

Zee News

BUY
Maintained
Rs44

Huge value unlocking

Reason for report: Q2FY10 results review & company update

Zee News (ZNL) is to undergo restructuring with its regional general entertainment channels (R-GEC) being transferred to Zee Entertainment Enterprises (ZEEL) in lieu of ZEEL's shares. While ZNL has a strong franchise in the R-GEC space in Marathi, Bengali, Telugu and Kannada markets, the company has been largely undervalued owing to losses in new initiatives such as *Zee Tamizh*, the Tamil GEC. R-GECs reported Rs3.4bn and Rs1.87bn revenues and Rs797mn and Rs597mn EBITDA in FY09 and H1FY10 respectively. We expect R-GECs to be valued at 13x FY10E EV/E (at 20% discount to ZEEL's EV/E) along with debt assumption of Rs1.5bn, implying an equity value of Rs14.4bn or Rs60/share. Our valuations assume a share swap ratio of 1:3.77, implying 14.7% dilution for ZEEL, while being EPS accretive. We raise FY10 and FY11 earnings led by conversion of the Tamil GEC into a predominantly news channel. We also raise target price to Rs60. Even without factoring in the upside from restructuring, upside exists in ZNL owing to the conversion of the Tamil GEC. **Maintain BUY.**

- **R-GECs hived off and to get premium value.** The hived-off R-GECs by ZNL reported Rs3.3bn and Rs1.87bn revenues and Rs797mn and Rs597mn EBITDA in FY09 and H1FY10 respectively. We value ZNL's regional business at 13x FY10E EV/E (at 20% discount to ZEEL), implying an EV of Rs15.9bn and equity value of Rs14.4bn or Rs60/share after assuming Rs1.5bn debt. Our valuations assume a swap ratio of one share of ZEEL for 3.77 shares of ZNL.
- **Q2FY10 results in line; FY11 earnings raised on conversion of Tamil GEC.** ZNL's Q2FY10 ad revenues and subscription revenues grew 26% YoY and 17.8% YoY to Rs1.3bn and Rs276mn respectively. PAT grew 14.6% to Rs131mn even as new businesses struggled. However, the decision to convert Tamil GEC into a predominantly news channels is likely to reduce losses significantly in FY11. We raise FY11E and FY12E EPS to Rs2.3 and Rs3 from Rs2.1 and Rs2.3 respectively.
- **News business profitable, but dragged by losses from new initiatives.** ZNL, post the restructuring, will essentially be a news channel company – in FY09, the company reported Rs1.8bn revenues but only Rs39mn EBITDA, largely owing to losses in *Zee Tamizh*, and Telugu & Uttar Pradesh news channels.
- **We raise target price to Rs60** based on FY11E P/E of 20x. However, premium valuation for quality assets can lead to a swap ratio of 1:4, implying Rs67 value.

Media

Target price Rs60

Earnings revision

(%)	FY10E	FY11E
Sales	↓ 0.3	↓ 2.5
EBITDA	↑ 5.6	↑ 14.5
EPS	↑ 7.3	↑ 19.1

Shareholding pattern

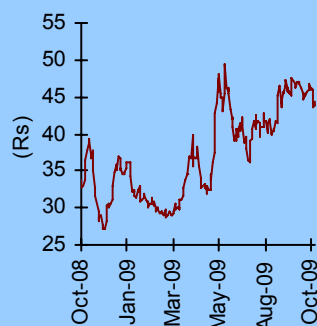
	Mar '09	Jun '09	Sep '09
Promoters	54.1	54.1	54.1
Institutional investors	30.9	29.0	28.8
MFs and UTI	20.2	21.8	21.9
Insurance Cos.	3.9	3.9	3.5
FII's	6.9	3.4	3.4
Others	14.9	16.9	17.1

Source: NSE

Target price revision

Rs60 from Rs45

Price chart



Vikash Mantri, CFA

vikash.mantri@icicisecurities.com
+91 22 6637 7161

Suchitra W L

suchitra.wl@icicisecurities.com
+91 22 6637 7510

Market Cap	Rs10.5bn/US\$227mn
Reuters/Bloomberg	ZNLI.BO/ZEEN IN
Shares Outstanding (mn)	239.8
52-week Range (Rs)	49/27
Free Float (%)	45.9
FII (%)	6.9
Daily Volume (US\$/'000)	1,50
Absolute Return 3m (%)	7.5
Absolute Return 12m (%)	34.7
Sensex Return 3m (%)	9.3
Sensex Return 12m (%)	93.2

