14 October 2010 | 10 pages

UTV Software Communications (UTVS.BO)

2QFY11 Operationally In-line; Gaming – The Joker in the Pack

- Company Update
- Target price change
- Estimate change

- **In-line quarter** — EBIT growth of ~180% Y/Y to ~Rs420m was largely in line with our/consensus estimates. Margins for both movies & TV increased Y/Y – a mix of a) business turnaround and b) partly buoyed by the inventory write-off against the net worth, which boosted 'reported' profits. Revenues at ~Rs2.4bn were flat Y/Y & headline PAT increased ~4x on last year's low base to Rs402m.
- **Debt equity remains >1x** — Increasing leverage is a concern – net debt increased ~Rs1bn QoQ to ~Rs10bn. As per FY10 annual report, net worth declined by Rs6bn driven by the inventory write-down – mgmt indicates the split between movies & broadcasting verticals was ~Rs4.5bn & ~Rs1.5bn respectively.
- **Gaming – the joker in the pack?** — We are currently ~35% below mgmt's FY11E Ignition revenue guidance as we build in some delays; however, we have ~18% EBIT margins in FY12E assuming sale of ~1m units of *El Sheddai* and *Reich*. Visibility on pre-sale agreements, publisher/distribution tie-ups, timelines of the final launch (will depend on publisher), and status of the other 6-8 planned publishing titles are important events to watch out for. Mgmt highlighted that Indiagames has turned to black this quarter & Truegames too is expected to break even in FY11E; however, Ignition is the key for overall segmental performance.
- **Key points to focus on** — a) Visibility of gaming launch timing and any indicators determining financial performance; b) increased gearing and impact on cost of debt; c) return ratios for movie business given the gradual reduction in business volatility; and d) margin performance of broadcasting in future.
- **Maintain Sell** — Despite a marginal cut to our FY11-12E revenues forecasts, we increase our EBIT estimates by 29-35%; factoring both the inventory write-down & good movie business performance in 1HFY11. We reiterate Sell/High Risk and revise our SOTP-based target price to Rs505 as we roll forward to Mar12E from Sept11E. The stock has underperformed the market by ~115% in the last 2 years; it has been flat relatively in the last 6 months.

Sell/High Risk	**3H**
Price (14 Oct 10)	Rs563.95
Target price	Rs505.00
from Rs375.00	
Expected share price return	-10.5%
Expected dividend yield	0.1%
Expected total return	**-10.4%**
Market Cap	Rs22,915M
	US$517M

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 (%)
2009A	356	10.42	-55.1	54.1	1.4	3.9	0.0
2010A	533	13.13	26.0	43.0	3.0	4.9	0.0
2011E	1,173	28.86	119.9	19.5	2.6	14.1	0.1
2012E	1,470	36.18	25.4	15.6	2.2	15.3	0.2
2013E	1,719	42.30	16.9	13.3	1.9	15.4	0.2

