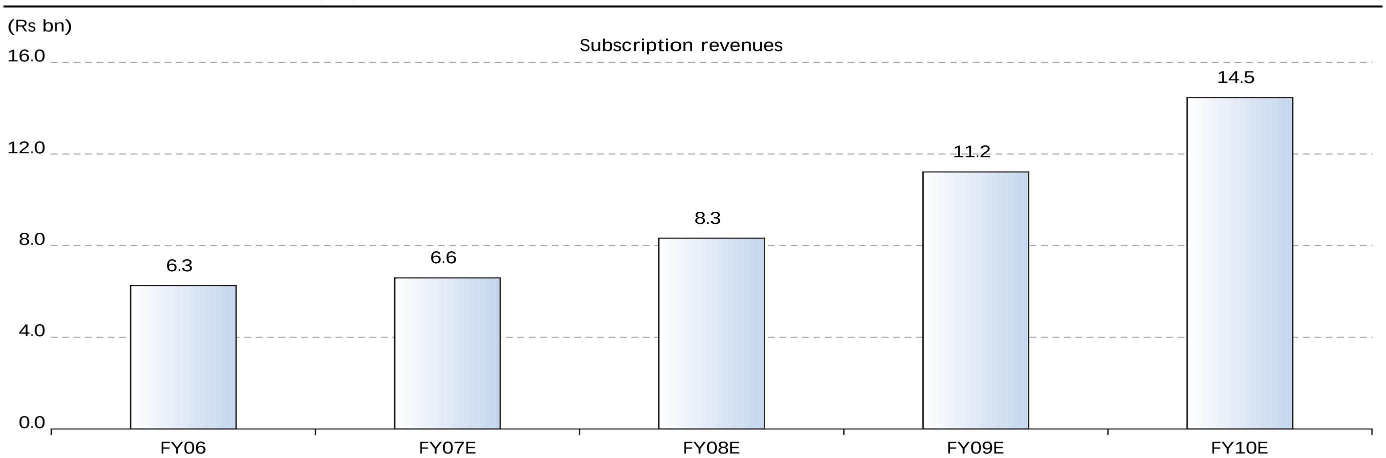


Source: SSKI Research

❑ 'Pay' revenues – thy time has come

With changing landscape of Indian television distribution and 37m digital C&S homes expected by 2010, the biggest beneficiary will be content provider, irrespective of what platform clicks (digital cable, DTH, IPTV) or which distributor wins the distribution race. CAS roll out has begun in notified areas and will be extended to new areas. Even the DTH platform is witnessing rapid growth as incumbents – Dish TV and Tata Sky up their ante, as also new players like Reliance, Bharti and Sun Direct line up heavy investments. We believe that with emergence of digitized households, the biggest issue of under-declaration will be taken care of and broadcaster's share of pay revenue pie is expected to move up from 10-15% now to 30-35% in the next four years. ZEEL, being the leading broadcast bouquet, is expected to garner Rs10bn of domestic pay revenues by FY10 (from current Rs3bn) and overall pay revenues of Rs14.5bn.

Pay revenues – ride upon changing distribution landscape



Source: SSKI Research

❑ Key risk – increasing competition in GEC space

While we are quite positive on the high growth traction and improving subscription revenues in the broadcasting space, we see competition escalating in the general entertainment segment. While NDTV has stated its plans to enter the segment and has roped in Sameer Nair and Karan Johar for the same, Peter Mukherjea's INX Media has also lined up an entry into the general broadcasting space (believed to be backed by Mukesh Ambani, Temasek, Kotak and New Vernon). With higher competition, ZEEL may see some pressure on retention costs and advertising revenues in the short term. However, we are confident of ZEEL remaining among the top three broadcasters in the long run.