Year to Mar	2009	2010E	2011E	2012E
Revenue (Rs mn)	5,221	6,187	7,046	8,128
Rec. Net Income (Rs mn)	446	544	720	855
EPS (Rs)	1.9	2.3	3.0	3.6
% Chg YoY	20.4	22.0	32.3	18.7
P/E (x)	23.6	19.4	14.6	12.3
CEPS (Rs)	2.3	2.7	3.5	4.1
EV/E (x)	14.4	11.1	8.4	7.2
Dividend Yield (%)	0.9	1.5	2.0	2.4
RoCE (%)	17.4	15.1	17.8	18.9
RoE (%)	19.9	21.1	24.0	24.3

Target price raised to 60; restructuring to unlock value

We raise ZNL's target price to Rs60 from Rs45 based on FY11E P/E of 20x after raising earnings estimates owing to lower losses in the Tamil GEC. However, we believe that R-GECs, in the restructuring exercise, can command an enterprise value of Rs15.9bn based on 13x FY10E EV/E (at 20% discount to ZEEL). We value the news business at Rs2.45bn based on 1x FY10E sales owing to high gestation period for the turnaround of regional news channels. Our valuations for R-GECs imply a share swap ratio of 1:3.77 shares in favour of ZEEL. We believe any valuation upwards of Rs19bn for ZNL's R-GECs will be EPS-dilutive for ZEEL and is unjustified.

Table 1: Sensitivity of ZNL's valuations to swap ratio

(Rs mn)

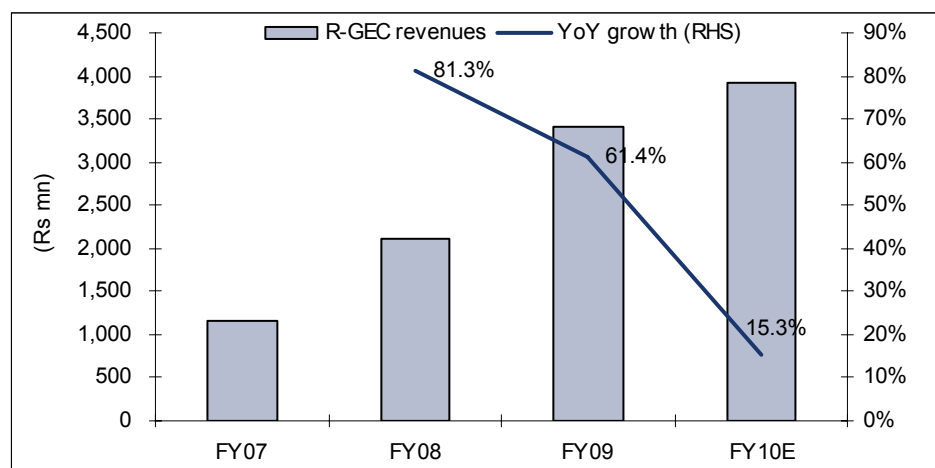
	I-Sec	Scenarios			
Swap ratio	1:3.77	1:3	1:4	1:5	
R-GEC implied valuation	14,410	18,142	13,607	10,885	
Debt assumed	1,500	1,500	1,500	1,500	
Enterprise value	15,910	19,642	15,107	12,385	
Implied EV/EBITDA multiple	13.0	16.0	12.3	10.1	
News business value at 1x FY10E sales	2450	2450	2450	2450	
ZNL's value	16,860	20,592	16,057	13,335	
ZNL's Share price (Rs)	70	86	67	56	
Dilution for ZEEL (%)	14.7	18.5	13.8	11.1	
EPS impact on ZEEL in FY11 (%)	1.7	(1.6)	2.4	5.0	