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	54.1	43.0	19.5	15.6	13.3
EV/EBITDA adjusted (x)	nm	60.9	17.3	12.6	10.1
P/BV (x)	1.4	3.0	2.6	2.2	1.9
Dividend yield (%)	0.0	0.0	0.1	0.2	0.2
Per Share Data (Rs)					
EPS adjusted	10.42	13.13	28.86	36.18	42.30
EPS reported	10.42	13.13	28.86	36.18	42.30
BVPS	405.68	190.07	218.34	253.35	294.48
DPS	0.00	0.00	0.50	1.00	1.00
Profit & Loss (RsM)					
Net sales	6,066	6,641	10,709	13,999	17,476
Operating expenses	-6,964	-6,229	-8,970	-11,627	-14,600
EBIT	**-899**	**412**	**1,739**	**2,372**	**2,877**
Net interest expense	77	-384	-619	-753	-731
Non-operating/exceptionals	854	204	210	265	310
Pre-tax profit	**32**	**231**	**1,330**	**1,885**	**2,455**
Tax	433	270	-173	-415	-737
Extraord./Min.Int./Pref.div.	-109	32	15	0	0
Reported net income	**356**	**533**	**1,173**	**1,470**	**1,719**
Adjusted earnings	356	533	1,173	1,470	1,719
Adjusted EBITDA	-829	473	1,811	2,512	3,028
Growth Rates (%)					
Sales	39.7	9.5	61.3	30.7	24.8
EBIT adjusted	-247.7	145.8	322.5	36.4	21.3
EBITDA adjusted	-228.1	157.1	282.6	38.7	20.5
EPS adjusted	-55.1	26.0	119.9	25.4	16.9
Cash Flow (RsM)					
Operating cash flow	**-7,376**	**2,773**	**-917**	**1,139**	**2,042**
Depreciation/amortization	70	62	71	140	152
Net working capital	-7,376	2,432	-2,146	-471	171
Investing cash flow	**-3,663**	**-179**	**-346**	**-657**	**-405**
Capital expenditure	-3,380	-263	-346	-657	-405
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**11,261**	**-2,820**	**1,350**	**-548**	**-1,548**
Borrowings	2,003	4,927	1,373	-500	-1,500
Dividends paid	0	0	-24	-48	-48
Change in cash	**223**	**-226**	**87**	**-65**	**90**
Balance Sheet (RsM)					
Total assets	**22,597**	**20,070**	**24,735**	**26,973**	**28,535**
Cash & cash equivalent	937	711	797	732	822
Accounts receivable	1,960	1,403	2,054	2,570	3,112
Net fixed assets	4,392	4,593	4,868	5,384	5,637
Total liabilities	**7,303**	**12,021**	**15,552**	**16,368**	**16,259**
Accounts payable	0	0	0	0	0
Total Debt	4,700	9,627	11,000	10,500	9,000
Shareholders' funds	**15,294**	**8,049**	**9,183**	**10,605**	**12,277**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	-13.7	7.1	16.9	17.9	17.3
ROE adjusted	3.9	4.9	14.1	15.3	15.4
ROIC adjusted	-3.7	4.0	9.2	10.5	11.1
Net debt to equity	24.6	110.8	111.1	92.1	66.6
Total debt to capital	23.5	54.5	54.5	49.8	42.3

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2QFY11 Results Review

Revenues at ~Rs2.4bn were flat Y/Y – in line with expectations

~4x increase in the 'reported' PAT on last year's low base, though high, was marginally below our estimates

Operationally, EBIT growth of ~180% Y/Y to ~Rs420m was largely in line with our/consensus estimates

Margins expanded Y/Y reflecting a mix of business turnaround and to some extent buoyed by the inventory write-off against the net worth

Figure 1. Profit and Loss Summary (Rupees in Millions, Percent)

	2Q FY 10	2Q FY 11	% Change
Revenues from operations	2,345	2,378	1.4
Expenditure	-2,176	-1,940	-10.9
EBITDA	**169**	**438**	**159.0**
Operating Margin (%)	*7.2*	*18.4*	*1121 bps*
Other Income	45	37	-18.7
Interest	-119	-43	-64.0
Depreciation	-20	-21	5.6
Profit before Tax	**76**	**412**	**439.6**
Tax	27	0	-100.2
Tax Rate (%)	*-35.8*	*0.0*	*3584 bps*
Profit after Tax	**104**	**412**	**297.2**
Minority interest	-21	-10	-52.8
PAT and MI	**83**	**402**	**383.8**
Cost Details			
Direct Costs	1,768	1,503	-15.0
% of sales	*75.4*	*63.2*	*-1217 bps*
Personnel Costs	161	189	17.6
% of sales	*6.9*	*8.0*	*110 bps*
Other Expenditure	247	247	0.1
% of sales	*10.5*	*10.4*	*-14 bps*