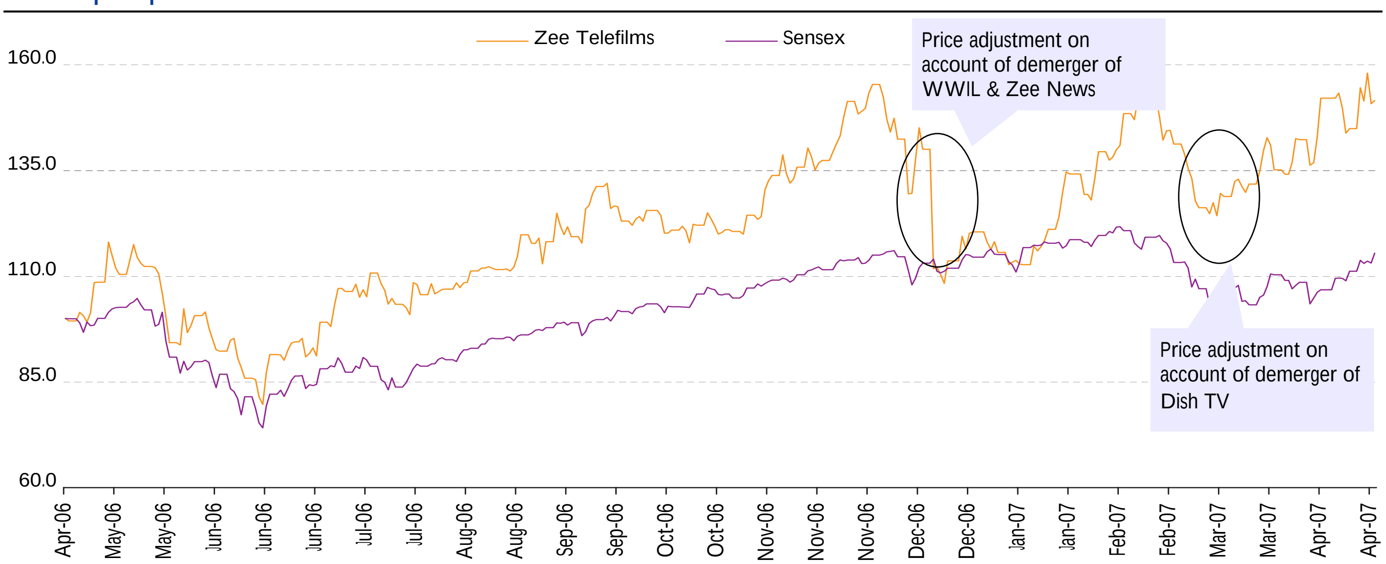
❑ Reiterate Outperformer – Price target of Rs315

With content enhancement driving advertising revenue growth at 18% CAGR and changing distribution landscape driving domestic pay revenue growth to 3x, ZEEL is poised for 25% revenues growth over FY07-10. Given the fact that pay revenues flow down to the bottomline, EBITDA margins are expected to expand from 22% now to 33.7% by FY10. We expect PAT CAGR at 40% over FY07-10. Strong earnings visibility, even post FY10 and emerging media space, lead us to maintain our Outperformer call on ZEEL and set a price target of Rs315.

Quarterly performance

(Rs m)	Q4FY06	Q4FY07	FY07E	FY08E	FY09E
Net Sales	**3,476**	**3,844**	**14,415**	**18,701**	**22,656**
% yoy growth		*10.6*	*31.6*	*29.8*	*21.1*
Expenditure	3,027	2,893	11,224	13,767	15,947
EBITDA	**449**	**951**	**3,188**	**4,934**	**6,708**
Margin (%)	12.9	24.8	22.1	26.4	29.6
Other Income	195	177	630	661	695
Interest	(68)	8	220	204	144
Depreciation	34	56	228	263	315
PBT	**678**	**1,064**	**3,370**	**5,129**	**6,943**
Tax	151	365	964	1,566	2,115
Minority interest	-	95	212	300	330
PAT	**527**	**604**	**2,195**	**3,263**	**4,499**
% yoy growth		*14.6*	*1.9*	*48.9*	*37.9*

Relative price performance



Source: SSKI Research

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Explanation of Ratings:

1. Outperformer: More than 10% to Index
2. Neutral: Within 0-10% to Index
3. Underperformer: Less than 10% to Index

Disclosure of interest:

1. SSKI and its affiliates have not received compensation from the company covered herein in the past twelve months for Issue Management, Capital Structure, Mergers & Acquisitions, Buyback of shares and Other corporate advisory services.
2. Affiliates of SSKI are currently having a mandate from a subsidiary of Zee Telefilms Ltd.
3. SSKI and its affiliates do not hold paid up capital of the company.
4. The Equity Analyst and his/her relatives/dependents hold no shares of the company covered as on the date of publication of research on the subject company.