Source: Company data, I-Sec Research

Regional business highly profitable, offers better growth opportunity

ZNL's R-GEC portfolio includes *Zee Marathi* (GEC), *Zee Bengali* (GEC), *Zee Kannada* (GEC), *Zee Telugu* (GEC), *Zee Talkies* (Marathi movies) and *Zee Cinemalu* (Telugu movies). These channels reported Rs3.4bn and Rs1.87bn revenues and Rs797mn and Rs597mn EBITDA in FY09 and H1FY10 respectively. The capital employed in the business was Rs2.3bn. ZNL's regional GEC business has witnessed strong 81% and 63% revenue growth in FY08 and FY09, with FY09 & FY10 EBITDA margin at 23% and 32% respectively. R-GECs offer better growth versus Hindi GECs and there is potential for margins to improve as subscription currently accounts for only 9% of revenues.

Chart 1: R-GECs offer strong growth potential



Source: Company, I-Sec Research

Table 2: Market share of ZNL's regional pack strong

(%)

	Q4FY07	Q1FY08	Q2FY08	Q3FY08	Q4FY08	Q1FY09	Q2FY09	Q3FY09	Q4FY09	Q1FY10	Q2FY10*
Zee Bangla	36.8	37.5	36.1	41.6	46.9	44.3	38.8	33.1	33.7	27.6	25.7
Zee Business	15.7	15.5	12.3	15.0	16.4	14.1	17.9	19.8	27.0	24.8	19.1
Zee Kannada	5.9	6.6	5.6	5.6	9.9	15.3	16.8	17.1	14.8	12.3	14.8
Zee Marathi	45.9	47.8	45.1	50.7	53.7	55.1	54.6	55.0	49.8	46.4	40.7
Zee News	14.2	12.9	10.2	11.0	10.6	10.3	10.9	10.9	11.1	10.2	10.9
Zee Telugu	6.4	5.4	6.8	8.3	11.1	10.7	11.7	14.2	14.6	15.5	14.6
Zee Tamizh								0.7	1.6	1.2	1.3

* August-September of CY09

Source: TAM; respective markets

Earnings upgrade driven by conversion of Tamil GEC

While ZNL stands to gain from the restructuring exercise, we see huge value unlocking from the decision to convert the heavily loss making Tamil GEC into a predominantly news channel, curbing annualised losses of Rs400mn to <Rs100mn. We revise FY10E & FY11E earnings 7.3% and 19.1% respectively owing to lower losses in the Tamil GEC.

Table 3: Earnings revision

(Rs mn)

	FY10E			FY11E		
	Revised	Old	% chg	Revised	Old	% chg
Sales	6,187	6,204	(0.3)	7,046	7,226	(2.5)
of which advertisement	4,799	4,849	(1.0)	5,458	5,681	(3.9)
of which subscription	1,224	1,224	-	1,408	1,408	-
of which others	164	130.8	25.0	180	137.34	31.0
EBITDA	1,082	1,025	5.6	1,427	1,247	14.5
PAT	544	507.4	7.3	720	605	19.1

Source: I-Sec Research

The restructuring of ZNL, which involves hiving off of regional GECs to ZEEL, is to enable business synergies between the Hindi GEC business of ZEEL and R-GECs. While we have been significantly positive on the regional broadcasting space, ZNL's valuations have been low owing to investor concerns on huge losses in the failed initiative of *Zee Tamizh*, losses in channels launched in the regional news space, high debt on books and apprehensions regarding entry into the English news space.

Residual business profitability dragged by new initiatives

Post ZNL's restructuring, the residual business will consist of news properties, the profitability of which is low, largely owing to losses from the Tamil GEC and losses from the newly launched Telugu & UP news channels. We expect EBITDA margin of the mature news business to stabilise within 20-25%. However, the current high profitability of ZNL's news properties is owing to relatively high subscription revenue appropriation of Rs660mn, whereas the market leader in Hindi news, TV Today Network, generates subscription revenues less than Rs200mn. We believe R-GECs offer better prospects for subscription revenues versus news properties, which are heavily commoditised.