Source: Company Reports

Movie business performance was healthy and largely in line with expectations - 2QFY10 movie revenues included Rs429m from the Hollywood movie, *The Happening*

Gaming business remained lackluster during the quarter

Management noted that the television segment margins improved YoY in both content and broadcasting segments

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

Segment Revenue	2Q FY 10	2Q FY 11	% Change
Television	509	815	60.0
Movies	1,310	1,207	-7.8
Gaming & Interactive	599	357	-40.4
Less: Inter segment revenues	-73	-1	nm
Total Revenues	2,345	2,378	1.4
Segment Results			
Television	-140	49	-135.3
Movies	299	447	49.3
Gaming & Interactive	70	53	-24.9
Total segment results before int, dep, tax	**229**	**548**	**139.0**
Less: Interest(net)	-119	-43	
Less: Other unallocable exp (net of other inc)	-34	-94	173.4
Total PBT	**76**	**412**	**439.6**
Segment EBIT (%)			
Television	*-27.4*	*6.0*	*3344 bps*
Movies	*22.8*	*37.0*	*1417 bps*
Gaming & Interactive	*11.7*	*14.7*	*304 bps*
Total	*9.5*	*23.0*	*1356 bps*

Source: Company Reports

Besides the profit margins, we would monitor the capital employed/return ratios for the various businesses, in light of the impact of the decline in the net worth and given that the new businesses are in their infancy

Figure 3. Segmental Capital Employed (Rs Mn, % ROCE on EBIT)

RoCE (%, On EBIT)	2Q FY 10	2Q FY 11	% Change
Television	-3.1	1.0	406 bps
Movies	3.1	7.9	477 bps
Gaming & Interactive	1.5	0.8	-67 bps

Source: Company Reports, CIRA

As per the FY10 annual report, decline in the net worth was ~Rs6.2bn driven by the inventory write-off

Net debt increased by 10% QoQ and is currently ~Rs10bn – mgmt expects to reduce debt through liquidity events (movie co-productions, release of AAA IPs), strategic initiatives and internal accruals from CY11 onwards

Leverage will remain at elevated levels in the near term; which may impact the cost of debt/interest costs going forward

Figure 4. Profit and Loss Summary (Rupees in Millions, Percent)

As of	30 Sept 09	31 Mar 10	30 Sept 10
Cash	838	711	520
Inventories	11,960	8,538	10,808
Sundry debtors	2,083	1,403	1,881
Loans and advances	3,528	3,336	2,875
Other current assets	2	3	4
Current assets	**18,410**	**13,992**	**16,089**
Current liabilities	2,299	2,005	2,181
Provisions	119	121	85
Total current liabilities& provisions	**2,418**	**2,126**	**2,266**
Net current assets	**15,992**	**11,866**	**13,823**
Net PPE	4,722	4,593	4,566
Investments	2,373	201	21
Deferred tax asset (net of liabilities)	908	1,016	1,027
Total assets	**23,995**	**17,944**	**19,436**
Capital	342	406	406
Advance against warrants	390	0	0
Reserves and Surplus	12,698	7,317	8,260
Shareholder's funds	**13,430**	**7,723**	**8,666**
Debt	9,200	9,627	10,511
Minority interest	1,366	326	259
Total liabilities and equity	**23,995**	**17,944**	**19,436**

Source: Company Reports

Maintain Sell, Target Price of Rs505

Our target price of Rs505 is based on our revised earnings estimates as we roll forward to Mar-12E estimates (from Sept-11E earlier). Our SOTP is enumerated below:

Figure 5. UTV Software Communications — Sum of the Parts Valuation

RsM	EV/EBIT Multiple	EBIT	EV adjusted for MI	Fair Value/share (Rs)
Movies	9.0x	2,111	19,000	468
TV Content	8.0x	129	1,034	24
Games Content	6.0x	652	3,420	84
	EV/Sales Multiple	**Sales**		
Broadcasting	2.0x	3,351	5,697	140
New Media	1.5x	205	308	8
Net cash			-8,916	-219
Equity value			**20,544**	**505**