Table 4: Pro forma financials of R-GECs and residual business

(Rs mn)

	FY09	H1FY10	FY10E	FY11E
Consolidated				
Revenues	5,221	2986.4	6,187	7,046
Costs	4,385	2480.9	5,104	5,619
EBITDA	836	505.5	1,082	1,427
EBITDA margin (%)	16.0	16.9	17.5	20.3
Regional GECs				
Revenue	3,403	1,868	3,736	4,296
Costs	2,606	1,271	2,542	2,923
EBITDA	797	597	1,224	1,407
EBITDA margin (%)	23.4	32.0	32.8	32.8
Residual business				
Revenues (news)	1,818	1,118	2,451	2,750
Costs (news)	1,779	1,210	2,562	2,596
EBITDA (news)	39	(91.5)	(141)	154
EBITDA margin (%)	2.2	(8.2)	(5.8)	5.6
Losses from Tamil + Telugu news+ UP news	(330.0)	(250.0)	(350.0)	(100.0)
Residual business EBITDA	369.4	158.5	209	254
EBITDA margin (%)	20.3	14.2	8.5	9.2

Source: Company, I-Sec Research

Q2FY10 results in line – Strong growth driven by advertisement

ZNL's Q2FY10 ad revenues and subscription revenues grew 26% YoY and 17.8% YoY to Rs1.3bn and Rs276mn respectively. PAT grew 14.6% to Rs131mn as losses from new business continued. EBITDA margin was at 16% for the quarter as new business continued to drag. New business, however, positively surprised on revenues with 41.5% QoQ growth, driven by better monetisation of *Zee Telugu* and *Zee Kannada*.

Table 5: Q2FY10 results review (consolidated)

(Rs mn, year ending March 31)

	I-Sec estimates	Q2FY10	Q2FY09	% chg YoY	% chg QoQ	YTD FY10	YTD FY09	% chg
Total revenues	1,461	1,612	1,277	26.3	17.3	2,986	2,404	24.2
Advertising revenues	1,134	1,280	1,013	26.4	17.3	2,371	1,902	24.6
Subscription revenues	294	276	234	17.8	4.0	541	446	21.3
Others sales & service	33	57	30	89.3	216.2	75	56	32.8
Expenditure	1,188	1,355	1,065	27.2	20.3	2,481	2,020	22.8
Programming costs	584	658	506	30.1	26.2	1,179	950	24.1
Staff costs	204	190	151	25.9	(3.3)	386	316	22.2
Selling, admin & other costs	400	507	409	24.0	24.1	916	754	21.4
EBITDA	273	258	212	21.8	3.9	506	384	31.5
Other income	42	46	2	NA	NA	87	5	1,610.4
Depreciation	31	31	22	36.3	(0.3)	61	43	40.8
Finance Expenses	70	71	11	NA	NA	148	14	931.3
PBT	214	203	180	12.5	11.8	384	332	15.7
Less: Provision for Tax	73	67	65	3.6	8.5	129	125	3.5
Adjusted PAT	136	132	115	14.6	10.3	251	208	20.6
Operating margin (%)	18.7	16.0	16.6			16.9	16.0	
Gross margin (%)	60.0	59.2	60.4			60.5	60.5	
Staff cost to revenues (%)	13.9	11.8	11.8			12.9	13.1	
Advertisement to sales (%)	77.6	79.4	79.3			79.4	79.1	
Effective tax rate (%)	34.0	33.2	36.1			33.7	37.7	
NPM (%)	9.3	8.2	9.0			8.4	8.6	

Source: Company data, I-Sec Research

Financial Summary

Table 6: Profit and Loss Statement
(Rs mn, year ending March 31)

	FY09	FY10E	FY11E	FY12E
Operating Income (Sales)	5,221	6,187	7,046	8,128
of which advertising	4,089	4,799	5,458	6,277
of which subscription	969	1,224	1,408	1,662
of which others	164	164	180	189
Operating Expenses	4,385	5,104	5,619	6,462
EBITDA	836	1,082	1,427	1,666
% margins	16.0	17.5	20.3	20.5
Depreciation & Amortisation	95	109	126	138
Gross Interest	211	242	279	307
Other Income	176	155	173	190
Recurring PBT	706	885	1,196	1,411
Add: Extraordinaries	-	-	-	-
Less: Taxes	259	319	431	508
Less: Minority Interest	1	22	45	48
Net Income (Reported)	446	544	720	855
Recurring Net Income	446	544	720	855

Source: Company data, I-Sec Research

Table 7: Balance Sheet
(Rs mn, year ending March 31)

	FY09	FY10E	FY11E	FY12E
Assets				
Total Current Assets	5,034	5,904	6,478	7,259
of which cash & cash eqv.	508	1,250	1,144	1,112
Total Current Liabilities & Provisions	1,625	2,024	2,193	2,498
Net Current Assets	3,410	3,880	4,285	4,762
Investments	-	-	-	-
Net Fixed Assets	1,047	936	1,005	1,090
Total Assets	4,457	4,815	5,289	5,852
Liabilities				
Borrowings	2,017	2,017	2,017	2,017
Deferred Tax Liability	(19)	(19)	(19)	(19)
Minority Interest	53	53	53	53
Equity Share Capital	240	240	240	240
Face Value per share (Rs)	1.0	1.0	1.0	1.0
Reserves & Surplus*	2,166	2,524	2,998	3,561
Less: Misc. Exp. n.w.o.	-	-	-	-
Net Worth	2,406	2,764	3,238	3,801
Total Liabilities	4,457	4,815	5,289	5,852

Source: Company data, I-Sec Research

Table 10: Quarterly trends
(Rs mn, year ending March 31)

	Dec-08	Mar-09	Jun-09	Sep-09
Net sales	1,430	1,384	1,374	1,612
% growth (YoY)	38.8	20.5	22.7	26.4
EBITDA	299	207	248	258
Margin (%)	20.9	14.9	18.0	16.0
Other income	24	49	41	46
Add: Extraordinaries	-	-	-	-
Net profit	152	88	119	132

Source: Company data

Table 8: Cash Flow Statement
(Rs mn, year ending March 31)

	FY09	FY10E	FY11E	FY12E
Operating Cash flow	65	522	718	851
Working Capital Changes	(1,236)	272	(511)	(509)
Capital Commitments	(327)	2	(195)	(224)
Free Cash Flow	(1,497)	796	12	118
Cash flow from Investing Activities	176	155	173	190
Issue of Share Capital	-	-	-	-
Buyback of shares	-	(0)	-	-
Inc (Dec) in Borrowings	1,900	-	-	-
Dividend paid	(109)	(186)	(246)	(292)
Extraordinary Items	-	-	-	-
Chg. in Cash & Bank balance	466	742	(106)	(32)

Source: Company data, I-Sec Research

Table 9: Key Ratios
(Year ending March 31)

	FY09	FY10E	FY11E	FY12E
Per Share Data (in Rs.)				
Diluted Reported EPS	1.9	2.3	3.0	3.6
Diluted Recurring EPS	1.9	2.3	3.0	3.6
Recurring Cash EPS	2.3	2.7	3.5	4.1
Dividend per share (DPS)	0.4	0.7	0.9	1.1
Book Value per share (BV)	10.0	11.5	13.5	15.9
Growth Ratios (%)				
Operating Income	42.1	18.5	13.9	15.3
EBITDA	23.4	29.4	31.9	16.7
Recurring Net Income	20.4	22.0	32.3	18.7
Diluted Recurring EPS	20.4	22.0	32.3	18.7
Diluted Recurring CEPS	18.9	20.8	29.4	17.4
Valuation Ratios (x)				
P/E	23.6	19.4	14.6	12.3
P/CEPS	19.5	16.1	12.5	10.6
P/BV	4.4	3.8	3.3	2.8
EV / EBITDA	14.4	11.1	8.4	7.2
EV / Operating Income	2.3	1.9	1.7	1.5
EV / Operating FCF	(10.3)	15.2	58.3	35.2
Operating Ratio (%)				
Production cost / Sales	40.9	44.8	45.3	45.1
Other Income / PBT	24.9	17.5	14.5	13.5
Effective Tax Rate	36.7	36.0	36.0	36.0
NWC / Total Assets	65.1	54.6	59.4	62.4
Inventory Turnover (days)	0.5	3.2	5.8	5.8
Receivables (days)	112.3	117.8	122.1	121.4
Payables (days)	100.3	118.8	126.4	123.3
D/E Ratio (x)	0.8	0.7	0.6	0.5
Return/Profitability Ratio (%)				
Recurring Net Income Margins	8.3	8.9	10.6	10.9
RoCE	17.4	15.1	17.8	18.9
RoNW	19.9	21.1	24.0	24.3
Dividend Payout Ratio	21.5	30.0	30.0	30.0
Dividend Yield	0.9	1.5	2.0	2.4
EBITDA Margins	16.0	17.5	20.3	20.5