Source: Citi Investment Research and Analysis estimates

Earnings Revisions

Figure 6. UTV Software Communications — Earnings Revision Summary

Year to 31-Mar	2011E			2012E		
	Old	New	% Chg	Old	New	% Chg
Sales (Rs Mils.)	11,540	10,709	-7%	14,080	13,999	-1%
EBIT (Rs Mils.)	1,285	1,739	35%	1,843	2,372	29%
Net Profit (Rs Mils.)	788	1,173	49%	1,218	1,470	21%
Diluted EPS (Rs)	19.4	28.9	49%	30.0	36.2	21%
Dividend Per Share (Rs)	0.5	0.5	0%	1.0	1.0	0%

Source: Citi Investment Research and Analysis estimates

- We have marginally reduced our revenue estimates by ~1-7% over FY11-12E tweaking our gaming and TV revenues.
- Our EBITDA estimates are increased by 29-35% over FY11-12E driven by a) better movie business performance in 1HFY11 (driven by *Rajneeti*) and b) taking into account the higher margins in movies and broadcasting post the inventory write-off against the net worth.
- Interest costs and tax remain imponderables given the increasing leverage and extent of carry forward losses – mgmt guides to interest expenses of ~5% and effective tax rates of <10%. Our current estimates are slightly higher than this guidance.

UTV Software Communications

Valuation

Our target price of Rs505 is based on sum-of-the-parts valuation. 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. We value the movie business at 9x Mar12E EV/EBIT, a ~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 Mar12E EV/EBIT of 8x, at a discount to Balaji Telefilms - one of the segment leaders in India - based on consensus earnings. We benchmark the gaming vertical in line with regional valuations and ascribe an EBIT multiple of 6x. We give the broadcasting business a 2x EV/Sales multiple on FY12E, at a discount to the leading broadcasters. We ascribe a 1.5x Mar12E EV/Sales on New Media.

Risks

We rate UTV shares High Risk, instead of Low Risk as suggested by our quantitative risk-rating system, which tracks 260-day historical share price volatility. We believe this is warranted given the inherent earnings volatility in most divisions. The company's capital structure remains challenging; coupled with execution risks necessitate a higher risk rating. Upside risks that could sustain the stock above our target price include: 1) 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 regional peers, a higher valuation accorded to UTV's gaming business (on account of higher growth) could result in upside; 2) The movie and/or broadcasting businesses doing better than expected could result in upside surprises to our estimates.

Appendix A-1

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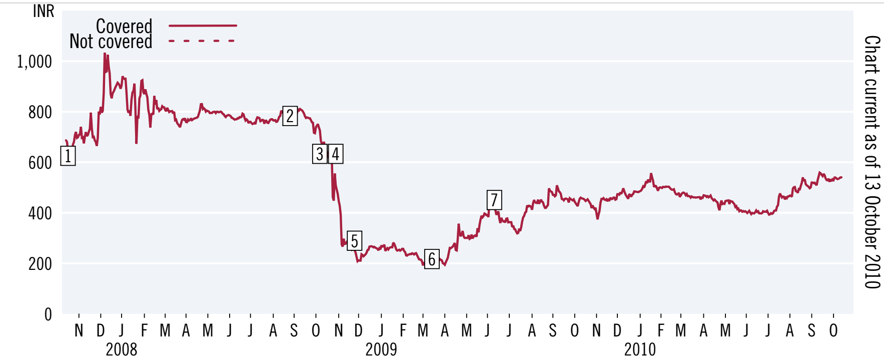
UTV Software Communications (UTVS.BO)

Ratings and Target Price History Fundamental Research

Analyst: Aditya Mathur
Covered since June 18 2010



	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
6	13-Mar-09	3H	*190.00	195.85
7	10-Jun-09	3H	*375.00	416.35

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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