Source: Company data, I-Sec Research

I-Sec investment ratings (all ratings relative to Sensex over next 12 months)

BUY: +10% outperformance; **HOLD:** -10% to +10% relative performance; **SELL:** +10% underperformance

ANALYST CERTIFICATION

We *I/*, *Vikash Mantri, PGDM, CFA; Suchitra W L, BE, MBA*, research analyst and the author of this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report. Analysts aren't registered as research analysts by FINRA and might not be an associated person of ICICI Securities Inc.

Disclosures:

ICICI Securities Limited (ICICI Securities) and its affiliates are a full-service, integrated investment banking, investment management and brokerage and financing group. We along with affiliates are leading underwriter of securities and participate in virtually all securities trading markets in India. We and our affiliates have investment banking and other business relationship with a significant percentage of companies covered by our Investment Research Department. Our research professionals provide important input into our investment banking and other business selection processes. ICICI Securities generally prohibits its analysts, persons reporting to analysts and their dependent family members from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. The information and opinions in this report have been prepared by ICICI Securities and are subject to change without any notice. The report and information contained herein is strictly confidential and meant solely for the selected recipient and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ICICI Securities. While we would endeavour to update the information herein on reasonable basis, ICICI Securities, its subsidiaries and associated companies, their directors and employees ("ICICI Securities and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance or other reasons that may prevent ICICI Securities from doing so. Nonrated securities indicate that rating on a particular security has been suspended temporarily and such suspension is in compliance with applicable regulations and/or ICICI Securities policies, in circumstances where ICICI Securities is acting in an advisory capacity to this company, or in certain other circumstances.

This report is based on information obtained from public sources and sources believed to be reliable, but no independent verification has been made nor is its accuracy or completeness guaranteed. This report and information herein is solely for informational purpose and may not be used or considered as an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. ICICI Securities will not treat recipients as customers by virtue of their receiving this report. Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to your specific circumstances. The securities discussed and opinions expressed in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient. This may not be taken in substitution for the exercise of independent judgement by any recipient. The recipient should independently evaluate the investment risks. The value and return of investment may vary because of changes in interest rates, foreign exchange rates or any other reason. ICICI Securities and affiliates accept no liabilities for any loss or damage of any kind arising out of the use of this report. Past performance is not necessarily a guide to future performance. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice.

ICICI Securities and its affiliates might have managed or co-managed a public offering for the subject company in the preceding twelve months. ICICI Securities and affiliates might have received compensation from the companies mentioned in the report during the period preceding twelve months from the date of this report for services in respect of public offerings, corporate finance, investment banking or other advisory services in a merger or specific transaction. ICICI Securities and affiliates expect to receive compensation from the companies mentioned in the report within a period of three months following the date of publication of the research report for services in respect of public offerings, corporate finance, investment banking or other advisory services in a merger or specific transaction. It is confirmed that *Vikash Mantri, PGDM, CFA; Suchitra W L, BE, MBA*, research analyst and the author of this report have not received any compensation from the companies mentioned in the report in the preceding twelve months. Our research professionals are paid in part based on the profitability of ICICI Securities, which include earnings from Investment Banking and other business.

ICICI Securities or its affiliates collectively do not own 1% or more of the equity securities of the Company mentioned in the report as of the last day of the month preceding the publication of the research report.

It is confirmed that *Vikash Mantri, PGDM, CFA; Suchitra W L, BE, MBA* research analyst and the author of this report or any of their family members does not serve as an officer, director or advisory board member of the companies mentioned in the report.

ICICI Securities may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report. ICICI Securities and affiliates may act upon or make use of information contained in the report prior to the publication thereof. This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject ICICI Securities and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.